PHELPS DODGE CORP
Form 10-K
February 27, 2007

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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, 2006

OR

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

For the transition period from___to ___

Commission file number 1-82

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, 2006, was approximately $16,759,938,107.

Number of Common Shares outstanding at February 23, 2007: 204,142,665 shares.

Documents Incorporated by Reference:

Document	Location in 10-K
Proxy Statement for 2007 Annual Meeting	Part III

PHELPS DODGE CORPORATION
Annual Report on Form 10-K
For the Year Ended December 31, 2006

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PHELPS DODGE CORPORATION
2006 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.

On November 18, 2006, Phelps Dodge and Freeport-McMoRan Copper & Gold Inc. (Freeport) entered into a definitive merger agreement under which Freeport will acquire Phelps Dodge, creating the world s largest publicly traded copper company. The combined company will represent one of the most geographically diversified portfolios of operating, expansion and growth projects in the copper mining industry.

The transaction, which is subject to Phelps Dodge and Freeport shareholder approval, regulatory approvals and customary closing conditions, is expected to close in March 2007. Phelps Dodge and Freeport will each hold a special meeting of shareholders on March 14, 2007, to vote on the proposed acquisition. Phelps Dodge and Freeport common shareholders of record at the close of business on February 12, 2007, will be entitled to vote on the proposed transaction.

Under the terms of the transaction, Freeport will acquire all of the outstanding common shares of Phelps Dodge for a combination of cash and common shares of Freeport. Each Phelps Dodge shareholder would receive $88.00 per share in cash plus 0.67 common shares of Freeport for each Phelps Dodge share. Freeport will deliver a total of approximately 137 million shares to Phelps Dodge shareholders, resulting in Phelps Dodge shareholders owning approximately 38 percent of the combined company on a fully diluted basis. Based upon the closing price of Freeport stock on February 16, 2007, the combination of cash and common shares would have a value of $126.57 per Phelps Dodge share.

The Company consists of two divisions, Phelps Dodge Mining Company (PDMC) and Phelps Dodge Industries (PDI).

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. We are also currently developing a copper mine in Safford, Arizona, and a copper/cobalt mine in the Katanga province in the Democratic Republic of Congo (DRC). The Primary Molybdenum segment includes our Henderson and Climax molybdenum mines in the United States.

In 2006, PDMC produced 1,218,700 tons of copper on a consolidated basis (1,006,300 tons on a pro rata basis, which reflects our ownership interest) from worldwide mining operations, and an additional 61,200 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 48 percent of the copper mined in the United States in 2006. 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.

In 2006, PDMC produced 68.2 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 molybdenum disulfide for use primarily in the lubricant industry.

Molybdenum concentrate also is 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 are engaged in exploration efforts for metals and minerals throughout the world. 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.

PDI, our international 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 Latin America, Asia and Africa. Its operations are characterized by products with internationally competitive costs and quality, and specialized engineering capabilities. Its factories, which are located in nine countries, manufacture energy cables for international markets.

Prior to the below-mentioned dispositions in the 2006 first quarter, PDI consisted of two reportable segments Specialty Chemicals and Wire and Cable. Specialty Chemicals consisted of Columbian Chemicals Company and its subsidiaries (Columbian Chemicals or Columbian), one of the world s largest producers of carbon black. Additionally, the Wire and Cable segment also produced magnet wire and specialty conductors.

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. The transaction was completed on March 16, 2006. (Refer to Note 2, Divestitures, for further discussion.)

In addition, on November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet wire assets, previously reported as part of the Wire and Cable segment, to Rea Magnet Wire Company, Inc. (Rea). The transaction was

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completed on February 10, 2006. On March 4, 2006, Phelps Dodge entered into an agreement to sell High Performance Conductors of SC & GA, Inc. (HPC), previously reported as part of the Wire and Cable segment, to International Wire Group, Inc. (IWG). The transaction was completed on March 31, 2006. Neither transaction met the criteria for classification as discontinued operations as the Company is continuing to supply Rea with copper rod and IWG with copper rod and certain copper alloys. (Refer to Note 2, Divestitures, for further discussion of these transactions.)

Note 24, 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 16,000 people worldwide on February 15, 2007.

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 100 F Street, NE, 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.

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 following mines produce by-products: the Candelaria, Ojos del Salado, Morenci, Bagdad, Sierrita and Chino mines produce gold and silver; the Bagdad, Sierrita and Chino mines produce molybdenum and rhenium; and the Cerro Verde mine produces molybdenum and silver. We are also currently developing a copper mine in Safford, Arizona, and a copper/cobalt mine in the Katanga province in the DRC.

The Manufacturing segment consists of conversion facilities including our smelter, refinery, rod mills and specialty copper products facility. The Manufacturing segment processes copper produced at our mining operations and copper purchased from others into copper anode, cathode, rod and custom copper shapes. In addition, at times it smelts and refines copper and produces copper rod and shapes 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 purchase and sell copper from our U.S. mines and Manufacturing segment. It also purchases and sells any copper not sold by our South American Mines to third parties. Copper is sold

to others primarily as rod, cathode or concentrate. Copper rod historically was sold to the HPC and Magnet Wire North American operations of PDI s Wire and Cable segment. Since the disposition of those businesses, we have continued to sell copper rod and certain copper alloys to them.

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.

PDMC Other, although not a reportable segment, includes our worldwide mineral exploration and development programs, a process technology center whose primary activities comprise improving existing processes and developing new cost-competitive technologies, other ancillary operations, including our Miami, Bisbee and Tohono operations, and eliminations within PDMC.

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

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reportable segments: Candelaria/Ojos del Salado, Cerro Verde and El Abra.

Properties, Facilities and Production

Following are maps indicating the approximate location of PDMC s U.S. copper and molybdenum mines:

United States Mines

We produce electrowon copper cathode at leaching and solution extraction/electrowinning (SX/EW) operations located near Tyrone and Silver City, New Mexico (Tyrone and Chino mines, respectively), and near Morenci, Bagdad, Green Valley and Miami, Arizona (Morenci, Bagdad, Sierrita and Miami mines, respectively). We produce copper concentrate from open-pit mines and concentrators located at Bagdad, Green Valley and Morenci, Arizona, and Silver City, New Mexico. 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 2006, we produced a total of 506,400 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 532,700 tons in 2005 and 567,100 tons in 2004. 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.

Arizona Mines

Morenci

Morenci is an open-pit copper mining complex located in Greenlee County, Arizona, approximately 50 miles northeast of Safford on U.S. Highway 191. The site is accessible by a paved highway and a railway spur. Phelps Dodge Corporation, which operates the facility, owns an 85 percent undivided interest in Morenci. The remaining 15 percent was acquired in 1986 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 s production.

The Morenci mine is developed on a porphyry copper deposit that has leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper mineral is chrysocolla; chalcocite is the most important secondary copper sulfide mineral and chalcopyrite the dominant primary copper sulfide.

The Morenci operation consists of a 54,000 ton-per-day concentrator that produces copper concentrate, an 88,000 ton-per-day crushed-ore leach pad and stacking system, a large low-grade run-of-mine (ROM) leaching system, four solution-extraction (SX) plants, and three electrowinning (EW) tankhouses that produce copper cathode. Total EW tankhouse capacity is approximately 890 million pounds of copper per year. The mining capacity will be sufficient by mid-2007 to move an average of 870,000 tons of material per day, utilizing a fleet of 260-ton haul trucks loaded by shovels with bucket sizes ranging from 62 to 72 cubic yards. The open-pit mine has been in continuous operation since 1939 and was mined prior to that date through underground workings.

In June 2005, the Phelps Dodge board of directors approved expenditures of $210 million (100 percent basis) to construct a concentrate-leach, direct-electrowinning facility at Morenci, and to restart its concentrator, which had been idle since 2001. The concentrate-leach 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, with copper production 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 EW processes instead of smelting and refining.

Morenci is located in a high-desert environment. The highest bench elevation is 6,400 feet above sea level, and the ultimate pit bottom will have an elevation of 3,000 feet above sea level. Rainfall averages 13 inches per year, with most occurring during late summer monsoons (July through September).

The Morenci operation encompasses approximately 53,944 acres comprising 47,609 acres of patented mining claims and other fee lands, 5,914 acres of unpatented mining claims, and 421 acres of land held by state or federal permits, easements and rights-of-way.

Morenci receives electrical power through Tucson Electric Power Company, Arizona Public Service, and the Luna Energy Facility (Luna) in Deming, New Mexico (in which we own a one-third interest). The Morenci operation has sufficient approved water sources for the duration of its operating life.

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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

Bagdad is an open-pit copper and molybdenum mining complex located in Yavapai County in west-central Arizona. It is approximately 60 miles west of Prescott and 100 miles northwest of Phoenix. The property can be reached by Arizona Highway 96, which ends at the town of Bagdad. The closest railroad siding is at Hillside, Arizona, approximately 24 miles southeast on Arizona Highway 96. Bagdad is wholly owned and operated by Phelps Dodge.

The Bagdad mine is developed on a porphyry copper deposit that has leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper minerals are chrysocolla, malachite and azurite; chalcocite is the most important secondary copper sulfide mineral, and chalcopyrite and molybdenite the dominant primary sulfides.

The Bagdad operation consists of an 85,000 ton-per-day concentrator that produces copper and molybdenum concentrates, and an SX/EW plant that produces copper cathode from solution generated by low-grade ROM leaching and from conversion of a portion of mill copper concentrates in a concentrate-leach plant. Annual copper production from the Bagdad concentrator varies from 150 million to 200 million pounds per year. The majority of concentrate produced is smelted at PD s Miami, Arizona, facility, and up to 35 million pounds per year are produced as cathode from the SX/EW and concentrate-leach plants. The EW tankhouse has a design capacity of approximately 65 million pounds of copper per year, which includes 35 million pounds of copper associated with its concentrate-leach facility. Bagdad produces 15 million to 20 million pounds per year of copper cathode from its ROM leaching system, with the copper plated at its SX/EW facility. Molybdenum production at the Bagdad mill ranges from 8 million to 11 million pounds per year. The current mining fleet has the capacity to move in excess of 200,000 tons of material per day using 260-ton haul trucks loaded by shovels with bucket sizes ranging from 26 to 62 cubic yards. The open-pit mining operations have been ongoing since 1945. The deposit was mined through underground workings prior to 1945.

In 2002, Bagdad constructed a high-temperature, concentrate-leaching demonstration plant designed to recover annually 35 million pounds of commercial-grade copper cathode from chalcopyrite concentrates. The plant was commissioned in 2003 and continues to operate. The facility is the first of its kind in the world to use high-temperature, pressure leaching to process chalcopyrite concentrates. In 2005, this facility was used to test and demonstrate medium-temperature, pressure-leaching and direct-electrowinning technology, which will be used at the Morenci concentrate-leaching facility. The plant was converted back to high-temperature, pressure leaching in December 2005. This technology could assist in our long-term, cost-reduction strategy.

Bagdad is located in a semi-arid desert environment. The highest bench elevation is 3,950 feet above sea level, and the ultimate pit bottom will have an elevation of 1,550 feet above sea level. The Bagdad region has annual average precipitation of approximately 15 inches, with most occurring during the months of July through September and from December through April.

The Bagdad operation encompasses approximately 21,743 acres comprising 21,143 acres of patented mining claims and other fee lands, and 600 acres of unpatented mining claims.

Bagdad receives electrical power from Arizona Public Service Company. The Bagdad operation has sufficient approved groundwater sources for the duration of its operating life.

Sierrita

Sierrita is an open-pit copper and molybdenum mining complex located in Pima County, Arizona, approximately 20 miles southwest of Tucson and seven miles west of the town of Green Valley and Interstate Highway 19. The site is accessible by a paved highway and by rail. Sierrita is wholly owned and operated by Phelps Dodge.

The Sierrita mine is developed on a porphyry copper deposit that has leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper minerals are malachite, azurite and chrysocolla; chalcocite is the most important secondary copper sulfide mineral, and chalcopyrite and molybdenite the dominant primary sulfides.

The Sierrita operation consists of a 112,000 ton-per-day concentrator, two molybdenum roasters and a rhenium processing facility. The facility produces copper and molybdenum concentrates. Sierrita also produces copper from a ROM oxide-leaching system. The copper is plated at the leased Twin Buttes EW facility with a design capacity of approximately 50 million pounds of copper per year. In 2004, a copper sulfate crystal plant began production. The facility

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has the capacity to produce 40 million pounds of copper sulfate per year. Copper production from Sierrita averages 170 million pounds per year. Molybdenum production averages approximately 20 million pounds per year. The molybdenum facility consists of a leaching circuit, two molybdenum roasters and a metallurgical (technical oxide) packaging facility. The molybdenum roasting plants process concentrates from Sierrita, Bagdad, Chino and third-party sources. The current mining fleet has the capacity to move an average of 172,000 tons of material per day using 260-ton haul trucks loaded by shovels with bucket sizes ranging from 28 to 62 cubic yards. The mine has been an open-pit operation since 1959.

Sierrita is located in a desert environment. The highest bench elevation is 4,450 feet above sea level, and the ultimate pit bottom will have an elevation of 2,100 feet above sea level. Rainfall averages 12 inches per year, with most occurring during the late summer monsoons (July through September).

The Sierrita operation encompasses approximately 22,427 acres comprising 14,507 acres of patented mining claims and other fee lands, 5,725 acres of unpatented mining claims (includes 3,655 acres overlaying federal minerals on previously counted fee lands), and 2,195 acres of leased lands.

Sierrita receives electrical power through long-term contracts with the Tucson Electric Power Company. The Sierrita operation has sufficient approved groundwater sources for the duration of its operating life.

Miami

Miami is an open-pit copper mining complex located in Gila County, Arizona, approximately 90 miles east of Phoenix and six miles west of the city of Globe on U.S. Highway 60. The site is accessible by a paved highway and by rail. The Miami operation is wholly owned and operated by Phelps Dodge.

The Miami mine is developed on a porphyry copper deposit that has leachable oxide and secondary sulfide mineralization. The predominant oxide copper minerals are chrysocolla, copper-bearing clays, malachite and azurite; chalcocite and covellite are the most important secondary copper sulfide minerals.

The Miami mining operation has been on care-and-maintenance status since 2002, but has historically processed copper ore using both flotation and leaching technologies since about 1915. Since 2002, residual leaching of stockpiles has continued with copper recovered (from solution) by the SX/EW process. The design capacity of the SX/EW plant is 200 million pounds per year. The Miami smelter processes concentrates primarily from Bagdad, Sierrita, Morenci and Chino, and has been in production for over 80 years. The smelter has been upgraded during that period to implement new technologies, to improve production and to comply with current air quality standards. During 2006 and 2005, approximately 675,000 and 750,000 tons of concentrate, respectively, were processed through the smelter. The Miami smelter is the most significant source of sulfuric acid for the various PD domestic leaching operations. The sulfuric acid is a by-product as sulfur released during the smelting of concentrates is captured. The rod plant produces about 316 million pounds of 5/16 inch diameter ISO9001 rod per year. An electro-refinery at the site has been permanently closed (see discussion under Manufacturing Segment beginning on page 10).

Miami is located in a high-desert environment. The highest bench elevation is 4,550 feet above sea level, and the ultimate pit bottom will have an elevation of 2,650 feet above sea level. Rainfall averages over 18 inches per year, equally divided between summer and winter.

The Miami operation encompasses approximately 9,058 acres comprising 8,725 acres of patented mining claims and other fee lands, and 333 acres of unpatented mining claims.

Miami receives electrical power through long-term contracts with the Salt River Project and natural gas through long-term contracts with El Paso Natural Gas as the transporter. It has sufficient water sources for its future operations.

Safford

See the Morenci Mine map on page 3 for the location of our Safford mine.

The Safford project is currently under construction and is expected to produce ore from two open-pit copper mines located in Graham County, Arizona, approximately eight miles north of the town of Safford and 170 miles east of Phoenix. The site is accessible by paved county road, off U.S. Highway 70. The two pits are to be operated as one property with a single process facility. The Safford project is wholly owned by Phelps Dodge.

The Safford mine is developed on two porphyry copper deposits that have leachable oxide and secondary sulfide mineralization. The predominant oxide copper minerals are chrysocolla and copper-bearing iron oxides; chalcocite is the most important secondary copper sulfide mineral.

The property is a mine-for-leach project and will produce copper cathodes. The operation will consist of two open pits feeding a crushing facility with a nominal capacity of 114,000 tons per day of crushed ore. The crushed ore will be delivered to a single leach pad by a series of overland and portable conveyors. ROM ore will be placed on the leach pad by haulage trucks. Leach solutions will feed an SX/EW facility with a capacity of 240 million pounds of copper per year. The mining fleet will consist of 260-ton haul trucks loaded by 40- and 44-cubic yard shovels, capable of moving approximately 314,000 tons of material per day. We anticipate the Safford mine will be in production during the first half of 2008, with full copper production initially expected to be approximately 240 million pounds per year. The life of the operation is expected to be at least 18 years.

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Safford is located in a semi-arid desert environment. The highest bench elevation is expected to be 4,400 feet above sea level, and the lowest ultimate pit bottom is expected to have an elevation of 2,450 feet above sea level. Rainfall averages 10 inches per year, equally divided between summer and winter.

The Safford operation encompasses approximately 24,957 acres comprising 20,994 acres of patented lands, 3,932 acres of unpatented lands and 31 acres of land held by federal permit.

The Safford project receives electrical power through the Southwest Transmission Cooperative, a subsidiary of Arizona Electric Power Cooperative, Inc. Adequate groundwater resources for the project have been identified and pump tested, and are sufficient for the duration of its operating life.

New Mexico Mines

Chino

Chino is an open-pit copper mining complex located in southwestern New Mexico in Grant County, approximately 15 miles east of the town of Silver City, off of State Highway 180. The mine is accessible by paved roads and by rail. Chino is wholly owned and operated by Phelps Dodge. Prior to December 19, 2003, we held a two-thirds interest. Heisei Minerals Corporation (Heisei), a subsidiary of Mitsubishi Materials Corporation and Mitsubishi Corporation, owned the remaining one-third interest.

The Chino mine is developed on a porphyry copper deposit and adjacent copper skarn deposits. There is leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper minerals are chrysocolla and azurite; chalcocite is the most important secondary copper sulfide mineral, and chalcopyrite and molybdenite the dominant primary sulfides.

The Chino operation consists of a 43,000 ton-per-day concentrator that produces copper and molybdenum concentrates, and a 150 million pound-per-year SX/EW plant that produces copper cathode from solution generated by ROM leaching. The mining capacity is sufficient to move an average of 200,000 tons of material per day utilizing a fleet of 320-ton haul trucks loaded by shovels with bucket sizes ranging from 40 to 62 cubic yards. Copper ore is crushed and sent to a 43,000 ton-per-day concentrator. Leach ore is placed on stockpiles located throughout the property and the leach solution is processed at Chino s SX/EW facility that has a maximum capacity of 153 million pounds of copper in cathode per year. Chino s annual metal production averages about 200 million pounds of copper and up to 1 million pounds of molybdenum. Open-pit operations began in 1910.

Chino is located in a semi-arid environment. Rainfall averages 16 inches per year, with most occurring during the late summer monsoons (July through September). The highest bench elevation is 7,400 feet above sea level, and the ultimate pit bottom will have an elevation of 4,950 feet above sea level.

The Chino operation encompasses approximately 118,062 acres comprising 113,258 acres of patented mining claims and other fee lands, and 4,804 acres of unpatented mining claims (includes 22,907 acres overlaying federal and state minerals on previously counted fee lands).

Chino receives power from Luna and from the open market. It also has the ability to self-generate. Chino has sufficient approved groundwater sources for the duration of its operating life.

Cobre

Cobre is an open-pit and underground copper mining complex located in southwestern New Mexico in Grant County. The mine is located approximately 15 miles east of the town of Silver City and seven miles northeast of the town of Bayard. It is approximately five miles north of Chino and State Road 152. The mine is accessible by paved roads and by rail. Cobre is wholly owned by Phelps Dodge.

The Cobre mine is developed on a porphyry copper deposit and adjacent copper skarn deposits. There is leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper mineral is azurite; chalcocite is the most important secondary copper sulfide mineral, and chalcopyrite the dominant primary copper sulfide.

Copper production at Cobre was temporarily suspended in 1999. The remaining Cobre reserves are all located within a proposed open-pit leaching operation. The planned operation will employ 260-ton haul trucks loaded by shovels with bucket sizes ranging from 40 to 62 cubic yards, capable of moving 60,000 tons of material per day. The

ore will be hauled four miles to leach stockpiles at Chino and the waste rock will be hauled to stockpiles located at Cobre. Chino will process the leach solutions at its existing SX/EW facility.

Cobre is located in a semi-arid environment. The highest bench elevation is 7,500 feet above sea level, and the ultimate pit bottom will have an elevation of 6,000 feet above sea level. Rainfall averages 16 inches per year, with most occurring during the late summer monsoons (July through September).

The Cobre operation encompasses approximately 10,817 acres comprising 5,319 acres of patented mining claims and other fee lands, and 5,498 acres of unpatented mining claims.

Cobre receives electrical power from Luna. Cobre has sufficient approved groundwater sources for the duration of its operating life.

Tyrone

Tyrone is an open-pit copper mining complex located in southwestern New Mexico in Grant County, approximately 10 miles south of Silver City, New Mexico, along State Highway 90. The site is accessible via paved road and by rail. Tyrone is wholly owned and operated by Phelps Dodge.

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The Tyrone mine is developed on a porphyry copper deposit. Mineralization is dominantly leachable secondary sulfide consisting of chalcocite.

Copper processing facilities consist of an SX/EW operation with a maximum capacity of 168 million tons of copper cathodes per year. The current mining fleet has the capacity to move an average of 120,000 tons of material per day using a fleet of 190-ton haul trucks loaded by shovels with bucket sizes ranging from 22 to 54 cubic yards. The open-pit mine has been in operation since 1967. Historically, ore production has occurred from numerous open pits throughout the site. Mining is currently ongoing in a single, large, central open pit.

Tyrone is located in a high desert woodland environment. The highest bench elevation is 6,500 feet above sea level, and the ultimate pit bottom has an elevation of 5,000 feet above sea level. Rainfall averages approximately 16 inches per year with most occurring during the late summer monsoons (July through September).

The Tyrone operation encompasses approximately 35,200 acres comprising 18,755 acres of patented mining claims and other fee lands, and 16,445 acres of unpatented mining claims (includes 1,116 acres overlaying federal minerals on previously counted fee lands).

Tyrone receives electrical power from Luna and from the open market. It also has the ability to self-generate. The Tyrone operation has sufficient approved groundwater sources for the duration of its operating life.

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, and an open-pit mine and new concentrator located near Arequipa, Peru.

In 2006, we produced a total of 347,400 tons of copper cathode at our SX/EW facilities in South America, compared with 335,300 tons in 2005 and 337,900 tons in 2004. 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

Candelaria is an open-pit and underground copper mining complex located approximately 12 miles south of Copiapó in northern Chile s Atacama province, Region III. The site is accessible by two maintained dirt roads, one coming through the Tierra Amarilla community and the other off of Route 5 of the International Pan-American Highway. Phelps Dodge holds an 80 percent partnership interest in Candelaria through Phelps Dodge Candelaria, Inc., a wholly owned subsidiary. The remaining 20 percent interest is owned by SMMA Candelaria, Inc., Sumitomo Metal Mining Co., Ltd. and Sumitomo Corporation.

The Candelaria mine is developed on an iron oxide, copper/gold deposit. Millable primary sulfide mineralization consists of chalcopyrite.

The Candelaria operation consists of an open-pit copper mine and a 4,400 ton-per-day underground copper mine feeding a 74,000 ton-per-day concentrator. On average, open-pit mining operations move 320,000 tons of material per day using a fleet of 249-ton haul trucks loaded by shovels with bucket sizes ranging from 17 to 56 cubic yards. Concentrates containing 300 million to 500 million pounds of copper per year are transported by truck to a port facility, Punta Padrones, which is located in Caldera, approximately 50 miles northwest of the mine. The open-pit copper mine has been in operation since 1993 and the underground copper mine since 2005.

Candelaria is located in a desert environment at an elevation of 2,200 feet above sea level, and the ultimate pit bottom will have an elevation of 100 feet below sea level. Rainfall averages less than one inch per year, generally occurring in July and August.

The Candelaria property encompasses approximately 13,390 acres, including approximately 544 acres for the port facility in Caldera. The remaining property consists of mineral rights owned by the Company in which the surface is not owned but rather controlled consistent with Chilean law.

Candelaria receives electrical power through long-term contracts with Empresa Eléctrica Guacolda S.A., a local energy company. Candelaria s water supply comes from wellfields in the area of Tierra Amarilla and Copiapó that draw water from the Copiapó River aquifer. Ongoing studies currently are addressing the adequacy of this water supply for the remaining life of the operations.

Ojos del Salado

See the Candelaria Mine map to the left for the location of our Ojos del Salado mine.

Ojos del Salado consists of two underground copper mines (Santos and Alcaparrosa) and a 4,400 ton-per-day concentrator. The operation is located approximately 10 miles east of Copiapó in northern Chile s Atacama province, Region III, and is accessible by paved highway. Phelps Dodge holds an 80 percent partnership interest in Ojos del Salado through our Chilean subsidiary, Compañía Contractual Minera Ojos del Salado. On December 22, 2005, Ojos del Salado completed a general capital increase transaction in which SMMA Candelaria, Inc. acquired a 20 percent partnership interest, thereby reducing PD s interest from 100 percent to its current 80 percent.

The Ojos del Salado mines are developed on iron oxide, copper/gold deposits. Millable primary sulfide mineralization consists of chalcopyrite.

The Ojos del Salado operation has a capacity of 4,200 tons per day of ore from the Santos underground mine and 4,400 tons per day

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from the Alcaparrosa underground mine. The ore from both mines is mined by sublevel stoping, which is a variation of blasthole stoping, since both the ore and enclosing rocks are competent. The broken ore is removed from the stopes using front-end loaders and loaded into 20- to 30-ton trucks, which transport the ore to the surface. The ore from the Santos mine is hauled directly to the Ojos del Salado mill for processing, and the ore from the Alcaparrosa mine is reloaded into 60-ton trucks and hauled 12 miles to the Candelaria mill for processing. The Ojos del Salado operation has the capacity to produce 30 million pounds of copper and 15,000 ounces of gold per year. Tailing from the Ojos del Salado mill is pumped to the Candelaria tailing facility for final deposition. The Candelaria facility has sufficient capacity for the remaining Ojos del Salado tailing in addition to Candelaria s tailing.

Ojos del Salado is located in a desert environment at an elevation of 1,600 feet above sea level, with the lowest underground level at an elevation of 500 feet above sea level. Rainfall averages less than one inch per year, generally occurring in July and August.

The Ojos del Salado mineral rights encompass approximately 15,815 acres, which includes approximately 6,784 acres of owned land in and around the Ojos del Salado underground mines and plant site.

Ojos del Salado receives electrical power through long-term contracts with Empresa Eléctrica Guacolda S.A. The Ojos operation has sufficient approved groundwater sources for the duration of its operating life.

El Abra

El Abra is an open-pit copper mining complex located 47 miles north of Calama in Chile s El Loa province, Region II. The site is accessible by paved highway and by rail. Phelps Dodge has a 51 percent partnership interest in Sociedad Contractual Minera El Abra (El Abra), a Chilean contractual mining company. The remaining interest is held by the state-owned copper enterprise Corporación Nacional del Cobre de Chile (CODELCO).

The El Abra mine is developed on a porphyry copper deposit that has leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper minerals are chrysocolla, pseudomalachite, copper-bearing clays and tenorite; chalcocite is the most important secondary copper sulfide mineral, bornite and chalcopyrite the dominant primary copper sulfide.

The El Abra operation consists of an open-pit copper mine and an SX/EW facility recovering up to 500 million pounds of copper cathode per year from a 130,000 ton-per-day crushed leach circuit and a similar-sized, ROM leaching operation. The mining operation has sufficient equipment to move an average of 245,000 tons per day using a fleet of 274-ton haul trucks loaded by shovels with buckets ranging in size from 34 to 54 cubic yards. Beginning in 2010, El Abra is expected to shift from an oxide-leach, on-off pad operation to a bornite-dominant, sulfide-leach operation, where ore will be leached on a permanent pad. ROM ore mining and leaching will continue throughout the life of the property. The mine has been in operation since 1996.

El Abra is located in a high-desert environment and in an active seismic zone. The highest bench elevation is 13,600 feet above sea level, and the ultimate pit bottom will have an elevation of 12,300 feet above sea level. Rainfall averages less than one inch per year, primarily occurring during January through March.

El Abra controls a total of 110,268 acres of mining claims covering the ore deposit, stockpiles, process plant, and water wellfield and pipeline. In addition, El Abra has acquired surface rights for the plant-mine access road, the wellfield, power transmission line, and for the water pipeline from the Salar de Ascotán. Acquisition of all additional surface area required for the future development of the sulfide project is in process.

El Abra currently receives electrical power under a contract with Electroandina, which will expire at the end of 2007. Alternative power sources are being studied, including joint efforts with other mining firms in the region. Diesel generation exists as a backup system. The El Abra operation has obtained sufficient water rights to ensure water supply throughout its mine life.

Cerro Verde

Cerro Verde is an open-pit copper and molybdenum mining complex located 20 miles southwest of Arequipa, Peru. The site is accessible by paved highway. Beginning June 1, 2005, Phelps Dodge has a 53.56 percent equity interest in Sociedad Minera Cerro Verde S.A.A. (Cerro Verde). The remaining 46.44 percent is held by SMM Cerro Verde Netherlands B.V. (21.0 percent), Compañia de Minas Buenaventura S.A.A. (18.5 percent) and other minority

shareholders through shares publicly traded on the Lima Stock Exchange (6.94 percent). Prior to the general capital increase transaction in June 2005, Phelps Dodge held an 82.5 percent equity interest in Cerro Verde.

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The Cerro Verde mine is developed on a porphyry copper deposit that has leachable oxide and secondary sulfide mineralization, and millable primary sulfide mineralization. The predominant oxide copper minerals are brochantite, chrysocolla, malachite and copper pitch; chalcocite and covellite are the most important secondary copper sulfide minerals. Chalcopyrite and molybdenite are the dominant primary sulfides.

Cerro Verde s current operation consists of an open-pit copper mine and SX/EW leaching facilities. Leach-copper production is derived from a 40,000 ton-per-day crushed leach facility and a ROM leach system. This leaching operation produces over 200 million pounds of copper per year. Construction of Cerro Verde s new 119,000 ton-per-day concentrator was completed in late 2006. Processing of sulfide ore began in the 2006 fourth quarter. The expanded production rate should be achieved in the first half of 2007. With the completion of Cerro Verde s expansion, copper production is initially expected to approximate 300,000 tons per year (approximately 160,700 tons per year for PD s share). In addition, the expansion is expected to produce an average of approximately 3,900 tons of molybdenum per year (approximately 2,100 tons per year for PD s share) for the next 10 years. The mine has been in operation since 1976.

The mine has sufficient equipment, including new equipment with scheduled 2007 delivery dates, to move an average of 300,000 tons of material per day using a fleet of 200-ton and 255-ton haul trucks loaded by shovels with bucket sizes ranging in size from 28 to 60 cubic yards.

Copper cathodes and concentrate production are transported approximately 70 miles by truck and rail to the Pacific Port of Matarani for shipment to international markets.

Cerro Verde is located in a desert environment. The highest bench elevation is 9,500 feet above sea level, and the ultimate pit bottom will have an elevation of 6,600 feet above sea level. Rainfall averages 1.5 inches per year, with most occurring during January through March.

Cerro Verde has a mining concession covering approximately 53,094 acres plus 15 acres of real properties and 22 acres of rights-of-way outside the mining concession area.

Cerro Verde receives electrical power under long-term contracts with Electroperu and EGASA. The existing freshwater intake and supply system on the Rio Chili was expanded for the Cerro Verde mill project. Cerro Verde s participation in the Pillones Reservoir Project has secured water rights sufficient to support the new Cerro Verde milling operations for the life of the operations.

Africa Deposit

Tenke Fungurume

The Tenke Fungurume copper/cobalt deposits are located in the Katanga province of the DRC approximately 110 miles northwest of Lubumbashi. The deposits are accessible by unpaved roads and by rail. Phelps Dodge, through a wholly owned subsidiary, holds an effective 57.75 percent interest in the concessions. The remaining ownership is held by Tenke Mining Corp. (TMC) (24.75 percent) and La Generale des Carrieres et des Mines (Gecamines) (17.5 percent).

The Tenke Fungurume deposits are sediment-hosted copper/cobalt deposits with leachable oxide, mixed oxide-sulfide and sulfide mineralization. The dominant oxide minerals are malachite, pseudomalachite and heterogenite. Important sulfide minerals consist of bornite, carrollite, chalcocite and chalcopyrite.

Copper and cobalt will be recovered through an agitation-leach plant capable of processing 7,700 tons per day of ore. We anticipate the commencement of production beginning in late 2008 or early 2009, with production of approximately 250 million pounds of copper (approximately 144 million pounds for PD s share) and approximately 18 million pounds of cobalt (approximately 10 million pounds for PD s share) per year for the first 10 years. The initial mining fleet includes 6-cubic-yard, front-end loaders, a fleet of 50-ton haul trucks, surface miners, production drills, sampling machines and crawler dozers.

Tenke Fungurume is located in a tropic region; however, temperatures are moderated by its higher altitudes. Weather in this region is characterized by a dry season and a wet season, each lasting about six months. Average rainfall is 47 inches per year, with nearly all occurring between the months of October and April. The highest bench elevation is expected to be 4,870 feet above sea level, and the lowest ultimate pit bottom is expected to have an

elevation of 4,170 feet above sea level.

The Tenke Fungurume copper/cobalt deposits are located within four concessions totaling 394,455 acres of mining claims.

La Societe Nationale d Electricite (SNEL) is the state-owned electric utility company serving the region. Tenke Fungurume has entered into a long-term power supply agreement with SNEL; however, an infrastructure funding agreement, associated with the power supply agreement, is awaiting ministerial approval by the DRC government. The results of a recent water exploration program, as well as the regional geological and hydro-geological conditions,

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indicate that adequate water will be available for the expected life of the operation.

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 carbonate, 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 southwestern U.S. operations, including our Chino smelter and Miami refinery. 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 our operations in the southwestern United States. Accordingly, the Chino smelter, which had been on care-and-maintenance status since 2002, was permanently closed and demolition was initiated. With the closing of the Chino smelter, we had unnecessary refining capacity in the region. Because of its superior capacity and operating flexibility, the El Paso refinery continues to operate. The El Paso refinery is more than twice the size of the Miami refinery 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 since 2002, 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 is 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

Phelps Dodge owns two primary molybdenum mines in Colorado, the Henderson underground mine and the Climax mine.

The Henderson mine is located approximately 42 miles west of Denver, Colorado, off U.S. Highway 40. Nearby communities include the towns of Empire, Georgetown and Idaho Springs. The Henderson mill site is located approximately 15 miles west of the mine, and is accessible from Colorado State Highway 9. The Henderson mine and mill are connected by a 10-mile conveyor tunnel under the Continental Divide and an additional five-mile surface conveyor. The tunnel portal is located five miles east of the mill.

The Henderson deposit is a classic Climax-type porphyry molybdenum deposit with molybdenite as the primary sulfide mineral.

The Henderson operation consists of a large block-cave underground mining complex feeding a 40,000 ton-per-day concentrator. Henderson has the capacity to produce up to 40 million pounds of molybdenum per year. The

underground mining equipment fleet consists of 10-ton load-haul-dumps, 40- and 80-ton haul trucks and an underground crusher feeding a series of three overland conveyors to the mill stockpiles. The mine has been in operation since 1976. Active extraction is currently from two production levels. The majority of the molybdenum concentrate produced is shipped to our Fort Madison, Iowa, processing facility.

The Henderson mine is located in a mountain region with the collar of the main access shaft at 10,433 feet above sea level. The main production levels are currently at elevations of 7,700 and 7,210 feet above sea level. This region experiences significant snowfall during the winter months.

The Henderson mine and mill operations encompass approximately 11,878 acres comprising 11,843 acres of patented mining claims and other fee lands, and a 35 acre easement with the U.S. Forest Service for the surface portion of the conveyor corridor.

Henderson operations receive electrical power through long-term contracts with Xcel Energy and natural gas through long-term contracts with BP Energy with Xcel Energy as the transporter. The property has sufficient approved water resources at the mine and mill for any planned production scenarios.

Phelps Dodge also owns the Climax molybdenum mine located 13 miles northeast of Leadville, Colorado, off Colorado State Highway

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91 at the top of Freemont Pass. The mine is accessible by paved roads.

The Climax mine deposit is a classic porphyry molybdenum deposit with molybdenite as the primary sulfide mineral.

The Climax mine was placed on care-and-maintenance status in 1995 by its previous owner. On April 5, 2006, the Phelps Dodge board of directors conditionally approved the restart of the Climax mine. Final approval is contingent upon completion of a new mill feasibility study and obtaining all required operating permits and regulatory approvals. Prior studies indicated that the open-pit mine could annually produce approximately 20 million to 30 million pounds of molybdenum contained in high-quality concentrates at highly competitive per-pound production costs. The restart of the Climax mine will require a capital investment of approximately $200 million to $250 million for a new, state-of-the-art concentrator and associated facilities. Assuming favorable market conditions and timely receipt of permits, the Company expects to have the Climax mine in production by the end of 2009.

The Climax mine is located in a mountain region. The highest bench elevation is approximately 13,300 feet above sea level, and the ultimate pit bottom will have an elevation of approximately 10,300 feet above sea level. This region experiences significant snowfall during the winter months.

The Climax operation encompasses approximately 14,339 acres of patented mining claims and other fee lands.

Climax s electrical power is supplied by Xcel Energy. We expect that if operations are restarted, Xcel Energy will be able to supply sufficient energy to the Climax mine. The water rights held by Climax are sufficient to support future mining activities.

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 molybdenum disulfide. 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 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 molybdenum disulfide.

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-chemicals plant.

We also produce ferromolybdenum and molybdenum disulfide 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. The Climax technology center produces molybdenum metal powders.

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 2002 through 2006; 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:

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

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;

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 continued 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;

partial curtailment of Henderson operations beginning in the 2000 second quarter to 18 million pounds, followed by increases in annual production to approximately 28 million pounds in 2004, 32 million pounds in 2005 and 37 million pounds in 2006;

Morenci concentrator, which had been idled since 2001, was restarted in the 2006 second quarter; and

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completion of the expansion at Cerro Verde Mine in the 2006 fourth quarter. The expansion permits the mining of a primary sulfide ore body beneath the leachable ore body currently in production. Once it reaches full production, the expansion will allow the mine to triple annual production from approximately 100,000 tons of copper to 300,000 tons. In addition, the expansion will allow the mine to produce an average of approximately 3,900 tons of molybdenum per year for the next 10 years.

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

	2006	2005	2004	2003	2002
Material mined (a)					
Morenci	271,713	255,887	234,491	237,338	248,505
Bagdad	63,646	64,093	61,194	48,935	42,912
Sierrita	60,633	63,358	53,231	35,525	23,066
Chino	63,276	65,060	43,443	12,299	220
Tyrone	22,154	28,840	1,647	16,319	45,515
Candelaria	107,188	105,344	106,585	108,442	109,211
Ojos del Salado	3,190	2,800	836		
Cerro Verde	72,811	68,620	75,727	72,965	75,982
El Abra	84,865	85,140	83,705	87,682	76,831
Total material mined	749,476	739,142	660,859	619,505	622,242
Less 15% undivided interest at Morenci	40,757	38,383	35,174	35,601	37,276
Material mined on a consolidated basis	708,719	700,759	625,685	583,904	584,966
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)				3,785	73
Candelaria (c)	21,438	21,069	21,317	21,688	21,842
Ojos del Salado (d)	638	15			
Cerro Verde (e)	33,813	23,810	13,252	12,769	13,297
El Abra (f)	41,584	41,719	41,015	42,964	37,647
Material mined on a pro rata basis	611,246	614,146	550,101	502,698	512,107
Mill ore processed					
Morenci	4,504				
Bagdad	27,826	26,592	27,157	26,103	19,783
Sierrita	38,439	39,199	34,885	26,654	21,439
Chino	9,418	12,604	4,895		
Cerro Verde	834				
Candelaria (g)	23,640	25,064	27,318	26,407	28,507
Ojos del Salado	3,068	2,586	742		
Total mill ore processed	107,729	106,045	94,997	79,164	69,729
Less 15% undivided interest at Morenci	676				

Mill ore processed on a consolidated basis	107,053	106,045	94,997	79,164	69,729
Less minority participants shares previously accounted for on a pro rata basis:					
Cerro Verde (e)	387				
Candelaria (c)	4,728	5,013	5,464	5,281	5,701
Ojos del Salado (d)	614	12			
Mill ore processed on a pro rata basis	101,324	101,020	89,533	73,883	64,028
Leach ore placed in stockpiles					
Morenci	253,879	239,052	224,918	228,940	241,955
Bagdad (h)	28,530	23,857	23,627		328
Sierrita	6,013	1,888	1,330	375	170
Chino (h)	19,339	28,103	30,799	11,066	198
Tyrone (h)	14,615	20,328	18,185	10,722	34,835
Cerro Verde	29,720	22,839	22,628	21,014	24,096
El Abra (h)	73,851	83,620	71,361	80,604	71,224
Total leach ore placed in stockpiles	425,947	419,687	392,848	352,721	372,806
Less 15% undivided interest at Morenci	38,082	35,858	33,738	34,341	36,293
Leach ore placed in stockpiles on a consolidated basis	387,865	383,829	359,110	318,380	336,513
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)				3,376	66
Cerro Verde (e)	13,802	8,025	3,959	3,677	4,217
El Abra (f)	36,187	40,974	34,967	39,496	34,900
Leach ore placed in stockpiles on a pro rata basis	337,876	334,830	320,184	271,831	297,330

See footnote explanations on page 16.

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

	2006	2005	2004	2003	2002
Grade of ore mined percent copper					
Morenci mill	0.56				
Morenci leach	0.33	0.28	0.29	0.28	0.28
Bagdad mill	0.33	0.40	0.41	0.43	0.43
Bagdad leach	0.14	0.10	0.09		0.29
Sierrita mill	0.23	0.22	0.25	0.29	0.32
Sierrita leach	0.18	0.20	0.23	0.26	0.21
Chino mill	0.67	0.51	0.81		
Chino leach	0.35	0.26	0.35	0.80	0.29
Tyrone leach	0.19	0.26	0.17	0.34	0.35
Candelaria mill	0.87	0.79	0.89	0.97	0.84
Ojos del Salado mill	0.99	1.35	1.57		
Cerro Verde mill	0.56				
Cerro Verde leach	0.55	0.59	0.66	0.60	0.55
El Abra leach	0.41	0.43	0.47	0.49	0.50
Average copper grade mill	0.47	0.46	0.52	0.56	0.56
Average copper grade leach	0.34	0.31	0.33	0.37	0.35
Copper production					
Morenci:					
Concentrate	16.5				
Electrowon	391.3	400.0	420.3	421.2	412.7
Bagdad:					
Concentrate	58.7	84.8	82.1	82.5	68.4
Electrowon	24.0	15.8	28.0	24.5	15.6
Sierrita (i):					
Concentrate	73.6	71.8	73.5	66.3	60.0
Electrowon	7.2	7.5	4.0	9.3	16.2
Chino:					
Concentrate	52.9	50.7	29.8		
Electrowon	40.0	54.1	61.9	39.9	53.8
Tyrone:					
Electrowon	31.8	40.5	43.1	56.9	69.9
Miami:					
Electrowon	9.5	12.3	9.8	17.8	10.5
Bisbee:					
Precipitate					0.1
Tohono:					
Electrowon	2.6	2.5			
Candelaria:					
Concentrate	187.0	179.3	220.5	234.5	219.5

Ojos del Salado:					
Concentrate	27.3	31.1	10.4		
Cerro Verde:					
Concentrate	4.5				
Electrowon	106.4	103.1	97.6	96.3	95.3
El Abra:					
Electrowon	241.0	232.2	240.3	249.8	248.2
Manufacturing (j)	5.6	2.3	2.3	6.6	5.4
Total copper production	1,279.9	1,288.0	1,323.6	1,305.6	1,275.6
Less 15% undivided interest at Morenci	61.2	60.0	63.0	63.3	61.9
Copper production on a consolidated basis	1,218.7	1,228.0	1,260.6	1,242.3	1,213.7
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)				12.5	17.9
Candelaria (c)	37.4	35.9	44.1	46.9	43.9
Ojos del Salado (d)	5.4	0.1			
Cerro Verde (e)	51.5	35.9	17.1	16.8	16.7
El Abra (f)	118.1	113.8	117.7	122.4	121.7
Manufacturing (j)				1.2	1.4
Copper production on a pro rata basis	1,006.3	1,042.3	1,081.7	1,042.5	1,012.1

See footnote explanations on page 16.

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

	2006	2005	2004	2003	2002
Copper sales:					
From own mines (k):					
Morenci	407.3	400.0	420.3	421.2	412.7
Bagdad	82.6	104.4	111.9	111.0	92.3
Sierrita	80.6	82.8	79.2	79.3	83.8
Chino	92.7	104.8	91.7	40.7	53.7
Tyrone	31.8	40.5	43.1	56.9	69.9
Miami	9.5	14.5	10.9	20.0	15.2
Bisbee					0.1
Tohono	2.6	2.5			
Candelaria	185.0	179.7	223.2	234.3	218.3
Ojos del Salado	27.5	30.9	10.3		
Cerro Verde	107.1	102.7	98.2	95.6	94.9
El Abra	243.3	233.3	240.8	251.8	254.1
Manufacturing (j)	5.6	2.3	2.3	6.6	5.9
Total copper sales from own mines	1,275.6	1,298.4	1,331.9	1,317.4	1,300.9
Less 15% undivided interest at Morenci	61.1	60.0	63.0	63.3	61.9
Copper sales from own mines on a consolidated basis	1,214.5	1,238.4	1,268.9	1,254.1	1,239.0
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)				13.3	17.9
Candelaria (c)	37.0	36.0	44.6	46.9	43.7
Ojos del Salado (d)	5.5	0.1			
Cerro Verde (e)	49.7	36.4	17.2	16.7	16.6
El Abra (f)	119.2	114.3	118.0	123.4	124.5
Manufacturing (j)				1.2	1.8
Copper sales from own mines on a pro rata basis	1,003.1	1,051.6	1,089.1	1,052.6	1,034.5
Purchased copper:					
Candelaria (c)	3.1	23.1	37.1	22.1	35.8
El Abra (f)				7.3	56.5
Manufacturing (j)	364.1	369.5	394.0	274.6	267.7
Sales	0.6	18.1	1.9	70.5	83.0
Total purchased copper	367.8	410.7	433.0	374.5	443.0

Total copper sales on a consolidated basis (l)	1,582.3	1,649.1	1,701.9	N/A	N/A
Total copper sales on a pro rata basis (l)	N/A	N/A	N/A	1,427.1	1,477.5

Phelps Dodge Other Metal Production and Sales

	2006	2005	2004	2003	2002
Gold (thousand ounces)					
Total production	131	134	134	129	132
Less minority participants shares previously accounted for on a pro rata basis:	22	20	23	26	24
Net Phelps Dodge share	109	114	111	103	108
Sales (k)	95	114	112	108	136
Silver (thousand ounces)					
Total production	3,595	3,090	3,018	2,754	2,582
Less minority participants shares previously accounted for on a pro rata basis:	420	250	284	265	225
Net Phelps Dodge share	3,175	2,840	2,734	2,489	2,357
Sales (k)	3,419	2,866	3,249	2,292	3,317
Molybdenum (thousand pounds)					
Primary Molybdenum Henderson	37,071	32,201	27,520	22,247	20,517
By-product production					
Sierrita	19,974	18,610	22,041	21,167	14,986
Bagdad	10,300	10,952	7,910	8,580	9,462
Chino	814	543	18		
Total production	68,159	62,306	57,489	51,994	44,965
Sales Net Phelps Dodge share					
from own mines (k)	68,785	59,947	63,108	54,158	46,665
Purchased molybdenum	8,349	12,830	12,844	8,199	7,393
Total sales	77,134	72,777	75,952	62,357	54,058
Sulfuric acid (thousand tons)					
Copper smelters (m)	675.8	726.1	722.0	647.6	748.6

Molybdenum (m)	155.3	130.5	122.5	116.5	114.3
Total production	831.1	856.6	844.5	764.1	862.9
Copper smelters (m)	57.3	98.6	99.0	45.5	14.5
Molybdenum (m)	157.1	144.8	121.4	117.9	115.4
Total sales	214.4	243.4	220.4	163.4	129.9

See footnote explanations on page 16.

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Prices
(per pound)

	2006	2005	2004	2003	2002
COMEX copper price (n)	$ 3.09	1.68	1.29	0.81	0.72
LME copper price (o)	$ 3.05	1.67	1.30	0.81	0.71
Metals Week molybdenum Dealer Oxide mean price (p)	$24.75	31.73	16.41	5.32	3.77

Phelps Dodge Manufacturing and Sales Production

	2006	2005	2004	2003	2002
Smelters (q)					
Total copper (thousand tons)	189.6	218.9	214.4	200.8	243.8
Less minority participants shares previously accounted for on a pro rata basis					0.5
Net Phelps Dodge share	189.6	218.9	214.4	200.8	243.3
Refineries (r)					
Copper (thousand tons)	281.8	295.0	308.4	284.6	319.6
Gold (thousand ounces) (s)					79.0
Silver (thousand ounces) (s)					1,786.0
Rod (t)					
Total copper (thousand tons)	981.8	1,008.1	1,014.6	825.8	850.6

Footnotes to tables on pages 13 through 16:

(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, 2002, 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 partnership 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) Excluded 8.3 million pounds of copper sulfate production, which has a copper content of approximately 25 percent of an electrowon copper cathode.

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

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

(l) Beginning in 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).

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

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

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

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

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

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

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

(t) Included rod, wire,

oxygen-free billets/cakes, scrap and other shapes.	

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Other Mining

Other mining includes our worldwide mineral exploration and development programs, a process technology center whose primary activities are 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 15 countries and maintains offices in Australia, Brazil, Bulgaria, Canada, Chile, China, central Africa, Macedonia, Mexico, Peru, Russia, Serbia, the Philippines, the United States and Zambia.

In 2006, Phelps Dodge expended $97.4 million on worldwide exploration, including feasibility studies, compared with $81.0 million in 2005 and $35.6 million in 2004. The increase in exploration for 2006 primarily was due to increased exploration in central Africa, mostly associated with Tenke Fungurume. Approximately 33 percent of the 2006 expenditures occurred in the United States, with approximately 28 percent being spent at our U.S. mine sites, and the remainder for support of U.S. and international exploration activities. This compares with 36 percent in 2005 (31 percent at U.S. mine sites) and 40 percent in 2004 (31 percent at U.S. mine sites). In addition, approximately 45 percent was spent in central Africa and approximately 10 percent was spent in South America, including amounts spent at our South American mine sites. The balance of exploration expenditures was spent principally in Europe, Canada, Australia and the Philippines.

During 2006, exploration programs continued at some of our existing copper operations. At our Morenci mine, a reserve addition was added based on definition drilling of the Garfield and Shannon deposits. In the Safford district, we continued exploration drilling of the Lone Star deposit situated about four miles from the Dos Pobres ore body. We also continued underground and surface drilling at Ojos del Salado.

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 copper/cobalt project in the 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 Tenke Fungurume copper/cobalt mineral deposit. On November 2, 2005, Phelps Dodge, through a wholly owned subsidiary, exercised its option to acquire a controlling interest in the Tenke Fungurume copper/cobalt mining concessions in the Katanga province of the DRC. The action came after the government of the DRC and 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 TMC at 24.75 percent and Gecamines at 17.5 percent (non-dilutable). Phelps Dodge 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, of which $15 million was paid in November 2005, that are in addition to $50 million of asset transfer payments made to Gecamines prior to Phelps Dodge acquiring controlling interest in the project. The remaining asset transfer payments will be paid over a period of approximately four years as specified project milestones are reached. Phelps Dodge is solely responsible for funding the next $10 million of asset transfer payments. Thereafter, Phelps Dodge will be responsible for funding 70 percent of the remaining asset transfer payments.

On December 6, 2006, the Phelps Dodge board of directors conditionally approved the development of the Tenke Fungurume copper/cobalt mining project, with final approval contingent upon finalizing a series of agreements with SNEL, the state-owned electric utility company serving the region. The initial project will include development of the mine as well as copper and cobalt processing facilities, and will require a capital investment of approximately $650 million. Phelps Dodge and TMC are responsible for funding 70 percent and 30 percent, respectively, of any

advances for project development.

Earthwork activity for Tenke Fungurume has commenced with initial focus on roads, plant-site cleaning and construction-camp installation. We anticipate the commencement of production in late 2008 or early 2009, with initial production of approximately 250 million pounds of copper (approximately 144 million pounds for PD s share) and approximately 18 million pounds of cobalt (approximately 10 million pounds for PD s share) per year for the first 10 years.

On September 16, 2005, the federal Bureau of Land Management (BLM) completed an Arizona land exchange with the Company. This action allowed us to advance our development of a copper mining operation approximately eight miles north of Safford, Arizona, which will include development of the Dos Pobres and San Juan copper ore bodies.

On February 1, 2006, the Phelps Dodge board of directors conditionally approved development of the new copper mine near Safford with final approval contingent upon receiving certain state permits needed for the mine. In May 2006, the Company received an aquifer protection permit from the Water Quality Division of the Arizona Department of Environmental Quality (ADEQ), and, in early July 2006, received an air quality permit from the Air Quality Division of ADEQ. The Company has received all requisite permits and commenced construction in early August 2006. The Safford mine will require a capital investment of approximately $550 million. During 2006, approximately $100 million was spent on the project.

The two deposits, Dos Pobres and San Juan, contain an estimated total of 616 million tons of leachable reserves with an ore grade of 0.36 percent copper. We anticipate that the Safford mine will be in production during the first half of 2008, with full copper production initially expected to approximate 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

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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. Production at Lumwana is expected to commence in 2008.

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 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 held by the Company, if the value of the Company s Dynatec shares is less than $70 million. Construction on the Ambatovy mine is expected to commence in mid-2007.

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 125 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 2006 were as follows:

The high-temperature, concentrate pressure-leaching demonstration plant at the Bagdad mine continued to operate throughout 2006. The high temperature (*i.e.,* 225°C) mode of operation provides the Bagdad operation with a significant portion of the sulfuric acid required for its low-grade stockpile leaching operations. In 2005, this facility was used to test and demonstrate medium-temperature, pressure-leaching and direct-electrowinning technology for use at Morenci and other potential future applications.

The design and construction of a concentrate-leaching facility at Morenci was advanced on schedule during 2006. This facility is being installed in conjunction with a restart 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 was demonstrated at Bagdad in 2005. The facility is expected to be in operation by mid-2007 with copper production projected to be approximately 150 million pounds per year. To date, approximately $128 million (PD s share) has been spent for the concentrate-leach, direct-electrowinning facility and restart of the concentrator, of which approximately $112 million (PD s share) was spent during 2006.

Construction and commissioning of a Central Analytical Service Center (CASC) to provide routine analytical services for PDMC s operations in Arizona and New Mexico was completed in early 2006. The facility, located in Safford, Arizona, replaces most analytical functions and capabilities at Phelps Dodge mining operations in Arizona and New Mexico, and provides high-quality, timely and cost-effective analytical services to PDMC s operations.

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 and the construction of a large, engineered, stockpile leaching operation at Morenci.

The development of cost-effective, heap-leaching options for primary sulfide material at El Abra continued to be 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 starting in 2010.

Investigation and commercial demonstration of alternative technologies to reduce the cost of copper electrowinning continued during 2006.

The commercial demonstration of proprietary alternative copper products and production techniques, specifically electrowon copper powder, was advanced during 2006.

We continued the operation and optimization of a facility at Bisbee, Arizona, using technology owned by BioteQ (Vancouver, Canada) to recover copper as a sulfide precipitate from low-grade, copper-bearing solution.

Total expenditures for PTC in 2006 were approximately $33 million, compared with $45 million in 2005 and $26 million in 2004. PDMC intends to advance all of the aforementioned research and

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development projects aggressively in 2007; however, there is no assurance that any of the non-commercial 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 (the 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 15, 2005, 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 prior years 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 in 2004.

Phelps Dodge owns an investment in First Quantum Minerals Ltd. (First Quantum), which is a Canadian mining and metals company whose principal activities include mineral exploration, development, mining and the production of copper cathode and concentrate, gold and sulfuric acid. We account for our investment in First Quantum as an available-for-sale security, which had a fair value of $75.7 million at December 31, 2006.

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, including projected long-term prices for copper and molybdenum and our estimate of future cost trends. Third-party consultants are employed to audit the ore reserves of three properties each year on a rotational basis.

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 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-value 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 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. The table below summarizes the lowest cutoff ore grades utilized to define ore reserves.

	As of December 31, 2006		
Property	Mill %	Crushed or Agitation Leach %	ROM Leach %
Morenci	0.31	0.25	0.03

Candelaria	0.25	N/A	N/A
El Abra	N/A	0.26	0.05
Miami	N/A	N/A	0.04
Ojos del Salado	0.85	N/A	N/A
Tyrone	N/A	N/A	0.07
Bagdad	0.19*	N/A	0.07
Cerro Verde	0.23	0.15	0.10
Chino	0.33	N/A	0.10
Sierrita	0.23*	N/A	0.07
Cobre	N/A	N/A	0.07
Safford	N/A	0.12	0.08
Tenke Fungurume	N/A	1.04**	N/A
Primary Molybdenum Properties			
Henderson	0.15	N/A	N/A
Climax	0.08	N/A	N/A

* Equivalent copper cutoffs based on molybdenum price of $5.00 per pound.

** Equivalent copper cutoff based on cobalt price of $12.00 per pound.

Proven and probable ore reserves at December 31, 2006 and 2005, for each of our operating, curtailed and development properties are summarized on the following pages.

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	Total Ore Reserves Estimated at December 31, 2006 [1]							
	Millable Reserves			Leachable Reserves				Phelps
				Crushed Leach		Run-of-Mine (ROM)		Dodge
	Million Tons	% Copper	% Moly	Million Tons	% Copper	Million Tons	% Copper	Interest (%)
Developed Properties								
Copper Properties								
Morenci (2)								
Proven Reserves	267.5	0.52		495.3	0.58	2,388.6	0.19	
Probable Reserves	2.9	0.64		22.5	0.50	108.3	0.21	
	270.4	0.52		517.8	0.57	2,496.9	0.19	85.0
Candelaria (3) & (4)								
Proven Reserves	283.0	0.64						
Probable Reserves	17.8	0.72						
	300.8	0.64						80.0
El Abra (5)								
Proven Reserves				517.3	0.54	416.1	0.26	
Probable Reserves				159.1	0.55	82.2	0.34	
				676.4	0.54	498.3	0.28	51.0
Miami (6)								
Proven Reserves						93.0	0.41	
Probable Reserves						2.7	0.30	
						95.7	0.41	100.0
Ojos del Salado (3)								
Proven Reserves	7.2	1.14						
Probable Reserves	4.8	1.14						
	12.0	1.14						80.0
Tyrone (7)								
Proven Reserves						80.9	0.36	
Probable Reserves						13.7	0.23	
						94.6	0.34	100.0
Copper and Molybdenum Properties								
Bagdad (7)								
Proven Reserves	517.4	0.36	0.02			12.2	0.32	
Probable Reserves	27.8	0.29	0.02			1.8	0.28	
	545.2	0.35	0.02			14.0	0.32	100.0
Cerro Verde (8)								

Proven Reserves	480.7	0.54	0.02	151.2	0.60	37.5	0.30	
Probable Reserves	1,070.4	0.44	0.01	135.6	0.43	44.2	0.22	
	1,551.1	0.47	0.02	286.8	0.52	81.7	0.26	53.56
Chino								
Proven Reserves	53.9	0.68	0.03			120.5	0.43	
Probable Reserves	10.5	0.69	0.02			20.4	0.35	
	64.4	0.68	0.03			140.9	0.42	100.0
Sierrita								
Proven Reserves	927.4	0.26	0.03			9.9	0.18	
Probable Reserves	91.6	0.24	0.03			5.2	0.18	
	1,019.0	0.26	0.03			15.1	0.18	100.0
Primary Molybdenum Property								
Henderson								
Proven Reserves	136.2		0.21					
Probable Reserves	5.6		0.20					
	141.8		0.21					100.0
Undeveloped Ore Reserves require substantial capital investments to bring into production								
Copper Properties								
Cobre (6)								
Proven Reserves						81.8	0.41	
Probable Reserves						3.3	0.33	
						85.1	0.40	100.0
Safford (9)								
Proven Reserves				285.3	0.46	45.7	0.21	
Probable Reserves				194.2	0.31	90.3	0.20	
				479.5	0.40	136.0	0.20	100.0

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Total Ore Reserves Estimated at December 31, 2006 *(continued)* (1)

	Millable Reserves			Leachable Reserves: Crushed Leach		Leachable Reserves: Run-of-Mine (ROM)		Phelps Dodge Interest
	Million Tons	% Copper	% Moly	Million Tons	% Copper	Million Tons	% Copper	(%)
Undeveloped Ore Reserves require substantial capital investments to bring into production								
Primary Molybdenum Property								
Climax (6) & (10)								
Proven Reserves	64.2		0.22					
Probable Reserves	92.2		0.16					
	156.4		0.19					100.0

	Agitation Leach Reserves			Phelps Dodge Interest
	Million Tons	% Copper	% Cobalt	(%)
Copper and Cobalt Property				
Tenke Fungurume (11)				
Proven Reserves	24.2	2.24	0.30	
Probable Reserves	89.7	2.05	0.31	
	113.9	2.09	0.31	57.75

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

	Millable Reserves			Leachable Reserves: Crushed Leach		Leachable Reserves: Run-of-Mine (ROM)		Phelps Dodge Interest
	Million Tons	% Copper	% Moly	Million Tons	% Copper	Million Tons	% Copper	(%)
Developed Ore Reserves								
Copper Properties								
Morenci	247.6	0.49		587.5	0.54	2,490.7	0.19	85.0
Candelaria	339.0	0.73						80.0
El Abra				227.7	0.47	226.4	0.32	51.0
Miami						112.1	0.37	100.0
Ojos del Salado	15.1	1.33						80.0
Tyrone						49.3	0.29	100.0
Copper and Molybdenum Properties								
Bagdad	618.9	0.35	0.02			16.3	0.31	100.0

Cerro Verde	1,392.0	0.49	0.02	268.1	0.50	97.1	0.29	53.56
Chino	72.6	0.70	0.02			156.0	0.40	100.0
Sierrita	1,061.6	0.26	0.03			26.1	0.18	100.0
Primary Molybdenum Property								
Henderson	150.7		0.21					100.0
Undeveloped Ore Reserves	require substantial capital investments to bring into production							
Copper Properties								
Cobre						110.3	0.35	100.0
Safford				455.3	0.40	82.7	0.21	100.0
Primary Molybdenum Property								
Climax	156.4		0.19					100.0

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

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

(3) Candelaria and Ojos del Salado deposits also contained 0.004 ounces and 0.010 ounces of gold per ton, respectively.

(4) Candelaria ore reserves included 6.3 million tons of underground ore reserves from the Candelaria Norte area. Candelaria recoverable pounds

decreased due to higher costs and a new resource model that lowered copper grades.

(5) El Abra amounts include oxide leach and new sulfide leach reserves at December 31, 2006, which were based on a recently updated feasibility study.

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

(7) Bagdad and Tyrone ore reserves reflected new pit designs based on updated slope and economic parameters.

(8) Cerro Verde millable ore reserves reflect its recently completed mill project.

(9) Safford leach deposit is in development and is expected to be in production during the first half of 2008.

(10) Significant capital investment is required prior to production from these molybdenum reserves.

(11) Tenke Fungurume ore reserves were included

based on a recently updated feasibility study.

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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, 2006			
	Proven (average spacing-feet)		Probable (average spacing-feet)	
Property	Mill	Leach	Mill	Leach
Morenci	283	283	400	400
Candelaria	115	N/A	230	N/A
El Abra	N/A	233	N/A	328
Miami	N/A	200	N/A	300
Ojos del Salado	82	N/A	164	N/A
Tyrone	N/A	283	N/A	283
Bagdad	190	81	441	323
Cerro Verde	164	164	328	328
Chino	141	200	200	283
Sierrita	223	144	347	242
Cobre	150	200	200	300
Safford	N/A	200	N/A	400
Tenke Fungurume	N/A	164	N/A	328
Henderson	65	N/A	290	N/A
Climax	200	N/A	200	N/A

Metallurgical Recovery

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

	As of December 31, 2006		
	Copper		Molybdenum
Property	Mill % (a)	Leach % (b)	Mill % (c)
Copper and Copper/Molybdenum Properties			
Morenci	78.8	55.1	N/A
Candelaria	91.1	N/A	N/A
El Abra (d)	N/A	53.7	N/A
Miami	N/A	61.6	N/A
Ojos del Salado	89.8	N/A	N/A
Tyrone	N/A	64.3	N/A
Bagdad	86.1	44.9	75.6
Cerro Verde	86.3	74.2	53.9
Chino	77.5	65.3	25.0
Sierrita	83.6	60.1	81.1
Cobre	N/A	61.9	N/A
Safford	N/A	61.7	N/A

Primary Molybdenum Properties			
Henderson	N/A	N/A	86.8
Climax	N/A	N/A	85.1

Property	Copper Agitation Leach %	Cobalt Agitation Leach %
Copper/Cobalt Property		
Tenke Fungurume (e)	95.0	83.5

(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 include both oxides and sulfide ores.

(e) Tenke Fungurume long-term cobalt metal recoveries are estimated to average 83.3 percent based on refined

cobalt metal production. Cobalt recoveries in hydroxide form are estimated to average 85.0 percent.

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 9, 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 (53.56 percent) and Morenci (85 percent).

(in million tons)	As of December 31, 2006			
	Stockpile Material	Contained Copper (%)*	Recovery (%)	Recoverable Copper
Mill stockpiles:				
100% basis	111	0.47	82.5	0.4
Consolidated basis				0.4
Phelps Dodge pro rata basis				0.3
Leach stockpiles:				
100% basis	9,100	0.27	5.6	1.4
Consolidated basis				1.4
Phelps Dodge pro rata basis				1.2

* Copper grade of ore when placed.

(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.

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 blasthole cuttings determine the estimated copper grades of the material delivered to the mill stockpiles.

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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 contained copper through a leaching process. Leach stockpiles are exposed to acidic solutions that dissolve contained copper and deliver it in solution to extraction processing facilities. The quantity of material is based on surveyed volumes of mined material and daily production records. Sampling and assaying of blasthole cuttings determine the estimated copper grade of material delivered to leach stockpiles.

Expected copper recovery rates are determined using small-scale laboratory tests, small- to 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,	
	2006	2005
Mill stockpiles:		
Candelaria	0.3	0.3
Cerro Verde	0.1	0.1
	0.4	0.4
Leach stockpiles:		
Morenci	0.3	0.2
El Abra	0.1	0.1
Tyrone	0.1	0.1
Bagdad	0.1	0.1
Cerro Verde	0.1	0.1
Chino	0.6	0.6
Sierrita	0.1	0.2
	1.4	1.4
Total (100% basis)	1.8	1.8
Consolidated basis	1.8	1.7
Phelps Dodge pro rata basis	1.5	1.5

Note: 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. Leach stockpiles are expected to be processed over the lives of the respective mines.

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

	2006	2005	2004	2003	2002
Milling reserves on a pro rata basis (billion tons) (a)	3.2	3.3	4.2	3.5	3.4
Leaching reserves on a pro rata basis (billion tons) (a)	4.5	4.1	4.5	4.0	4.3
Commercially recoverable copper (million tons):					
Ore reserves	19.5	17.7	23.2	19.5	19.6
Stockpiles and in-process inventories	1.5	1.5	1.6	1.6	1.4
Total Phelps Dodge pro rata basis	21.0	19.2	24.8	21.1	21.0
Total consolidated basis (b)	27.4	23.7	26.1	N/A	N/A
Commercially recoverable molybdenum (billion pounds)					
Phelps Dodge pro rata basis	1.8	1.9	2.1	2.0	2.1
Total consolidated basis	2.0	2.0	2.1	2.0	2.1
Commercially recoverable cobalt (billion pounds)					
Phelps Dodge pro rata basis	0.3	N/A	N/A	N/A	N/A
Total consolidated basis	0.6	N/A	N/A	N/A	N/A

(a) Milling and leaching reserves on a 100 percent basis would have been 4.1 and 5.7 billion tons, respectively, as of December 31, 2006 and 4.1 and 4.9 billion tons, respectively, as of December 31, 2005, if El Abra, Candelaria, Cerro Verde, Morenci, Ojos del Salado and Tenke were reflected on a 100 percent basis.

(b) Commercially recoverable copper on a

100 percent basis would have been 28.2 and 24.5 million tons of copper, respectively, as of December 31, 2006 and 2005, if Morenci was reflected on a 100 percent basis.

The increase in commercially recoverable copper at December 31, 2006, was primarily due to the inclusion of the Tenke Fungurume ore reserves and the El Abra sulfide leach ore reserves, offset by current year production. 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 53.56 percent from 82.5 percent, new pit designs at Bagdad, Cerro Verde, Chino, Cobre, Tyrone and Candelaria, as well as 2005 production.

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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
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
2006	408	213	309	28.40	20.50	24.75

Phelps Dodge s reported ore reserves are economic at the most-recent three-year historical average COMEX copper price of $2.02 per pound and the most-recent three-year historical average molybdenum price of $24.30 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 2006, we used a long-term average COMEX price of $1.05 per pound of copper, an average molybdenum price of $5.00 per pound (*Metals Week* Dealer Oxide mean price) and an average cobalt price of $12.00 per pound, along with near-term price forecasts reflective of the current price environment, to develop mine plans and production schedules.

The per pound COMEX copper price during the past 10 years, 15 years and 20 years averaged $1.17, $1.13 and $1.12, respectively. The per pound *Metals Week* Dealer Oxide molybdenum mean price over the same periods averaged $9.73, $7.88 and $6.66, 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, 2006:

		Milling Material				Leaching Material			Phelps Dodge
Property	Location	Millions of Tons	Percent Copper	Percent Molybdenum	Percent Cobalt	Millions of Tons	Percent Copper	Percent Cobalt	Interest %

Operating Copper Properties									
Morenci	Arizona	255	0.33			477	0.29		85.0
Candelaria (1)	Chile	61	0.53						80.0
El Abra	Chile	280	0.54			144	0.25		51.0
Tyrone	New Mexico					63	0.33		100.0
Operating Copper/Molybdenum Properties									
Bagdad	Arizona	830	0.32	0.02					100.0
Cerro Verde	Peru	624	0.36	0.01		8	0.46		53.56
Sierrita	Arizona	2,670	0.21	0.02		34	0.16		100.0
Non-Operating Copper Properties									
Ajo	Arizona	205	0.50						100.0
Cobre	New Mexico	3	0.94						100.0
Cochise/Bisbee	Arizona					276	0.47		100.0
Miami	Arizona					86	0.39		100.0
Safford	Arizona	233	0.73			52	0.10		100.0
Sanchez	Arizona					230	0.29		100.0
Lone Star	Arizona					1,600	0.38		100.0
Tohono	Arizona	276	0.70			404	0.63		100.0
Non-Operating Copper/Cobalt Property									
Tenke Fungurume	Dem. Rep. Congo	82	3.11		0.28	28	3.05	0.35	57.75
Primary Molybdenum Properties									
Henderson	Colorado	316		0.12					100.0
Climax Underground	Colorado	87		0.25					100.0
Climax Open Pit	Colorado	327		0.12					100.0

(1) Candelaria consists of both open-pit and underground mines. The stated tonnage also contains 0.004 ounces of gold per ton.

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.

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Sales and Competition

U.S. Mining Operations

A majority of the copper produced or purchased at our U.S. Mining Operations is cast into rod. Rod sales to outside wire and cable manufacturers constituted approximately 74 percent of PDMC s U.S. sales in 2006, 75 percent in 2005 and 70 percent in 2004. 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 and rod contract prices are generally based on the prevailing COMEX copper monthly average spot price for shipments in that period. We generally sell our copper rod and cathode produced at our U.S. Mining Operations at a premium over COMEX prices.

South American Mines

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 to other smelters or merchants. A 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 2006, 2005 and 2004, approximately 90 percent of Candelaria s concentrate sales were priced on the basis of the third calendar month following the month of arrival.

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 and concentrates. A majority of our Cerro Verde cathode production is shipped to our U.S. rod mills for processing. The remainder of Cerro Verde s cathode 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. In December 2006, Cerro Verde began shipping copper concentrates, which were priced on the basis of the third calendar month following the month of arrival.

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. Our principal methods of competing include pricing, product properties, product quality, customer service and dependability of supply. 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, employ new technologies, and find large-scale copper and copper/gold deposits 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.

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. Approximately 80 percent of molybdenum production is used in this application. 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 2007 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 was estimated at approximately 65 percent of global molybdenum production in 2006.

Prices, Supply and Consumption

Worldwide Copper Mining Operations

Copper is an internationally traded commodity, and its price is effectively determined by the major metals exchanges COMEX, the LME and the Shanghai Futures Exchange (SHFE). Prices on these exchanges generally reflect the worldwide balance of copper supply

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and demand, but also are influenced significantly, from time to time, by speculative actions and by currency exchange rates.

Copper is a critical component of the world s infrastructure. The demand for copper ultimately reflects the rate of underlying world economic growth, particularly in industrial production and construction. Copper s end-use markets reflect its fundamental role in the world economy. Copper s end-use markets (and their estimated shares of total consumption) are (i) construction (38 percent), (ii) electrical applications (28 percent), (iii) industrial machinery (13 percent), (iv) transportation (11 percent) and (v) consumer products (10 percent). Since 1990, refined copper consumption grew by an estimated compound annual growth rate of 3.1 percent to 17.6 million tons, according to published data by the World Bureau of Metals Statistics (WBMS) and Phelps Dodge s estimate for 2006. This rate of increase was slightly higher than the growth rate of 2.9 percent for world industrial production over the same period. Asian copper consumption, led by China, has been particularly strong, increasing by approximately 6 percent from 1990. Asia now represents approximately half of the world s refined copper consumption, compared with approximately 22 percent for Western Europe and approximately 20 percent for the Americas.

From 1990 through 2006, refined copper production has grown at an average annual rate of approximately 3 percent, based on published data by the WBMS and Phelps Dodge s estimates for 2006.

Copper consumption is closely associated with industrial production and, therefore, tends to follow economic cycles. During an expansion, demand for copper tends to increase, thereby, driving up the price. As a result, copper prices are volatile and cyclical. During the past 15 years, the LME price of copper averaged $1.126 per pound and ranged from a high annual average price of $3.049 per pound in 2006 to a low annual average price of 70.6 cents per pound in 2002. In addition, during the past 15 years, the COMEX price of copper averaged $1.135 per pound and has ranged from a high annual average price of $3.089 per pound in 2006 to a low annual average price of 71.6 cents per pound in 2002.

In 2006, the average COMEX price of $3.089 per pound was $1.407 above the average for 2005. Continued low global inventory levels, improved consumption in most regions, increased speculative investment in commodities and unanticipated production shortfalls resulted in record high copper prices throughout the year. During 2006, we estimate global refined copper production and copper consumption grew by approximately 5 percent and 4 percent, respectively. Consumption continued to be strong in Asia, specifically in China, which experienced growth of approximately 5 percent in 2006, a slightly slower pace than in prior years. In addition, as a result of stronger economic activity, European copper consumption improved, growing approximately 5 to 6 percent. During 2006, U.S. demand for copper was down approximately 3 to 4 percent as a result of slowing in the residential housing and auto markets. Visible exchange inventories increased by approximately 86,000 metric tons over the prior year to approximately 242,000 metric tons.

In 2005, the average COMEX price of $1.682 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 4.9 percent year-on-year while consumption was estimated to increase by a modest 1 percent year-on-year. Consumption was again led by Asia, specifically China, which grew at approximately 7.5 percent year-on-year. U.S. demand for copper cathode was down 7.0 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 $1.290 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 restarted 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.

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.

During 2006, primary mine production increased in both North America and China, although production in China remains difficult to estimate. By-product molybdenum production decreased from 2005 levels primarily due to lower production in South America. Tight supply of western, high-quality materials continued throughout the first half of 2006 and eased in the second half as demand slowed in the metallurgical segment. Western roaster capacity constraints were reduced in 2006 as increased capacity was realized and by-product supply decreased. Overall, market fundamentals shifted from a supply deficit in the first half of 2006 to a slight surplus late in the year, with the overall year being relatively balanced.

Although prices were lower than those experienced in 2005, 2006 molybdenum prices remained at historically high levels. Annual *Metals Week* Dealer Oxide mean prices averaged $24.75 per pound in 2006, compared with $31.73 per pound in 2005 and $16.41 per pound in 2004. Strong demand, which has outpaced supply over the past several years, has continued and inventory levels throughout the industry remain low. 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 $21.86 per pound in 2006, compared with $25.88 per pound in 2005 and $12.65 per pound in 2004, reflecting a broad mix of upgraded molybdenum products as well as technical-grade molybdic oxide.

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Costs

Worldwide Copper Mining Operations

Energy, including electricity, diesel fuel and natural gas, represents a significant portion of production costs at our operations. To moderate or offset the impact of increasing energy costs, we use a combination of multi-year energy contracts put in place at various points in the price cycle, as well as self-generation and diesel fuel 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, 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 prices, our energy cost per pound of copper increased in 2006. In 2007, we may continue to experience higher energy costs if prices remain at the levels experienced in 2006.

We continue to explore alternatives to moderate or offset the impact of increasing energy costs. In late 2004, we purchased a one-third interest in the partially constructed Luna power plant located near Deming, New Mexico. In April 2006, Luna became operational. Public Service Company of New Mexico (PNM), a subsidiary of PNM Resources, and Tucson Electric Power, a subsidiary of Unisource Energy Corporation, partnered with Phelps Dodge in the purchase of Luna. Each partner owns a one-third interest and each is responsible for a third of the costs and expenses. PNM is the operating partner of the plant. Approximately 190 megawatts, or one-third of the plant s electricity, is available to satisfy the electricity demands of PDMC s New Mexico and Arizona operations. Electricity in excess of PDMC s demand is sold on the wholesale market. Our interest in this 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, diesel fuel and natural gas call option contracts and fixed-price swaps for our North American and Chilean operations. The call option contracts give the holder the right, but not the obligation, to purchase a specific commodity at a pre-determined dollar cost, or strike price.

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 for delivery during a specific future period.

Our natural gas price protection program consists of purchasing call options for our North American operations. 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, for 2006, 2005 and 2004 we were 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 times of higher energy prices. Energy consumed in our mines and smelter was 20.2 cents per pound of our copper production cost in 2006, compared with 19.5 cents in 2005 and 14.6 cents in 2004.

In addition, we realized cost increases in 2006 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 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.

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 federal and state Superfund requirements. (Refer to the discussion of Superfund requirements in Other Environmental Matters on pages 33 through 36.) 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 comprehen-

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sive 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 storm water runoff from active and inactive mines and construction activities. EPA and authorized states have issued general permits that cover storm water 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 storm water 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

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 APP regulations. APP regulations require permits for certain facilities, activities and structures for mining, concentrating and smelting. APP requires compliance with aquifer water quality standards at an applicable point of compliance well or location. APP also may require mitigation and discharge reduction or elimination of some discharges. Existing facilities operating under 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 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, our Safford development property, portions of our Bagdad and Miami mines, a sewage treatment facility at Ajo, and a closed tailing impoundment in Clarkdale, Arizona. We have submitted proposed modifications to the

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Clarkdale APP to reflect capping actions taken in 2006. We have conducted groundwater studies and submitted APP applications for several of our other properties and facilities, including the Bagdad, Sierrita, Miami and Bisbee mines, and United Verde branch. Permits for most of these other properties and facilities likely will be issued by ADEQ in the first half of 2007. We will continue to submit all required APP applications for our remaining properties and facilities, and for modifications to our existing operations, as well as for any new properties or facilities. We do not know what 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. We are likely to continue to have to make expenditures to comply with the APP program.

At our Sierrita and Bisbee properties, ADEQ has proposed detailed requirements to protect public drinking water sources with respect to non-hazardous substances, such as sulfate. Sierrita has signed a Mitigation Order with ADEQ to address sulfate-impacted groundwater that is used for drinking water purposes. A similar draft Mitigation Order is being negotiated for Bisbee. Financial assurance, in the same form used for the Arizona APP program, will likely be required for any long-term measures implemented under these Mitigation Orders.

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 has provided guarantees for the financial assurance obligations of its subsidiaries that have pending APP permits and has provided financial strength demonstrations for pending APP permits that will be issued to Phelps Dodge.

At December 31, 2006 and 2005, we had accrued closure costs of approximately $74 million and $68 million, respectively, for our Arizona operations. The amount of financial assurance currently demonstrated for closure and reclamation activities is approximately $174 million. If the Company s credit rating for senior unsecured debt falls below investment grade, and if it could not meet the alternative financial strength test that is independent of debt ratings, our Arizona mining operations might be required to supply financial assurance in another form.

Ore mining at Cyprus Tohono ceased in July 1997, but copper cathode production continued from existing 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) issued by 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 lease. Previous studies indicate that closure and reclamation requirements, excluding any potential Superfund environmental response costs, are estimated at approximately $5 million. The Company has provided interim financial assurance in the amount of $5.1 million, of which $5.0 million is in the form of a corporate performance guarantee. Cyprus Tohono has committed to update previous closure and reclamation studies and associated cost estimates by June 2007.

(Refer to Note 22, Contingencies, for further discussion of Significant Arizona Environmental and Reclamation Programs.)

Significant New Mexico Environmental and Reclamation Programs

The Company s New Mexico operations, Chino, Tyrone, 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 measures to be taken to prevent groundwater quality standards from being exceeded following the closure of 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 of the New Mexico Energy, Minerals and Natural Resources Department (MMD). 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. As a result of this legislation, NMED and MMD have approved

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reductions of approximately $27 million (NPV basis) from the total amount of financial assurance required.

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.

At December 31, 2006 and 2005, we had accrued closure costs of approximately $296 million and $263 million, respectively, for our New Mexico operations.

(Refer to Note 22, Contingencies, for further discussion of Significant New Mexico Environmental and Reclamation Programs.)

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. Climax financial assurance comprises a single surety bond; 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, the Company finalized Henderson s reclamation plan and related financial assurance with the Colorado Division of Reclamation Mining and Safety, which resulted in a revision of our asset retirement obligation (ARO) estimates. At December 31, 2006 and 2005, we had accrued closure costs of approximately $23 million and $24 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 FWS investigations of avian mortalities at some of the Company s mining operations, including Cyprus Tohono, Tyrone, Chino and Morenci. As a result of FWS investigations, federal authorities have raised issues related to avian mortalities under two federal laws, the Migratory Bird Treaty Act (MBTA) and the natural resource damages provision of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). As part of the discussions regarding the MBTA, 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 water. 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. At December 31, 2006, we were in compliance with the plea agreement.

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. At December 31, 2006, we were in compliance with the plea agreement.

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 damages 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 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 (NJDEP) for the United States Metals Refining Company site. The Company offered to settle New Jersey s claim either through restoration work or a cash payment. The Company is involved in ongoing negotiations with NJDEP to resolve the New Jersey claim.

The Kansas Trustee Council has notified Cyprus Amax of the Council s intent to perform a natural resource damage assessment at 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.

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Significant 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 required 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 Environmental 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 submitted its closure plan on August 14, 2006. Cerro Verde is also in the process of determining its financial assurance obligations associated with the new regulation, which is not required to be submitted to the Peruvian Ministry of Energy and Mines until early 2008. Based on the submitted closure plan s scope of work, the revised site-wide cost estimate is approximately $78 million (undiscounted, unescalated and on a third-party cost basis). At December 31, 2006 and 2005, Cerro Verde had accrued closure costs of approximately $15 million and $5 million, respectively.

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 22, 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, 2006 and 2005, we had accrued closure costs of approximately $26 million and $20 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 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 Company has reduced its use of surety bonds in support of financial assurance obligations in recent years due to significantly increasing costs and because many surety companies require a significant level of collateral supporting the bonds. If remaining surety bonds are unavailable at commercially reasonable terms, the Company could be required to post other collateral or cash or cash equivalents directly in support of financial assurance obligations.

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 FWS as endangered or threatened, as well as designated critical habitats for those species. Some listed species and critical habitats 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 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.

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 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.

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African Deposit

At the Tenke Fungurume operations in the DRC, mine properties and facilities are controlled through mining concessions under general mining laws. 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 international 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 internationally competitive costs and quality, and specialized engineering capabilities.

Prior to the 2006 first quarter dispositions, PDI consisted of two reportable segments Specialty Chemicals and Wire and Cable. Specialty Chemicals consisted of Columbian Chemicals Company and its subsidiaries, one of the world s largest producers of carbon black. Additionally, the Wire and Cable segment also produced magnet wire and specialty conductors.

Wire and Cable Segment

Prior to the 2006 first quarter dispositions, the Wire and Cable segment consisted of three worldwide product line businesses comprising magnet wire, energy cables and specialty conductors. Magnet wire had manufacturing facilities in Indiana; Monterrey, Mexico; and Suzhou, China; and had closed facilities in North Carolina, Texas and Kentucky. HPC, which produced specialty conductors, had manufacturing facilities in South Carolina and Georgia and had closed facilities in New Jersey. During the early 2000s, and through the sale of our North American magnet wire and HPC assets, both businesses had restructured and consolidated certain of their operations to reduce costs and to strengthen their competitiveness in the global market place. As a result, asset impairment charges or write-downs were recorded for both magnet wire and HPC of approximately $39.2 million pre-tax ($34.5 million, after-tax) on a cumulative basis for the years of 2002 to 2005.

On November 15, 2005, Phelps Dodge entered into an agreement to sell substantially all its North American magnet wire assets to Rea for approximately $125 million in cash, subject to a working capital adjustment at the time of closing. The transaction was completed on February 10, 2006, resulting in net sales proceeds of approximately $132 million, net of approximately $10 million in taxes and related expenses.

On March 4, 2006, Phelps Dodge entered into an agreement to sell HPC to IWG. Under the agreement, IWG purchased the stock of HPC, as well as certain copper inventory. The transaction was completed on March 31, 2006, resulting in total net sales proceeds, exclusive of the contingent payment, of approximately $48 million (net of approximately $4 million in taxes and related expenses).

Phelps Dodge International Corporation manufactures energy cables for international markets in factories located in nine 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 eight countries Brazil, Chile, China, 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 nine countries in addition to the United States Guatemala, El Salvador, Honduras, Panama, Puerto Rico, Colombia, Mexico, Ecuador and South Africa.

Competition and Markets

Our international energy cable companies primarily sell products to contractors, distributors, and public and private utilities. Our products are used in lighting, power distribution and other electrical applications. Our competitors range

from worldwide wire and cable manufacturers to small local producers.

Until the sale of our North American magnet wire assets, Phelps Dodge was one of the world s largest manufacturers of magnet wire, selling to original equipment manufacturers for use in electric motors, generators, transformers, televisions, automobiles and a variety of small electrical appliances. We principally competed with two international and two U.S. magnet wire producers.

Until the sale of HPC, specialty conductors were sold primarily to intermediaries (insulators, assemblers, subcontractors and distributors). Specialty conductors also are used in appliances, instrumentation, computers, telecommunications, military electronics, medical equipment and other products. We had two primary U.S. competitors and competed with three importers in the specialty conductor market.

Raw Materials and Energy Supplies

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 principal raw materials used by our magnet wire manufacturing operations were copper, aluminum and various chemicals and resins used in the manufacture of electrical insulating materials.

Prior to the sale of HPC, the specialty conductor product line was usually plated with silver, nickel or tin.

Most of our international energy cable operations generally use purchased electricity and natural gas as their principal sources of energy.

Ownership of Property

We own or owned most of the plants and land on which our wire and cable operations are or were located. We lease land for our Suzhou, China, facility. This land is not material to our overall operations.

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Discontinued Operations

On November 15, 2005, Phelps Dodge entered into an agreement to sell Columbian Chemicals. The transaction was completed on March 16, 2006, resulting in net sales proceeds of approximately $595 million (including approximately $100 million of Columbian s foreign held cash and net of approximately $27 million in taxes and related expenses).

Prior to their sale, Columbian and its subsidiaries were headquartered in Marietta, Georgia. They were an international producer and marketer of carbon black. Columbian produced a full range of rubber and industrial carbon black in 12 plants worldwide.

Competition and Markets

Columbian was among the world s largest producers of carbon black. The majority of the carbon black it produced was used in rubber applications, a substantial portion of which was used in the tire industry. Major tire manufacturers worldwide accounted for a significant portion of Columbian s carbon black sales. 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 purchased substantially all of its feedstock at market prices that fluctuate with world oil prices.

Ownership of Property

Columbian owned all property other than the leased land at its U.K., German and Korean facilities.

LABOR MATTERS

At December 31, 2006, the Company employed approximately 15,600 people to sustain its global operations. Approximately 13,000 employees worked for PDMC, and most of those employees were 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.

Phelps Dodge Mining Company

Location	Number of Unions	Number of Union-Represented Employees	Expiration Date
El Abra Chile	2	455	Oct-08
Candelaria Chile	2	506	Oct-09
Aurex Chile	1	35	Feb-10
Cerro Verde Peru	1	460	Dec-08
Chino New Mexico	1	275	Nov-09
Rotterdam The Netherlands	2	41	Mar-08
Stowmarket United Kingdom	1	50	May-08
Tenke Fungurume DRC	2	522	Mar-08
Bayway New Jersey	1	48	Apr-07

In addition, we currently have labor agreements covering most of our international manufacturing division plants. Wire and Cable employed approximately 2,600 people. Below is a list of Wire and Cable operations 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 Union-Represented Employees

	Number of Unions		Expiration Date
Luanshya, Zambia	1	72	Jun-07
Peços de Caldas, Brazil	2	471	Aug-07 & Oct-07
Valencia, Venezuela	1	380	Jul-09
Santiago, Chile	2	166	Sep-10

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. Expenditures for research and development programs, including expenditures associated with discontinued operations, together with contributions to industry and government-supported programs, totaled $35.3 million in 2006, $48.6 million in 2005 and $32.5 million in 2004.

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 damages to natural resources. In addition, the Company is subject to potential liabilities under 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 damages 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,

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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. Environmental 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 $377.9 million and $367.9 million were recorded as of December 31, 2006 and 2005, respectively. The long-term portion of these reserves is included in other liabilities and deferred credits on the Consolidated Balance Sheet and amounted to $261.0 million and $285.6 million at December 31, 2006 and 2005, 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 during 2006 were the Chino Administrative Order on Consent (Chino AOC), the Tohono Tailing and Evaporation Pond Remediation, and the Anniston Lead and PCB sites. The sites with the most significant reserve changes during 2005 were the Anniston Lead and PCB sites, and the Laurel Hill 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 pages 41 and 42 for further discussion of the litigation associated with this site including litigation in respect to 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.

Chino AOC

In December 1994, Chino entered into an AOC with NMED, which requires Chino to perform a CERCLA-quality investigation of environmental impacts and the potential risks to human health and the environment associated with portions of the Chino property affected by historical mining operations. The remedial investigation began in 1995 and is still in progress, although substantial portions of the investigation are complete. During 2006, soil removal actions in residential yards were initiated at the Hurley townsite. Although no feasibility studies have been completed, the Company expects that additional remediation will also be required in other areas. We are currently negotiating an interim remedial action with NMED for the Whitewater Creek Investigative Unit and a technology pilot test at the Smelter/Tailing Investigative Unit, and expect to conduct feasibility studies for these areas after several years of monitoring the results of these actions. During 2006, the Company increased its reserve associated with these implemented and planned actions at the Chino AOC by approximately $14 million, which was partially offset by spending during the year, for a total reserve at December 31, 2006, of approximately $27 million.

Tohono Tailing and Evaporation Pond Remediation

Cyprus Tohono leases certain land from the Nation, including the mine operation site that comprises an open pit, underground mine workings, leach and non-leach rock stockpiles, tailing and evaporation ponds, SX/EW operations and ancillary facilities. The Nation, along with several federal agencies, has notified Cyprus Tohono of groundwater quality concerns and concerns with other environmental impacts from historical mining operations. In recent years, Cyprus Tohono expanded its groundwater-monitoring well network, with some samples showing contaminant levels above primary and secondary drinking water standards. In addition, tests from a neighboring Native American village s water supply well indicated 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 (NPL). The Nation has asked EPA not to list the Tohono mine on the

NPL.

During 2006, Cyprus Tohono entered into an AOC with EPA to conduct a non-time-critical removal action and perform remediation at the former tailing impoundment and evaporation pond areas. In January 2007, the Nation requested the assistance of EPA to evaluate groundwater contamination associated with the Cyprus Tohono mine. The Company expects to negotiate and enter into a separate AOC to perform a remedial investigation and feasibility study for groundwater contamination at the site. During 2006, based on the work plan submitted to EPA for the removal action, the Company increased its reserve for this Superfund matter by approximately $12 million, which was partially offset by spending during the year, for a total reserve at December 31, 2006, of approximately $25 million.

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 became final on January 17, 2006. During 2006, PDII and the other PRPs reached a final cost-sharing agreement that, among other things, assigns PDII the responsibility

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to manage the PRPs obligations under the Settlement Agreement. In addition, since finalizing the Settlement Agreement, sampling of residential yards and required soil removal actions commenced. During 2006 and 2005, PDII increased its reserve by approximately $11 million and $22 million, respectively, which was offset by spending during those years, for a total reserve of approximately $27 million at December 31, 2006, covering 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 2007.

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 scheduled to submit its remedial investigation report and its remedial feasibility report to NYSDEC in 2007. The Company is currently engaged in settlement discussions with NYSDEC concerning the types of remedial actions in the feasibility study that would be acceptable to the agency. During 2005, based on the types of remedial actions being discussed and associated transactional costs, the environmental reserve was increased by approximately $21 million. At December 31, 2006, the total reserve for the Laurel Hill site was approximately $19 million, which covers ongoing consulting and legal costs to complete the required studies and assess contributions from other potential parties plus expected remedial action costs for impacted sediments. The Company also is currently engaged in settlement discussions with federal and state natural resource trustees concerning potential natural resource damages attributable to historical operations at the Laurel Hill facility. The environmental reserve also covers possible settlement amounts for these potential natural resource damages being discussed with federal and state trustees.

On February 8, 2007, the Attorney General for the state of New York issued a Notice of Intent to Sue under the citizen suit provision of RCRA alleging that historical contamination from the Laurel Hill site has created an imminent and substantial endangerment to health and the environment in the adjacent Newtown Creek and portions of the adjacent shoreline. The notice seeks injunctive relief under RCRA for alleged environmental contamination. The Company intends to discuss the notice with the Office of the Attorney General.

Other

For the years 2006, 2005 and 2004, the Company recognized net charges of $82.4 million, $113.4 million and $58.9 million, respectively, for environmental remediation. As discussed above, the sites with the most significant reserve changes during 2006 were the Chino AOC, the Tohono Tailing and Evaporation Pond Remediation, and the Anniston Lead and PCB sites (a total increase of approximately $37 million). The sites with the most significant reserve changes during 2005 were the Anniston Lead and PCB sites and the Laurel Hill site (a total increase of approximately $43 million). The remainder of environmental remediation charges was primarily for closed or non-owned sites, none of which increased or decreased individually more than approximately $10 million during 2006 or 2005.

At December 31, 2006, the cost range for reasonably possible outcomes for all reservable environmental remediation sites (including Pinal Creek s estimate of approximately $92 million to $205 million) was approximately $332 million to $631 million (of which $377.9 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 it has other potential claims for recovery from other third parties, including the United States government and other PRPs. Neither claims nor offsets are recognized unless such offsets are considered

probable of realization.

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, 2006, the cost range for reasonably possible outcomes for all such sites, for which an estimate can be made, was approximately $3 million to $18 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. The estimates given in those discussions of the capital expenditures to comply with environmental laws and regulations in 2007 and 2008, and the expenditures in 2006 are separate from the reserves and estimates described above.

In January 2007, the Morenci facility received the International Organization for Standardization (ISO) 14001 environmental certification. During 2006, the following facilities received ISO 14001 environmental certification: the Fort Madison molybdenum processing facility; the Chino mine and mill; the Sierrita mine, mill and roaster; the Bagdad mine and mill; the Tyrone mine; the Venezuela wire plant; the Honduras wire plant; and the Costa Rica wire plant. During 2005, the following facilities received ISO 14001 environmental certification: the Henderson mine and mill; the Miami mine, smelter, refinery and rod plant; the El Paso refinery and rod plant; the Norwich rod and wire plant; the Zamefa, Zambia wire plant; and the

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Bayway manufacturing plant. 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 four times in 2006 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 $4.076 to a low of 60.4 cents. 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 2007 annual consolidated production of approximately 2.9 billion pounds of copper, each 1 cent per pound change in our average annual realized copper price (or our average annual cost of production) causes a variation in annual operating income, excluding the impact of our copper collars and before taxes and adjustments for minority interests, of approximately $29 million. 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 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 have and may continue to cause significant volatility in our financial performance. At December 31, 2006, we had in place zero-premium copper collars (consisting of both put and call options) for approximately 486 million pounds of PDMC s expected 2007 copper sales. For 2007, the annual average LME call strike price (ceiling) for our zero-premium copper collars is $2.002 per pound. At December 31, 2006, we also had in place copper put options for approximately 730 million pounds of PDMC s expected 2007 copper sales, with an annual average LME put strike price (floor) for 2007 of 95 cents per pound. In accordance with generally accepted accounting principles in the United States, transactions under these copper price protection programs do not qualify for hedge accounting treatment and are adjusted to fair market value based on the forward-curve price and implied volatility as of the last day of the respective reporting period, with the gain or loss recorded in revenues. These adjustments represent non-cash events as the contracts are settled in cash only after the end of the relevant year based on the average annual LME copper price. For the year ended December 31, 2006, the pre-tax charges arising from our 2006 and 2007 copper price protection programs reduced operating income by approximately $1,009 million. Based on the LME forward-curve price average as of February 23, 2007, we estimate unrealized after-tax gains of approximately $46 million for the 2007 first quarter associated with our 2007 copper collars and copper put options.

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The following is a summary of significant derivative financial instruments for our copper price protection programs at December 31 (refer to Note 23, Derivative Financial Instruments and Fair Value of Financial Instruments, for further discussion of our derivative financial instruments):

(Units in millions)	Open Derivative Positions				Expired Derivative Positions	
	Year	Open Position	Gain/ (Loss) (1)	Maturity	Hedged Sales Price Per Unit	Gain/ (Loss) (1)
Fair Value Hedges						
Copper fixed-price rod sales (lbs.) (2) & (3)	2005	13		December 2006	1.71/lb.	
	2004	11		December 2005	1.29/lb.	
Other Economic Price Protection Programs Not Qualifying for Hedge Accounting						
Copper fixed-price rod sales (lbs.) (2)	2006	103	(29.4)	November 2008	3.14/lb.	138.4
	2005	72	14.6	December 2006	1.71/lb.	69.3
	2004	51	6.8	October 2006	1.29/lb.	22.3
Copper price protection (lbs.) (4), (5) & (6)	2006	1,216	(371.3)	December 2007	1.63/lb.	(637.6)
	2005	2,344	(223.9)	December 2006/2007	1.38/lb.	(186.6)
	2004	650	(0.6)	December 2005		
Copper quotational period swaps (lbs.)	2006	3	1.7	January 2007	3.13/lb.	(113.7)
	2005	92	(14.0)	March 2006	1.68/lb.	(71.9)
	2004	130	(10.9)	April 2005	1.33/lb.	(12.0)

(1) Gains/losses are recognized in the Consolidated Statement of Income for the periods presented, except for cash flow hedges, which are recorded in other comprehensive

income (loss).

(2) Expired positions for hedge gains/losses for both the qualifying copper fixed-price program and the non-qualifying copper fixed-price rod sales are combined in the copper fixed-price rod sales realized gain/loss column. As a result of the 2006 first quarter sale of Magnet Wire North American assets, we discontinued the qualifying copper fixed-price program.

(3) The hedge gain or loss from changes in fair value is recognized in earnings. Changes in fair value of the hedged item (or hedged exposure) attributable to hedged risk are also recognized in earnings.

(4) Losses from the copper price protection

programs include premium expense.

(5) The Company has recognized the following pre-tax charges associated with its 2005, 2006 and 2007 copper collar price protection programs: (i) a $0.6 million loss in 2004 and a $186.6 million loss in 2005 for a cumulative loss of $187.2 million on 2005 El Abra and PDMC zero-premium copper collar price protection programs; (ii) a $175.0 million loss in 2005 and a $637.6 million loss in 2006 for a cumulative loss of $812.6 million on 2006 zero-premium copper collar and purchased put option price protection programs; and (iii) a $48.9 million loss in 2005 and a $371.3 million loss in 2006 for a cumulative loss of $420.2 million on 2007 zero-premium

copper collar and purchased put option price protection programs.

(6) At December 31, 2005, we had entered into copper price protection positions expiring December 2006 and December 2007.

Increased Energy Costs Could Reduce Our Profitability or Result in Losses

Energy represents a significant portion of the production costs of our operations. The principal sources of energy for our mining operations are electricity, diesel fuel 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 put in place at various points in the price cycle, as well as self-generation and diesel fuel 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 times of higher energy prices. During 2006, energy consumed in our mines and smelter accounted for 20.2 cents per pound of production costs, compared with 19.5 cents in 2005 and 14.6 cents in 2004. 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 strong demand for copper, to return to 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.

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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 stringent federal, state and local environmental 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 federal Clean Air Act has had a significant impact, particularly on our smelter 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 22, 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.

The amount of financial assurance that has been provided for our Chino, Tyrone and Cobre mines, pursuant to an agreement we reached with two New Mexico state agencies, totaled approximately $495 million at December 31, 2006. Up to 70 percent of such financial assurance is in the form of third-party guarantees issued by us on behalf of our operating subsidiaries with the balance, or approximately 30 percent, provided in the form of trust funds, real property collateral 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 $174 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, the Company s credit rating for senior unsecured debt falls below investment grade, we may still be able to maintain all or a part of the Company s financial assurance using alternative financial strength tests in New Mexico and Arizona. However, a portion of our financial assurance requirements might be required to be supplied in another form, such as letters of credit, real property collateral or cash.

The Company has reduced its use of surety bonds in support of financial assurance obligations in recent years due to significantly increasing costs and because many surety companies require a significant level of collateral supporting the bonds. If remaining surety bonds are unavailable at commercially reasonable terms, the Company 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. (Refer to Note 22, Contingencies, for further discussion of International Closure and Reclamation Programs.)

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.

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Declines in the market price of a particular metal also may render the exploitation of ore 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 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; 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. In addition, the Company s business depends on its ability to attract and retain skilled and experienced employees. Phelps Dodge faces significant competition from other mining companies for key executives and other employees with applicable technical skills and experience in the mining industry.

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

In 2006, our international operations provided approximately 39 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 approximately 54 percent of the Company s consolidated operating income. Due to the current development project in the Democratic Republic of Congo and expansion projects at Cerro Verde and El Abra, the Company expects international operations to increase as a percentage of sales and operating income in future years. 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 2006, our minority partners in our South American Mines were entitled to approximately 212,400 tons, or 38 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.

Failure to Complete the Merger with Freeport-McMoRan May Negatively Impact Our Stock Price and Financial Results

On November 18, 2006, Phelps Dodge and Freeport-McMoRan Copper & Gold Inc. (Freeport) entered into a definitive merger agreement under which Freeport will acquire Phelps Dodge. The proposed merger is subject to

closing conditions, including shareholder approval, regulatory approvals and other customary closing conditions. There is no assurance that the merger will be approved by our shareholders and Freeport s shareholders, and there is no assurance that the other conditions to complete the merger will be satisfied. If the merger is not completed, we may be required to pay Freeport a termination fee of up to $750 million. In addition, the current market price of our common stock may reflect a market assumption that the merger will occur, and a failure to complete the merger could result in a negative perception by the stock market of us generally and a decline in the market price of our common stock.

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;

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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), (filed 1974; consolidated 1981). The major parties in addition to Phelps Dodge in the Gila River adjudication are: the Gila Valley Irrigation District, the San Carlos Irrigation and Drainage District, the state of Arizona, the Salt River Project, 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.

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 the 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)

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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 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 accordance with the legislation, an Exchange Agreement between the 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 (ADEQ) Water Quality Assurance Revolving

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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 the U.S. Environmental Protection Agency (EPA) under the Comprehensive Environmental Response, Compensation, and Liability Act (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, has been postponed due to a discovery dispute and related orders and appeals, and has not yet been rescheduled.

Approximately $102 million remained in the Company s Pinal Creek remediation reserve at December 31, 2006. 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.

IV. Litigation remains pending regarding closure permits issued by the New Mexico Environmental Department for the Phelps Dodge Tyrone, Inc. (Tyrone) and Chino Mines Company (Chino) operations. 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. In this case, Tyrone objected to permit conditions requiring Tyrone to perform approximately $75 million of additional closure work. On June 15, 2006, the New Mexico Court of Appeals issued its decision overturning two permit conditions that Tyrone had challenged in its closure permit. The New Mexico Supreme Court denied Petitions for Certiorari and the case has been remanded by the Court of Appeals to WQCC for further proceedings. Chino s Supplemental Discharge Permit for Closure, DP-1340, was appealed by a third party, whose appeal was dismissed by WQCC on procedural grounds. 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 WQCC for further proceedings. WQCC has postponed the hearing on the Chino closure permit pending a report by the parties on settlement discussions, which are ongoing.

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 attorney s 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. The defendants motion for summary judgment has been fully briefed and argued and is awaiting decision.

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 was consolidated with the class action for pretrial purposes. No separate proceedings have occurred in this action, which is not subject to the summary judgment motion in the class action.

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 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 received a demand for relief on behalf of indirect purchasers in Massachusetts, but no lawsuit has been filed.

The Company retained responsibility for the claims against Columbian pursuant to the agreement for the sale of Columbian.

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Columbian has committed to provide appropriate assistance to defend these matters. The Company believes the claims are without merit and intends to defend the lawsuits vigorously.

VII. On March 1, 2006, the Indiana Department of Environmental Management (IDEM) served Rea Magnet Wire Company, Inc. (Rea) with a Notice of Violation (NOV) letter for the former Phelps Dodge Magnet Wire Company (PDMW), Fort Wayne facility, alleging violation of certain temperature, recordkeeping and labeling requirements. This facility was sold to Rea on February 10, 2006, and the alleged events occurred prior to the sale to Rea. IDEM subsequently amended the NOV to add Phelps Dodge Industries (PDI) d/b/a PDMW as an additional respondent. The terms of the sale to Rea include certain indemnity provisions. The Company, on both its behalf and for PDI, and Rea, disagreed concerning liability for this matter and each made a claim for indemnity. On November 30, 2006, PDI and IDEM entered an Agreed Order that resolved the NOV and required PDI to pay a $216,000 fine. On February 9, 2007, the Company and Rea settled their disagreement concerning liability for this matter.

VIII. In September and October 2006, ADEQ sent NOVs to the Phelps Dodge Sierrita operations in southeastern Arizona. The two NOVs alleged certain visibility and permit violations associated with dust emissions from Sierrita s tailing facility during high-wind events. No action has been filed at this time and Sierrita has responded to the NOVs by acknowledging that dust likely did exceed a certain visibility standard, but denying the other allegations. Sierrita has implemented response actions that ADEQ has accepted, and has entered into discussions with ADEQ to seek to resolve the NOVs.

IX. In September 2006, EPA notified Phelps Dodge Sierrita, Inc. (PDSI) of the possible assessment of stipulated penalties arising from deviations from certain provisions of a Consent Decree dated June 21, 2004, by and among PDSI, the United States and ADEQ, entitled United States and the State of Arizona v. Phelps Dodge Sierrita, Inc. No. CIV 04-312 TUC FRZ. PDSI is preparing to enter into negotiations with EPA and ADEQ concerning the potential assessment of the stipulated penalties.

X. In accordance with the terms of the Combination Agreement between Phelps Dodge Corporation and Inco Ltd. (Inco) dated June 25, 2006, Inco was liable to pay a break-up fee of $475 million to Phelps Dodge. The break-up fee was paid to Phelps Dodge in two payments. The first payment of $125 million was made on September 5, 2006. The second payment of $350 million was made on October 25, 2006. From the second payment, Inco withheld approximately $119 million representing 25 percent of the total break-up fee of $475 million. The $119 million withheld was remitted to the Canadian revenue authority on November 15, 2006. Inco s incorrect withholding was based on proposed amendments to the Canadian income tax law that have not been enacted. It is unknown if and when the proposed amendments will be enacted, and if enacted whether they will be retroactive or if they will have application to the break-up fee. On November 23, 2006, Phelps Dodge filed refund claims with the Canadian Minister of Revenue requesting restitution of the $119 million withheld. In January 2007, having not received the requested refunds, Phelps Dodge filed an action in Canadian Federal Court to recover the $119 million withheld along with interest accrued thereon.

XI. The Company and its directors have been named as defendants in three actions brought on behalf of a purported class of all shareholders of the Company, one filed in the Supreme Court of the state of New York, county of New York (*Phillips v. Phelps Dodge Corporation, et al*., No. 06604255, filed December 12, 2006) and two in the Superior Court of the state of Arizona, county of Maricopa, (*Nathanson v. Phelps Dodge Corporation, et al*., No. CV2006-017963, filed November 22, 2006, and *Knisley v. Phelps Dodge Corp. et al*., No. CV2006-053422, filed December 14, 2006), alleging that the directors breached their fiduciary duties when they approved the proposed merger of the Company with Freeport-McMoRan Copper & Gold Inc. (Freeport). The complaints in these actions seek various forms of injunctive relief, including prohibition of the consummation of the merger with Freeport, imposition of a constructive trust on any benefits improperly received by the defendants, an accounting for any damages sustained by the purported class members, and costs and disbursements, including plaintiffs attorney fees. The time for defendants to move or answer has been extended and has not yet expired in each case. The Company believes the claims are without merit and intends to defend the lawsuits vigorously.

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

No matters were submitted during the fourth quarter of 2006 to a vote of security holders through solicitation of proxies or otherwise.

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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 26, 2007, the executive officers of Phelps Dodge Corporation were as follows:

Name	Age at 2/26/07	Position	Officer of the Corporation Since
J. Steven Whisler	52	Chairman of the Board and Chief Executive Officer	1987
Timothy R. Snider	56	President and Chief Operating Officer	1997
Ramiro G. Peru	51	Executive Vice President and Chief Financial Officer	1995
David C. Naccarati	54	President, Phelps Dodge Mining Company	
S. David Colton	51	Senior Vice President and General Counsel	1998
Nancy Mailhot	43	Senior 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 and 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. 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 Senior Vice President-Human Resources in December 2006. Prior to that Ms. Mailhot was Vice President Human Resources, a position she held since October 2005, and 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.

Mr. Arthur R. Miele, formerly Senior Vice President-Marketing, retired as of December 31, 2006. Mr. Miele served the Company in various roles for approximately 40 years, and the Company thanks him for his dedicated service.

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PHELPS DODGE CORPORATION
2006 Annual Report on Form 10-K
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 100 and 101 and page 130 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, 2006:

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, 2006	16	$ 92.50		
November 1-30, 2006	1,485	115.43		
December 1-31, 2006	240	120.52		
Total	1,741	115.92		

* 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.

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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,*				
	2006 (a)	2005 (b)	2004 (c)	2003 (d)	2002 (e)
Statement of Operations Data					
Sales and other operating revenues	$ 11,910.4	8,287.1	6,415.2	3,498.5	3,173.2
Operating income (loss)	4,226.9	1,764.9	1,474.9	142.8	(257.4)
Income (loss) from continuing operations before extraordinary item and cumulative effect of accounting changes	3,035.9	1,583.9	1,023.6	(21.1)	(356.5)
Income (loss) from discontinued operations, net of taxes**	(18.1)	(17.4)	22.7	39.2	41.3
Income (loss) before extraordinary item and cumulative effect of accounting changes	3,017.8	1,566.5	1,046.3	18.1	(315.2)
Net income (loss)	3,017.8	1,556.4	1,046.3	94.8	(338.1)
Basic earnings (loss) per common share from continuing operations***	15.00	8.06	5.41	(0.19)	(2.17)
Diluted earnings (loss) per common share from continuing operations***	14.92	7.82	5.18	(0.19)	(2.17)
Basic earnings (loss) per common share from discontinued operations, extraordinary item and cumulative effect of accounting changes***	(0.09)	(0.14)	0.12	0.65	0.11
Diluted earnings (loss) per common share from discontinued operations, extraordinary item and cumulative effect of accounting changes***	(0.09)	(0.13)	0.11	0.65	0.11
Basic earnings (loss) per common share***	14.91	7.92	5.53	0.46	(2.06)
Diluted earnings (loss) per common share***	14.83	7.69	5.29	0.46	(2.06)
Balance Sheet Data (at period end)					
Current assets	$ 7,600.9	4,070.7	2,661.7	1,790.0	1,428.2
Total assets	14,632.3	10,358.0	8,594.1	7,272.9	7,029.0
Total debt	891.9	694.5	1,096.9	1,959.0	2,110.6
Long-term debt	770.1	677.7	972.2	1,703.9	1,948.4
Shareholders equity	7,690.4	5,601.6	4,343.1	3,063.8	2,813.6
Cash dividends declared per common share***	4.7875	3.1250	0.2500		

Other Data					
Net cash provided by operating activities	$ 5,079.2	1,769.7	1,700.1	461.6	359.1
Capital expenditures and investments	1,187.8	698.2	317.3	102.4	133.2
Net cash used in investing activities	(844.2)	(368.0)	(291.0)	(87.7)	(140.3)
Net cash used in financing activities	(1,213.2)	(685.8)	(947.2)	(48.8)	(244.8)
Division Results					
Phelps Dodge Mining Company operating income (loss)	$ 4,365.7	1,929.9	1,606.7	265.2	(65.0)
Phelps Dodge Industries operating income (loss)	57.6	14.6	18.8	13.7	(17.5)
Corporate and Other operating loss	(196.4)	(179.6)	(150.6)	(136.1)	(174.9)
	$ 4,226.9	1,764.9	1,474.9	142.8	(257.4)
Copper					
Copper production thousand short tons (h)	1,218.7	1,228.0	1,260.6	1,042.5	1,012.1
Copper sales from own mines thousand short tons (h)	1,214.5	1,238.4	1,268.9	1,052.6	1,034.5
COMEX copper price (per pound) (f)	$ 3.09	1.68	1.29	0.81	0.72
LME copper price (per pound) (g)	$ 3.05	1.67	1.30	0.81	0.71
Commercially recoverable copper (million tons) (i)					
Ore reserves	19.5	17.7	23.2	19.5	19.6
Stockpiles and in-process inventories	1.5	1.5	1.6	1.6	1.4
	21.0	19.2	24.8	21.1	21.0

* 2006, 2005 and 2004 reflected full consolidation of El Abra and Candelaria; 2003 and 2002 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), the operating results for Columbian have been reported separately from continuing operations and shown as discontinued operations for all periods presented.

** Refer to Note 2, Divestitures, to our Consolidated Financial Statements contained herein for further discussion.

*** Basic and diluted earnings per common share and cash dividends declared per common share reflect the March 10, 2006, two-for-one stock split, which was approved by the board of directors on February 1, 2006. Refer to Note 16, Shareholders Equity, for further discussion.

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

(a) Reported amounts included after-tax, net special gains of $330.7 million, or $1.62 per common share, for Inco termination fee; $127.5 million, or 63 cents per common share, for the reversal of U.S. deferred tax asset valuation allowance; $2.0 million, or 1 cent per common share, for legal matters; $0.4 million for sale of non-core real estate; and $0.2 million for the reversal of Minera PD Peru deferred tax asset valuation allowance; partially offset by net special charges of $54.5 million, or 27 cents per common share, for environmental provisions; $30.9 million, or 15 cents per common share, for charges associated with discontinued operations in connection with the sale of Columbian; $9.6 million, or 5 cents per common share, for asset impairment charges; $7.6 million (net of minority interest), or 4 cents per common share, for tax on unremitted foreign earnings; $5.1 million, or 3 cents per common share, for charges and loss on disposal in connection with the sale of North American magnet wire assets; $4.7 million, or 2 cents per common share, for charges and loss on the disposal in connection with the sale of HPC; $3.0 million, or 1 cent per common share, for a lease termination settlement; and $1.2 million associated with dissolution of an international wire and cable entity.

(b) Reported amounts included after-tax, net special charges of $331.8 million, or $1.64 per common share, for asset impairment charges; tax expense of $88.1 million, or 44 cents per common share, for foreign dividend taxes; $86.4 million, or 42 cents per common share, for environmental provisions; $42.6 million, or 21 cents per common share, for charges associated with discontinued operations in connection with the pending sale of Columbian; $41.3 million, or 20 cents per common share, for early debt extinguishment costs; $34.5 million (net of minority interest), or 17 cents per common share, for tax on unremitted foreign earnings; $23.6 million, or 12 cents per common share, for a tax charge associated with minimum pension liability reversal; $10.1 million, or 5 cents per common share, for cumulative effect of accounting change; $5.9 million, or 3 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 $1.92 per common share, for sale of a cost-basis investment; $181.7 million, or 89 cents per common share, for change of interest gains at Cerro Verde and Ojos del Salado; $15.6 million, or 8 cents per common share, for legal matters; $11.9 million, or 6 cents per common share, for the reversal of PD Brazil deferred tax asset valuation allowance; $8.5 million, or 4 cents per common share, for the sale of non-core real estate; $4.0 million, or 2 cents per common share, for the reversal of U.S. deferred tax asset valuation allowance; $0.4 million 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 33 cents per common share, for a goodwill impairment charge; taxes of $7.6 million, or 4 cents per common share, associated with the sale and dividends paid in 2005; and $5.0 million, or 2 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 18 cents per common share.

(c) Reported amounts included after-tax, net special charges of $44.7 million, or 23 cents per common share, for environmental provisions; $30.9 million (net of minority interests), or 15 cents per common share, for early debt extinguishment costs; $9.9 million, or 5 cents per common share, for the write-down of two cost-basis investments; $9.6 million, or 5 cents per common share, for taxes on anticipated foreign dividends; $9.0 million, or 5 cents per common share, for a deferred tax asset valuation allowance at our Brazilian wire and cable operation; $7.6 million, or 4 cents per common share, for Magnet Wire restructuring activities; $5.9 million, or 3 cents per common share, for asset impairments (included $4.5 million, or 2 cents per common share, for discontinued operations); and $0.7 million for interest on a Texas franchise tax matter; partially offset by special gains of $30.0 million, or 15 cents per common share, for the reversal of a U.S. deferred tax asset valuation allowance; $15.7 million (net of minority interest), or 8 cents per common share, for the reversal of an El Abra deferred tax asset valuation allowance; $10.1 million, or 5 cents per common share, for the gain on the sale of

uranium royalty rights; $7.4 million, or 4 cents per common share, for environmental insurance recoveries; and $4.7 million, or 3 cents per common share, for the settlement of historical legal matters.

(d) Reported amounts included after-tax, net special gains of $2.4 million, or 1 cent per common share, for the termination of a foreign postretirement benefit plan associated with discontinued operations; $0.5 million for environmental insurance recoveries; $0.2 million for the reassessment of prior restructuring programs; $6.4 million, or 4 cents per common share, on the sale of a cost-basis investment; $8.4 million, or 5 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 38 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 16 cents per common share, for environmental provisions (included a gain of $0.5 million for discontinued operations); $8.0 million, or 4 cents per common share, for a probable Texas franchise tax matter; $2.9 million, or 2 cents per common share, for the settlement of historical legal matters; and $2.6 million, or 1 cent per common share, for asset and goodwill impairments.

(e) Reported amounts included after-tax, net special charges of $153.5 million, or 91 cents per common share, for Phelps Dodge Mining Company asset impairment charges and closure provisions; $53.0 million, or 31 cents per common share, for historical lawsuit settlements; $45.0 million, or 27 cents per common share, for a historical arbitration award; $26.6 million, or 16 cents per common share, for early debt extinguishment costs; $23.0 million, or 14 cents per common share, for Phelps Dodge Industries restructuring activities; $22.9 million, or 13 cents per common share, for cumulative effect of an accounting change; $14.0 million, or 8 cents per common share, for environmental provisions (included a gain of $0.6 million 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 for the reassessment and additional retirement benefits in connection with prior restructuring programs; partially offset by special gains of $29.1 million, or 17 cents per common share, for environmental insurance recoveries; $22.6 million, or 13 cents per common share, for the gain on the sale of a non-core parcel of real estate; $13.0 million, or 8 cents per common share, for the release of deferred taxes previously provided with regard to Plateau Mining Corporation; and $66.6 million, or 40 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 associated with discontinued operations for the reassessment of a prior restructuring program.

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

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

(h) 2006, 2005 and 2004 reflected production and sales on a consolidated basis; 2003 and 2002 reflected that information on a pro rata basis.

(i) Commercially recoverable copper is reflected on a pro rata basis. The increase in ore reserves at December 31, 2006, was primarily due to the addition of Tenke Fungurume ore reserves and sulfide leach ore reserves at El Abra. The decrease in ore reserves at December 31, 2005, was primarily due to the reduction of the Company s interest in Cerro Verde to 53.56 percent from 82.5 percent, new pit designs at Bagdad, Cerro Verde, Chino, Cobre, Tyrone and Candelaria, as well as 2005 production.

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

The information called for in Item 7 appears on pages 49 through 102 of this report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information called for in Item 7A appears on pages 36 through 39, 49 through 51 and 87 through 92 of this report.

Item 8. Financial Statements and Supplementary Data

The information called for in Item 8 appears on pages 105 through 153 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 103 and 104, 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, 2006.

Item 9B. Other Information

None.

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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 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 other risks: 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 and molybdenum production costs; the cost of environmental and regulatory compliance; the cost of mine closure regulations, including the ability to obtain 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; the results of financing efforts and financial market conditions; and the failure to complete the proposed merger with Freeport-McMoRan Copper & Gold Inc. (Freeport).

These and other risk factors are discussed in more detail under Risk Factors on pages 36 through 39 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 our international business division comprising 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. 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. We are also developing a copper mine in Safford, Arizona, and a copper/cobalt mine in the Katanga province in the Democratic Republic of Congo (DRC). The Primary Molybdenum segment includes our Henderson and Climax molybdenum mines in the United States.

PDI, our international 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 internationally competitive costs and quality, and specialized engineering capabilities. Its factories, which are located in nine countries, manufacture energy cables for international markets.

On November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals Company (Columbian Chemicals or Columbian). The transaction was completed on March 16, 2006. As a result of the transaction, the operating results of Columbian have been reported separately from continuing operations and shown as discontinued operations in the Consolidated Statement of Income for all periods presented. (Refer to Note 2, Divestitures, for further discussion.)

In addition, on November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet wire assets, previously reported as part of the Wire and Cable segment, to Rea Magnet Wire Company, Inc. (Rea). The transaction was completed on February 10, 2006. On March 4, 2006, Phelps Dodge entered into an agreement to sell High Performance Conductors of SC & GA, Inc. (HPC), previously reported as part of the Wire and Cable segment, to International Wire Group, Inc. (IWG). The transaction was completed on March 31, 2006. Neither transaction met the criteria for classification as discontinued operations as the Company is continuing to supply Rea with copper rod and IWG with copper rod and certain copper alloys. (Refer to Note 2, Divestitures, for further discussion of these transactions.)

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

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under Risk Factors on pages 36 through 39, 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 molybdenum prices, increased energy costs, our cost structure, environmental and regulatory compliance, and mine closure regulations, affected our operations and financial results during 2006 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, an internationally traded commodity, is used in residential and commercial construction, electrical and electronics equipment, transportation, industrial machinery and consumer durable goods. The copper market is volatile and cyclical. During the past 15 years, the New York Commodity Exchange (COMEX) prices have ranged from a high of $4.076 per pound to a low of 60.4 cents per pound. 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 2006.

In 2003, China overtook the United States as the largest consumer of refined copper in the world and retained this position during 2006. We estimate global refined copper production grew approximately 5 percent during 2006, and, as was the case in 2005, output was constrained by numerous production disruptions at mines and smelters around the world, including strikes, equipment failures and various other disruptions. During 2006, we estimate copper consumption increased approximately 4 percent. As a result, for year-end 2006 the copper market was generally in balance. While exchange inventories increased approximately 86,000 metric tons, off-exchange stocks, particularly in China, are believed to have decreased. Accordingly, overall copper inventories continued to remain tight throughout 2006.

Favorable market fundamentals, combined with large, speculative positions, resulted in COMEX prices averaging $3.089 per pound in 2006, $1.407 above the average for 2005. While we expect the market to return to a modest surplus in 2007, continued worldwide consumption growth and low inventory levels are expected to continue to support copper prices in 2007.

Molybdenum is characterized by volatile and cyclical prices, even more so than copper. During the past 15 years, *Metals Week* Dealer Oxide prices have ranged from a high of $40.00 per pound to a low of $1.82 per pound. In 2006, the *Metals Week* Dealer Oxide mean price decreased 22 percent from the 2005 mean price of $31.73 per pound to $24.75 per pound. Although price levels were lower than those experienced in 2005, 2006 molybdenum prices remained at historically high levels.

During 2006, global molybdenum production was about the same as in 2005, with increases in primary mine production offset by decreases in by-product mine production. Supplemented by inventory produced in 2005, we estimate consumption increased approximately 5 to 6 percent in 2006 due to growth in the metallurgical segment (*i.e.*, steel industry) and in chemical applications. Although difficult to estimate, we believe production and consumption increased in China during 2006. In 2007, supply is expected to increase as several by-product mines reach full molybdenum production capacity and China s production continues to increase. The stainless steel, specialty steel and specialty chemical sectors are expected to continue to grow, led by capital spending increases and increasing demand in China.

Wire and cable products serve a variety of markets, including energy, construction, consumer and industrial products, transportation and natural resources. Products include low-, medium- and high-voltage copper cables, housing wire, aluminum power cables and control and instrumentation cables. These products advance technology and support infrastructure development in growing regions of the world.

During 2006, our Wire and Cable segment experienced an increase in sales and profitability resulting from higher metal prices and increased demand in international markets. For 2007, Wire and Cable expects increased sales volumes, with moderate increases in profitability as Asian, African and Latin American economies continue to grow.

Energy Costs. Energy, including electricity, diesel fuel and natural gas, represents a significant portion of production costs at our operations. In 2006, energy consumed in our mines and smelter was 20.2 cents per pound of copper

production cost, compared with 19.5 cents in 2005 and 14.6 cents in 2004.

To moderate or offset the impact of increasing energy costs, we use a combination of multi-year energy contracts put in place at various points in the price cycle, as well as self-generation and diesel fuel 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, as mentioned above, increasing energy costs have affected our profitability over the last three years. In 2007, we may continue to experience higher energy costs if prices remain at the levels experienced in 2006.

We continue to explore alternatives to moderate or offset the impact of increasing energy costs. In late 2004, we purchased a one-third interest in the partially constructed Luna Energy Facility (Luna) located near Deming, New Mexico. In April 2006, Luna became operational. Approximately 190 megawatts, or one-third of the plant s electricity, is available to satisfy the electricity demands of PDMC s New Mexico and Arizona operations. Electricity in excess of PDMC s demand is sold on the wholesale market. Our interest in this 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

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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 competitive cost position receives much attention from senior management and we continue to drive cost improvements 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 various stringent 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 2006 and 2005, we accelerated certain reclamation and remediation activities on a voluntary basis. In December 2005, the Company established a trust dedicated to funding our global reclamation and remediation activities and made an initial cash contribution of $100 million. In March 2006, the Company made an additional cash contribution of $300 million to the trust. The Company also has trust assets that are legally restricted to fund a portion of its asset retirement obligations for Chino, Tyrone and Cobre as required for New Mexico financial assurance. At December 31, 2006 and 2005, the fair value of these trust assets was approximately $514 million and $191 million, respectively, with approximately $97 million and $91 million, respectively, 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, BLM completed a land exchange with the Company for property in Safford, Arizona. On February 1, 2006, the Company s board of directors conditionally approved development of a new copper mine on the property, and in early July 2006, the Company received an air quality permit from the Air Quality Division of the Arizona Department of Environmental Quality (ADEQ) needed to initiate formal construction. Various resources from our nearby operations and additional local resources will be used to develop the facility. (Refer to page 79 for further discussion of the development of the Safford copper mine.)

Additionally, as a result of a feasibility study completed at our El Abra mine in 2006, we added 417 million tons of crushed-leach sulfide ore reserves and 298 million tons of run-of-mine (ROM) ore reserves to remaining oxide ore reserves. The existing three-stage crushing system, overland conveyors and solution extraction/electrowinning (SX/EW) facilities at El Abra will be utilized to process the additional ore reserves, thereby minimizing capital spending requirements.

Technology innovations not only improve productivity, but also may increase our ore reserves. Developing and applying new technologies, such as our success with SX/EW 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 copper sulfide 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, Europe, 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.

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. On December 6, 2006, the Phelps Dodge board of directors conditionally approved development of the Tenke Fungurume copper/cobalt mining project, which includes the development of the mine as well as copper and cobalt processing facilities. Phelps Dodge and Tenke Mining Corp., our Canadian partner, will provide 70 percent and

30 percent, respectively, of the funding for this project. (Refer to page 79 for further discussion of the Tenke project.)

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 and molybdenum in ore reserves and 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 and release of valuation allowances; reserves for contingencies and litigation; and fair value of financial instruments. Phelps Dodge bases its estimates on the Company s historical experience, its expectations of the future and on various other assumptions 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

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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 ore 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 depreciation expense by approximately $24 million in 2007; a 10 percent decrease would increase total depreciation expense by approximately $30 million in 2007.

Phelps Dodge s reported ore reserves are economical to mine at the most recent three-year historical average COMEX copper price of $2.020 per pound and the most recent three-year historical average molybdenum price of $24.30 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 developed using a time horizon reflective of the historical, moving average for the full price cycle. We currently use a long-term average COMEX price of $1.05 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. PDI s business plans are based on remaining asset lives of asset groups, and its economic projections are based on market supply and demand forecasts. We use an estimate of future pre-tax, 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 based on observable market prices; in the absence of observable market prices, fair value is generally estimated using the Company s expectation of after-tax, discounted net cash flows.

The per pound COMEX copper price during the past 10-year, 15-year and 20-year periods averaged $1.166, $1.135 and $1.122, respectively. The molybdenum per pound *Metals Week* Dealer Oxide mean price over the same periods averaged $9.73, $7.88 and $6.66, 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 based on proven processing technologies. 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 blasthole cuttings determine the estimated copper grade 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 adjusted as material is added or removed and fed to the mill. At December 31, 2006, 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 $111.2 million. 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.

The quantity of material in leach stockpiles is based on surveyed volumes of mined material and daily production records. Sampling and assaying of blasthole cuttings determine the estimated copper grade contained in material delivered to the leach stockpiles. Expected copper recovery rates are determined using small-scale laboratory tests, small- to 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, 2006, 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 $161.4 million. 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.

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 and laws is recognized in income in the period in which such changes are enacted.

With the exception of amounts provided for undistributed earnings of Candelaria, Ojos del Salado and El Abra, deferred income taxes have not been provided on our share (approximately $501 million) of

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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. These earnings could become subject to additional tax if remitted as dividends, if foreign earnings were loaned to any of our U.S. entities, or if we sell our stock in the subsidiaries. It is estimated that repatriation of these earnings would generate additional foreign tax withholdings and U.S. taxes of approximately $33 million and $5 million, respectively.

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, 2006, our valuation allowances totaled $46.1 million and covered a portion of our U.S. state net operating loss carryforwards and a portion of our Peruvian net operating loss carryforwards. At December 31, 2005, our valuation allowances totaled $363.5 million and covered a portion of our U.S. minimum tax credits, a portion of our stock basis differences, a portion of our U.S. state net operating loss carryforwards, all of our Peruvian net operating loss carryforwards and all of our U.S. capital loss carryforwards.

During 2006, our valuation allowances decreased by $317.4 million primarily due to increased profits associated with higher copper prices. This decrease comprised valuation allowances attributable to U.S. minimum tax credits ($284.1 million), U.S. capital loss carryforwards ($23.6 million), U.S. state net operating loss carryforwards ($6.5 million) and Peruvian net operating loss carryforwards ($3.2 million). Of the total amount released, $127.7 million is expected to be realized after 2006, including $125.1 million for U.S. minimum tax credits, $2.4 million for U.S. state net operating losses and $0.2 million for foreign net operating losses.

Pension Plans. 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 benefits are calculated for any particular group of employees. During 2006, we amended the Phelps Dodge Retirement Plan (the Retirement Plan) covering non-bargained employees so that employees hired after December 31, 2006, are not eligible to participate in the Retirement Plan. In addition, any employee rehired after December 31, 2006, will not be eligible to accrue any additional benefits under the Retirement Plan. Individuals who are not eligible to participate in the Retirement Plan may be eligible to participate in the Phelps Dodge Service Based Defined Contribution Plan, which was adopted effective January 1, 2007 (refer to page 54 for further discussion of the newly adopted, company-funded defined contribution plan).

Among the assumptions used to estimate the benefit obligation is a discount rate used to calculate the present value of expected future benefit payments for service to date. 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 for our U.S. pension plans of approximately 5.59 percent at year-end 2006, 5.63 percent at year-end 2005 and 5.75 percent at year-end 2004. 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 in earnings when they fall outside of a calculated corridor, the effect of changes in the discount rate on pension expense may not be linear. Each of the first four 25-basis-point increases in our assumed discount rate assumption as of the beginning of 2007 would decrease our pension expense by approximately $5 million per year during the next three years. Each of the first four 25-basis-point decreases in our assumed discount rate assumption as of the beginning of 2007 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, 2004, and January 1, 2005, and between December 1, 2005, and January 1, 2006. Obligations were projected and assets were valued as of the end of 2005 and 2006. The majority of plan assets are invested in a diversified portfolio of stocks, bonds, and cash or cash equivalents. A small portion of plan assets is invested in pooled real estate and other private investment funds.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132 (R), which will require measurement of our plans assets and obligations as of the balance sheet date for fiscal years ending after December 15, 2008. (Refer to New Accounting Pronouncements on pages 98 through 100 for further discussion.)

The Phelps Dodge Corporation Defined Benefit Master Trust (Master Trust), which holds plan assets for the Retirement Plan and U.S. pension plans for bargained employees, constituted approximately 99 percent of total plan assets as of year-end 2006. These plans accounted for approximately 95 percent of benefit obligations. The investment portfolio for this trust as of year-end 2006 had an asset mix that included 57 percent equities (34 percent U.S. equities, 14 percent international equities and 9 percent emerging market equities), 33 percent fixed income (17 percent U.S. fixed income, 5 percent international fixed income, 5 percent U.S. high yield, 3 percent emerging market fixed income and 3 percent treasury inflation-protected securities), 7 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

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investment portfolios). Management considers these studies in the formal establishment of asset-mix targets that are reviewed by the Company s trust investment committee and the finance committee of the board of directors.

Our expected long-term rate of return on plan assets is evaluated 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. For our U.S. plans, we utilize a nationally recognized, third-party financial consultant to assist in the determination of the expected long-term rate of return on plan assets, which is based on expected future performance of our plan asset mix and active plan asset management. 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, 2006, 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 8.6 percent with a premium for active management of 0.5 percent. Our average rate of return and standard deviation estimates remain unchanged from December 1, 2005.

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 2006 will be reflected in results of operations by December 31, 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. Due to better-than-expected returns for the past three years, combined with the Company s cash contributions of $250 million made during 2005 to certain U.S. pension plans, the entire benefit obligation for the Retirement Plan and U.S. pension plans for bargained employees was funded at year-end 2006, with no minimum cash contribution due for these plans in 2007. The Company does not anticipate any further appreciable funding requirements for these plans through 2008. We continue to analyze funding strategies and monitor pension reform under various economic scenarios to effectively manage future contribution requirements.

Postretirement and Other Employee Benefits Other Than Pensions. 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.

In December 2005, the Company established and funded two trusts intended to constitute Voluntary Employees Beneficiary Association (VEBA) trusts under Section 501(c)(9) of the Internal Revenue Code. One trust is dedicated to funding postretirement medical obligations and the other to funding postretirement life insurance obligations for eligible U.S. retirees. The trusts help provide assurance to participants in these plans that Phelps Dodge 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. In December 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. There were no contributions made to these trusts in 2006. At the end of the 2006 second quarter, each VEBA trust commenced making payments in support of the benefit obligations funded by the respective trust.

Our funding policy provides that contributions to the VEBA trusts shall be at least sufficient to pay plan benefits as they come due. Additional contributions may be made from time to time. For participants not eligible to receive

amounts from the VEBA trusts, our funding policy provides that contributions shall be at least equal to our cash basis obligation.

During 2006, the Company adopted the Phelps Dodge Service Based Defined Contribution Plan, a company-funded defined contribution plan, for employees hired on or after January 1, 2007. This plan is effective January 1, 2007, and eligible employees vest after three years of service. The Company contribution for each eligible employee is based on each employee s annual salary and years of service.

Assumed medical-care cost trend rates have a significant effect on the amounts reported for the postretirement medical benefits. 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 2013. A 1 percentage-point increase in the assumed health-care cost trend rate would increase net periodic benefit cost by approximately $2 million and increase our postretirement benefit obligation by approximately $10 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 $9 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

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will earn an average of 3.7 and 4.5 percent per annum, respectively, over the long term beginning January 1, 2007.

The Citibank Pension Discount Curve together with projected future cash flow from the postretirement medical and life insurance benefit plans resulted in discount rates for retiree medical and retiree life of 5.67 percent and 5.71 percent, respectively, at year-end 2006. The discount rates for retiree medical and retiree life were 5.37 percent and 5.41 percent, respectively, at year-end 2005 and 5.75 and 6.00 percent, respectively, at year-end 2004. 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 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. Each of the first four 25-basis-point increases in our assumed discount rate assumption as of the beginning of 2007 would decrease our periodic benefit cost by less than $1 million per year during the next three years. Each of the first four 25-basis-point decreases in our assumed discount rate assumption as of the beginning of 2007 would increase 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 historical operating activities are subject to various stringent laws and regulations governing the protection of the environment, which, from time to time, require 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 of 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. 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, 2006, environmental reserves totaled $377.9 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, where a liability was recognized, was approximately $332 million to $631 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, 2006, the cost range for reasonably possible outcomes for all such sites was approximately $3 million to $18 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 any 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 number of years.

Reclamation/Asset Retirement Obligations. Reclamation is an ongoing activity that occurs throughout the life of a mine. In accordance with SFAS No. 143, Accounting for Asset Retirement Obligations, we recognize asset retirement obligations (AROs) as liabilities when incurred, with initial measurement at fair value. With the adoption of FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143 (FIN 47) in the 2005 fourth quarter, we recognize conditional AROs as liabilities when sufficient information

exists to reasonably estimate the 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 respective useful life. Reclamation costs for future disturbances are recognized as an ARO and as a related ARC in the period of the disturbance. 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.

(Refer to Note 1, Summary of Significant Accounting Policies, for further discussion of our accounting policy for asset retirement obligations.)

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, on a quarterly basis, senior management reviews, with the Company s environmental and reclamation management as well as its financial and legal management, changes in facts and circumstances associated with its AROs. 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, 2006, we estimated our share of the total cost of AROs, including anticipated future disturbances and cumulative payments, at approximately $1.4 billion (unescalated, undiscounted

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and on a third-party cost basis), leaving approximately $900 million remaining to be accreted over time. These aggregate costs may increase or decrease materially in the future as a result of changes in regulations, engineering designs and technology, permit modifications or updates, 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. ARO activities and expenditures generally are made over an extended period of time commencing near the end of the mine life; however, certain reclamation activities could be accelerated if they are determined to be economically beneficial.

(Refer to Note 22, Contingencies, for further discussion of our New Mexico closure and reclamation programs.)

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

Interests in our majority-owned subsidiaries are reported using the full-consolidation method. We fully consolidate the results of operations and the assets and liabilities of these subsidiaries and report the minority interests in our Consolidated Financial Statements. All material intercompany balances and transactions are eliminated. 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. This includes the Morenci mine, located in Arizona, in which we hold an 85 percent undivided interest.

As discussed in Note 2, Divestitures, on November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals. The transaction was completed on March 16, 2006. As a result of the transaction, the operating results of Columbian have been reported separately from continuing operations and shown as discontinued operations in the Consolidated Statement of Income for all periods presented. 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.

All per share amounts for 2005 and 2004 have been adjusted to reflect the March 10, 2006, two-for-one stock split. (Refer to Note 16, Shareholders Equity, for further discussion.)

All references to earnings or losses per common share are based on diluted earnings or losses per common share.

For comparative purposes, certain amounts for 2005 and 2004 have been reclassified to conform to current-year presentation.

Consolidated financial results for the years 2006, 2005 and 2004 were as follows:

($ in millions except per share data)

	2006	2005	2004
Sales and other operating revenues	$11,910.4	8,287.1	6,415.2
Operating income	$ 4,226.9	1,764.9	1,474.9
Minority interests in consolidated subsidiaries	$ (792.4)	(190.4)	(201.1)
Income from continuing operations before cumulative effect of accounting change	$ 3,035.9	1,583.9	1,023.6
Income (loss) from discontinued operations	(18.1)	(17.4)	22.7
Cumulative effect of accounting change		(10.1)	
Net income	$ 3,017.8	1,556.4	1,046.3
Basic earnings per common share:*			
	$ 15.00	8.06	5.41

Income from continuing operations before cumulative effect of accounting change			
Income (loss) from discontinued operations	(0.09)	(0.09)	0.12
Cumulative effect of accounting change		(0.05)	
Basic earnings per common share	$ 14.91	7.92	5.53
Diluted earnings per common share:*			
Income from continuing operations before cumulative effect of accounting change	$ 14.92	7.82	5.18
Income (loss) from discontinued operations	(0.09)	(0.08)	0.11
Cumulative effect of accounting change		(0.05)	
Diluted earnings per common share	$ 14.83	7.69	5.29

* Earnings per common share for 2005 and 2004 have been adjusted to reflect the March 10, 2006, two-for-one stock split.

In 2006, consolidated net income was $3.0 billion, or $14.83 per common share, including an after-tax charge of $766.8 million, or $3.77 per common share, for mark-to-market accounting adjustments on our 2006 and 2007 copper collars and copper put options. Also included in consolidated net income for 2006 were (i) special, net gains from continuing operations of $375.1 million, or $1.84 per common share, after taxes and (ii) a loss from discontinued operations of $18.1 million, or 9 cents per common share, which included special, net charges of $30.9 million, or 15 cents per common share, after taxes.

In 2005, consolidated net income was $1.6 billion, or $7.69 per common share, including an after-tax charge of $312.0 million, or $1.54 per common share, for mark-to-market accounting adjustments on our 2005, 2006 and 2007 copper collars and copper put options. Also included in consolidated net income for 2005 were (i) special, net charges from continuing operations of $1.4 million, or 1 cent per common share, after taxes, (ii) a loss from discontinued operations of $17.4 million, or 8 cents per common share, which included special, net charges of $42.6 million, or 21 cents per common share, after taxes and (iii) an after-tax charge of $10.1 million, or 5 cents per common share for a cumulative effect of accounting change.

The $1,462.1 million increase in income from continuing operations in 2006 compared with 2005 primarily was due to the effects of (i) higher average copper prices (approximately $3.4 billion), (ii) lower asset impairment charges ($421.6 million) mostly due to the absence of 2005 second quarter charges recorded at PDMC, (iii) the 2006 net gain recognized from the Inco termination fee ($435.1 million), (iv) higher interest income (approximately $116 million) and (v) higher earnings from primary molybdenum mines (approximately $107 million). These were partially offset by (i) the negative impact of

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higher net copper pricing adjustments for our copper collars and copper put options (approximately $598 million) and for provisionally priced copper contracts at December 31, 2006 (approximately $83 million), (ii) a higher tax provision ($433.2 million) primarily due to higher earnings, net of the reversal of U.S. deferred tax asset valuation allowances, (iii) the absence of the 2005 gain recognized on the sale of our Southern Peru Copper Corporation (SPCC) investment ($438.4 million), (iv) higher minority interests in consolidated subsidiaries ($602.0 million) mostly resulting from increased earnings at our South American mining operations and the reduction of our ownership interests in Cerro Verde and Ojos del Salado, (v) higher copper production costs (approximately $426 million), (vi) lower by-product molybdenum revenues (approximately $208 million) and (vii) the absence of the 2005 change-in-interest gains ($168.3 million) associated with Cerro Verde and Ojos del Salado stock issuances.

In 2004, consolidated net income was $1.0 billion, or 5.29 per common share. Also, included in consolidated net income for 2004 was income from discontinued operations of $22.7 million, or 11 cents per common share, which included a special charge of $4.5 million, or 2 cents per common share, after taxes.

The $550.2 million increase in income from continuing operations in 2005 compared with 2004 primarily was due to the effects of (i) higher average copper prices (approximately $946 million) and other net pricing adjustments (approximately $50 million) mostly for provisionally priced copper contracts at December 31, 2005, (ii) higher by-product molybdenum revenues (approximately $551 million) due to higher prices, (iii) the gain recognized on the sale of our SPCC investment ($438.4 million), (iv) higher earnings from primary molybdenum mines (approximately $222 million) and (v) the change-in-interest gains ($168.3 million) associated with Cerro Verde and Ojos del Salado stock issuances. These were partially offset by (i) higher copper production costs (approximately $525 million), (ii) a higher tax provision ($445.7 million) primarily 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, (iv) the negative impact of net copper pricing adjustments for our copper collars and copper put options (approximately $411 million) and (v) higher special, net charges for environmental provisions ($54.4 million) recognized for closed facilities and closed portions of operating facilities.

Special Items, Net of Taxes (Includes Special Items and Provisions, Net, in Operating Income and Other Non-Operating Significant Items Affecting Comparability of Results)

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. Special items include those operating and non-operating items that management believes should be separately disclosed to assist in the understanding of the financial performance of the Company and the comparability of its results. Such special items and provisions are primarily unpredictable and atypical of the Company s operations in a given period. In certain instances, certain transactions such as restructuring costs, asset impairment charges, certain asset disposals, certain legal matters, early debt extinguishment costs or certain tax items are reflected as special items or other non-operating significant items as they are not considered representative of the normal course of business. Additionally, environmental provisions and recoveries are included due to their nature and the impact of these amounts on comparison between periods. 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 jurisdictions, 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 the resultant net income excluding these special items, net of taxes for the years 2006, 2005 and 2004:

($ in millions)

	2006	2005	2004
Net income	$3,017.8	1,556.4	1,046.3
Special items, net of taxes	344.2	(54.1)	(50.4)
Net income excluding special items (after taxes)	$2,673.6	1,610.5	1,096.7

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Note: Supplemental Data

The following table summarizes the special items for the year ended December 31, 2006 (refer to Note 3, Special Items and Provisions, Net, for further discussion of special items and provisions, net, included in operating income): ($ in millions except per share data)

Consolidated Statement of Income Line Item	Pre-tax	After-tax	$/Share After-tax
Special items and provisions, net (included in operating income):			
PDMC (see Business Segment disclosure)	$ (45.6)	(34.6)	(0.17)
PDI (see Business Segment disclosure)	(15.8)	(16.6)	(0.08)
Corporate and Other			
Environmental provisions, net	(22.2)	(16.9)	(0.08)
Environmental insurance recoveries, net	0.4	0.3	
Asset impairment charges	(2.8)	(2.1)	(0.01)
Historical legal matters	(4.2)	(3.2)	(0.02)
Lease termination settlement	(3.9)	(3.0)	(0.01)
Sale of non-core real estate	0.5	0.4	
	(32.2)	(24.5)	(0.12)
Special items and provisions, net (included in operating income)	(93.6)	(75.7)	(0.37)
Other non-operating significant items affecting comparability of results:			
Inco termination fee	435.1	330.7	1.62
Provision for taxes on income (A):			
Tax on unremitted foreign earnings		(9.5)	(0.05)
Reversal of U.S. deferred tax asset valuation allowance		127.5	0.63
Reversal of Minera PD Peru deferred tax asset valuation allowance		0.2	
		118.2	0.58

Minority interests in consolidated subsidiaries (B):			
Tax on unremitted foreign earnings		1.9	0.01
Discontinued operations (C):			
Loss on disposal	(15.9)	(16.5)	(0.08)
Transaction and employee-related costs	(14.4)	(14.4)	(0.07)
	(30.3)	(30.9)	(0.15)
	$311.2	344.2	1.69

(A) Provision for taxes on income of $1,010.2 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items as these amounts are typical and representative of the normal course of the Company s business in a given period.

(B) Minority interests in consolidated subsidiaries of $792.4 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items as these amounts are typical and representative of

the normal course of the Company s business in a given period.

(C) Loss from discontinued operations of $18.1 million, as reflected in the Consolidated Statement of Income, included the operating results of Columbian Chemicals of $12.8 million, which has not been separately disclosed as special items. Refer to Note 2, Divestitures, for further discussion of special items recorded in discontinued operations.

Following is a discussion of other non-operating significant items affecting the comparability of results for the year ended December 31, 2006:

Inco termination fee. In connection with terminating the Combination Agreement with Inco Ltd. (Inco), Phelps Dodge recognized a pre-tax net gain of $435.1 million ($330.7 million after-tax). The termination fee consisted of gross proceeds of approximately $356 million (approximately $316 million net of expenses) received during 2006. We also recorded an income tax receivable of approximately $119 million for the remaining proceeds associated with Canadian income taxes withheld, which we expect to receive in 2007. (Refer to Inco Termination Fee on page 82 for further discussion.)

Provision for taxes on income. Tax on unremitted prior years foreign earnings of $9.5 million ($7.6 million net of minority interest) was recognized in the 2006 fourth quarter at our 80 percent owned Ojos del Salado underground mine.

A tax benefit of $127.7 million was recognized for the reversal of U.S. ($127.5 million) and Minera PD Peru ($0.2 million) deferred tax asset valuation allowances that are expected to be realized after 2006. (Refer to Note 8, Income Taxes, for further discussion of the Company s provision for taxes on income.)

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The following table summarizes the special items for the year ended December 31, 2005 (refer to Note 3, Special Items and Provisions, Net, for further discussion of special items and provisions, net, included in operating income): ($ in millions except per share data)

Consolidated Statement of Income Line Item	Pre-tax	After-tax	$/Share After-tax*
Special items and provisions, net (included in operating income):			
PDMC (see Business Segment disclosure)	$(447.3)	(342.4)	(1.69)
PDI (see Business Segment disclosure)	(18.6)	(14.2)	(0.07)
Corporate and Other			
Environmental provisions, net	(75.4)	(57.6)	(0.28)
Environmental insurance recoveries, net	2.1	1.6	0.01
Historical legal matters	4.9	4.6	0.02
Sale of non-core real estate	11.2	8.5	0.04
	(57.2)	(42.9)	(0.21)
Special items and provisions, net (included in operating income)	(523.1)	(399.5)	(1.97)
Other non-operating significant items affecting comparability of results:			
Early debt extinguishment costs	(54.0)	(41.3)	(0.20)
Gain on sale of cost-basis investment	438.4	388.0	1.92
Change in interest gains:			
Cerro Verde stock issuance	159.5	172.9	0.85
Ojos del Salado stock issuance	8.8	8.8	0.04
	168.3	181.7	0.89
Provision for taxes on income (A):			
Foreign dividend taxes		(88.1)	(0.44)
Tax on unremitted foreign earnings		(43.1)	(0.21)

Tax charge associated with minimum pension liability reversal		(23.6)	(0.12)
Reversal of U.S. deferred tax asset valuation allowance		4.0	0.02
Reversal of PD Brazil deferred tax asset valuation allowance		11.9	0.06
		(138.9)	(0.69)
Minority interests in consolidated subsidiaries (B):			
Tax on unremitted foreign earnings		8.6	0.04
Discontinued operations (C):			
Transaction and employee-related costs	(5.8)	(5.0)	(0.02)
Goodwill impairment charge	(89.0)	(67.0)	(0.33)
Transaction and dividend taxes		(7.6)	(0.04)
Deferred income tax benefit		37.0	0.18
	$ (94.8)	(42.6)	(0.21)
Cumulative effect of accounting change	(13.5)	(10.1)	(0.05)
	$ (78.7)	(54.1)	(0.27)

* After-tax per common share amounts have been adjusted to reflect the March 10, 2006, two-for-one stock split.

(A) Provision for taxes on income of $577.0 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items as these amounts are typical and

representative of the normal course of the Company s business in a given period.

(B) Minority interests in consolidated subsidiaries of $190.4 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items as these amounts are typical and representative of the normal course of the Company s business in a given period.

(C) Loss from discontinued operations of $17.4 million, as reflected in the Consolidated Statement of Income, included the operating results of Columbian Chemicals of $25.2 million, which have not been separately disclosed as special items. Refer to Note 2,

Divestitures, for further discussion of special items recorded in discontinued operations.

Following is a discussion of other non-operating significant items affecting the comparability of results for the year ended December 31, 2005:

Early debt extinguishment costs. In July 2005, the Company completed a tender offer for its 8.75 percent Notes due in 2011, which resulted in the retirement of long-term debt with a book value of approximately $280 million (representing approximately 72 percent of the outstanding notes). This resulted in a 2005 pre-tax charge of $54.0 million ($41.3 million after-tax), including purchase premiums, for early debt extinguishment costs.

Gain on sale of cost-basis investment. 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 purchase price of $40.635 per share (based on a market purchase price of $42.00 per share less underwriting fees). The transaction resulted in a 2005 pre-tax gain of $438.4 million ($388.0 million after-tax).

Change in interest gains. In the 2005 second quarter, our Cerro Verde copper mine in Peru completed a general capital increase transaction. The transaction resulted in SMM Cerro Verde Netherlands B.V. acquiring an equity position in Cerro Verde totaling 21.0 percent. In addition, Compañía de Minas Buenaventura S.A.A. (Buenaventura) increased its ownership position in Cerro Verde to 18.2 percent, and the remaining minority shareholders owned 7.2 percent of Cerro Verde through shares publicly traded on the Lima Stock Exchange. As a result of the transaction, Phelps Dodge s equity interest in Cerro Verde was reduced from 82.5 percent to its current 53.56 percent.

In connection with the transaction, Cerro Verde issued 122.7 million of its common shares at $3.6074 per share to SMM Cerro Verde Netherlands B.V., Buenaventura and the remaining minority shareholders, and received $441.8 million in cash (net of $1.0 million of expenses). This stock issuance transaction resulted in a 2005 pre-tax gain of $159.5 million ($172.9 million after-tax) associated with our change in interest. The $13.4 million tax benefit related to this transaction included a reduction in deferred tax liabilities ($16.1 million) resulting from the recognition of certain book adjustments to reflect the dilution of our ownership interest, partially offset by taxes charged ($2.7 million) on the transfer of stock subscription rights to

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Buenaventura and SMM Cerro Verde Netherlands B.V. The inflow of capital from Buenaventura and SMM Cerro Verde Netherlands B.V. has been used to partially finance the approximate $850 million expansion project to mine a primary sulfide ore body beneath the leachable ore body currently in production at Cerro Verde.

In the 2005 fourth quarter, our Ojos del Salado copper mine in Chile completed a general capital increase transaction. The transaction resulted in SMMA Candelaria, Inc. acquiring a partnership interest in Ojos del Salado totaling 20 percent, thereby reducing Phelps Dodge s interest from 100 percent to its current 80 percent. In connection with the transaction, Ojos del Salado issued 2,500 of its Series B Preferential Stock (Series B Common Shares) at $10,000 per share to SMMA Candelaria, Inc. and received $24.8 million in cash (net of $0.2 million in expenses). The stock issuance transaction resulted in a 2005 gain of $8.8 million (before and after taxes) associated with the change in interest.

Provision for taxes on income. Foreign dividend taxes of $88.1 million were recognized in 2005, consisting of tax expense of $2.4 million for U.S. taxes incurred with respect to dividends received from Cerro Verde and $85.7 million for U.S. and foreign taxes incurred with respect to dividends received from certain South American operations in the 2005 fourth quarter and early January 2006.

Tax on unremitted foreign earnings of $43.1 million ($34.5 million net of minority interest) was recognized in the 2005 fourth quarter at our 80 percent-owned Candelaria copper mine.

Tax expense of $23.6 million was recognized in connection with the funding of the minimum pension liability associated with our U.S. qualified pension plans.

A tax benefit of $4.0 million was recognized for the reversal of the valuation allowance associated with U.S. deferred tax assets that were expected to be realized after 2005, and a tax benefit of $11.9 million was recognized for the reversal of the valuation allowance associated with deferred tax assets at our Brazilian wire and cable operation that were expected to be realized after 2005.

Cumulative effect of accounting change. A 2005 pre-tax charge of $13.5 million ($10.1 million after-tax) was recorded as a cumulative effect of accounting change associated with the adoption of FIN 47 (refer to Cumulative Effect of Accounting Change on page 84 for further discussion).

The following table summarizes the special items for the year ended December 31, 2004 (refer to Note 3, Special Items and Provisions, Net, for further discussion of special items and provisions, net, included in operating income): ($ in millions except per share data)

Consolidated Statement of Income Line Item	Pre-tax	After-tax	$/Share After-tax*
Special items and provisions, net (included in operating income):			
PDMC (see Business Segment disclosure)	$ (11.3)	(8.3)	(0.05)
PDI (see Business Segment disclosure)	(11.4)	(8.3)	(0.04)
Corporate and Other			
Environmental provisions, net	(41.8)	(31.8)	(0.16)
Environmental insurance recoveries, net	0.2	0.1	
Historical legal matters	2.7	(0.5)	
	(38.9)	(32.2)	(0.16)

Special items and provisions, net (included in operating income)	(61.6)	(48.8)	(0.25)
Other non-operating significant items affecting comparability of results:			
Interest expense (A):			
Texas franchise tax matter	(0.9)	(0.7)	
Early debt extinguishment costs	(43.2)	(34.3)	(0.17)
Miscellaneous income and expense, net (B):			
Cost-basis investment write-downs	(11.1)	(9.9)	(0.05)
Gain on sale of miscellaneous asset	10.1	10.1	0.05
Historical legal matter	9.5	7.2	0.04
	8.5	7.4	0.04
Provision for taxes on income (C):			
Foreign dividend taxes		(9.6)	(0.05)
PD Brazil deferred tax asset valuation allowance		(9.0)	(0.05)
Reversal of El Abra deferred tax asset valuation allowance		30.8	0.16
Reversal of U.S. deferred tax asset valuation allowance		30.0	0.15
		42.2	0.21
Minority interests in consolidated subsidiaries (D):			
Reversal of El Abra deferred tax asset valuation allowance		(15.1)	(0.08)
Candelaria early debt extinguishment costs		2.5	0.01
El Abra early debt extinguishment costs		0.9	0.01
		(11.7)	(0.06)
Discontinued operations (E):			
Asset impairment charge	(5.9)	(4.5)	(0.02)
	$(103.1)	(50.4)	(0.25)

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* After-tax per common share amounts have been adjusted to reflect the March 10, 2006, two-for-one stock split.

(A) Interest expense of $123.2 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items as these amounts are typical and representative of the normal course of the Company s business in a given period.

(B) Miscellaneous income and expense, net, of $45.3 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items, as these amounts are typical and representative of the normal course of the Company s business in a given period.

(C) Provision for taxes on income of $131.3 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items as these amounts are typical and representative of the normal course of the Company s business in a given period.

(D) Minority interests in consolidated subsidiaries of $201.1 million, as reflected in the Consolidated Statement of Income, included other amounts that have not been separately disclosed as special items, as these amounts are typical and representative of the normal course of the Company s business in a given period.

(E) Income from discontinued operations of $22.7 million, as reflected in the Consolidated Statement of Income, included the operating results of Columbian Chemicals of $27.2 million, which have not been separately disclosed as special items.

Following is a discussion of other non-operating significant items affecting the comparability of results for the year ended December 31, 2004:

Interest expense. In 2004, it was determined that Phelps Dodge and certain of our subsidiaries were considered to conduct business in Texas due to the activities of affiliates in that state. As a result, the Company was obligated to pay franchise taxes that they had not previously paid. The appropriate payments were made under the state s amnesty program, which were accrued at the end of 2003. In the 2004 first quarter, a pre-tax charge of $0.9 million ($0.7 million after-tax) was recognized for interest associated with this Texas franchise tax matter.

Early debt extinguishment costs. During 2004, the Company began its stated program of lowering the Company s debt, reducing interest expense and managing the maturity profile of its long-term commitments by making early payments on certain long-term debt. These early payments resulted in the recognition of total 2004 pre-tax charges of $43.2 million ($30.9 million after-tax and net of minority interests) for early debt extinguishment costs. (Refer to Early Debt Extinguishment Costs on pages 81 and 82 for further discussion.)

Miscellaneous income and expense, net. During 2004, pre-tax charges of $11.1 million ($9.9 million after-tax) were recognized for the write-down of two cost-basis investments.

In 2004, a gain of $10.1 million (before and after-taxes) was recognized for the sale of a miscellaneous asset associated with uranium royalty rights in Australia.

In 2004, a pre-tax gain of $9.5 million ($7.2 million after-tax) was recognized in connection with a favorable settlement of an historical legal matter.

Provision for taxes on income. Foreign dividend taxes of $9.6 million were recognized in the 2004 fourth quarter for U.S. and foreign taxes expected to be incurred with respect to dividends anticipated to be received from Cerro Verde in 2005.

Tax expense of $9.0 million was recognized for a valuation allowance for deferred tax assets at our Brazilian wire and cable operation.

A tax benefit of $30.8 million ($15.7 million net of minority interest) was recognized for the reversal of the valuation allowance associated with deferred tax assets that were expected to be realized after 2004 at our 51 percent-owned El Abra copper mine.

A tax benefit of $30.0 million was recognized for the reversal of the valuation allowance associated with U.S. deferred tax assets that were expected to be realized after 2004.

Discontinued operations. Due to continued excess capacity in the North American market, in 2004, a pre-tax asset impairment charge of $5.9 million ($4.5 million after-tax) was recognized at Columbian Chemicals El Dorado,

Arkansas, facility.

Business Divisions

Results for 2006, 2005 and 2004 can be meaningfully compared by separate reference to our business divisions, PDMC and PDI. PDMC is our international business division comprising 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. PDI, our international 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. The transaction was completed on March 16, 2006. As a result of the transaction, the operating results of Columbian have been reported separately from continuing operations and shown as discontinued operations in the Consolidated Statement of Income for all periods presented. (Refer to Note 2, Divestitures, for further discussion.)

In addition, on November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet wire assets, previously reported as part of the Wire and Cable segment, to Rea. The transaction was completed on February 10, 2006. On March 4, 2006, Phelps Dodge entered into an agreement to sell HPC, previously reported as part of the Wire and Cable segment, to IWG. The transaction was completed on March 31, 2006. Neither transaction met the criteria for classification as discontinued operations as the Company is continuing to supply Rea with copper rod and IWG with copper rod and certain copper alloys. (Refer to Note 2, Divestitures, for further discussion of these transactions.)

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.

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

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programs. PDMC includes 11 reportable segments and other mining activities.

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 following mines produce by-products: the Candelaria, Ojos del Salado, Morenci, Bagdad, Sierrita and Chino mines produce gold and silver; the Bagdad, Sierrita and Chino mines produce molybdenum and rhenium; and the Cerro Verde mine produces molybdenum and silver.

The Manufacturing segment consists of conversion facilities, including our smelter, refinery, rod mills and specialty copper products facility. The Manufacturing segment processes copper produced at our mining operations and copper purchased from others into copper anode, cathode, rod and custom copper shapes. In addition, at times it smelts and refines copper and produces copper rod and shapes 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 purchase and sell copper from our U.S. mines and Manufacturing segment. It also purchases and sells any copper not sold by our South American Mines to third parties. Copper is sold to others primarily as rod, cathode or concentrate. Copper rod historically was sold to the HPC and Magnet Wire North American operations of PDI s Wire and Cable segment. Since the disposition of those businesses, we have continued to sell copper rod and certain copper alloys to them.

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.

PDMC Other, although not a reportable segment, includes our worldwide mineral exploration and development programs, a process technology center whose primary activities comprise improving existing processes and developing new cost-competitive technologies, other ancillary operations, including our Miami, Bisbee and Tohono operations, and eliminations within PDMC.

Major operating and financial results of PDMC for the years 2006, 2005 and 2004 are summarized in the following table:

($ in millions except per pound amounts)

	2006	2005	2004
Sales and other operating revenues to unaffiliated customers	$ 10,656.4	7,097.5	5,443.4
Operating income	$ 4,365.7	1,929.9	1,606.7
Operating income before special items and provisions, net	$ 4,411.3	2,377.2	1,618.0
Minority interests in consolidated subsidiaries (A)	$ (784.9)	(184.9)	(196.8)
Copper production (thousand short tons):			
Total copper production	1,279.9	1,288.0	1,323.6
Less undivided interest (B)	61.2	60.0	63.0

Copper production on a consolidated basis	1,218.7	1,228.0	1,260.6
Less minority participants shares (A)	212.4	185.7	178.9
Copper production on a pro rata basis	1,006.3	1,042.3	1,081.7
Copper sales (thousand short tons):			
Total copper sales from own mines	1,275.6	1,298.4	1,331.9
Less undivided interest (B)	61.1	60.0	63.0
Copper sales from own mines on a consolidated basis	1,214.5	1,238.4	1,268.9
Less minority participants shares (A)	211.4	186.8	179.8
Copper sales from own mines on a pro rata basis	1,003.1	1,051.6	1,089.1
Purchased copper	367.8	410.7	433.0
Total copper sales on a consolidated basis	1,582.3	1,649.1	1,701.9
LME average spot copper price per pound cathodes	$ 3.049	1.669	1.300
COMEX average spot copper price per pound cathodes	$ 3.089	1.682	1.290
Molybdenum production (million pounds)	68.2	62.3	57.5
Molybdenum sales (million pounds):			
Net Phelps Dodge share from own mines	68.8	59.9	63.1
Purchased molybdenum	8.3	12.9	12.9
Total molybdenum sales	77.1	72.8	76.0
Metals Week:			
Molybdenum Dealer Oxide mean price per pound	$ 24.75	31.73	16.41
M-1 price per pound	$ 24.90	32.12	14.42

(A) Minority participant interests include (i) a 20 percent partnership interest in Candelaria in Chile owned by SMMA Candelaria, Inc., Sumitomo Metal Mining Co., Ltd. and Sumitomo

Corporation, (ii) a 49 percent partnership interest in the El Abra copper mining operation in Chile held by Corporación Nacional del Cobre de Chile (CODELCO), (iii) a 17.5 percent equity interest through May 31, 2005, and a 46.44 percent equity interest beginning June 1, 2005, in the Cerro Verde copper mining operation in Peru held by SMM Cerro Verde Netherlands B.V., Compañía de Minas Buenaventura S.A.A. and other shareholders, and (iv) a 20 percent partnership interest beginning December 23, 2005, in the Ojos del Salado copper mining operation in Chile held by SMMA Candelaria, Inc.

(B) Represents a 15 percent undivided

interest in Morenci, Arizona, copper mining complex held by Sumitomo Metal Mining Arizona, Inc.

(thousand short tons)

	2006	2005	2004
Minority participants share of copper production:			
Candelaria	37.4	35.9	44.1
Ojos del Salado	5.4	0.1	
Cerro Verde	51.5	35.9	17.1
El Abra	118.1	113.8	117.7
	212.4	185.7	178.9

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Total PDMC Division Sales

PDMC s sales and other operating revenues to unaffiliated customers increased $3.6 billion, or 50 percent, in 2006 compared with 2005. The increase primarily reflected higher average copper prices (approximately $4.4 billion) and higher primary molybdenum sales volumes (approximately $113 million); partially offset by higher net copper pricing adjustments for our copper collars and copper put options (approximately $598 million) and for provisionally priced copper contracts at December 31, 2006 (approximately $83 million) and lower average molybdenum realizations (approximately $310 million).

The increase of $1.7 billion, or 30 percent, in sales and other operating revenues to unaffiliated customers in 2005 compared with 2004 reflected (i) higher average copper prices (approximately $1.2 billion) and other net pricing adjustments (approximately $50 million) mostly for provisionally priced copper contracts at December 31, 2005, (ii) higher average molybdenum realizations (approximately $962 million), (iii) higher molybdenum tolling revenues (approximately $24 million) and (iv) higher precious metals and by-product revenue (approximately $16 million). These were partially offset by (i) the negative impact of net copper pricing adjustments for our copper collars and copper put options (approximately $411 million), (ii) lower copper sales volumes, including purchased copper (approximately $150 million), (iii) higher markdown of concentrates from cathode prices due to higher treatment and refining charges (approximately $59 million) and (iv) lower primary molybdenum sales volumes (approximately $40 million).

PDMC s sales and other operating revenues to unaffiliated customers for the years ended December 31, 2006 and 2005, were negatively impacted by our 2005, 2006 and 2007 copper collar price protection programs. These programs represented approximately 97 percent of El Abra s copper sales and approximately 11 percent of PDMC s remaining copper sales in 2005, approximately 28 percent of copper sales in 2006 and approximately 20 percent of our expected annual copper sales for 2007. As these sales do not qualify for hedge accounting treatment under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, the entire quantity hedged was adjusted to fair market value based on the London Metal Exchange (LME) forward curve prices at December 31, 2006 and 2005, with the gain or loss recorded in revenues. The actual impact of our 2007 zero-premium copper collar price protection program will not be fully determinable until the maturity of the copper collars at December 31, 2007, with final adjustments based on the average annual price. Approximately 89 percent of copper sales (excluding El Abra) in 2005, approximately 72 percent of copper sales in 2006 and approximately 80 percent for 2007 were or are not covered by the copper collar price protection programs and, therefore, have and will participate fully in higher LME and COMEX copper prices.

Total PDMC Division Operating Income

PDMC reported operating income of $4.4 billion in 2006, including special, net pre-tax charges of $45.6 million, compared with operating income of $1.9 billion in 2005, including special, net pre-tax charges of $447.3 million, and operating income of $1.6 billion in 2004, including special, net pre-tax charges of $11.3 million.

The increase in operating income of $2,435.8 million, or 126 percent, for 2006 compared with 2005 primarily included the effects of higher average copper prices (approximately $3.4 billion), lower special, net pre-tax charges ($401.7 million) mostly associated with the absence of asset impairment charges recognized in the 2005 second quarter, and higher primary molybdenum earnings (approximately $107 million). These were partially offset by (i) higher net copper pricing adjustments for our copper collars and copper put options (approximately $598 million) and for provisionally priced copper contracts at December 31, 2006 (approximately $83 million), (ii) higher copper production costs (approximately $426 million) and (iii) lower by-product molybdenum revenues (approximately $208 million). Higher copper production costs were primarily due to (i) higher mining and milling costs (approximately $330 million), (ii) higher smelting, refining and freight costs (approximately $113 million), (iii) higher depreciation expense (approximately $21 million) and (iv) higher energy costs (approximately $14 million); partially offset by an increase in work-in-process inventories (approximately $52 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) and other net pricing

adjustments (approximately $50 million) mostly for provisionally priced copper contracts at December 31, 2005, (ii) higher by-product molybdenum revenues (approximately $551 million) mostly due to higher prices, (iii) higher primary molybdenum earnings (approximately $222 million) and (iv) gains associated with the sale of exploration properties (approximately $15 million). These were partially offset by (i) higher copper production costs (approximately $525 million), (ii) higher special, net pre-tax charges ($436.0 million) mostly associated with asset impairment charges recorded in the 2005 second quarter, (iii) the negative impact of net copper pricing adjustments for our copper collars and copper put options (approximately $411 million), (iv) higher exploration and research expense (approximately $61 million) and (v) lower copper sales volumes (approximately $38 million). Higher copper production costs were primarily due to higher mining rates reflecting 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).

For 2004 through 2006, higher average copper prices, including premiums, reflected improved copper fundamentals and an improved economic environment. (Refer to Item 7A. Quantitative and Qualitative Disclosures About Market Risk, for further discussion of the Company s market risk.)

Copper is an internationally traded commodity, and its price is effectively determined by the major metals exchanges COMEX, the LME and the Shanghai Futures Exchange (SHFE). 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, 2006. We principally base our selling price for U.S. sales on the COMEX spot price per pound of copper cathode, which averaged $3.089 in 2006, $1.682 in 2005 and $1.290 in 2004. Internationally,

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our copper selling prices are generally based on the monthly LME spot price average per pound of copper cathode, which averaged $3.049 in 2006, $1.669 in 2005 and $1.300 in 2004. The COMEX and LME prices averaged $2.571 and $2.562 per pound, respectively, for the first 54 days of 2007, and closed at $2.837 and $2.806, respectively, on February 23, 2007.

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 2007 annual consolidated production of approximately 2.9 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 approximately $29 million.

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, 2006, approximately 221 million pounds of copper sales were provisionally priced at an average of $2.870 per pound with final quotational periods of January through May 2007. Candelaria accounted for approximately 53 percent of the outstanding provisionally priced sales at December 31, 2006.

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 23, Derivative Financial Instruments and Fair Value of Financial Instruments. As of February 23, 2007, we placed copper swap contracts for approximately 2 percent of Candelaria s provisionally priced copper sales outstanding at December 31, 2006.

Phelps Dodge entered into programs to protect a portion of its expected copper production by purchasing zero-premium copper collars (consisting of both 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. In 2006 and 2005, the copper collar put options settled monthly. Also in 2006, the purchased copper put options settled monthly. For 2007, the copper collar put options and purchased copper put options will settle annually. All of the copper collar call options settle annually. The zero-premium copper collar price protection programs represented approximately 97 percent of El Abra s copper sales and approximately 11 percent of PDMC s remaining copper sales in 2005, approximately 28 percent of copper sales in 2006 and approximately 20 percent of our expected annual copper sales for 2007. Approximately 89 percent of copper sales (excluding El Abra) in 2005, approximately 72 percent of sales in 2006 and approximately 80 percent for 2007 were or are not covered by the copper collar price protection programs and, therefore, have and will participate fully in higher LME and COMEX copper prices. Phelps Dodge entered into these protection programs as insurance to help ameliorate the effects of unanticipated copper price decreases.

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

(in millions except per pound amounts)

	2005	2006	2007
Copper Collars:			
Pounds of zero-premium copper collars purchased (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 gains (charges) for 2006 (B):			

Intrinsic value component	$ N/A	(651)	(400)
Time value component	$ N/A	13	32
Associated pre-tax charges for 2005 (A)(B):			
Intrinsic value component	$ (54)	(151)	
Time value component	$	(13)	(35)
Copper Put Options:			
Pounds of copper put options purchased	$	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 2006 (B):			
Intrinsic value component	$		
Time value component	$		(3)
Associated pre-tax charges for 2005 (A)(B):			
Intrinsic value component	$	(11)	
Time value component	$		(14)

(A) 2005 excludes El Abra (refer to the table on page 65 for a summary of El Abra s 2005 zero-premium copper collars).

(B) The 2005 realized pre-tax charges resulted from the 2005 LME annual average of $1.671 per pound, calculated on a daily price basis, exceeding the $1.400 per pound ceiling of our 2005 zero-premium copper collars. The 2006 realized pre-tax charges resulted from the 2006 LME annual average of $3.053 per pound, calculated on a

daily price basis, exceeding the $1.632 per pound ceiling of our 2006 zero-premium copper collars. The cumulative pre-tax charges for our 2006 copper collars and copper put options were approximately $813 million, reflecting primarily intrinsic value charges and put option premiums. The 2007 unrealized pre-tax charges resulted from the 2007 LME forward-curve price average of $2.870 per pound exceeding the $2.002 per pound ceiling of our 2007 zero-premium copper collars. The cumulative pre-tax charges for our 2007 copper collars and copper put options, including amounts recognized in 2005 and 2006, were approximately $420 million, consisting of approximately $400 million for

the intrinsic value component and approximately $3 million for the time value component and approximately $17 million for put option premiums.

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

(in millions except per pound amounts)	
El Abra Copper Collars:	
Pounds of zero-premium copper collars purchased	452
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 (A)	$ (133)

(A) The 2005 realized pre-tax charges resulted from the 2005 LME annual price average of $1.671 per pound, calculated on a daily price basis, 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 based on the forward-curve price and implied volatility as of the last day of the respective reporting period, with the gain or loss recorded in revenues. During the 2006 first quarter, approximately $187 million was paid to the respective counterparts for the PDMC and El Abra 2005 zero-premium copper collar programs. In January 2007, approximately $801 million was paid for the PDMC 2006 zero-premium copper collar programs; the remainder of approximately $12 million, for put option premiums, was paid at inception.

The actual impact of our 2007 zero-premium copper collar price protection program will not be fully determinable until the maturity of the collars at December 31, 2007, with final adjustments based on the average annual LME copper price. Based on the LME forward-curve price average as of February 23, 2007, we estimate unrealized after-tax gains of approximately $46 million for the 2007 first quarter associated with our 2007 copper collars and copper put options.

Energy, including electricity, diesel fuel and natural gas, represents a significant portion of production costs for our operations. 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 various points in the price cycle as well as self-generation and diesel fuel and natural gas hedging.

We continue to explore alternatives to moderate or offset the impact of increasing energy costs. In late 2004, we purchased a one-third interest in the partially constructed Luna power plant located near Deming, New Mexico. In April 2006, Luna became operational. Public Service Company of New Mexico (PNM), a subsidiary of PNM

Resources, and Tucson Electric Power, a subsidiary of Unisource Energy Corporation, partnered with Phelps Dodge in the purchase of Luna; each owning a one-third interest and each responsible for a third of the costs and expenses. PNM is the operating partner of the plant. Approximately 190 megawatts, one-third of the plant s electricity, is available to satisfy the electricity demands of PDMC s New Mexico and Arizona operations. Electricity in excess of PDMC s demand is sold on the wholesale market. Our interest in this 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, diesel fuel and natural gas call option contracts and fixed-price swaps for our North American and Chilean operations. The call option contracts give the holder the right, but not the obligation, to purchase a specific commodity at a pre-determined dollar cost, or strike price.

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 for delivery during a specific future period.

Our natural gas price protection program consists of purchasing call options for our North American operations. 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, for 2006, 2005 and 2004, we were 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 times of higher energy prices. Energy consumed in our mines and smelter was 20.2 cents per pound of our copper production cost in 2006, compared with 19.5 cents in 2005 and 14.6 cents in 2004.

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 2006, PDMC sold approximately 58 percent, 27 percent and 15 percent of its copper pounds as copper rod, copper cathode and concentrates, respectively. During 2005, approximately 60 percent, 25 percent and 15 percent of PDMC s copper pounds was sold as copper rod, copper cathode and concentrates, respectively.

During 2006, operations outside the United States provided 33 percent of PDMC s sales (including sales through PDMC s U.S.-based sales company), compared with 25 percent in 2005 and 30 percent in 2004. Additionally, operations outside the United States (including international exploration) contributed 51 percent of the division s operating income in 2006, compared with 40 percent for 2005 and 44 percent for 2004.

The 2006 exploration program continued to place emphasis on the search for and delineation of large-scale copper and copper/gold deposits. Phelps Dodge expended $97.4 million on worldwide exploration, including feasibility studies, during 2006, compared with $81.0 million in 2005 and $35.6 million in 2004. The increase in exploration for 2006 primarily was due to increased exploration spending in central Africa mostly associated with Tenke Fungurume (refer to page 79 for further discussion of the Tenke project). Approximately 33 percent of the 2006 expenditures occurred in the United States, with approximately 28 percent being spent at our U.S. mine sites and the remainder for support of U.S. and international exploration activities. In addition, approximately 45 percent was spent

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in central Africa and approximately 10 percent was spent in South America, including amounts spent at our South American mine sites. The balance of international exploration expenditures was spent principally in Europe, Canada, Australia and the Philippines.

Note: Supplemental Data

The following table summarizes PDMC s special items and provisions, net, included in operating income for the years 2006, 2005 and 2004 (refer to Note 3, Special Items and Provisions, Net, for further discussion):

($ in millions)

	2006	2005	2004
Environmental provisions, net	$ (49.5)	(35.7)	(16.8)
Environmental insurance recoveries, net	(0.4)	(1.5)	9.1
Asset impairment charges	(2.5)	(424.6)	(1.1)
Historical legal matters	6.8	14.5	(2.5)
	$ (45.6)	(447.3)	(11.3)

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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 the years 2006, 2005 and 2004:

	U.S. Mines						South American Mines			
	Morenci	Bagdad	Sierrita	Chino/ Cobre	Tyrone	Subtotal	Candelaria/ Ojos del Salado	Cerro Verde	El Abra	Subtotal
2006										
Copper production (thousand short tons):										
Total production	407.8	82.7	80.8	92.9	31.8	696.0	214.3	110.9	241.0	566.2
Less undivided interest	61.2					61.2				
Copper production on a consolidated basis	346.6	82.7	80.8	92.9	31.8	634.8	214.3	110.9	241.0	566.2
Less minority participants shares							42.8	51.5	118.1	212.4
Copper production on a pro rata basis	346.6	82.7	80.8	92.9	31.8	634.8	171.5	59.4	122.9	353.8
Copper sales (thousand short tons):										
Total copper sales from own mines	407.3	82.6	80.6	92.7	31.8	695.0	212.5	107.1	243.3	562.9
Less undivided interest	61.1					61.1				
Copper sales from own mines on a consolidated basis	346.2	82.6	80.6	92.7	31.8	633.9	212.5	107.1	243.3	562.9

Less minority participants shares							42.5	49.7	119.2	211.4
Copper sales from own mines on a pro rata basis	346.2	82.6	80.6	92.7	31.8	633.9	170.0	57.4	124.1	351.5
Total purchased copper							3.1			3.1
Total copper sales on a consolidated basis	346.2	82.6	80.6	92.7	31.8	633.9	215.6	107.1	243.3	566.0
($ in millions)										
Operating income (loss)	$820.6	317.8	559.8	148.1	43.5	1,889.8	794.7	418.2	1,070.9	2,283.8
Special items and provisions, net	(1.4)	2.2	(5.1)	(24.5)	(2.2)	(31.0)				
Operating income (loss) before special items and provisions, net	$822.0	315.6	564.9	172.6	45.7	1,920.8	794.7	418.2	1,070.9	2,283.8
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
Copper sales from own mines on a pro rata basis	340.0	104.4	82.8	104.8	40.5	672.5	174.5	66.3	119.0	359.8
Total purchased copper							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) before special items and provisions, net	$400.1	377.7	567.6	49.2	6.6	1,401.2	306.8	209.8	274.7	791.3

Refer to segment discussion on pages 72 through 78.
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 pages 72 and 73 for further discussion.)

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PDMC Results By Reportable Segments (continued)

	U.S. Mines						South American Mines			
	Morenci	Bagdad	Sierrita	Chino/ Cobre	Tyrone	Subtotal	Candelaria/ Ojos del Salado	Cerro Verde	El Abra	Subtotal
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
	357.3	111.9	79.2	91.7	43.1	683.2	188.9	81.0	122.8	392.7

Copper sales from own mines on a pro rata basis										
Total purchased copper							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)