CAPTION SHEET CASE MANAGEMENT SYSTEM

1. REPORT DATE: 00/00/0	:	
2. BUREAU: FUS	:	
3. SECTION(S):	:	4. PUBLIC MEETING DATE: 00/00/00
5. APPROVED BY:	:	
DIRECTOR:	:	
SUPERVISOR:	:	
6. PERSON IN CHARGE:	:	7. DATE FILED: 09/26/00
8. DOCKET NO: A-125095	:	9. EFFECTIVE DATE: 00/00/00

PARTY/COMPLAINANT:

RESPONDENT/APPLICANT: ALLIANCE ENERGY SERVICES

COMP/APP COUNTY: UTILITY CODE: 125095

ALLEGATION OR SUBJECT

APPLICATION OF ALLIANCE ENERGY SERVICES PARTNERSHIP FOR APPROVAL TO OFFER, RENDER, FURNISH, OR SUPPLY NATURAL GAS SERVICES AS A BROKER/MARKETER TO THE PUBLIC IN THE COMMONWEALTH OF PENNSYLVANIA, SPECIFICALLY IN THE SERVICE TERRITORIES OF NUI VALLEY CITIES GAS; PENN FUEL; T.W. PHILLIPS GS AND OIL COMPANY; PG ENERGY; CARNEGIE NATURAL GAS COMPANY; NATIONAL FUEL GAS DISTRIBUTION CORP.; THE PEOPLES NATURAL GAS COMPANY; UGI; EQUITABLE GAS COMPANY; COLUMBIA GAS OF PA, INC.; AND PECO.

DOCKETED
NOV 08 2000

DOCUMENT
FOLDER

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of ALLIANCE ENERGY SERVICES PARTNERSHIP, d/b/a ______________________, for approval to offer, render, furnish, or as a(n)Broker/Marketer engaged in the business of supplying natural gas services to the public in the Commonwealth of Pennsylvania.

A-125095

To the Pennsylvania Public Utility Commission:

RECEIVED
SEP 26 2000
PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

1. **IDENTITY OF THE APPLICANT:** The name, address, telephone number, and FAX number of the Applicant are:

   Alliance Energy Services Partnership
   9300 Shelbyville Road, Suite 810
   Louisville, Kentucky 40222
   Phone: (502) 426-4500
   Fax: (502) 426-8800

   Please identify any predecessor(s) of the Applicant and provide other names under which the Applicant has *operated within the preceding five (5) years, including name, address, and telephone number.*

   NONE

ORIGINAL

2. a. **CONTACT PERSON:** The name, title, address, telephone number, and FAX number of the person to whom questions about this Application should be addressed are:

   Deb Carroll - Operations
   Alliance Energy Services Partnership
   9300 Shelbyville Road, Suite 810
   Louisville, Kentucky 40222
   Phone: (502) 426-4500
   Fax: (502) 426-8800

DOCUMENT FOLDER

   b. **CONTACT PERSON-PENNSYLVANIA EMERGENCY MANAGEMENT AGENCY:** The name, title, address telephone number and FAX number of the person with whom contact should be made by PEMA:

   Deb Carroll - Operations
   Alliance Energy Services Partnership
   9300 Shelbyville Road, Suite 810
   Louisville, Kentucky 40222
   Phone: (502) 426-4500
   Fax: (502) 426-8800

DOCKETED
NOV 08 2000

3.a. **ATTORNEY:** If applicable, the name, address, telephone number, and FAX number of the Applicant's attorney are:

   Kennedy Helm, Esq.
   Stites & Harbison
   400 West Market Street
   Suite 1800
   Louisville, KY 40202-3352
   Phone: (502) 681-0449
   Fax: (502) 587-6391

47

b. **REGISTERED AGENT**: If the Applicant does not maintain a principal office in the Commonwealth, the required name, address, telephone number and FAX number of the Applicant's Registered Agent in the Commonwealth are:

4. **FICTITIOUS NAME:** (select and complete appropriate statement)

☒ The Applicant will be using a fictitious name or doing business as ("d/b/a"):

Alliance Energy Services Partnership

Attach to the Application a copy of the Applicant's filing with the Commonwealth's Department of State pursuant to 54 Pa. C.S. §311, Form PA-953.

or

☐ The Applicant will not be using a fictitious name.

5. **BUSINESS ENTITY AND DEPARTMENT OF STATE FILINGS:** (select and complete appropriate statement)

☐ The Applicant is a sole proprietor.

If the Applicant is located outside the Commonwealth, provide proof of compliance with 15 Pa. C.S. §4124 relating to Department of State filing requirements.

or

☐ The Applicant is a:

- ☐ domestic general partnership (*)
- ☐ domestic limited partnership (15 Pa. C.S. §8511)
- ☒ foreign general or limited partnership (15 Pa. C.S. §4124)
- ☐ domestic limited liability partnership (15 Pa. C.S. §8201)
- ☐ foreign limited liability general partnership (15 Pa. C.S. §8211)
- ☐ foreign limited liability limited partnership (15 Pa. C.S. §8211)

Provide proof of compliance with appropriate Department of State filing requirements as indicated above.

Give name, d/b/a, and address of partners. If any partner is not an individual, identify the business nature of the partner entity and identify its partners or officers.

Alliance Gas Services, Inc., a Kentucky corporation	9300 Shelbyville Road, Louisville, KY 40222
Conoco, Inc., a Delaware corporation	600 North Dairy Ashford, Houston, TX 77079

FEB 23 2000 10:42 ...

Microfilm Number ____________

Entity Number 2926307

Filed with the Department of State on FEB 24 2000

Kim Pizzingrilli

Secretary of the Commonwealth

APPLICATION FOR REGISTRATION OF FICTITIOUS NAME

DSCB:54-311 (Rev 90)

In compliance with the requirements of 54 Pa.C.S. § 311 (relating to registration), the undersigned entity(ies) desiring to register a fictitious name under 54 Pa.C.S. Ch. 3 (relating to fictitious names), hereby state(s) that:

1. The fictitious name is: Alliance Energy Services Partnership

2. A brief statement of the character or nature of the business or other activity to be carried on under or through the fictitious name is:

   natural gas and energy marketer

3. The address, including number and street, if any, of the principal place of business of the business or other activity to be carried on under or through the fictitious name is (P.O. Box alone is not acceptable):

Number and Street	City	State	Zip	County
9300 Shelbyville Road	Louisville	KY	40222	Jefferson

4. The name and address, including number and street, if any, of each individual interested in the business is:

Name	Number and Street	City	State	Zip

5. Each entity, other than an individual, interested in such business is (are):

Name	Form of Organization	Organizing Jurisdiction	Principal Office Address	Pa. Registered Office, if any
Alliance Gas Services Inc.	KY corporation		9300 Shelbyville Rd Louisville, KY 40222	
Conoco Inc	DE corporation		600 North Dairy Ashford Houston, TX 77079	

6. The applicant is familiar with the provisions of 54 Pa.C.S. § 332 (relating to effect of registration) and understands that filing under the Fictitious Names Act does not create any exclusive or other right in the fictitious name.

7. (Optional): The name(s) of the agent(s), if any, any one of whom is authorized to execute amendments to, withdrawals from or cancellation of this registration in behalf of all then existing parties to the registration, is (are):

____

IN TESTIMONY WHEREOF, the undersigned have caused this Application for Registration of Fictitious Name to be executed this 17th day of February, 2000.

(Individual Signature)	(Individual Signature)
(Individual Signature)	(Individual Signature)
CONOCO INC.	ALIANCE
(Name of Entity)	(Name of Entity)
BY: Maria Hooper	BY:
TITLE: Director, NG&GP	TITLE: President

FEB 22 2000 09:52

502 426 8888 PAGE.03

** TOTAL PAGE.03 **

** TOTAL PAGE.04 **

** TOTAL PAGE.04 **

☐ * If a corporate partner in the Applicant's domestic partnership is not domiciled in Pennsylvania, attach a copy of the Applicant's Department of State filing pursuant to 15 *Pa. C.S.* §4124.

or

☐ The Applicant is a :

- ☐ domestic corporation (none)
- ☐ foreign corporation (15 Pa. C.S. §4124)
- ☐ domestic limited liability company (15 Pa. C.S. §8913)
- ☐ foreign limited liability company (15 Pa. C.S. §8981)
- ☐ Other ______________________________

Provide proof of compliance with appropriate Department of State filing requirements as indicated above. Additionally, provide a copy of the Applicant's Articles of Incorporation.

Give name and address of officers.

The Applicant is incorporated in the state of Kentucky.

6. **AFFILIATES AND PREDECESSORS WITHIN PENNSYLVANIA:** (select and complete appropriate statement)

☐ Affiliate(s) of the Applicant doing business in Pennsylvania are:

Give name and address of the affiliate(s) and state whether the affiliate(s) are jurisdictional public utilities.

☐ Does the Applicant have any affiliation with or *ownership interest in:*

(a) any other Pennsylvania retail natural gas supplier licensee or licensee applicant,
(b) any other Pennsylvania retail licensed electric generation supplier or license applicant,
(c) any Pennsylvania natural gas producer and/or marketer,
(d) any natural gas wells or
(e) any local distribution companies (LDCs) in the Commonwealth

NONE

If the response to parts a, b, c, or d above is affirmative, provide a detailed description and explanation of the affiliation and/or ownership interest.

☐ Provide specific details concerning the affiliation and/or ownership interests involving:

(a) any natural gas producer and/or marketers,
(b) any wholesale or retail supplier or marketer of natural gas, electricity, oil, propane or other energy sources.

☐ Provide the Pa PUC Docket Number if the applicant has ever applied:
(a) for a Pennsylvania Natural Gas Supplier license, or
(b) for a Pennsylvania Electric Generation Supplier license.

☐ If the Applicant or an affiliate has a predecessor who has done business within Pennsylvania, give name and address of the predecessor(s) and state whether the predecessor(s) were jurisdictional public utilities.

or

☐ The Applicant has no affiliates doing business in Pennsylvania or predecessors which have done business in Pennsylvania.

7. **APPLICANT'S PRESENT OPERATIONS:** (select and complete the appropriate statement)

☒ The Applicant is presently doing business in Pennsylvania as a

☐ natural gas interstate pipeline.
☐ municipal providing service outside its municipal limits.
☐ local gas distribution company
☒ retail supplier of natural gas services in the Commonwealth
☐ a natural gas producer
☐ Other. (Identify the nature of service being rendered.)

or

☐ The Applicant is not presently doing business in Pennsylvania.

8. **APPLICANT'S PROPOSED OPERATIONS:** The Applicant proposes to operate as a:

☐ supplier of natural gas services.
☐ Municipal supplier of natural gas services.
☐ Cooperative supplier of natural gas services.
☒ Broker/Marketer engaged in the business of supplying natural gas services.
☐ Aggregator engaged in the business of supplying natural gas services.
☐ Other (Describe):

9. **PROPOSED SERVICES:** Generally describe the natural gas services which the Applicant proposes to offer.

Supply natural gas services to industrial customers.

10. **SERVICE AREA:** Generally describe the geographic area in which Applicant proposes to offer services.

Ambler, Chester, Neville Island, Valley Forge

11. **CUSTOMERS:** Applicant proposes to initially provide services to:

- ☐ Residential Customers
- ☐ Commercial Customers - (Less than 6,000 Mcf annually)
- ☐ Commercial Customers - (6,000 Mcf or more annually)
- ☒ Industrial Customers
- ☐ Governmental Customers
- ☐ All of above
- ☐ Other (Describe):

START DATE: The Applicant proposes to begin delivering services on (approximate date)

currently providing services

13. **NOTICE:** Pursuant to Section 5.14 of the Commission's Regulations, 52 Pa. Code §5.14, serve a copy of *the signed and verified* Application with attachments on the following:

Irwin A. Popowsky Office of Consumer Advocate 5th Floor, Forum Place 555 Walnut Street Harrisburg, PA 17120-1921	Office of the Attorney General Bureau of Consumer Protection Strawberry Square, 14th Floor Harrisburg, PA 17120
Bernard A. Ryan, Jr. Commerce Building, Suite 1102 Small Business Advocate 300 North Second Street Harrisburg, PA 17101	Commonwealth of Pennsylvania *Department of Revenue* Bureau of Compliance Harrisburg, PA 17128-0946

Any of the following Natural Gas Distribution Companies through whose transmission and distribution facilities the applicant intends to supply customers:

NUI Valley Cities Gas (NUI Transportation Services) Mike Vogel PO Box 3175 Union, NJ 07083-1975 PH: 908.289.5000 ext. 5441 FAX: 908.2898.6444	**National Fuel Gas Distribution Corp.** James E. Patterson 10 Lafayette Square Buffalo, NY 14203 PH: 716.857.7130 FAX: 716.857-7823
Penn Fuel [North Penn Gas Company & Penn Fuel Gas] Jim Evans <u>or</u> Tom Olsen 2 North 9th Street GENA94 Allentown, PA 18101 PH: 610.774.7981 610.774.4975 FAX: 610.774.5694 610.774.4975 e-mail: jevans@papl.com or teolson@papl.com	**The Peoples Natural Gas Company** Joe Gregorini <u>or</u> Bill McKeown 625 Liberty Avenue Pittsburgh, PA 15222 e-mail: jgregorini@png.cng.com PH: 412.497.6851 <u>or</u> 412.497.6840 FAX: 412.497.6630
T. W. Phillips Gas and Oil Company Robert M. Hovanec 205 North Main Street Butler, PA 16001 PH: 724.287.2725 FAX: 724.287.5021 e-mail: rhovanec@twphillips.com	**UGI** David Beaston <u>or</u> Bob Krieger PO Box 12677 <u>or</u> 225 Morgantown Rd Reading, PA 15222 Reading, PA 15222 PH: 610.796.3425 PH: 610.796.3516 FAX: 610.796.3559
PG Energy Richard N. Marshall <u>or</u> Wendy K. Saxe One PEI Center Wilkes-Barre, PA 18711-0601 e-mail: marshall@pgenergy.com <u>or</u> saxe@pgenergy.com PH: 570.829.8795 FAX: 570.829.8652	**Equitable Gas Company** Antionette Litchy 200 Allegheny Center Mall Pittsburgh, PA 15212-5352 PH: 412.395.3117 FAX: 412.395.3156
Carnegie Natural Gas Company Donald A. Melzer *800 Regis Avenue* Pittsburgh, PA 19236 PH: 412.655.8510 ext. 331 FAX: 412.655.0335	**Columbia Gas of PA, Inc.** Paula Frauen <u>or</u> Shirley Bardes-Hasson 650 Washington Road Pittsburgh, PA 15228 e-mail: pfrauen@columbiaenergygroup.com PH: 412.572.7131 FAX: 412.572.7161
	PECO Kevin Carrabine 300 Front Street Building 2 Conshohocken, PA 19428 PH: 610.832.6413

Pursuant to Sections 1.57 and 1.58 of the Commission's Regulations, 52 Pa. Code §§1.57 and 1.58, attach Proof of Service of the Application and attachments upon the above named parties. Upon review of the Application, further notice may be required pursuant to Section 5.14 of the Commission's Regulations, 52 Pa. Code §5.14.

14. **TAXATION:** Complete the TAX CERTIFICATION STATEMENT attached as Appendix B to this application.

15. **COMPLIANCE:** State specifically whether the Applicant, an affiliate, a predecessor of either, or a person identified in this Application has been convicted of a crime involving fraud or similar activity. Identify all proceedings, by name, subject and citation, dealing with business operations, in the last five (5) years, whether before an administrative body or in a judicial forum, in which the Applicant, an affiliate, a predecessor of either, or a person identified herein has been a defendant or a respondent. Provide a statement as to the resolution or present status of any such proceedings.

16. **STANDARDS, BILLING PRACTICES, TERMS AND CONDITIONS OF PROVIDING SERVICE AND CONSUMER EDUCATION:** All services should be priced in clearly stated terms to the extent possible. Common definitions should be used. All consumer contracts or sales agreements should be written in plain language with any exclusions, exceptions, add-ons, package offers, limited time offers or other deadlines prominently communicated. Penalties and procedures for ending contracts should be clearly communicated.

a. Contacts for Consumer Service and Complaints: Provide the name, title, address, telephone number and FAX number of the person and an alternate person responsible for addressing customer complaints. These persons will ordinarily be the initial point(s) of contact for resolving complaints filed with Applicant, the Distribution Company, the Pennsylvania Public Utility Commission or other agencies.

b. Provide a copy of all standard forms or contracts that you use, or propose to use, for service provided to residential customers.

c. If proposing to serve Residential and/or Small Commercial customers, provide a disclosure statement. A sample disclosure statement is provided as Appendix B to this Application.

17. **FINANCIAL FITNESS:**

A. Applicant shall provide sufficient information to demonstrate financial fitness commensurate with the service proposed to be provided. Examples of such information which may be submitted include the following:

- Actual (or proposed) organizational structure including parent, affiliated or subsidiary companies.
- Published parent company financial and credit information.
- Applicant's balance sheet and income statement for the most recent fiscal year. Published financial information such as 10K's and 10Q's may be provided, if available.
- Evidence of Applicant's credit rating. Applicant may provide a copy of its Dun and Bradstreet Credit Report and Robert Morris and Associates financial form or other independent financial service reports.
- A description of the types and amounts of insurance carried by Applicant which are specifically intended to provide for or support its financial fitness to perform its obligations as a licensee.
- Audited financial statements
- Such other information that demonstrates Applicant's financial fitness.

B. Applicant must provide the following information:

- Identify Applicant's chief officers including names and their professional resumes.
- Provide the name, title, address, telephone number and FAX number of Applicant's custodian for its accounting records.

15. Compliance. No Applicant, affiliate, predecessor or person identified in this Application has been convicted of a crime involving fraud or similar activity.

16. (a) contacts for Consumer Service and Complaints:

main: Deb Carroll
Alliance Energy Services Partnership
9300 Shelbyville Road, Suite 810
Louisville, KY 40222
(502) 426-4500

alternate: Amy Kistner
Alliance Energy Services Partnership
9300 Shelbyville Road, Suite 810
Louisville, KY 40222
(502) 426-4500

17. Financial Fitness

A. See attachments.

Bank References: PNC Bank Kentucky – Greg Carroll (502) 581-4779

B. Chief Officers:

ANDREW R. (DREW) FELLON

Andrew R. Fellon received his Bachelor of Science degree in Industrial and Management Systems Engineering from Pennsylvania State University. Beginning as an Industrial Marketing Engineer with the Columbia Gas Distribution System, Mr. Fellon worked closely with Columbia Gulf Transmission and Columbia Gas Transmission during the earliest days of natural gas deregulation. From Columbia, Mr. Fellon went on to open Centran Corporation's regional natural gas marketing office in Lexington, Kentucky where he was responsible for Centran's enduser sales and marketing. Ultimately, he was promoted to Senior Vice President, National Accounts, Natural Gas Division for Centran Corporation. As Senior Vice President, Mr. Fellon had oversight responsibilities for the marketing, supply, transportation & exchange and gas accounting functions for the company's eastern U.S. activities, as well as, oversight of enduser sales and marketing nationally. Mr. Fellon actively participated in Centran's natural gas cash and futures market trading. Mr. Fellon created and established Centran's Appalachian natural gas procurement and trading function of approximately 75,000 Dth/day. While Mr. Fellon was at Centran, the company enjoyed an increase in sales from $4 million to $119 million annually. Mr. Fellon is very active in all areas of Alliance Energy's energy supply, transportation and markets consulting and management activities.

JOHN C. McCORD

John C. McCord received his undergraduate degree from the University of Vermont before attending the University of Louisville School of Law where he received his Juris Doctor. Following graduation, Mr. McCord became a partner in the Louisville law firm of Boehl, Stopher, Graves, and Deindoerfer, specializing in corporate and trial law with emphasis in energy related matters. After practicing law for seven years, he became an owner and officer of the Buddeke Coal Company. His coal experience included surface mining production, sales and transportation. In 1990, Mr. McCord joined Centran Corporation as Director of Project Development. In that capacity, he was responsible for developing Appalachian and Gulf Coast sources of supply, as well as, Centran's Northeastern U.S. marketing operations. Mr. McCord is very active in natural gas supply and transportation contract negotiations, as well as, consulting on regulatory and legal issues for Alliance Energy's clients.

Custodian of Accounting Records:

John Lewis
Deloitte & Touche
220 W. Main Street
Suite 2100
Louisville, KY 40202
Phone: 502-562-2017
Fax: 502-562-2073

Alliance Energy Services

BUSINESS STRUCTURE

ALLIANCE GAS SERVICES, INC.
50%

CONOCO, INC.
50%

ALLIANCE ENERGY SERVICES PARTNERSHIP
(Kentucky General Partnership)

83-938-0581 [ALLIANCE ENERGY SERVICES]

IN DATE

AES p1

DUNS: 83-938-0581
ALLIANCE ENERGY SERVICES

9300 SHELBYVILLE RD STE 810
AND BRANCH(ES) OR DIVISION(S)
LOUISVILLE KY 40222
TEL: 502 426-4500

DATE PRINTED
JAN 21 2000

MARKETING OF
NATURAL GAS &
NATURAL GAS
SERVICES
SIC NO.
49 24

SUMMARY
RATING --

STARTED 1995
GR REV E $300,000,000
EMPLOYS 40(37 HERE)
HISTORY CLEAR

JOHN MCCORD, MANAGING PARTNER

* * * CUSTOMER SERVICE * * *

If you have questions about this report, please call our Customer Service Center at 1-800-234-3867 from anywhere within the U.S. If you are outside the U.S., contact your local D&B office.

*** Additional Decision Support Available ***

Additional D&B products, credit recommendations and specialized investigations are available to help you evaluate this company or its industry. Call Dun & Bradstreet's Solution Center at 1-800-362-3425 from anywhere within the U.S.

* * * SUMMARY ANALYSIS * * *

The Summary Analysis section reflects information in D&B's file as of January 17, 2000.

RATING SUMMARY

The absence of a Rating (--) indicates that the information available to D&B does not permit us to assign a Rating to this business. In this case, no Rating was assigned because of D&B's overall assessment of the company's financial, payment, and its historical information.

Below is an overview of the company's D&B Rating(s) since 01/18/96:

RATING	DATE APPLIED
--	01/18/96

* * * PAYMENT SUMMARY * * *

The Payment Summary section reflects payment information in D&B's file as of the date of this report.

D&B has not received a sufficient sample of payment experiences to establish a PAYDEX score.

Below is an overview of the company's dollar-weighted payments, segmented by its suppliers' primary industries:

	TOTAL RCV'D	TOTAL DOLLAR AMOUNTS	LARGEST HIGH CREDIT	% W/IN TERMS	DAYS SLOW <31	31-60	61-90	91+

AES p. 2

	#	$	$	%	%	%	%	%
Total in D&B's file	2	36,000	35,000					
Payment By Industry:								
1 Natural gas distrib	1	35,000	35,000	100	-	-	-	-
2 Petroleum refining	1	1,000	1,000	100	-	-	-	-
Other Payment Categories:								
Cash experiences	0	0	0					
Payment record unknown	0	0	0					
Unfavorable comments	0	0	0					
Placed for collection								
with D&B	0	0						
other	0	N/A						

The highest "Now Owes" on file is $35,000
The highest "Past Due" on file is $ 0

D&B receives over 315 million payment experiences each year. We enter these new and updated experiences into D&B Reports as this information is received.

PAYMENTS (Amounts may be rounded to nearest figure in prescribed ranges)

Antic - Anticipated (Payments received prior to date of invoice)
Disc - Discounted (Payments received within trade discount period)
Ppt - Prompt (Payments received within terms granted)

REPORTED	PAYING RECORD	HIGH CREDIT	NOW OWES	PAST DUE	SELLING TERMS	LAST SALE WITHIN
09/99	Ppt	1000	-0-	-0-		4-5 Mos
03/99	Ppt	35000	35000	-0-		1 Mo

Each experience shown represents a separate account reported by a supplier. Updated trade experiences replace those previously reported.

FINANCE
04/20/99

On APR 20 1999 Karen Pearl, Accountant, declined financial statement.

She submitted the following partial estimates dated APR 20 1999. Sales for 1998 were $300,000,000.

HISTORY
12/13/99

JOHN MCCORD, MANAGING PARTNER
GAS SERVICES INC, PARTNER
CONOCO INC, PARTNER
ANDREW FELLON, MANAGING PARTNER

Business started Dec 1995 by partners.

JOHN MCCORD born 1944. OCCUPATIONAL BACKGROUND: 1967 graduated University of Vermont, Burlington, VT. 1970 graduated University of Louisville, Louisville, KY.

CONOCO INC Houston, TX Duns # 00-842-7692. Started 1981 and operates as a worldwide integrated oil company. BUSINESS RECORD: On Jun 1 1976 a Federal Grand Jury in Baltimore, MD, indicted Kayo Oil Company, a wholly-owned subsidiary of the company, as well as five other oil companies, and a trade association, alleging a conspiracy to fix and the fixing of the price of retail gasoline in the States of New York, Pennsylvania, New Jersey, Delaware, Maryland, Virginia and

Acordia.

SCHEDULE OF INSURANCE
AS OF: 2/10/00

INSURED: FELLON-MCCORD & ASSOCIATES INC
9300 SHELBYVILLE RD STE 810
LOUISVILLE, KY 40222

COVERAGE DESCRIPTION	COMPANY	POLICY NUMBER	EFF. DATE	EXP. DATE
Commercial Package	**Cincinnati Insurance Com**	**CPP0642526**	**9/14/99**	**9/14/00**

Other Named Insureds:

Alliance Gas Services Inc.

Alliance Energy Services Partnership

Locations:

#001 9300 SHELBYVILLE ROAD, STE 810
LOUISVILLE, KY 40220
Interest: Tenant
Part Occupied: 7484 SF

#003 33790 Bainbridge #210
Solon, OH 44139
Interest: Tenant

#004 6251 N. Winthrop Ave.
Indianapolis, IN
Interest: Tenant

Simplified Commercial Property

Risk Information:

Location: #1
9300 SHELBYVILLE ROAD, STE 810
LOUISVILLE, KY 40220

Building: #1
Construction: Fire Resistive
Occupancy: OFFICE
Protection class: 02
Total Area: 7484

Coverage on: Personal Property
OFFICE EQUIPMENT INCLUDING COMPUTERS

MCISCH

SCHEDULE OF INSURANCE
AS OF: 2/10/00

INSURED: FELLON-MCCORD & ASSOCIATES INC

COVERAGE DESCRIPTION	COMPANY	POLICY NUMBER	EFF. DATE	EXP. DATE

Commercial Package **- Continued**

Loss Payee: AT&T Credit Corporation
P.O. Box 96064
Bellevue, WA 98009
Does Interest Pay Premium: No

Loss Payee: Mid States leasing
900 West Market Street
Louisville, KY 40202
Does Interest Pay Premium: No

Special Causes of Loss		317,000
Coinsurance %		90
Deductible		250
Valuation	Replacement Cost	

Coverage on: Improvements/Betterments
IMPROVEMENT/BETTERMENTS

Special Causes of Loss		51,000
Coinsurance %		90
Deductible		250
Valuation	Replacement Cost	

Location: #3
33790 Bainbridge #210
Solon, OH 44139

Building: #1
Construction: Non-Combustible
Occupancy: Office
Other occupancies: Insd occupies 512 squ ft

Coverage on: Personal Property
Office contents, not including Laptop Computer

Special Causes of Loss		4,000
Coinsurance %		90
Deductible		250
Valuation	Replacement Cost	

INSURED: FELLON-MCCORD & ASSOCIATES INC

COVERAGE DESCRIPTION	COMPANY	POLICY NUMBER	EFF. DATE	EXP. DATE

Commercial Package - Continued

Location: #4
8251 N. Winthrop Ave.
Indianapolis, IN

Building: #1
Construction: Non-Combustible
Occupancy: Office
Other occupancies: Insd occupies 575 squ ft

Coverage on: Personal Property
Office Contents not including Laptop computers

Special Causes of Loss		5,000
Coinsurance %		80
Deductible		250
Valuation	*Replacement Cost*	

Electronic Data Processing

Risk Information:
Description of equipment: COMPUTER SOFTWARE LOC: 9300 SHELBYVILLE RD
Maximum item value: 20,000

Description of equipment: (1) Laptop Computer Loc 3: Solon OH
Maximum item value: 2,000

Description of equipment: (2) Laptop Computers Loc 4: Indianapolis IN
($2500 each) Maximum item value: 5,000

Policy Coverages:		Limits:
EDP Hardware		8,000
Deductible		250
Perils	Special	
Valuation	Replacement Cost	
EDP Media		20,000
Deductible		250
Perils	Special	
Valuation	*Replacement Cost*	
EDP Bus.Income & Extra Expense		1,200

INSURED: FELLON-MCCORD & ASSOCIATES INC

COVERAGE DESCRIPTION	COMPANY	POLICY NUMBER	EFF. DATE	EXP. DATE
Commercial Package	**- Continued**			
Special Deductible				
Deductible		1,000		

Commercial General Liability

Risk Information:
Location: 9300 SHELBYVILLE ROAD, STE 810
LOUISVILLE, KY 40220

Rating classification: BUILDING OR PREMISES INCLUDING PRODUCTS &/OR COMPLETED OPERATIONS
Rating code: 61212 Premium basis: 7,484 Area

Additional Insured: IPC COMMERCIAL PROPERTIES, LLC
9200 SHELBYVILLE ROAD, STE 600
ATTN: CHRIS REYNOLDS
LOUISVILLE, KY 40222

Additional Insured: THE METROPOLITAN GOVERNMENT OF
NASHVILLE AND DAVIDSON COUNTY
222 3RD AVE N 5TH FL
NASHVILLE, TN 37201

Additional Insured: LOUISVILLE & JEFFERSON COUNTY
METROPOLITAN SEWER DISTRICT
700 WEST LIBERTY STREET
LOUISVILLE, KY 40203-1913

Location: 33790 Bainbridge #210
Solon, OH 44139

Rating classification: BUILDING OR PREMISES INCLUDING PRODUCTS &/OR COMPLETED OPERATIONS
Rating code: 061212 Premium basis: 512 Area

Add'l Insured-Landlord: The Landerwood Company
21 Landerwood Plaza
30559 Pinetree Road #211
Pepper Pike, OH 44124

INSURED: FELLON-MCCORD & ASSOCIATES INC

COVERAGE DESCRIPTION	COMPANY	POLICY NUMBER	EFF. DATE	EXP. DATE

Commercial Package **- Continued**

Location: 6251 N. Winthrop Ave.
Indianapolis, IN

Rating classification: BUILDING OR PREMISES INCLUDING PRODUCTS &/OR COMPLETED OPERATIONS
Rating code: 061212 Premium basis: 575 Area

Add'l Insured-Landlord: 1001 Properties, Inc.
4530 N. Keystone Avenue
Indianapolis, IN 46205

Policy Coverages:	Limits:
Products/Compl.Ops.Aggregate	
Aggregate Limit	1,000,000
Personal & Advertising Injury	
Lt.per Pers/Organization	1,000,000
Each Occurrence CSL	1,000,000
Fire Damage Liability	
Limit per Fire	100,000
Medical Expense Limit	
Limit per person	5,000
Add'l Insd/Contract or Permit	

Business Auto Coverage

Risk Information:

#1 1998 TOYOTA CAMRY 4T1BG22K2WU262520 Rate class: 7391
Garaged: LOUISVILLE, KY

Additional Insured: TOYOTA MOTOR CREDIT CORP
P.O. BOX 3035
CEDAR RAPIDS, IA 52406

Loss Payee: TOYOTA MOTOR CREDIT CORP
P.O. BOX 3035
CEDAR RAPIDS, IA 52406

REFERENCES

END USERS – NATURAL GAS

Aluminum Company of America

Ashland Petroleum Company

Century Aluminum

Commonwealth Aluminum

Calgon Carbon Corporation

Carolina Power & Light

Dow Corning Corporation

Easco Aluminum, Inc.

East Kentucky Power Cooperative

Board of Education of
Fayette County - Lexington, KY

General Electric Company - Lighting Division

G. F. Vaughn Tobacco Company

IMCO Recycling, Inc.

Johnson Controls, Inc.

Lexmark International, Inc.

Norandal USA, Inc.

Toyota Motor Manufacturing North America, Inc.

Transylvania University

University of Kentucky

Wabash Alloys

CONOCO

Greg M. Finn
Coordinator
Corporate Credit & Financial Services

Conoco Inc.
600 North Dairy Ashford
Houston, TX 77079-1175
(281) 293-6897
(281) 293-6947 (fax)

May 17, 1999

To Suppliers and Customers of Alliance Energy Services:

Alliance Energy Services (AES) is providing this information so you will have knowledge of the structure and ownership of this entity.

1. AES is a general partnership formed under the provisions of the Kentucky Uniform Partnership Act, KRS 362.150-.360 (Michie 1995) and is in good standing under the laws of the state of Kentucky.

2. Conoco Inc. and Alliance Gas Services, Inc. are the general partners of AES.

3. As general partners of AES, Conoco Inc. and Alliance Gas Services, Inc. are jointly liable for all debts and obligations of AES.

The continued success and growth of AES are of strategic importance to Conoco and we have committed substantial resources and support to further those objectives. We recognize that mutually beneficial and long-term business relationships with trade partners are critical to the success of AES. Given the extent of our investment in the partnership and its importance to our long-term goals, Conoco intends to play an active role in the management of the partnership and in the growth of developing markets. We intend to fully support its effort to develop and further those relationships.

Should you need any further financial information about Conoco Inc. please do not hesitate to contact me at 281-293-6897.

Sincerely,

Gregory M. Finn

18. **TECHNICAL FITNESS:** To ensure that the present quality and availability of service provided by natural gas utilities does not deteriorate, the Applicant shall provide sufficient information to demonstrate technical fitness commensurate with the service proposed to be provided. Examples of such information which may be submitted include the following:

- The identity of the Applicant's officers directly responsible for operations, including names and their professional resumes.
- A copy of any Federal energy license currently held by the Applicant.
- Proposed staffing and employee training commitments.
- Business plans.

19. **TRANSFER OF LICENSE:** The Applicant understands that if it plans to transfer its license to another entity, it is required to request authority from the Commission for permission prior to transferring the license. See 66 Pa. C.S. Section 2208(D). Transferee will be required to file the appropriate licensing application.

20. **UNIFORM STANDARDS OF CONDUCT AND DISCLOSURE:** As a condition of receiving a license, Applicant agrees to conform to any Uniform Standards of Conduct and Disclosure as set forth by the Commission.

21. **REPORTING REQUIREMENTS:** Applicant agrees to provide the following information to the Commission or the Department of Revenue, as appropriate:

a. Reports of Gross Receipts: Applicant shall report its Pennsylvania intrastate gross receipts to the Commission on an annual basis no later than 30 days following the end of the calendar year.

Applicant will be required to meet periodic reporting requirements as may be issued by the Commission to fulfill the Commission's duty under Chapter 22 pertaining to reliability and to inform the Governor and Legislature of the progress of the transition to a fully competitive natural gas market.

22. **FURTHER DEVELOPMENTS:** Applicant is under a continuing obligation to amend its application if substantial changes occur in the information upon which the Commission relied in approving the original filing.

23. **FALSIFICATION:** The Applicant understands that the making of false statement(s) herein may be grounds for denying the Application or, if later discovered, for revoking any authority granted pursuant to the Application. This Application is subject to 18 Pa. C.S. §§4903 and 4904, relating to perjury and falsification in official matters.

24. **FEE:** The Applicant has enclosed the required initial licensing fee of $350.00 payable to the Commonwealth of Pennsylvania.

Applicant:: ALLIANCE ENERGY SERVICES

By: Andrew R. Vollen

Title: AUTHORIZED REPRESENTATIVE

18. Technical Fitness

DEBRA R. CARROLL
OPERATIONS

Debra Carroll received her Honorable Discharge from the United States Navy after completing six and one half years of active service. Mrs. Carroll was a cryptologic technician with top secret/special intelligence clearance. After her tour of duty, with the Navy, Mrs. Carroll attended Passaic College and majored in accounting. Mrs. Carroll has seven years experience as a cost accountant with Mosler and Raytheon, both Fortune 500 manufacturing companies. Mrs. Carroll has ten years of natural gas experience including: scheduling, dispatching and gas accounting through her employment with Centran Corporation and Alliance Energy Services. Mrs. Carroll's area of responsibility with Alliance Energy is the management of Transportation and Exchange, Administration, Market Support and Information Services areas.

BRYAN K. ROBINSON
FINANCE

Bryan Robinson joined Alliance Energy Services effective August 1, 1997. Prior to that time, Mr. Robinson was employed for eleven years by Northeast Ohio Operating Companies, Inc. (A Public Utility holding company) as Vice President, Finance, and Treasurer of that company and its various wholly-owned subsidiaries involved in natural gas transmission, distribution and marketing. In addition to Mr. Robinson's financial responsibilities, he also served as President of Northeast Ohio Gas Marketing, Inc. and was responsible for providing procurement, fuel management and marketing services to various industrial endusers and natural gas suppliers. Before joining Northeast Ohio, Mr. Robinson was employed by Arthur Andersen & Co. as a manager in the accounting and auditing division. During Mr. Robinson's seven years with Arthur Andersen & Co., he provided various accounting and consulting services to companies involved in the utilities and telecommunication industries. Mr. Robinson is a graduate of the Ohio State University with a Bachelor of Science in Business Administration Degree. Mr. Robinson is a Certified Public Accountant in the State of Ohio and a member of The American Institute of Certified Public Accountants and The Ohio Society of Certified Public Accountants.

ELLIS C. KUYKENDALL
GAS MARKETING & SUPPLY

Ellis C. Kuykendall received his undergraduate degree from Rensselaer Polytechnic Institute before serving as an officer in the U. S. Army and receiving his MBA from the University of Oklahoma. Mr. Kuykendall worked for several years as a buyer and sales manager for Foley's Department Stores before joining Conoco Inc.'s Management Development Program. He advanced through eight levels of progressively more responsible assignments to become Director, Gas Marketing – East Region. Mr. Kuykendall staffed and led this top performance team, generating double-digit growth for the $800 million region. Throughout his almost 20 years of industry experience, Mr. Kuykendall has developed expertise with regard to all aspects of natural gas production, gathering, processing, transmission and marketing. Mr. Kuykendall is actively involved in all aspects of Alliance Energy's energy services and consulting activities with particular emphasis in the areas of supply and markets.

FRANK RILEY
POWER MARKETING & SUPPLY

Frank Riley received his Bachelor of Science in Electrical Engineering in 1990 and his Masters in Electrical Engineering in 1991 both from the University of Louisville. While attending the University of Louisville Mr. Riley was employed by PSI Energy as a Co-op Engineer. After graduating Mr. Riley joined PSI Energy as a Distribution Engineer. In 1993, he joined Kentucky Utilities as a Technical Engineer in their System Operations Service area providing assistance in off-system sales, as well as, development of K.U. Operations system for tracking and analysing off-system transactions. Most recently, Mr. Riley was employed at NP Energy as their Energy Operations Manager where he was responsible for the development and oversight of NP's physical power operations, real-time 24-hour desk, implementation of electricity marketing deals and all aspects of NP's transmission of power. Mr. Riley's responsibilities with Alliance Energy Services Partnership are the on-going development and supervision of the Electric Services Group for the company.

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D.C. 20426

APR - 8 1999

To: Alliance Energy Services Partnership

Docket No. ER99-1945-000

You submitted for filing with the Commission a rate schedule under which you will engage in wholesale electric power and energy transactions as a marketer. Pursuant to authority delegated to the Director, Division of Rate Applications, under 18 C.F.R. 375.308, your submittal is accepted for filing and is designated and made effective as shown below.

Alliance Energy Services Partnership

Rate Schedule FERC No. 1 Effective: Date of this Order

Any waivers requested in your application are granted or denied along with the authorizations and subject to the conditions provided in the Appendix.

Under 18 C.F.R. 385.210, interventions are timely if made within the time prescribed by the Secretary. Under 18 C.F.R. 385.214, the filing of a timely motion to intervene makes the movant a party to the proceeding, if no answer in opposition is filed within fifteen days. The filing of a timely notice of intervention makes a State Commission a party to the proceeding.

This action does not constitute approval of any service, rate, charge, classification, or any rule, regulation, contract, or practice affecting such rate or service provided for in the filed documents; nor shall such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against the applicant.

This order constitutes final agency action. Requests for rehearing by the Commission may be filed within 30 days of the date of issuance of this order, pursuant to 18 CFR 385.713.

Sincerely,

for P. Alexander

Donald J. Gelinas, Director
Division of Rate Applications

Waivers and Authorizations Under the Commission's Regulations Which are Granted or Denied for Unaffiliated Power Marketers

Waivers and Authorizations Granted/Denied

The following Regulations are waived for power marketers:

1) Subparts B and C of Part 35, regarding the filing of rate schedules, except for Sections 35.12(a), 35.13(b), 35.15 (which requires a power marketer to file a Notice of Cancellation or Termination when it ceases its marketing activities), and 35.16 (which requires a power marketer to file a notice of succession whenever its name or operational control is changed).
2) Part 41, regarding accounts, records, and memoranda;
3) Part 101, regarding the uniform system of accounts; and
4) Part 141, regarding statements and reports.

See Citizens Energy Corporation (Citizens Energy), 35 FERC ¶ 61,198 (1986), Citizens Power and Light Corporation (Citizens P&L), 48 FERC ¶61,210 (1989), and Enron Power Marketing, Inc. (Enron), 65 FERC ¶ 61,305 (1993), order on rehearing, 66 FERC ¶ 61,244 (1994).

The requirements of Part 34 of the Commission's Regulations regarding securities and assumptions of liabilities are statutory in nature and cannot be waived. If a power marketer requests blanket approval under Part 34, a notice will be published in the Federal Register establishing a period during which protests may be filed. Absent a request to be heard within the period set forth in the notice, the power marketer is authorized to issue securities and assume obligations or liabilities as guarantor, endorser, surety, or otherwise in respect of any security of another person; provided that such issue or assumption is for some lawful object within the corporate purposes, compatible with the public interest, and reasonably necessary or appropriate for such purposes. See Citizens P&L and Enron.

Requests that the Commission waive the requirements of Part 46 of its Regulations regarding interlocking directors are denied. In Enron, the Commission stated that the requirements of Part 46 regarding interlocking directors are statutory in nature and may not be waived.

The full requirements of Part 45 of the Commission's Regulations are waived for power marketers. Instead, a person holding or who may hold an otherwise proscribed interlocking directorate involving the power marketer shall file a sworn application providing: (1) full name and business address, and (2) all jurisdictional interlocks, identifying the affected companies and the positions held by that person. See Enron.

The Commission reserves the right to require a further showing that neither public not private interests will be adversely affected by continued Commission approval of the power marketer's issuances of securities or assumptions of liabilities, or by the continued holding of any affected interlocks.

Requests for disclaimer of jurisdiction over brokering activities, in which title to electricity is not taken, must be filed separately as a petition for a declaratory order accompanied by the appropriate filing fee. See Citizens Energy and Heartland Energy Services, Inc., 68 FERC ¶ 61,223 (1994).

Requests that the Commission waive annual charges for power marketers, under Part 382 of the Commission's Regulations, are denied. See Morgan Stanley Capital Group Inc. (Morgan Stanley I), 69 FERC ¶ 61,175 (1994) and Morgan Stanley Capital Group Inc. (Morgan Stanley II), 72 FERC ¶ 61,082 (1995).

Requests for a blanket waiver of the 60-day prior notice requirement for rate schedule filings made by a power marketer's suppliers, are denied. See Aquila Power Corporation, 70 FERC ¶ 61,021 (1995). However, in Central Hudson Gas & Electric Corp., et al., 60 FERC ¶ 61,106, reh'g denied, 61 FERC ¶ 61,089 (1992), and Prior Notice and Filing Requirements under Part II of the Federal Power Act, Docket No. PL93-2-002, 64 FERC ¶ 61,139 (1993), the Commission explained its policy on waiver of notice for all jurisdictional sellers. Responding to concerns that sellers may be unable to file new services 60 days prior to the effective date, the Commission stated that it would grant waiver of the 60 day notice requirement 1) for uncontested filings involving new services that were filed at least one day prior to the commencement of service, or 2) for service agreements under tariffs already on file as long as the service agreements are filed within 30 days after service commences.

Requests for waiver of the provisions of Section 203 regarding the disposition of jurisdictional facilities, the merger or consolidation of such facilities, or the acquisition of the securities of another public utility, are denied. The provisions of Section 203 are statutory in nature and may not be waived. See Resources Recovery (Dade County), Inc., 20 FERC ¶ 61,138 (1982). Requests for clarification that sales of accounts receivable are not dispositions of jurisdictional facilities and are, therefore, not within the scope of Section 203, are granted. See Enron. Requests for clarification that the assignment of a power sales contract constitutes a disposition of jurisdictional facilities under Section 203, are granted. See Enron. Requests

for clarification that funds received from the sale of electricity are not jurisdictional facilities within the meaning of Section 203, are granted. See Citizens Energy. Also, requests for clarification that the requirements of Section 203 do not apply to the facilities of a power marketer that are not involved in the generation, transmission or sale for resale of electric energy, are granted. See Howell Gas Management Co., 40 FERC ¶ 61,336 (1987).

Requests that the Commission waive its requirement that purchasers of electricity under market-based rate schedules certify that the purchase price was equal to or less than its avoided cost, are moot. The Commission dropped the requirement in Louisville Gas & Electric Company, 62 FERC ¶ 61,016 (1993).

Reporting Requirements

Power marketers must provide, within 30 days of the end of each calendar quarter, the following information for each transaction in which it engaged during the prior quarter:

1) identification of buyer/seller;
2) description of the service, e.g., purchase/sale, firm/non-firm;
3) delivery point(s);
4) price(s);
5) quantities, e.g., MWh/MW; and
6) dates of service

See Citizens P&L and Enron.

Requests for different reporting requirements are denied, pending the Commission's completion of the generic review of reporting requirements for all public utilities with market-based rates announced in Morgan Stanley I. See Citizens Lehman Power Sales, 71 FERC ¶ 61,149 (1995).

Requests to include in the quarterly reports only those risk management transactions that result in the actual delivery of electricity, until the Commission issues an order addressing the issue of its jurisdiction over risk management transactions, are granted. See Morgan Stanley I.

Requests to file quarterly transaction reports on a confidential basis are denied. See National Electric Associates L.P., 50 FERC ¶ 61,378 (1990). See also AIG Trading Corporation, 71 FERC ¶ 61,148 (1995), LG&E Power Marketing Inc., 68 FERC ¶ 61,247, and Enron.

Power marketers must file with the Commission any change in status. See Citizens P&L, Enron, and Morgan Stanley II. Changes in status include departures from the characteristics the Commission has relied upon in approving the power marketer's market-based pricing, including but not limited to:

1) lack of ownership of generation or transmission facilities or other inputs to electric power production other than those identified in the application for market-based rates;

2) lack of affiliation with any entity which owns generation or transmission facilities or other inputs to electric power production other than those identified in the application for market-based rates; or

3) lack of affiliation with any entity that has a franchised service area.

Requests to file a revised market analysis every three years in lieu of reporting changes on an ongoing basis, are granted. See Morgan Stanley I, as clarified in Engelhard Power Marketing, Inc., 70 FERC ¶ 61,250 (1995).

AFFIDAVIT

RECEIVED
SEP 26 2000
PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Commonwealth of Kentucky :

: ss:

County of Jefferson :

Andrew R. Fellon, Affiant, being duly [sworn/affirmed] according to law, deposes and says that:

He/she is the Authorized Partnership Representative (Office of Affiant) of Alliance Energy Services Partnership;

That he/she is authorized to and does make this affidavit for said Applicant;

That Alliance Energy Services Partnership, the Applicant herein, acknowledges that Alliance Energy Services Partnership may have obligations pursuant to this Application consistent with the Public Utility Code of the Commonwealth of Pennsylvania, Title 66 of the Pennsylvania Consolidated Statutes; or with other applicable statutes or regulations including Emergency Orders which may be issued verbally or in writing during any emergency situations that may unexpectedly develop from time to time in the course of doing business in Pennsylvania.

That Alliance Energy Services Partnership, the Applicant herein, asserts that it possesses the requisite technical, managerial, and financial fitness to render natural gas supply service within the Commonwealth of Pennsylvania and that the Applicant will abide by all applicable federal and state laws and regulations and by the decisions of the Pennsylvania Public Utility Commission.

That Alliance Energy Services Partnership, the Applicant herein, certifies to the Commission that it is subject to, will pay, and in the past has paid, the full amount of taxes imposed by Articles II and XI of the Act of March 4, 1971 (P.L. 6, No. 2), known as the Tax Reform Act of 1971 and any tax imposed by Chapter 22 of Title 66. The Applicant acknowledges that failure to pay such taxes or otherwise comply with the taxation requirements of, shall be cause for the Commission to revoke the license of the Applicant. The Applicant acknowledges that it shall report to the Commission its jurisdictional natural gas sales for ultimate consumption, for the previous year or as otherwise required by the Commission. The Applicant also acknowledges that it is subject to 66 Pa. C.S. §506 (relating to the inspection of facilities and records).

Applicant, by filing of this application waives confidentiality with respect to its state tax information in the possession of the Department of Revenue, regardless of the source of the information, and shall consent to the Department of Revenue providing that information to the Pennsylvania Public Utility Commission.

That Alliance Energy Services Partnership, the Applicant herein, acknowledges that it has a statutory obligation to conform with 66 Pa. C.S. §506, and the standards and billing practices of 52 PA. Code Chapter 56.

47

That the Applicant agrees to provide all consumer education materials and information in a timely manner as requested by the Commission's Office of Communications or other Commission bureaus. Materials and information requested may be analyzed by the Commission to meet obligations under applicable sections of the law.

That the facts above set forth are true and correct/true and correct to the best of his/her knowledge, information, and belief.

Signature of Affiant

Sworn and subscribed before me this 21st day of April, 2000.

Signature of official administering oath

My commission expires 3-3-2001.

Debra R. Carroll, Notary Public
State at Large, Kentucky
My Commission Expires 3/3/2001

AFFIDAVIT

Commonwealth of Kentucky :

: ss.

County of Jefferson :

Andrew R. Fellon, Affiant, being duly [sworn/affirmed] according to law, deposes and says that:

He is the Authorized Partnership Representative of Alliance Energy Services Partnership;

That he is authorized to and does make this affidavit for said Applicant;

That the Applicant herein, has the burden of producing information and supporting documentation demonstrating its technical and financial fitness to be licensed as a natural gas supplier pursuant to 66 Pa. C.S. §2208(c)(1).

That the Applicant herein has answered the questions on the application correctly, truthfully, and completely and provided supporting documentation as required.

That the Applicant herein acknowledges that it is under a duty to update information provided in answer to questions on this application and contained in supporting documents.

That the Applicant herein acknowledges that it is under a duty to supplement information provided in answer to questions on this application and contained in supporting documents as requested by the Commission.

That the facts above set forth are true and correct to the best of his/her knowledge, information, and belief, and that he/she expects said Applicant to be able to prove the same at hearing.

Signature of Affiant

Sworn and subscribed before me this 21st day of April, 2000.

Signature of official administering oath

My commission expires 3-3-2001.

Debra R. Carroll, Notary Public
State at Large, Kentucky
My Commission Expires 3/3/2001

CONOCO 1998 ANNUAL REPORT

conoco

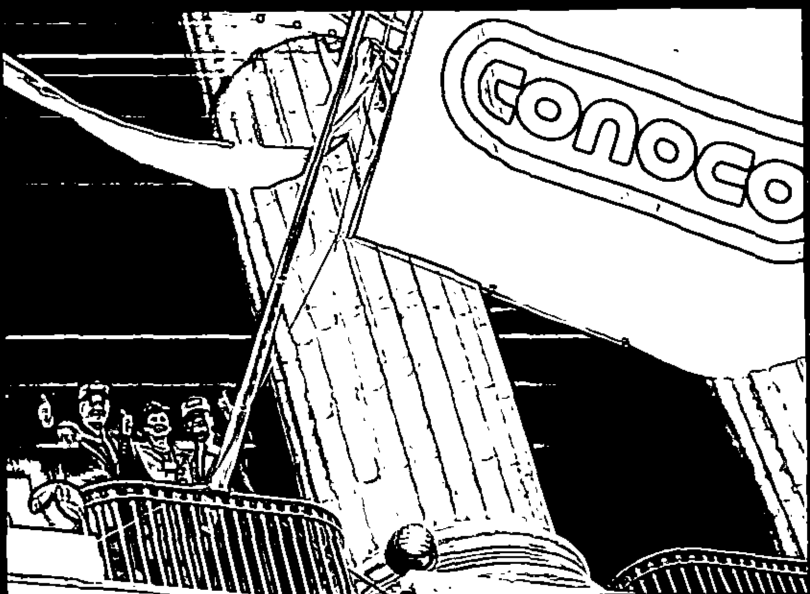
On October 22, 1998, Conoco returned to the New York Stock Exchange through the largest initial public offering in U.S. history.

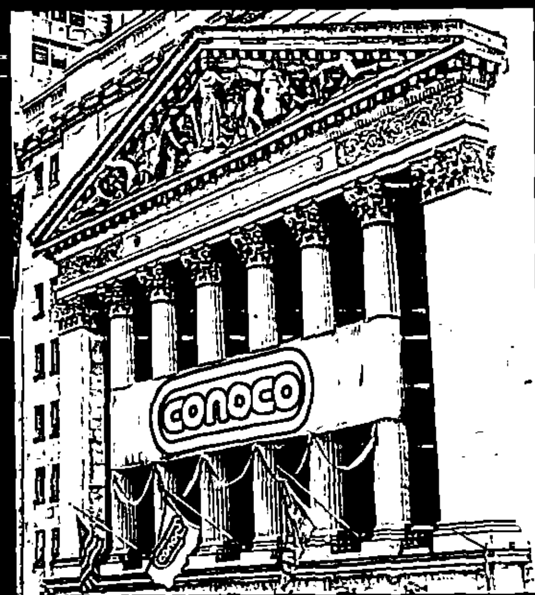
What's Next...

OCTOBER 22, 1998

Independence Day!

It was a day of celebration – a day when Wall Street wore Conoco red. We call it "Independence Day." Our successful initial public offering was a milestone for the company, but it's only the beginning. In this report, we'll focus on *what's next* – how we'll build shareholder value through aggressive growth, operating excellence, distinctive strengths and strong core values.





Conoco President and CEO Archie Dunham (left), his wife, Linda, and New York Stock Exchange Chairman and CEO Richard Grasso gave the "*thumbs up*" *signal* from the balcony of the exchange, where a Conoco flag flew – celebrating our successful IPO. A giant banner spanned the NYSE, telling the world Conoco was back!

CONOCO AT A GLANCE: This world map shows Conoco's operations and growth areas 2

A LETTER FROM THE CEO: Archie Dunham discusses the company's performance and future outlook 4

DISTINCTIVE STRENGTHS: Several key strengths distinguish Conoco from the competition 7

E&P: Our Exploration and Production business is on a course for aggressive growth, while generating strong earnings 8

RMS&T: *Refining, Marketing, Supply and Transportation* is a strong cash generator that is supporting Conoco's global growth 16

POWER: Conoco is well-positioned to capture promising opportunities in power generation 22

CORPORATE RESPONSIBILITY: Conoco is guided by *four core values* 24

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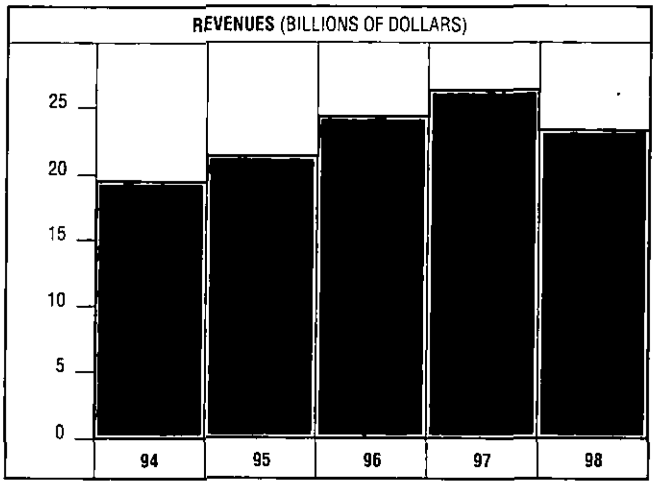
OFFICERS AND STOCKHOLDER INFORMATION ..... Inside Back Cover

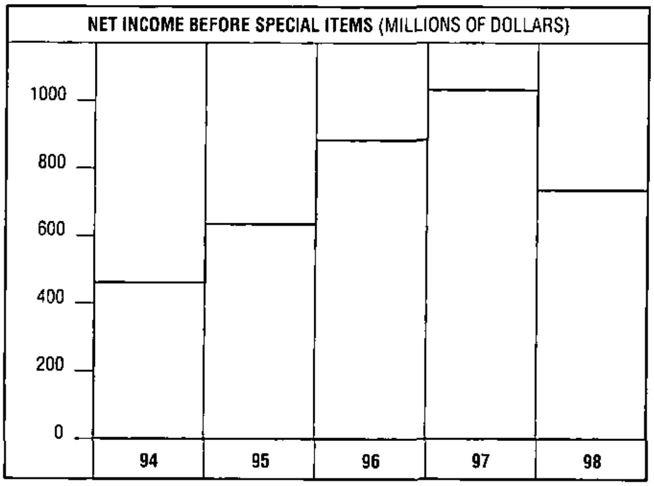
Financial and Operating Highlights

Millions of Dollars	1998	1997	% change
Revenues	23,168	26,263	(12%)
Net Income	450	1,097	(59%)
Net Income Before Special Items[(1)]	721	1,017	(29%)
Cash Provided By Operations	1,373	2,876	(52%)
Capital Expenditures and Investments	2,516	3,114	(19%)
Capital Employed	9,179	9,228	(1%)
Proved Reserves *million bbl. of oil equivalent*	2,622	2,601	1%
Petroleum Liquids Production *thousand bbl./day*	348	374	(7%)
Natural Gas Production *million cu. ft./day*	1,411	1,203	17%
Natural Gas Liquids Processed *thousand bbl./day*	67	68	(1%)
Total Refinery Inputs Processed *thousand bbl./day*	823	780	6%
Sales of Refined Products *thousand bbl./day*	1,049	1,048	–

(1) *Excludes the effect of non-recurring items*



Conoco's 1998 revenues were $23.2 billion, down 12 percent from the previous year's $26.3 billion, as significantly lower crude oil and natural gas prices and lower downstream prices more than offset increased natural gas volumes.

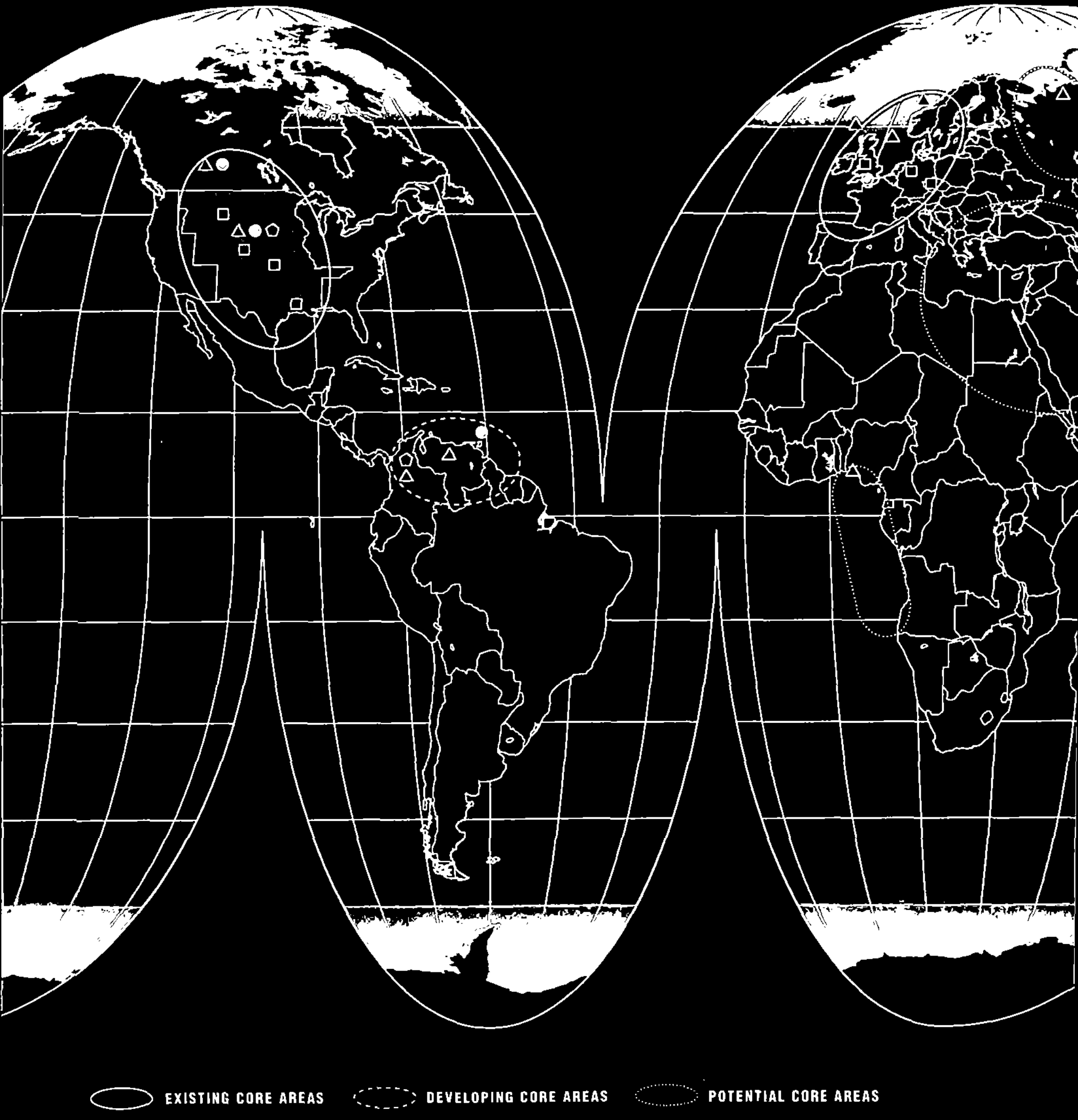


Conoco's net income before special items was $721 million in 1998, down 29 percent from the previous year's record $1,017 million. Significantly lower prices were partly offset by higher natural gas volumes, lower exploration expenses and improved international marketing margins.

This Annual Report includes forward-looking statements within the meaning of the Securities Acts. You can identify our forward-looking statements by the words "expects," "intends," "plans," "projects," "believes," "estimates" and similar expressions. For information concerning our forward-looking statements and important factors that could cause actual results to differ materially from those in such statements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" on page 29.

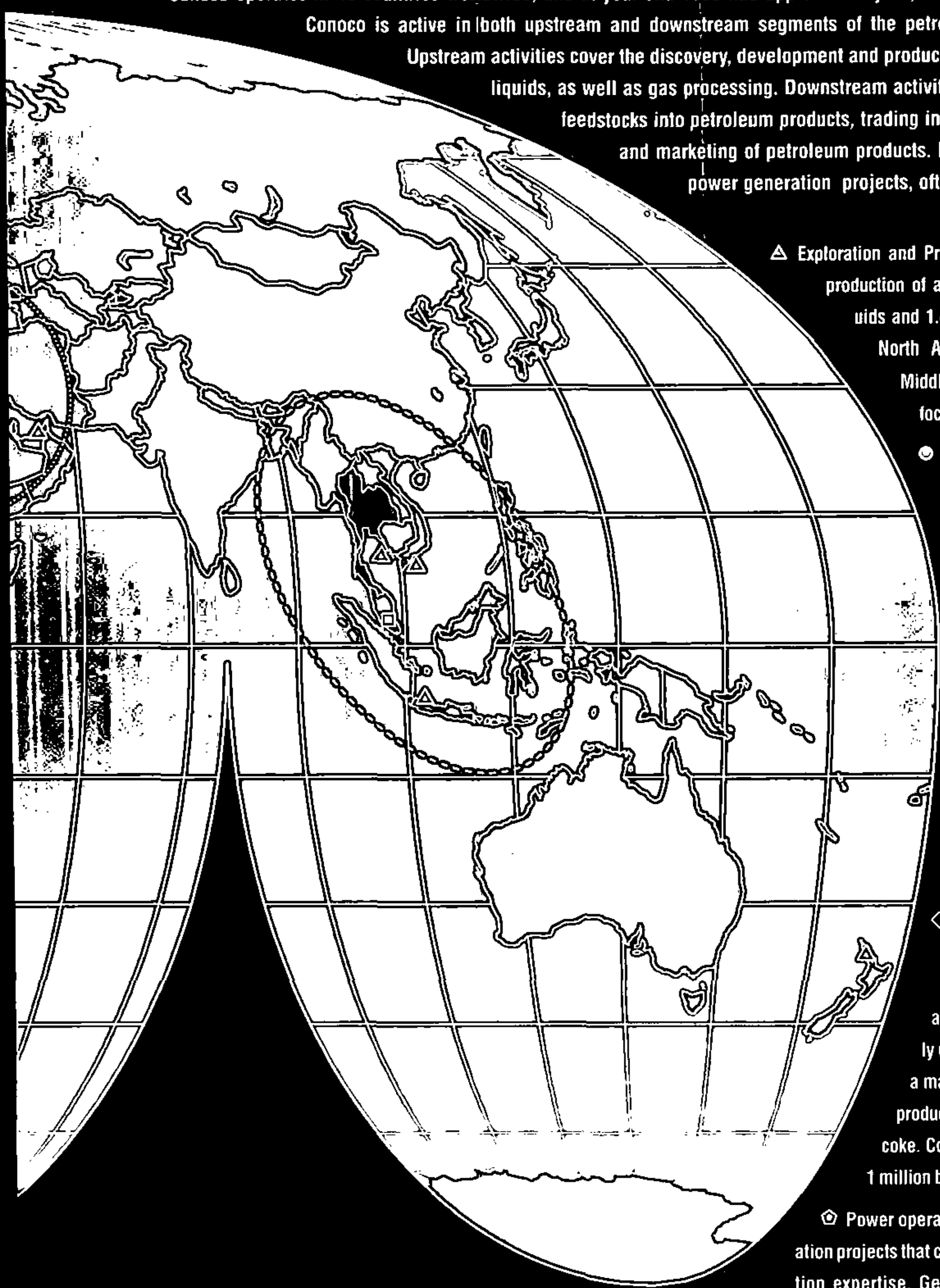
"Conoco," "the company," "we," "us" and "our" are used interchangeably in this report to refer to the business of Conoco Inc., its consolidated subsidiaries and its equity affiliates. Where reference is made to a particular company, it is wholly owned unless otherwise stated. Conoco, *breakplace*, Jet, Hydroclear, LiquidPower, ArcticPower, Projet and Pure Performance are trademarks for the company's products or operations named in this report.

Conoco at a Glance



Our vision is to be recognized around the world as a truly great, integrated, international energy company that gets to the future first.

Conoco operates in 40 countries worldwide, and at year-end 1998 had approximately 16,000 employees. In the global energy industry, Conoco is active in both upstream and downstream segments of the petroleum business, and in power generation. Upstream activities cover the discovery, development and production of crude oil, natural gas and natural gas liquids, as well as gas processing. Downstream activities cover the refining of crude oil and other feedstocks into petroleum products, trading in crude oil and products, and the distribution and marketing of petroleum products. Power activities involve the development of power generation projects, often drawing on Conoco's fuel resources.



△ Exploration and Production operations in 1998 included the daily production of approximately 348,000 barrels of petroleum liquids and 1.4 billion cubic feet of natural gas from fields in North America, South America, Europe, Africa, the Middle East and Asia Pacific. Exploration activities are focused in 15 countries.

Natural gas and gas products operations include the gathering, processing, distribution and marketing of natural gas and natural gas liquids in North America, the U.K., Norway and Trinidad. In 1998, Conoco marketed natural gas volumes in excess of 4.1 billion cubic feet per day in the U.S. and Europe.

Refining operations include four refineries in the U.S., one in the U.K., and partial ownership of a refinery in Germany, two in the Czech Republic and the recently commissioned refinery in Malaysia. Conoco has processing capacity of about 800,000 barrels of crude oil per day at these facilities.

◇ Marketing operations include the distribution and sale of gasoline, diesel fuel and motor oils through about 7,900 outlets in the U.S., Europe and Asia Pacific. These products are sold primarily under the Conoco and Jet brands. The company is a major supplier of industrial lubricants and specialty products and is the world's leading supplier of graphite coke. Conoco's total refined product sales are more than 1 million barrels per day.

Power operations focus on the development of power generation projects that combine Conoco's fuels and industrial cogeneration expertise. Generating facilities developed by Conoco are onstream in the Netherlands and Colombia, and one plant is under construction, while another is under development, in Texas. Also, an agreement has been finalized for plants in four European countries.

A Letter From the CEO

Successful Initial Public Offering Highlights an Extraordinary Year

If one message sums up the Conoco story in 1998, it's – "We're back!"

After 17 successful years as a DuPont subsidiary, last fall Conoco returned to the New York Stock Exchange as a public company. Investors purchased 30 percent (191 million shares) of Conoco stock for $4.4 billion – the largest initial public offering (IPO) in U.S. history.

That would be an impressive debut in any business climate. It was *superb* at a time of extremely low oil prices and a roller-coaster stock market. The success of our IPO was an *endorsement of Conoco's strategic direction and strong track record of performance.*

When investors look at Conoco today, they see a company that is:

- Building for long-term growth in profits and return on capital employed,
- Investing to be an industry leader in production growth,
- Capitalizing on distinctive strengths that differentiate us from the competition, and
- Benefiting from highly skilled, motivated employees and a proven, growth-oriented management team.

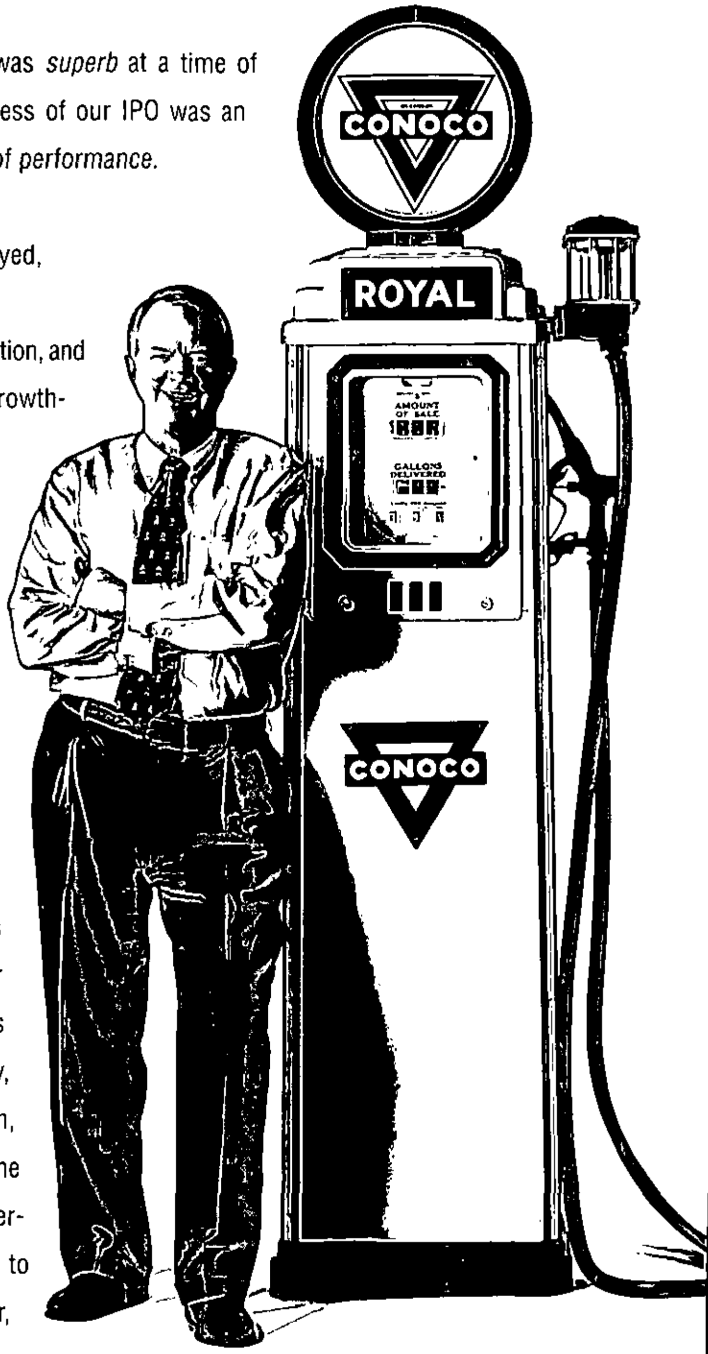
These attributes are all key to achieving our most important financial goal – increasing Conoco's total enterprise value to $30 billion within the next few years.

In this report, we'll review the strides we've made in financial and operating performance. And we'll discuss *what's next* – how Conoco will become "the energy company of the next millennium."

Exceptional Earnings Followed By Sharply Lower Oil Prices

Conoco has achieved exceptional earnings growth during the last few years, culminating in our record-setting 1997 earnings of more than $1 billion.

This outstanding performance was the prelude to a difficult 1998, as oil prices dropped by more than a third during the year, falling to their lowest levels in 25 years (adjusted for inflation). Declining natural gas prices and industry refining margins also took their toll. Consequently, Conoco's 1998 net income before special items declined to $721 million, down 29 percent from 1997, but still a strong showing considering the dismal price environment. Net income of $450 million was down 59 percent from 1997, reflecting special items that included charges related to the separation from DuPont. On an underlying earnings basis, however, in 1998 we were able to maintain our year-to-year performance better than all but one of our largest international competitors.



Archie W. Dunham, President and Chief Executive Officer

Conoco's determination to reduce costs, restructure the *portfolio, focus exploration and improve operating efficiency* helped us weather the storm during the year. And it's keeping us on course for aggressive growth in the future.

World-Class Projects Debut

Over the last few years we've "primed the pump" for long-term growth with the completion of five world-class projects that should increase production and earnings for decades. In 1998, they all made their debut:

- Britannia, the largest natural gas / condensate field in the U.K. North Sea, commenced production in August. At peak production, Britannia has the capacity to supply up to 8 percent of the U.K.'s gas requirements.
- Petrozuata, a major joint venture in Venezuela, began producing extra-heavy oil in August. An upgrader that will process the extra-heavy oil into higher-value synthetic crude will be completed in 2000.
- In the Lobo natural gas trend in South Texas, Conoco increased production by nearly 50 percent in 1998 to 750 million cubic feet per day at year-end. Conoco made a major acquisition of Lobo properties in 1997.
- The *Deepwater Pathfinder*, the first of two ultra-deepwater drillships, was christened in September and commenced drilling on our highly prospective deepwater Gulf of Mexico acreage in early 1999.
- The new Melaka refinery in Malaysia began processing crude oil in August, providing Conoco a strategic foothold in the Southeast Asia region.

A key component of our strategy is to be an industry leader in production growth. We expect to achieve that goal as a result of the additional production from Britannia, Petrozuata, Lobo and the Ursa field in the Gulf of Mexico.

Over the long term, we expect to increase production through exploration, new ventures and acquisitions. Today, most of our production is from North America and the North Sea. In the future, we plan to create at least two new core areas with significant earnings potential.

Exploration is critical to growth, and in 1998 our explorers delivered Conoco's best performance in 15 years. We expect the company's portfolio of high-potential prospects to lead to *significantly increased production in the years ahead.*

Operating Excellence – A Top Priority

Operating excellence is the backbone of any successful company. Safe, efficient and cost-effective operations provide the funds that fuel growth.

Conoco's operations have changed dramatically since 1992, the year we began major restructuring and cost reduction programs throughout the company.

In Exploration and Production (E&P), we've upgraded Conoco's portfolio of properties by selling or exchanging $2 billion in assets and reinvesting the proceeds in properties that will provide longer-term value. Today, our portfolio is far more focused, productive and profitable.

We've reduced the number of producing fields by nearly 65 percent and dramatically cut costs. At the same time, oil and natural gas production increased and proved reserves rose by nearly 60 percent. As a result, E&P earnings tripled during the 1992-1998 period.

In Refining, Marketing, Supply and Transportation (RMS&T), lower costs and higher refinery utilization led to a 60 percent increase in earnings during the same time period, even though industry refining margins steadily deteriorated. This excellent performance has made RMS&T one of the industry's top performers.

Clearly, we've made great progress in improving operating efficiency, and we've accomplished it while working safely and protecting the environment. Conoco has been the safest company in the U.S. petroleum industry for 10 of the last 15 years, and in 1998 we achieved our best safety performance on record. We also achieved our best environmental performance, with zero significant environmental incidents during the year.

Operating excellence demands continuous improvement. And during the first half of 1999, E&P will be restructured to become even more cost-effective and focused on high-potential opportunities. We're also working to further improve RMS&T results and to more closely align support organizations with business goals.

These efforts will reduce costs by about $100 million annually and further improve operating efficiency. While this will benefit the company, change is never easy. These actions will reduce our worldwide work force of approximately 16,000 by about 1,000 positions in 1999.

A Year of Sweeping Changes

1998 was a year of sweeping changes in the petroleum industry – specifically, the sharp decline in oil prices and the mergers of several major petroleum companies.

What do these developments mean for Conoco? First, let's look at oil prices. We believe prices will remain low in 1999 but will begin to recover within the next 18 months, as worldwide production declines, Asian economies strengthen and energy demand returns to more normal levels.

The steps we're taking to improve Conoco's performance will benefit the company in *any* price environment. To preserve shareholder value while low prices continue, we're reducing discretionary capital spending in 1999 by about $700 million, from $2.5 billion in 1998. But when prices improve, we'll be poised to quickly increase drilling and production.

The other big story in 1998 was the "urge to merge" among some of the industry's largest competitors. These mega-mergers might make you wonder if a company like Conoco – a mid-sized, integrated, international major – can succeed. We believe the answer is a resounding "yes!"

Conoco is determined to grow in value, and our size allows us to be fast, nimble and aggressive in capturing opportunities. We also have distinctive strengths that differentiate us from the competition and make Conoco an attractive partner for world-class projects (page 7).

By joining with partners for individual projects, we're able to provide the technical resources of an industry giant, without the overhead and bureaucracy that often accompany size. This approach gives Conoco both strength *and* flexibility.

The Road to Independence

I began this letter by talking about Conoco's successful IPO – our first step toward full independence. We expect to complete the transition later this year, when DuPont offers its shareholders the opportunity to exchange their DuPont shares for Conoco shares.

Edgar S. Woolard, Jr.

This will complete DuPont's divestiture of its remaining 70 percent ownership of Conoco, the largest corporate "split-off" ever. The split-off will give us greater freedom to pursue opportunities in the energy sector – making Conoco an even stronger competitor.

In closing, Ed Woolard, Chairman of the Board of Directors, and I would like to welcome Conoco's new shareholders. By choosing Conoco, you have invested in a financially strong company with a highly productive growth portfolio and an extraordinary team of employees. At all levels of the company, we're working to create value and provide superior returns on your investment.

We also would like to thank the men and women of Conoco. Every day, employees are finding new and better ways to do business. The achievements discussed in this letter – from our world-class projects to the transformation in our financial and operating performance to our industry-leading safety record – all reflect the contributions of thousands of Conoco people around the world. Our employees' commitment to excellence has made Conoco a leader in the global energy industry.

As we move forward as an independent company, many aspects of our business will change. But some things will remain constant. We will hold firmly to our core values of safety, environmental stewardship, ethical behavior and valuing all people.

We'll also rely on an attribute that has defined Conoco for years. That is *the ability to adapt* ... to rise to the occasion and meet new challenges with an absolute determination to succeed.

Archie W. Dunham
President and CEO
March 7, 1999

Conoco's Distinctive Strengths

Conoco has six key strengths that together distinguish us from other energy companies. While some competitors may be as skilled in one or another of these attributes, we believe no other company has them all.

The Power of Integration

1 To be truly integrated, a company's different businesses must function in concert on behalf of the customer. Our Upstream, Downstream and Power businesses work together to meet the needs of the customer – whether a government, a state-owned oil company, an industry partner or an individual consumer.

Conoco's success in Venezuela is an excellent example of how integration can create value. We were chosen by PDVSA, the Venezuelan national oil company, to be its partner in the country's first strategic alliance created to develop the extra-heavy oil reserves in the Orinoco oil belt. Many companies were considered, but Venezuela chose Conoco first because we offered an integrated package of skills in heavy crude oil production; transporting complex mixtures by pipeline; carbon upgrading; and marine operations – all critical to the success of this vast project.

Capturing Value From the "Bottom of the Barrel"

2 Conoco is recognized throughout the petroleum industry as a leader in carbon upgrading – shifting the yield of a barrel of crude oil to reduce the production of heavy, low-value products at the bottom of the barrel (such as tar, asphalt and residual fuel oil), while increasing the production of higher-value products (such as gasoline, diesel fuel and specialty petroleum coke). Conoco's leadership in this area is demonstrated by the extensive licensing of our proprietary coking technologies.

The company produces a range of coke products, including premium "needle" coke, the primary component in ultra-high-quality electrodes used in manufacturing steel. This high-value coke earns Conoco a strong position in the global market.

Coking expertise is becoming increasingly valuable, as countries around the world – from Venezuela to Kuwait to Malaysia – seek to raise the value of products made from their crude oil. Conoco's coking skills provide the company access to growth opportunities in heavy oil worldwide.

Deepwater Expertise Taps New Frontier

3 When forecasters look at the global energy picture, most predict the rate of demand growth will increase substantially over time. To satisfy the expected rise, explorers will be drilling in ever-deeper waters – from 5,000 to 10,000 feet – where the greatest potential for major discoveries lies.

Conoco has long been a leader in deepwater exploration and production technology. We pioneered the use of tension-leg platforms (TLPs) in the North Sea (1984) and the Gulf of Mexico (1989), clearing the way for the industry's move into deep water during the past decade. TLPs are floating facilities held in place by tendons attached to the sea floor – a more economical approach to deepwater production than fixed facilities. Several years ago – again ahead of the industry – Conoco made a strategic decision to build two ultra-deepwater drillships. These vessels, the first of which is now in service in the Gulf of Mexico, give us a powerful advantage in deepwater exploration.

Managing World-Class Projects

4 Conoco is widely recognized for our ability to implement large, complex projects on time and within budget. A prime example is the huge Britannia natural gas / condensate development in the U.K. North Sea. Working through an innovative joint operatorship with Chevron, Conoco provided expertise that helped reduce capital costs by nearly 50 percent from original estimates, achieve production ahead of schedule and maintain an industry-leading safety performance.

Our reputation as a skilled project manager has opened the door to many major opportunities and enables us to secure creative, cost-competitive financing for world-class projects.

Transforming Vision Into Reality

5 Another of our critical skills is the ability to turn *ideas* for profitable growth into value-creating *businesses*. For example, we were the first U.S.-based company to develop a new field in Russia, the first to have an integrated extra-heavy oil project in Venezuela, and the first to negotiate an agreement in Iran, laying the groundwork for future opportunities there when U.S. sanctions are lifted.

Whether it's a major new project or making the most of existing assets, Conoco is "cracking the code" in opportunity development.

Working Safely and Protecting the Environment

6 In the petroleum industry, Conoco is a leader in safety and environmental stewardship. This attribute is critical to the success of our operations and has made Conoco a partner of choice for many companies and governments around the world.

We believe our outstanding safety and environmental performance flows directly from three important practices:

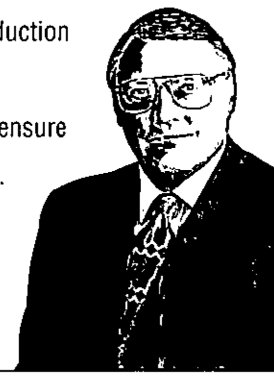
- *Visible, committed leadership* – Managers and supervisors are committed to making safety and environmental excellence the top priorities in all our operations and activities.
- *Worker ownership* – Employees take personal accountability for Conoco's safety and environmental performance.
- *Investment in safety and environmental systems* – We use formal plans and processes to manage safety and reliability in our day-to-day operations.

E&P on a Course for Strong Profits, Aggressive Global Growth

"In Exploration and Production (E&P), our strategy is to continue providing strong earnings by maximizing the value of our existing assets and by aggressively pursuing growth opportunities around the world. In 1998, we made strides with three 'legacy' projects – large, long-lived ventures that are expected to generate substantial earnings and help us meet our ambitious production targets. The Britannia natural gas / condensate development in the U.K. North Sea and the Petrozuata extra-heavy oil project in Venezuela both began production, and we substantially increased production from our Lobo natural gas properties in South Texas.

We also put into service the first of two new ultra-deepwater drillships in early 1999. These vessels ensure our access to promising opportunities in the deepwater Gulf of Mexico and other regions of the world. I'm also very proud of our outstanding exploration success in 1998. These were all great accomplishments. The progress we've made serves as the foundation for future production growth."

— **Rob McKee,** E&P Executive Vice President



Upstream Highlights

Growth on a Global Scale

Conoco's E&P operations are centered in two core areas, the United States and the North Sea, and we're working to establish at least two new core areas. Northern South America will undoubtedly become our third core area, anchored by the Petrozuata project's huge reserves and our large exploration position in the La Luna trend, which extends across northern South America and the eastern Caribbean. Our fourth core area should emerge from areas where we're already operating or "prospecting," such as Russia, the Middle East, West Africa and the Asia Pacific region.

A Great Year in Exploration

In 1998, Conoco had its best exploratory success rate in 15 years. Approximately 30 percent of the exploratory wells we drilled (excluding appraisal wells) were potentially commercial. We made discoveries in Canada, the United States, the United Kingdom, Norway, Venezuela, Indonesia and Nigeria.

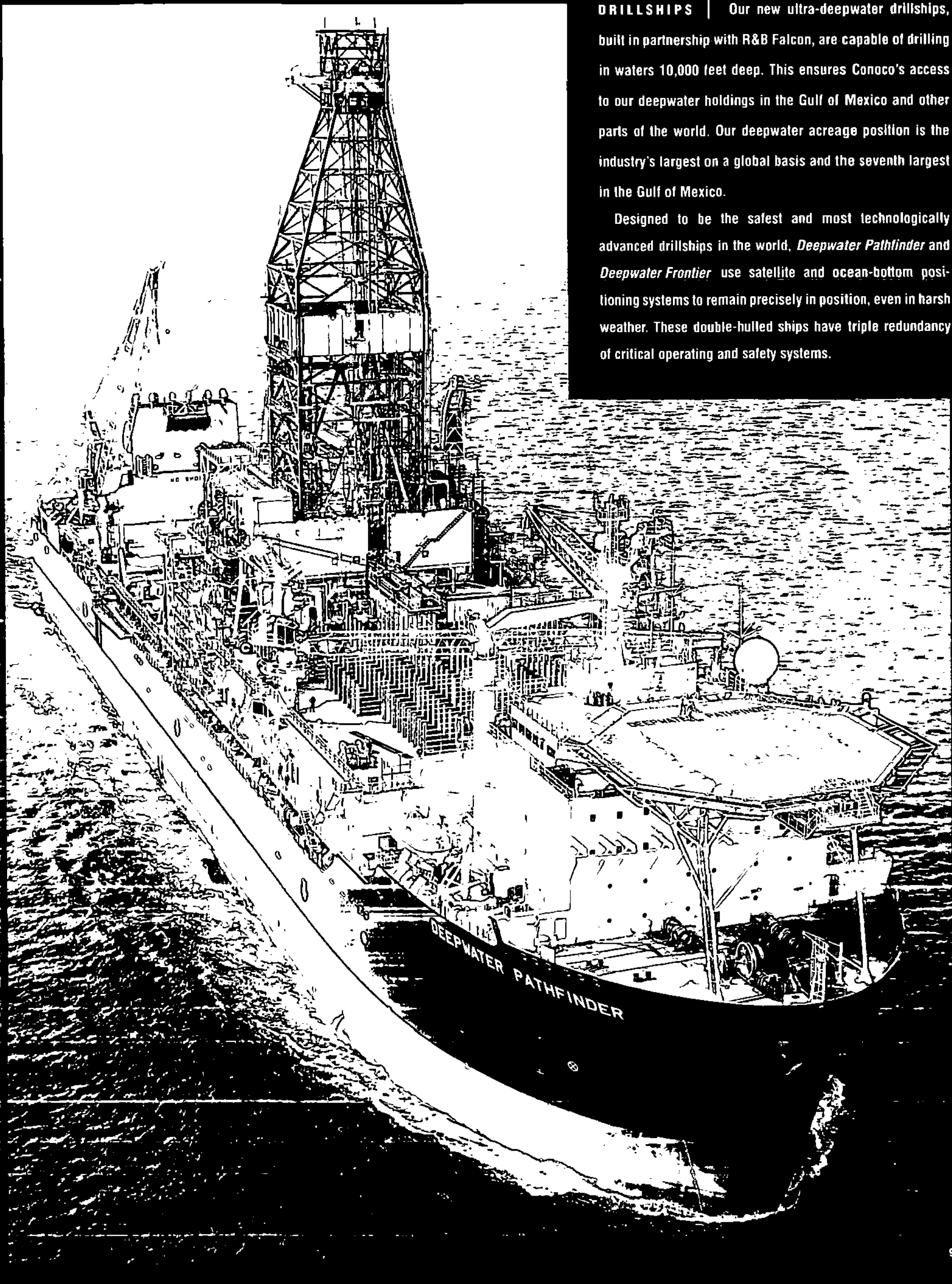
"Over the past few years we've become very focused in our exploration program," says Roger Pinkerton, head of the Upstream finding team. "Our strategy is to acquire large acreage positions in areas that are relatively under-explored and hold the potential for major discoveries. By establishing our acreage early on, we're well-positioned to capitalize on opportunities as discoveries are made."

Today, Conoco has its sights set on five highly prospective exploration areas – the deepwater Gulf of Mexico, the La Luna trend in northern South America and the Caribbean, the Atlantic Margin of northwest Europe, Asia Pacific and West Africa. In 1999, we plan exploration drilling in the United States, Venezuela, Colombia, Trinidad, the United Kingdom, Norway, Indonesia, New Zealand and Canada.

Upgrading the Portfolio – A Top Priority

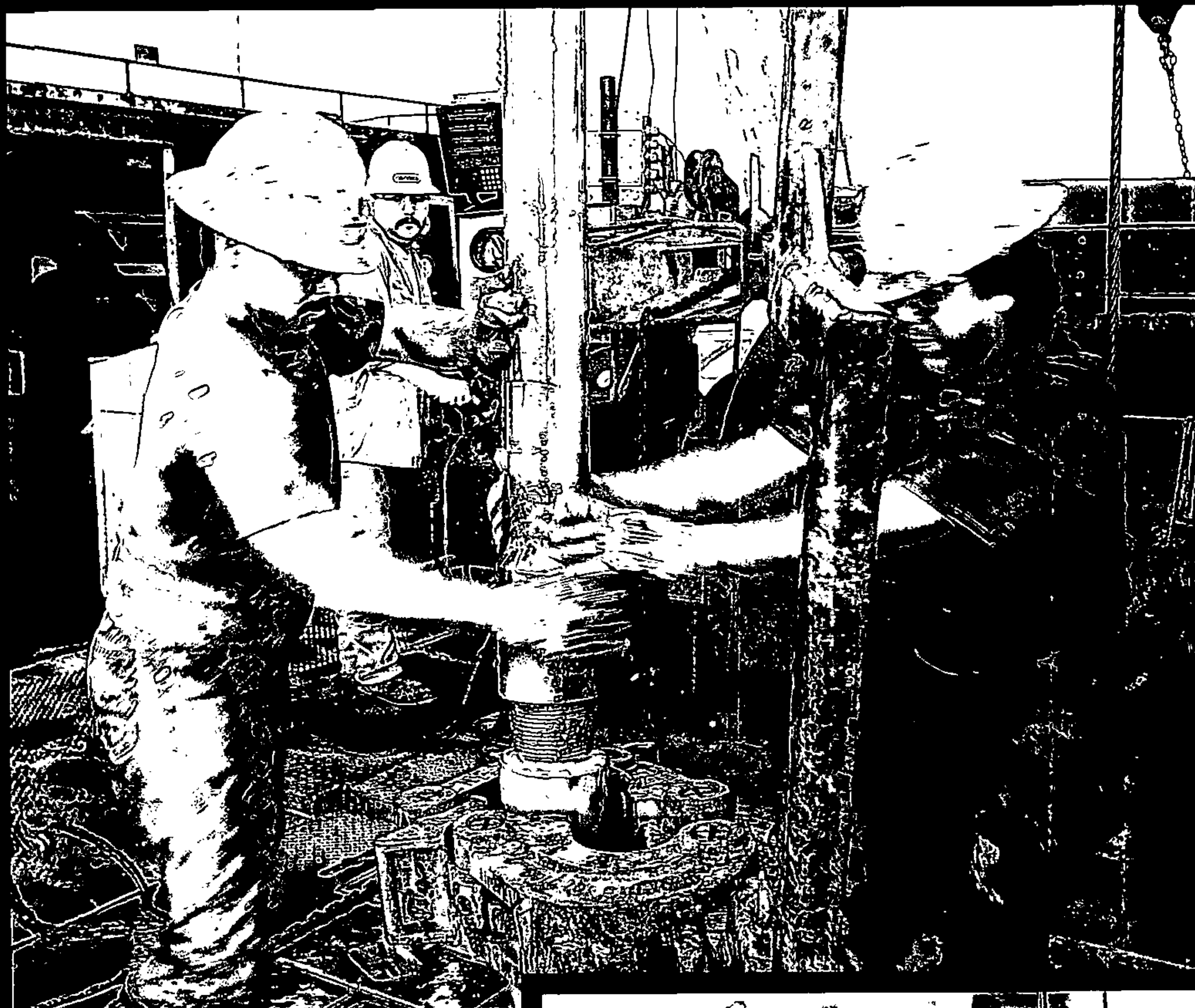
In 1992, E&P began an aggressive effort to upgrade its asset portfolio. Over the last six years, we reduced by nearly 65 percent the number of producing fields in which Conoco holds an interest. At the same time, we increased worldwide production by 9 percent, boosted reserves by nearly 60 percent and replaced 176 percent of our production.

We're also finding and developing new reserves more economically – reducing those costs from about $7 per barrel-of-oil-equivalent (BOE) in 1992 to $4 in 1998, using a five-year average.



DRILLSHIPS | Our new ultra-deepwater drillships, built in partnership with R&B Falcon, are capable of drilling in waters 10,000 feet deep. This ensures Conoco's access to our deepwater holdings in the Gulf of Mexico and other parts of the world. Our deepwater acreage position is the industry's largest on a global basis and the seventh largest in the Gulf of Mexico.

Designed to be the safest and most technologically advanced drillships in the world, *Deepwater Pathfinder* and *Deepwater Frontier* use satellite and ocean-bottom positioning systems to remain precisely in position, even in harsh weather. These double-hulled ships have triple redundancy of critical operating and safety systems.



LOBO | In 1997, Conoco purchased $929 million in natural gas-producing properties and transportation assets in the Lobo trend of South Texas — our largest acquisition in 30 years. Since the purchase, we've drilled more than 200 wells, achieving a 90 percent success rate. This enabled Conoco to increase total Lobo gas production from about 510 MMCFD at year-end 1997 to 750 MMCFD at year-end 1998. This success, coupled with an active leasing program that increased our Lobo acreage by 30 percent, has made Conoco the largest natural gas producer in the area and the second largest gas producer in Texas.

Above: Conoco had more than a dozen drilling rigs operating simultaneously in the Lobo trend in 1998. *Right:* To accommodate additional production, the company is expanding the Lobo pipeline system.

"We've made great progress," says McKee. "But improving our performance must be an ongoing effort if we are to achieve earnings growth, even in a difficult price environment." To continue to improve, the Upstream organization will be restructured in 1999 to become even more focused, competitive and cost-efficient.

Low Prices Weaken Earnings;
Production and Reserves Climb

Upstream's earnings before special items were $491 million in 1998, down 33 percent from 1997 mainly because of lower crude oil and natural gas prices. Earnings benefited from increased natural gas production and lower exploration costs.

Total worldwide production (excluding natural gas liquids from gas plant ownership) rose about 2 percent in 1998 to 213 million BOE. The increase was due to a 17 percent rise in worldwide natural gas production. In 1999, we plan to increase production about 10 percent over 1998, bringing us closer to our goal of industry leadership in production growth.

For the sixth consecutive year, Conoco replaced more reserves than were produced. In 1998, we replaced 110 percent of our oil and natural gas production. At year-end 1998, reserves were at 2.6 billion BOE – the highest level in 20 years and up 21 million BOE from 1997.

Upstream Projects Around the World

The Americas

In 1998, we increased our acreage position in the deepwater Gulf of Mexico – one of the world's most promising energy frontiers. At year-end, Conoco owned an average 70 percent interest in nearly 300 deepwater blocks, where depths range from about 1,200 feet to just over 10,000 feet.

Our new ultra-deepwater drillships will be a great advantage in cost-effectively evaluating this and other deepwater acreage. The *Deepwater Pathfinder* went into service in January 1999 and is committed to a five-year exploratory drilling program in the Gulf of Mexico.

Ursa Tension Leg Platform Installed

Another milestone in the Gulf of Mexico was the installation of a tension leg platform (TLP) in the Ursa field. Conoco has a 16 percent interest in the $1.5 billion project, which is expected to come onstream in the first quarter of 1999. Located in approximately 3,900 feet of water, the Ursa platform is the deepest TLP in the world. By 2001, peak production from the Ursa field is expected to reach 150,000 barrels per day of petroleum liquids and 400 million cubic feet per day (MMCFD) of gas.

Growth in Gas Business Continues

Expanding our natural gas business is an important part of our growth strategy. In 1997, we purchased extensive natural gas assets in the Lobo trend of South Texas and have substantially increased production there (page 10). In the future, we expect higher production from these operations, as well as from our gas assets in Appalachia.

Seeking Additional San Juan Reserves

Conoco is one of the largest producers of natural gas in the prolific San Juan Basin of New Mexico. We believe additional hydrocarbons may lie below the basin's traditional producing formations. In 1998, we conducted a 300-square-mile 3-D seismic survey covering the most promising deep areas of the basin.

Pocahontas Gas Project Expanding

In 1999, the Pocahontas Gas Partnership – a 50-50 partnership between Conoco and Consol Energy Inc. – will greatly expand coal-bed methane production in conjunction with ongoing mining operations in southwestern Virginia. In 1999, we'll drill up to 75 wells and expect total gas production to reach 40 MMCFD.

The partnership has also invested in a new 20-inch-diameter, 30-mile pipeline gathering system that in late 1998 began delivering gas from the Pocahontas project to the interstate gas pipeline grid in West Virginia.

Canada Discoveries to Come Onstream

Conoco has major interests in gas properties and processing assets in the eastern foothills of the Canadian Rockies. In 1999 and 2000, we plan to bring two more discoveries onstream, bringing our total number of producing fields in the foothills to seven.

Phoenix Park Increasing Capacity

Phoenix Park Gas Processors Ltd., a natural gas processing operation in Trinidad and Tobago, is doubling the capacity of its plant to 1,400 MMCFD of gas. Conoco has a 39 percent interest in the facility. The plant also is increasing its capacity to separate gas liquids to

33,000 barrels per day, and is adding more storage and marine export facilities. The project should be completed in the first half of 1999, creating a focal point for the extraction and marketing of natural gas liquids throughout the eastern Caribbean.

First Production Achieved at Petrozuata

At the Petrozuata venture in Venezuela, production of extra-heavy oil began in August 1998 (page 13). The 35-year, $2.4 billion project is the first joint venture in more than 20 years between PDVSA, Venezuela's national oil company, and an international partner to develop Venezuelan crude oil for export. Conoco has a 50.1 percent interest in the project. At its peak, Petrozuata is expected to produce 120,000 barrels of extra-heavy crude oil per day (BOPD). Starting in 2000, the extra-heavy crude will be upgraded to a higher-value synthetic crude oil that will be used as feedstock at refineries operated by Conoco and PDVSA.

Exploration Under Way in Latin America

Conoco is establishing a strong presence in Latin America, one of the Western Hemisphere's most exciting petroleum provinces. Our Petrozuata project in Venezuela will anchor our growth in the region, which will be focused in northern South America and the Caribbean.

In 1998, Conoco completed a seismic survey in the shallow-water Gulf of Paria West block in Venezuela. In northwestern Colombia, seismic surveys have been conducted on three tracts in which we have a 50 percent interest. In Trinidad, we completed seismic surveys on two large, prospective offshore blocks. Exploratory drilling continues in Venezuela, Colombia and Trinidad.

Conoco also is continuing an evaluation of the hydrocarbon potential of the offshore Barbados area, where our deepwater expertise will be utilized to drill any significant prospects.

Europe

Conoco's producing assets in the United Kingdom, Norway and Russia contributed nearly 250,000 BOE per day to our worldwide production in 1998, with the majority from the U.K. and Norway. We have significant growth prospects in each of these countries, and are applying innovative technology to new and existing fields to cost-effectively maximize production. We're also working to strengthen our natural gas business throughout Europe.

Natural Gas Business Expanding

In the U.K. North Sea, the Britannia gas / condensate development began commercial sales in 1998 (page 14). Production in 1999 is expected to be slightly above previous forecasts. Conoco has a 42 percent interest in the field, which has the capacity to supply up to 8 percent of the U.K.'s gas requirements at peak production.

In the southern North Sea, we're using innovative approaches to extend the life of the prolific Viking field, in which Conoco holds a 50 percent interest. The field has already yielded 2.8 trillion cubic feet (TCF) of gas during its quarter-century of production.

In 1998, we acquired additional interests in several southern North Sea gas fields, including 7.9 percent in Vulcan and 12.5 percent in Valiant (both of which Conoco operates). This brought our interest to 50 percent in each of the fields. We also acquired a 30 percent interest in Caister.

A key part of our European gas strategy is to use our 10 percent share of the newly commissioned Interconnector pipeline (which links the United Kingdom and continental Europe) to expand gas distribution across Europe. In 1998, we became the first Interconnector owner to fill its share of pipeline capacity.

Creating Value From Smaller Fields

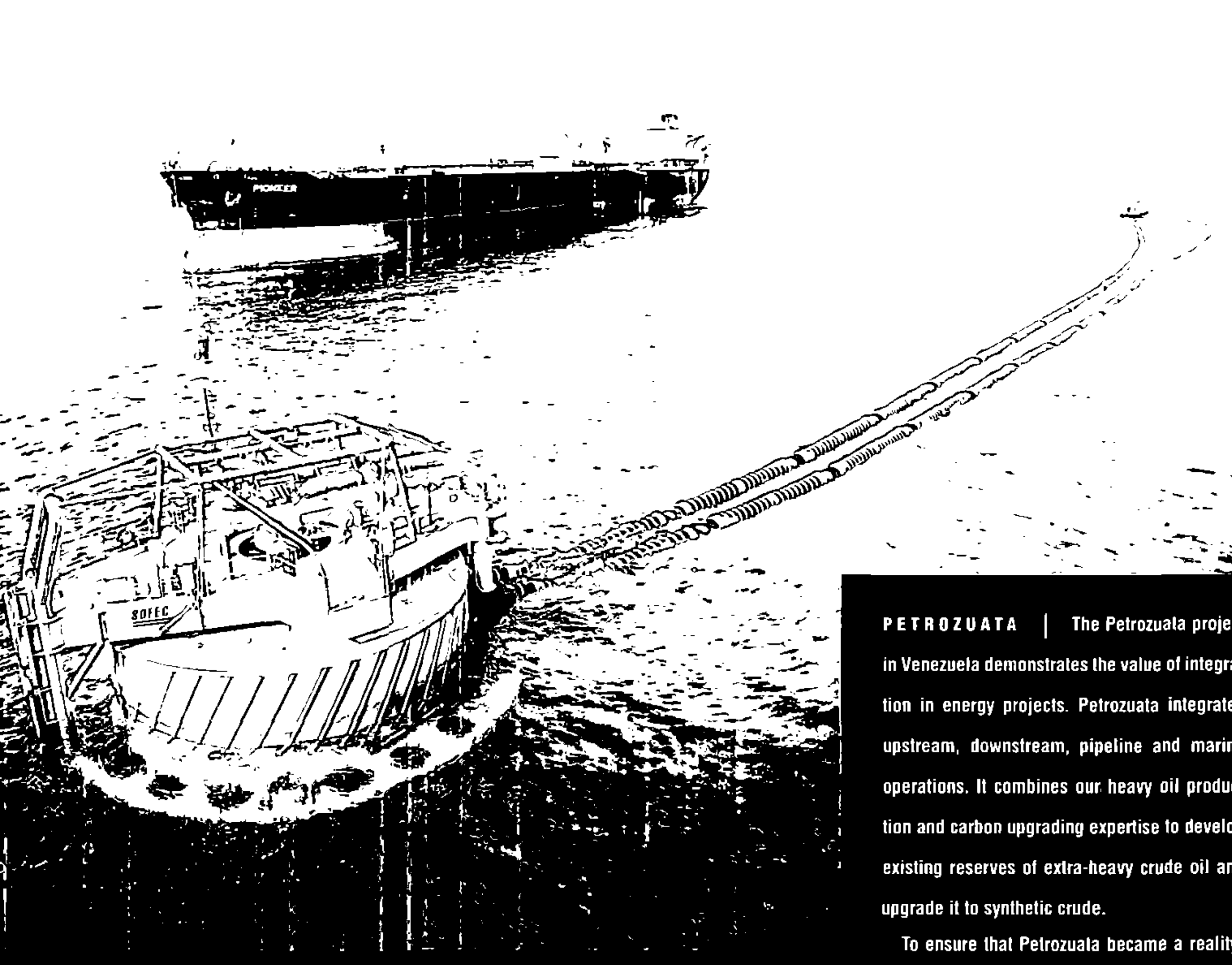
We completed development of the Boulton gas field in the southern North Sea in 1998, achieving first gas ahead of schedule and using an unmanned platform. The platform was fabricated and installed in only 10 months, compared with a more typical construction period of nearly two years. Conoco owns a 46 percent interest in Boulton.

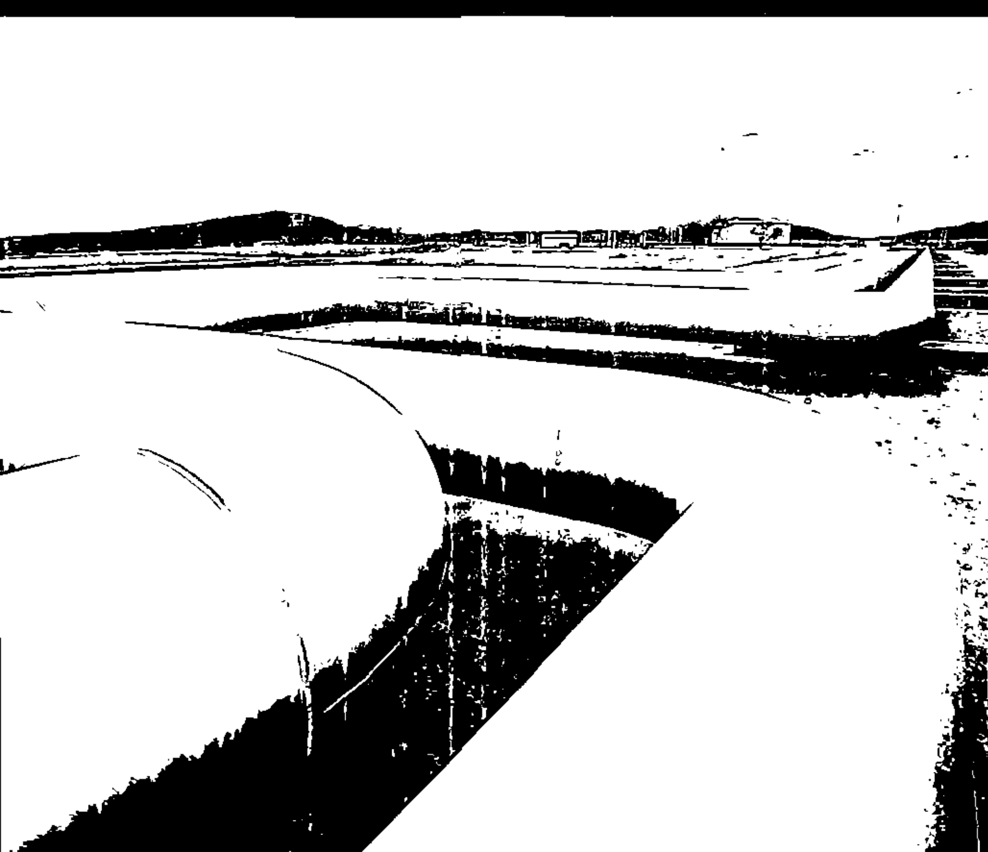
In addition, the Banff field was developed in two years using a unique floating production, storage and offtake (FPSO) vessel, which provides several advantages over conventional tanker-shaped FPSOs. Conoco has a 32 percent interest in Banff.

Pursuing Opportunities in the Atlantic Margin

West of the Shetland Islands, Conoco and our partners are evaluating a well drilled in 1998 on one of two high-potential deepwater blocks that are adjacent to existing production.

Conoco also holds a 21 percent interest in the Clair discovery, one of the largest undeveloped oil discoveries in western Europe.





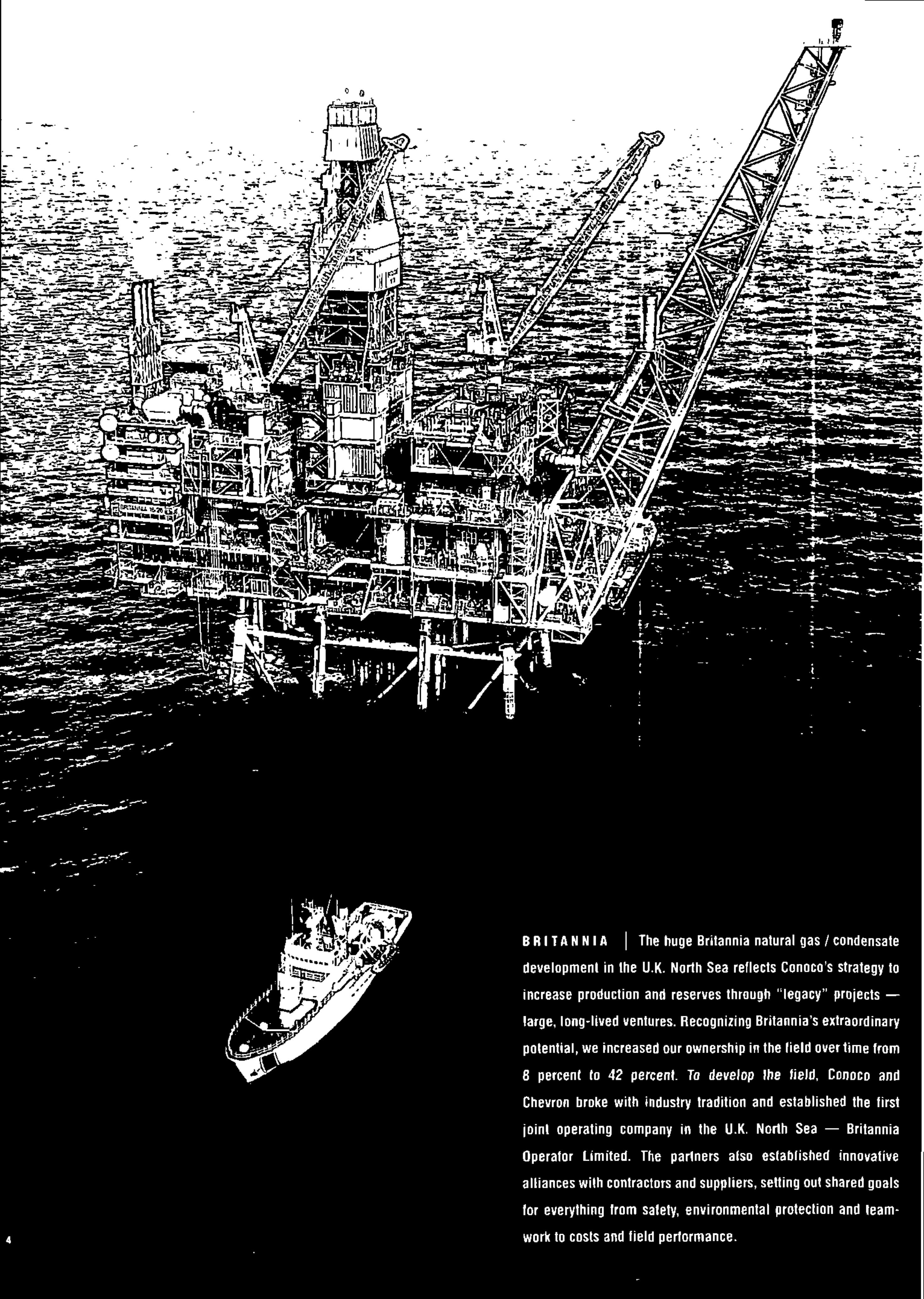
PETROZUATA | The Petrozuata projec in Venezuela demonstrates the value of integra tion in energy projects. Petrozuata integrate upstream, downstream, pipeline and marin operations. It combines our heavy oil produc tion and carbon upgrading expertise to develo existing reserves of extra-heavy crude oil an upgrade it to synthetic crude.

To ensure that Petrozuata became a reality the company secured $1.5 billion in projec financing – the largest ever in Latin America.

In 1998, Conoco and its partner, PDVSA (the national oil company of Venezuela), bega early production of extra-heavy oil. By year-end 1999, 100 wells should be producing o completed. Starting in 2000, Petrozuata's extra-heavy oil will be processed into synthetic crude by a $1 billion upgrading facility unde construction in Venezuela.

With its huge reserves, Petrozuata is expected to produce at steady rates for 35 years or more.

Above: The double-hulled Conoco tanker *Pioneer* takes on a cargo of blended heavy crude oil at the new Petrozuata monobuoy. *Left*: A new pipeline system carries crude oil from the production area to Venezuela's northern coast.



BRITANNIA | The huge Britannia natural gas / condensate development in the U.K. North Sea reflects Conoco's strategy to increase production and reserves through "legacy" projects — large, long-lived ventures. Recognizing Britannia's extraordinary potential, we increased our ownership in the field over time from 8 percent to 42 percent. *To develop the field,* Conoco and Chevron broke with industry tradition and established the first joint operating company in the U.K. North Sea — Britannia Operator Limited. The partners also established innovative alliances with contractors and suppliers, setting out shared goals for everything from safety, environmental protection and teamwork to costs and field performance.

Strong Performance and Growth in Norway

Conoco is the sixth largest oil producer in Norway. In addition to equity ownership in the Statfjord, Heidrun and Troll fields (offshore Norway), Norske Conoco has ownership in pipelines that transport our Norwegian gas to shore. We also own a world-class, double-hulled oil tanker that has serviced the Heidrun and other North Sea fields since 1995.

During 1998, we increased our ownership in the giant Statfjord field to more than 15 percent for the U.K. and Norway sections combined, becoming the largest non-Norwegian stakeholder in the field. Production from Statfjord and its satellites exceeded 450,000 BOPD in 1998.

We also have an 18 percent interest in the Heidrun oil and gas field, again making Conoco the largest non-Norwegian holder. Heidrun produces about 200,000 BOPD, and the Heidrun North Flank is now being developed.

Conoco has a small but valuable interest in the huge Troll gas field, where total field production was 740 billion cubic feet (BCF) of gas in 1998 and is expected to increase in 1999. Development of an oil reservoir at Troll continued during the year.

Conoco also participated in several new development projects that will be brought onstream in 1999, keeping us on a production growth path in Norway.

Russia Holds Long-Term Potential

We believe Russia could become an increasingly important producing area for Conoco in the next century. Currently, we hold a 50 percent direct interest in the Polar Lights Company, the first Russian-American joint venture to develop a new field in the country. Polar Lights operates the Ardalin field, located 1,000 miles northeast of Moscow in the Timan Pechora region.

Conoco and Lukoil, the largest oil company in Russia, are pursuing development of the 1.2-million-acre Northern Territories block, located immediately northwest of the Polar Lights operating area.

Africa and Asia

Expanding in Nigeria

Offshore Nigeria is another oil province that could contribute significantly to our long-term growth. In 1998, Conoco drilled its second exploration well in Nigeria's deep waters. The results are currently under evaluation.

In 1997, the company brought the shallow-water Ukpokiti field onstream using a converted Conoco tanker as a floating production, storage and offtake vessel. Production, achieved ahead of schedule and well below budget, is at 20,000 BOPD. Conoco has a 90 percent revenue interest in the field.

Indonesia Reserves to Be Developed

Conoco has had a major presence in Indonesia for 30 years and currently operates the Belida and Sembilang fields in Block B of the West Natuna Sea. Conoco owns a 40 percent interest in the block. We're now expanding our presence through an agreement to supply about 1 TCF of Indonesian natural gas from the block to Singapore.

By 2001, Conoco and its partners will construct a 300-mile subsea pipeline and begin delivering 325 MMCFD of gas to Singapore. Conoco will be the pipeline operator. This world-class project sets the stage for long-term growth of our natural gas business in the region, and reflects our skill in turning promising ideas into value-creating businesses.

Deepwater Drilling Planned in New Zealand

In 1999, we plan to use our second deepwater drillship, *Deepwater Frontier*, for an exploration well on the 440,000-square-mile Northland block offshore New Zealand. This follows the most extensive seismic data acquisition survey ever conducted in New Zealand, which identified several promising prospects.

Vietnam Exploration Contract Signed

Conoco and its partners signed a petroleum contract in 1998 for Block 15-1 offshore Vietnam. Exploration is expected to begin in 1999. Conoco holds a 23.25 percent interest in the block.

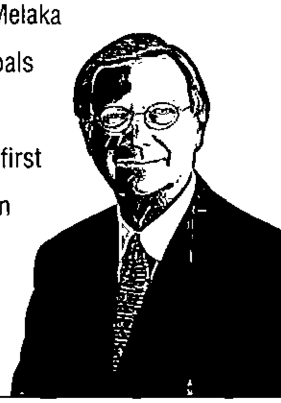
"Today, there are more exciting opportunities in the Upstream business than ever before," says E&P's Rob McKee. "New technology and tools, such as our deepwater drillships, are paving the way for promising ventures that weren't possible just a few years ago. Our challenge will be to selectively invest in the very best projects – those that will create maximum value for our shareholders."

Operating Improvements Drive Strong Results

"Refining, Marketing, Supply and Transportation (RMS&T) had another year of solid financial performance in 1998. Earnings before special items were $376 million – an outstanding performance that reflects the work we've done in recent years to achieve sustainable, continuous improvement. As a strong cash generator, Downstream is playing an important role in funding Conoco's global growth. A highlight of the year was the completion of the new Melaka refinery in Malaysia. This world-class facility is a major step toward one of Conoco's strategic goals – to establish substantial refining capacity in Asia Pacific.

The 'face' of Conoco that most people see is our retail outlets. We want to be the motorist's first choice for fuel and convenience products, wherever we market. So we're upgrading our outlets in the U.S. and Europe with a brighter look and a wider range of products and services, changes we believe will keep customers coming back again and again."

— **Gary Edwards,** RMS&T Executive Vice President



Downstream Highlights

Melaka Propels Asia Pacific Growth

The 40-percent-owned Melaka refinery will anchor our growth in Asia Pacific's emerging markets in the years ahead (page 17). Over time, we plan to distribute the majority of our share of the refinery's output through our expanding retail network in Thailand and planned marketing operations in Malaysia and elsewhere in the region. With Melaka now in operation, in 1999 RMS&T will focus on continuing to build new businesses in Asia Pacific, as well as pursuing its other two key strategies – to improve, and to selectively grow, our core businesses in North America and Europe.

Dramatic Improvement Sustained

RMS&T has substantially improved its financial and operating performance since 1992, when we undertook a major restructuring of the business. Earnings in 1998 were 60 percent higher than in 1992, even though industry refining margins were as much as 50 percent lower in some regions. Over that period, our refinery throughput rose 24 percent and unit costs were cut by a third.

Looking at 1998, company refineries – operating reliably and efficiently at 95 percent of capacity (on average, excluding Melaka) – processed a record 731,000 barrels of crude oil and condensate per day. This, along with higher marketing margins and lower feedstock and operating costs, contributed to RMS&T's outstanding financial results. In Europe, an important effort is getting under way to upgrade our refineries to produce cleaner fuels, in some cases meeting standards that won't be required until 2005. This is good for the environment, and it also allows Conoco to capture certain tax advantages.

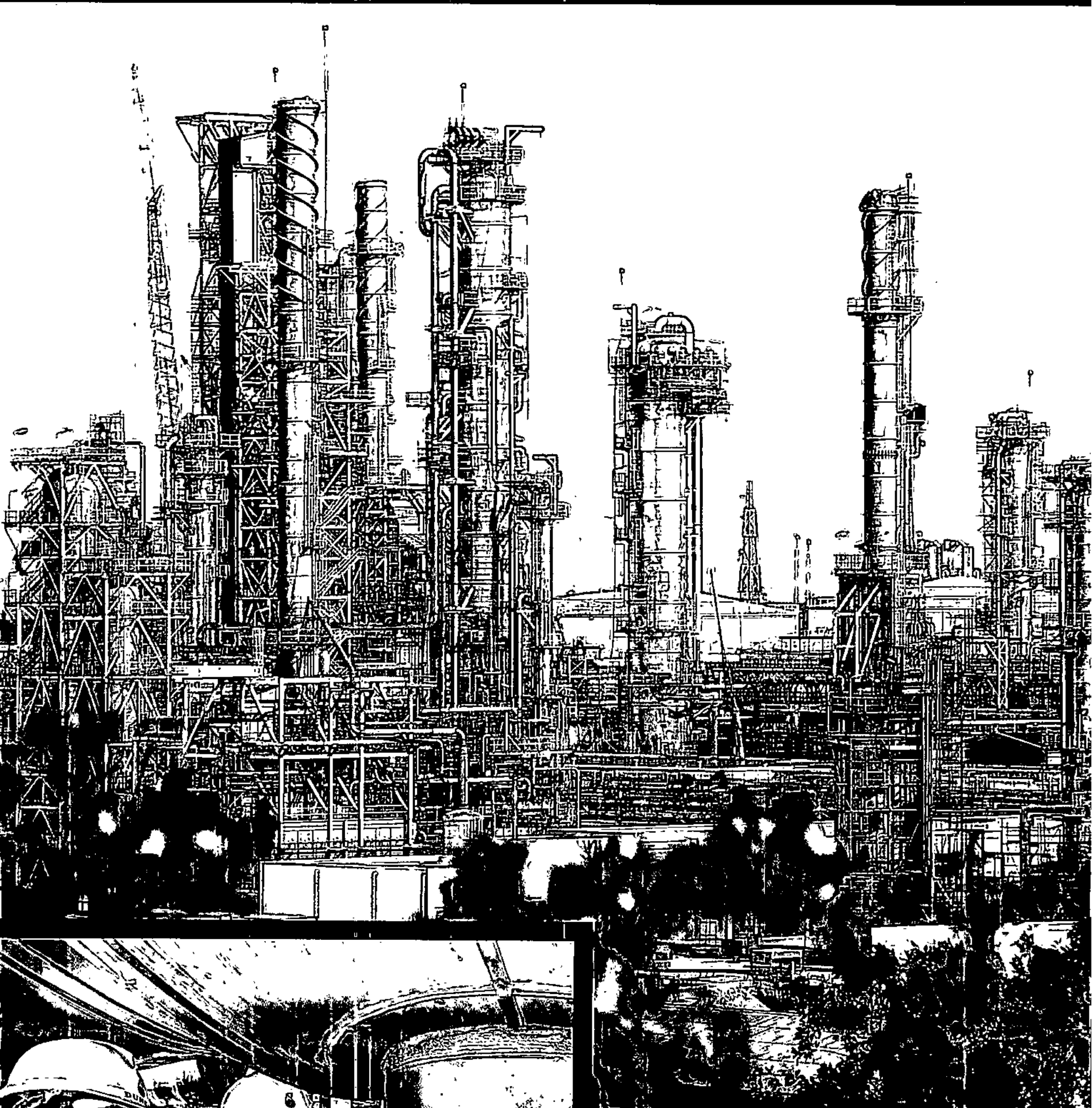
In Marketing, sales volumes of fuels, lubricants and specialty products remained strong despite decreased demand in some markets. We're also working to make customers more aware of the global scope of Conoco's business by displaying our corporate logo alongside our regional brands at 2,900 retail outlets in Europe and Asia Pacific. This will further strengthen the value of the Conoco brand.

In our marine operations, we reached our goal of having a 100-percent double-hulled tanker fleet in U.S. waters. This beat our own target by over a year, and preceded the U.S. government mandate by more than a decade.

Downstream Projects Around the World

North America

In North America, we strengthened our refining, marketing and transportation operations; grew specialty products through aggressive marketing of new and innovative products; and continued our



MELAKA | The new 100,000-barrel-per-day Melaka refinery in Malaysia is one of the most sophisticated and complex facilities in Asia. It is operated as a joint venture of Conoco, Petronas (the Malaysian national oil company) and Statoil (the Norwegian national oil company). One of the refinery's competitive advantages is its use of Conoco's proprietary delayed coking technology to maximize production of diesel fuel, which is in high demand in the region.
Left: Conoco's Duncan Wohlgenant, plant manager (left), and Harlan Graf, unit manager, inspect piping on a process vessel during Melaka's construction.

Above: An extra dose of "Conoco Red," along with enhanced lighting and other image improvements, is brightening up Conoco-branded outlets in the United States.

Right: Fresh fruit is one of the distinctive offerings at our new-generation *breakplace* convenience stores.

Far right: A dynamic new image for all Conoco retail outlets in Europe was introduced in Germany in 1998. The addition of the Conoco logo at stations in both Europe and Asia Pacific will enhance our marketing presence.

leadership in carbon upgrading by expanding the licensing of our proprietary coking technology.

Refineries Increase Throughput

In refining, our four U.S. facilities – at Lake Charles, Louisiana; Ponca City, Oklahoma; Denver, Colorado; and Billings, Montana – improved efficiency and reliability, setting monthly throughput records. Three of the four refineries set annual records.

New Image, Approach Attract Customers

In retail marketing, Conoco introduced an enhanced image featuring brighter exterior lighting and improved signage to draw customers. Company-owned outlets now sport the new look, and about one-third of our independent Conoco-branded marketers have adopted the image. We expect the entire U.S. network of 4,900 outlets to be transformed over time.

Conoco marketers also are targeting frequent convenience store customers, whom we call "convenience connoisseurs." Our *breakplace* convenience stores are designed to meet the high expectations of these customers by offering a wider range of products and an exceptional level of personalized service. "Fresh" is the word at these stores – fresh fruit, fresh-baked pastries and fresh coffee brewed every 30 minutes. In 1998, Conoco and its independent marketers opened 26 *breakplace* stores in Colorado, Tennessee, Oklahoma and Missouri, bringing the total to 34.

At Conoco's Houston headquarters, where our U.S. pipeline network is controlled, a new computerized pipeline control and leak detection system is being installed. Beginning in mid-1999, this advanced system – which is Y2K-compliant – will improve operating efficiency, while providing state-of-the-art safety and environmental protection for the millions of barrels of crude oil and refined products we move.

Europe

Top-Quartile Refineries Anchor Operations

Conoco's European downstream operations are anchored by the Humber refinery in the United Kingdom and our 18.75 percent interest in the MiRO refinery complex in Germany. In 1996, both of these facilities ranked in the top quartile of Western European refineries for financial and operating performance, according to Solomon Associates, an independent benchmarking company.

At Humber, we continue to increase our ability to process less expensive acidic North Sea crude oils. That capacity is now up to 80,000 barrels a day. At MiRO, improvements increased production of gasoline, diesel fuel and propylene.

Upgrades Under Way at Czech Refineries

Conoco also owns an equity interest in two refineries in the Czech Republic. In keeping with our strategy to continuously upgrade our investments, two projects are under construction to increase production of high-value light oils at these facilities. Our Czech refining capacity provides a secure source of supply for the expansion of our retail marketing activities in Central and Eastern Europe.

Marketing Networks Expand

We now have 126 outlets in Slovakia, Poland, Hungary and the Czech Republic, and are continuing to grow. We're also expanding our relatively new joint-venture marketing operations in Spain and Turkey, while continuing to selectively increase Conoco's presence in our established markets.

In response to the increasing political and economic ties between countries of Western Europe, as well as the opening of markets in other parts of Europe, we've developed a common retail marketing image for all of Conoco's European outlets. This bright look with its dynamic logo was well received at Conoco / Jet-branded outlets in Germany, following its introduction in 1998.

Asia Pacific

Thai Outlets Pace the Industry

The new Melaka refinery and our established retail marketing business in Thailand are the foundation for Conoco's aggressive growth plans in the Asia Pacific region.

The company opened 25 new Conoco / Jet retail outlets in Thailand in 1998, bringing the total to 100. Despite the volatile Asian economy, we increased both pump volumes and convenience store revenues. In fact, Conoco's outlets have the highest sales volumes in Thailand, according to industry data.

First Malaysia Stores to Open

In 1999, we'll begin retail marketing operations in Malaysia through a joint venture with Sime Darby, a Malaysian company. The venture will market motor fuels under the Projet brand. The design of our outlets will emulate the colorful and spacious image that's been so well received in Thailand, but with a Malaysian architectural flavor. The Conoco-Sime Darby venture will be only the eighth petroleum products marketer allowed into Malaysia.

Specialty Products

Leading the Pack in Coking

Conoco is a world leader in the production of high-quality petroleum coke products, used in making steel, aluminum and titanium dioxide. In 1998, we sold 1.4 million tons of these high-value products, manufactured primarily at the Lake Charles and Humber refineries. We maintain our industry leadership by establishing close working relationships with major customers.

We are also a leader in licensing delayed coking technology, which converts low-value, bottom-of-the-barrel crude oil residuals into higher-value petroleum products, such as diesel fuel and gasoline. Today, our coking process is used by more than two dozen facilities – representing one-third of the world's delayed coking capacity. In 1998, we licensed Conoco's technology to seven additional cokers operated by other companies, including Exxon and Phillips.

Technology Spurs Growth in Lubes

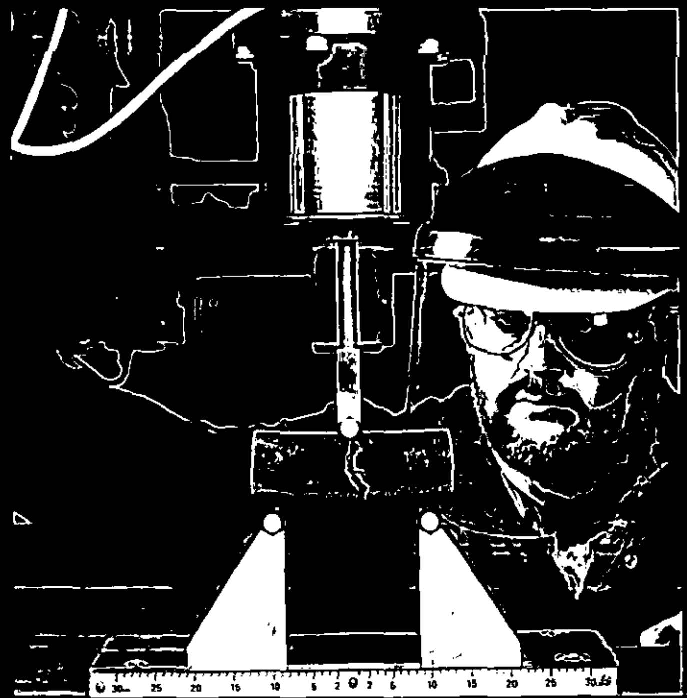
The hydrocracker at Lake Charles, a 50-50 joint venture with Pennzoil-Quaker State, manufactures a high-quality lubricant base oil. In its second full year of operation the facility turned in a stellar performance. During the last half of 1998, production volumes were 10 percent above design capacity.

The crystal-clear base oils manufactured by the hydrocracker are the basis of our extensive line of hydrocracked consumer and industrial lubricants. Our Hydroclear brand premium lube oils cost less to produce than synthetic lubricants, yet offer many of the same benefits, and they have won several industry awards for quality. New segments of the lube oil market are now being targeted for the sale of Hydroclear products, including the fleet, industrial and construction industries.

Flow Improvers Gaining Market Share

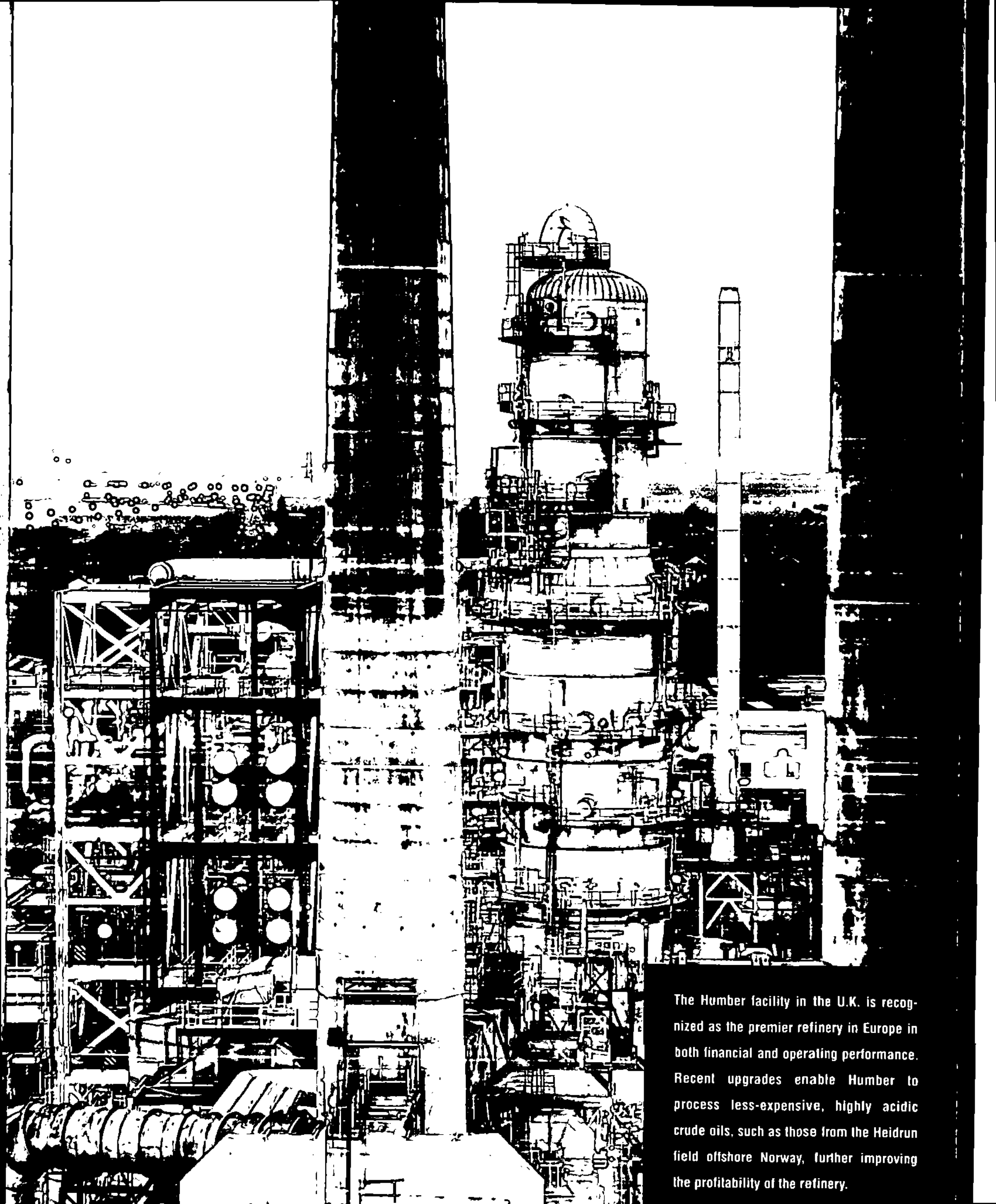
Another specialty product rapidly gaining market share is LiquidPower flow improver, which increases the efficiency of pipelines. In 1998, ArcticPower, a variation formulated for the arctic environment, was first used in the Trans-Alaska Pipeline System.

"Our industry-leading technology and world-class facilities, combined with strong profit margins, make specialty products an important part of Downstream's growth strategy," says RMS&T's Gary Edwards.



At the company's research facility in Ponca City, Oklahoma, Anthony Biddinger, associate research technician, tests the strength of a core section from an anode made of petroleum coke. Full-size anodes, which weigh about one ton, are subjected to extreme heat during the aluminum manufacturing process.

Mary Graham, research associate, blends an additive with Conoco's new Pure Performance hydrocracked lubricant base oil at the research center. The beaker in the foreground shows the exceptional clarity of the base oil.



The Humber facility in the U.K. is recognized as the premier refinery in Europe in both financial and operating performance. Recent upgrades enable Humber to process less-expensive, highly acidic crude oils, such as those from the Heidrun field offshore Norway, further improving the profitability of the refinery.

The 440-megawatt power plant being constructed by Conoco Global Power near Corpus Christi, Texas, is one of the largest generating projects undertaken in the U.S. in 1998. The plant will provide electricity to two area chemical complexes. A similar project is under development near Orange, Texas. Conoco has started up plants in the Netherlands and Colombia, and four more projects are under development in Europe.

Growing Power Business Provides Energy Solutions

Conoco entered the electric power business in 1995 with three objectives – to offer our customers integrated energy solutions, to provide the company with business diversification, and to capitalize on our strengths in managing major growth projects and industrial operations. We're achieving these goals by focusing on projects that combine our fuels and industrial cogeneration expertise. These skills differentiate Conoco from our competitors and give us a strong business advantage.

"We intend to make Power a profitable business segment as rapidly as possible, and have already developed two power plants that are now onstream, one in Colombia and one now owned by DuPont in the Netherlands. A third is under construction in Texas and we're finalizing plans for five more projects," says Ron Walsh, president of Conoco Global Power. "Our intention is to grow in the United States and Europe, as well as in developing countries where the demand for energy is increasing at a rapid pace."

North America

New Power Generation Units Spur Expansion

In the U.S., deregulation of the utility industry and increasing demand for electric power are creating attractive investment opportunities. As a major natural gas and fuel coke producer with expertise in power generation, Conoco is well-positioned to capitalize on these developments.

In 1998, Conoco Global Power (CGP) focused on industrial energy ventures with DuPont. Construction began on a 440-megawatt, gas-fired cogeneration facility at Ingleside, near Corpus Christi, Texas, a 50-50 joint venture between Conoco and OxyChem. This plant, which will provide power and steam to nearby DuPont and OxyChem chemical complexes, should be completed during the third quarter of 1999.

Conoco will serve as fuel supplier for the Ingleside plant, helping to maximize the value of our natural gas assets in South Texas, a prolific region where we are a leading gas producer.

Conoco and DuPont also have signed a letter of intent to construct a second 440-megawatt cogeneration plant on the Texas Gulf Coast. This facility will supply electricity and steam to a DuPont chemical facility at Sabine, near Orange, Texas.

We're working to rapidly develop, construct and operate new, world-scale natural gas- and coke-fired power generation facilities at Conoco locations and other industrial sites.

"With each new project, our goals are to optimize the use of Conoco fuels, reduce the cost of delivering energy to our customers, minimize emissions and deliver an excellent return on Conoco's invested capital," says Walsh.

Europe

Agreement Reached for New Projects

CGP has an agreement with DuPont to pursue development of gas-fired cogeneration units at chemical facilities in Spain, Luxembourg, Germany and the U.K. The four plants, with a total capacity of 510 megawatts, will provide electricity and steam for various DuPont operations. Conoco also will sell surplus electric power to other customers, including local utilities. Through fast-track development, all four plants are expected to be in operation by 2002.

CGP's focus in Europe is on expanding its role as a power generator for industrial customers, as well as finding ways to link power projects with our extensive natural gas assets in the North Sea.

Emerging Markets

Increasing Demand Provides Opportunities

One of CGP's business strategies is to expand the company's presence in emerging countries where the demand for electric power is growing rapidly. In mid-1998, we brought onstream a 160-megawatt gas-fired power generation plant in Barrancabermeja, in northwestern Colombia. The facility provides supplemental electric power to the local grid, especially during the dry season when output from the country's hydroelectric plants is reduced. We're also pursuing opportunities for another 1,500 megawatts of generating capacity linked to Conoco's fuels and business development initiatives in Asia, Latin America and the Middle East.

Living By Our Core Values — Every Day

At Conoco, everything we do is guided by our core values of safety, environmental stewardship, valuing all people and maintaining high ethical standards. These core values are woven into our culture. They are fundamental to sustainability and to *our vision of being recognized around the world as a truly great company.*

Conoco employees *live* our core values every day, everywhere we operate. Because of their dedication to treat all people with respect, operate in a safe, environmentally responsible manner and conduct our business with the highest ethical standards, Conoco is known around the world for its integrity and corporate citizenship.

We firmly believe that our excellent reputation makes us the partner of choice for both companies and governments, giving us a competitive edge in developing new business opportunities. Our core values are also fundamental to Conoco's "sustainability" – providing cost-effective energy to fuel global growth, while protecting the environment and contributing to the quality of life in the communities where we operate.

Within the company, one of the highest honors an employee can receive is a Conoco President's Award, which each year recognizes outstanding contributions in upholding our core values.

1998 Safety Performance Is the Company's Best

In 1998, Conoco's recordable injury rate was 0.3 injuries per 100 full-time employees, the lowest recorded in company history. We expect our safety performance to again lead the U.S. petroleum industry, as we have done in 10 of the last 15 years.

We believe Conoco has achieved this exceptional level of care because employees take personal accountability for their safety and the safety of their co-workers. They live by our safety motto: *"Our work is never so urgent or important that we cannot take time to do it safely."* These recent achievements reflect this commitment:

- In the Czech Republic, Conoco and its partners in the Czech Refining Company have reduced lost-workday injuries at two facilities by a remarkable 80 percent since the venture was formed in 1996.
- The 1,250 employees working in Conoco's refining and marketing operations in the United Kingdom experienced no lost-workday cases in nearly four years.
- Conoco has consistently earned awards from Britain's Royal Society for the Prevention of Accidents.
- Employees and contract personnel at Conoco-operated Dubai Petroleum Company in the United Arab Emirates implemented three significant facility upgrades on offshore platforms in 1998, involving thousands of employee-hours, without a single recordable injury.

Conoco Has Zero Significant Environmental Incidents

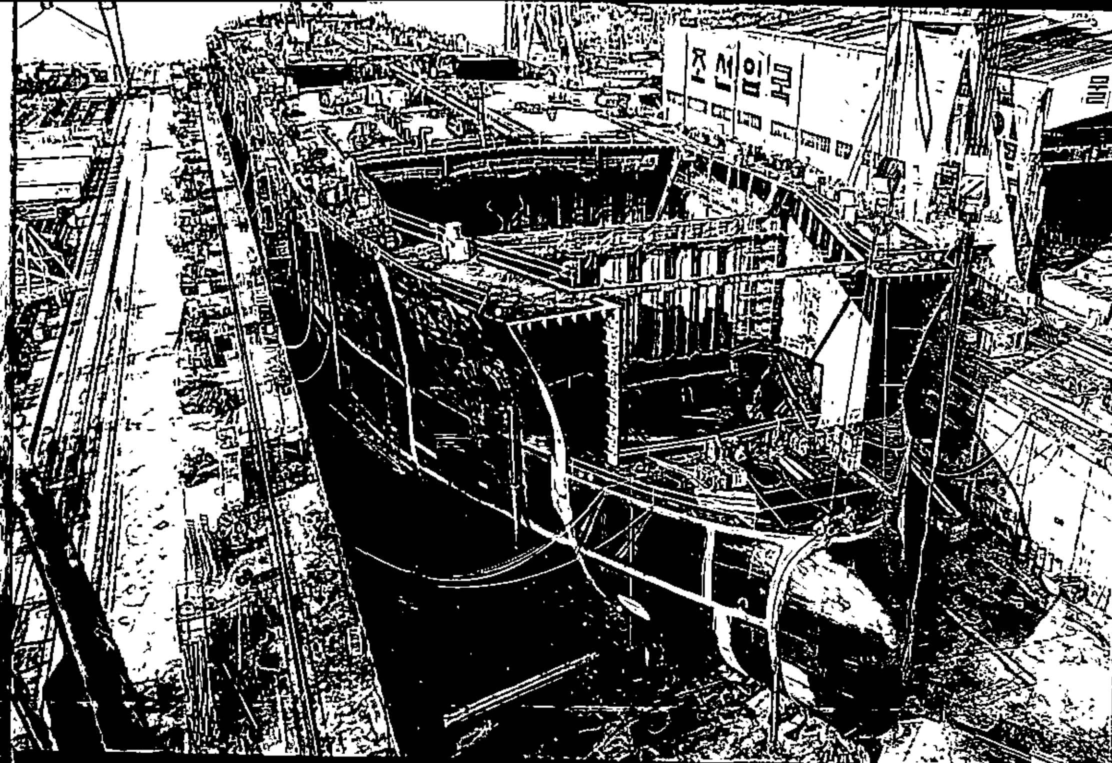
In 1998, Conoco's efforts to minimize the impact of our operations on the environment resulted in zero significant environmental incidents – a company record. "Significant" incidents are major releases or spills with the potential to affect our neighbors. Conoco's worldwide refining operations also achieved their lowest-ever level of emissions per barrel of oil processed.

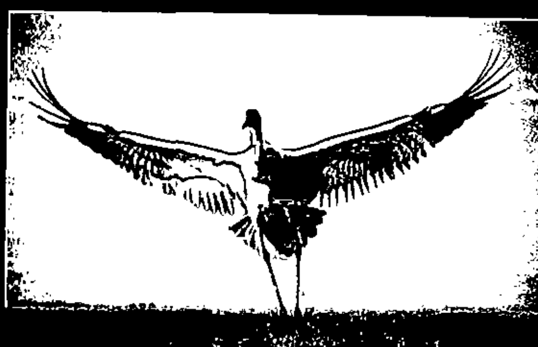
In mid-1998, we fulfilled a commitment that all Conoco tankers operating in U.S. waters would be double-hulled, a significant safeguard against an oil spill in the event of a collision. This achievement was completed years in advance of the U.S. government's deadline of 2015 and more than one year ahead of Conoco's self-imposed deadline, established in 1990.

Conoco also has converted its U.S. fleet of 14 tank barges to double hulls, and incorporated the protective design in our two new deepwater drillships.

Environmental highlights that demonstrate our commitment to sustainable development include:

- Conoco adapted and applied seismic technology that enables crews in the field to avoid environmentally sensitive areas, while reducing workers' exposure to hazardous terrain. The project received Conoco's 1998 President's Environmental Award.
- In the Russian Arctic, Conoco's 50-percent-owned Polar Lights joint venture introduced the use of an "ice pad," rather than conventional gravel, as the base for Russian drilling rigs. This innovative approach reduced by 95 percent the surface area needed for





Top: All of Conoco's tankers operating in U.S. waters now incorporate double hulls, which prevent or minimize environmental damage in the event of a grounding or other mishap. Both hulls are visible in this photo of a tanker under construction. The company's two new deepwater drillships, and two more tankers now being built, also feature this protective design.

Middle: The gray fox and the whooping crane are two of hundreds of species of wildlife making their home in the Aransas National Wildlife Refuge on the Texas Gulf Coast. Conoco has conducted exploration and production operations on the land for nearly 60 years, since before the refuge was established.

Below: Our safety philosophy is focused on preventing incidents that endanger people or threaten the environment. But to ensure that we are prepared for any situation, Conoco people around the world conduct regular drills to keep their response skills sharp. Here, employees practice containment techniques in an ice-covered river.

Above: When the company returned to the New York Stock Exchange, 15 employees representing Conoco's worldwide work force joined in the New York festivities. The employees, who won an IPO essay contest, are from left (front row to back): Lucie Melicharova, Czech Republic; Reesa Wilkes, Midland, Texas; Titie Wibipriatno, Indonesia; Mike Rooney, Venezuela; Sue Oldfield, Ponca City, Okla.; Carson West, Laredo, Texas; Amy Liu, Taiwan; Kemal Besikcioglu, Germany; Ludmila Shirshikova, Russia; Farhad Ghassemi, Dubai; Judy Dargis, Houston; Guy Putham, U.K.; Jens Helge Jenssen, Norway; John Gott, Billings, Mont.; and Chuks Ezeokafor, Nigeria.

Top right: In Nigeria, hundreds of students are learning about computers using equipment provided by Conoco and our local partner. The program aids 10 elementary schools and is coordinated by Tunde Folorunsho, of Conoco Nigeria Energy Limited (seen here wearing a Conoco hat).

Below right: These sea scouts in England were among the beneficiaries of a Conoco effort to completely recycle four North Sea platforms being taken out of service. In recycling 99 percent of the platforms' weight, the company donated the life boats to the scouting group. The achievement earned a Conoco President's Environmental Award.

drilling and cut development costs by a projected $14 million.

- With an investment of less than $200,000 in emissions-reducing equipment, our Canadian production operations cut their greenhouse gas emissions by more than 30 percent, significantly surpassing the 7 percent voluntary reduction sought by the Canadian government.
- Conoco was the driving force behind the 1998 establishment of the St. Andrews Prize and Seminar, an international initiative aimed at finding practical solutions to environmental problems. Conoco and the University of St. Andrews in Scotland are offering a monetary prize for the essay proposing the most useful new idea that addresses a timely environmental issue through a combination of good science, economic reality and political acceptability.

Valuing All People – A Powerful Advantage

As an international energy company, Conoco has an extremely diverse global work force. By drawing on the different perspectives and cultures of our employees, along with their combined knowledge and creativity, Conoco has a powerful business advantage around the world.

At Conoco, we strive to create an inclusive work environment that treats all people with dignity and respect, and encourages employees to express their ideas and develop to their maximum ability. This helps employees reach their personal career goals, while increasing their contributions toward achieving the company's objectives.

"In order to reach our ambitious business goals, we must have the committed involvement of the entire work force," says Mike Rocconi, senior vice president for Human Resources. "In Conoco, we reinforce our *valuing all people* commitment in many ways."

Conoco's strategic staffing and development process takes a long-term view. Employees and supervisors work together to identify actions employees can take to develop new skills in their current jobs, as well as setting a course for future development. The staffing process ensures that we are developing a globally diverse work force with the skills and talents to support our long-term business objectives.

Under the umbrella of "Conoco University," a wide range of programs have been designed to create and sustain a continuous learning environment within Conoco. This benefits the company and responds to skill gaps identified by the staffing and development processes.

Conoco University addresses a variety of critical development challenges, ranging from enhancing business literacy skills to first line supervisor training to developing visionary leaders at the executive level.

Conoco's performance management process integrates business plans with the pursuit of individual goals. Inherent in the process is accountability for not only achieving results, but doing so in a way that supports our core values and enables employees to develop new skills. Underpinning the process is a variety of reinforcement tools that support achievement and development.

In 1999, we introduced Total Shareholder Return as a significant metric in Conoco's global variable compensation programs, in which almost all employees participate. This creates a direct link between achieving business goals and rewarding employees.

Valuing all people also means respecting the concerns and striving to satisfy the expectations of customers, host governments and the communities in which we do business.

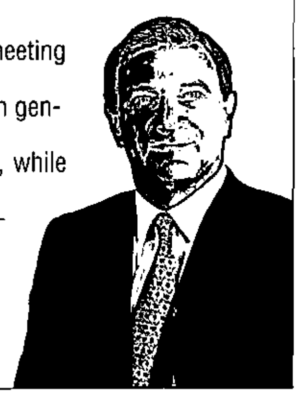
Volunteerism and community service are Conoco trademarks. For example, more than 900 employees at the company's Houston headquarters – joined by family members, retirees and company contractors – staff the annual Conoco Rodeo Run. In 12 years, this nationally recognized 10K race has raised more than $850,000 to fund scholarships for area students.

Strong Ethical Standards Guide Conoco

At Conoco, adherence to the highest ethical standards is a condition of employment. We have a formal ethics policy and established procedures for conducting business with integrity and in compliance with all applicable laws. Employees are required to review the policy and procedures regularly and complete an annual certificate of compliance. We also have a 24-hour telephone hotline that provides employees an avenue for seeking guidance on ethics issues or reporting possible problems.

To reinforce this core value, we have established a President's Award for Ethical Conduct. The award, which will first be presented in 2000, will honor employees or work groups whose actions exemplify the highest standards of ethical business behavior.

Financial Review



"Conoco has a proven track record of generating cash to fund operations and investments, while meeting our financial obligations and rewarding our shareholders. In the future, we will continue to focus on generating strong earnings from our operations and maintaining a very competitive capital structure, while growing our businesses around the world. This supports our commitment to provide Conoco shareholders with a superior return on their investment."

— **Bob Goldman**, Senior Vice President, Finance, and Chief Financial Officer

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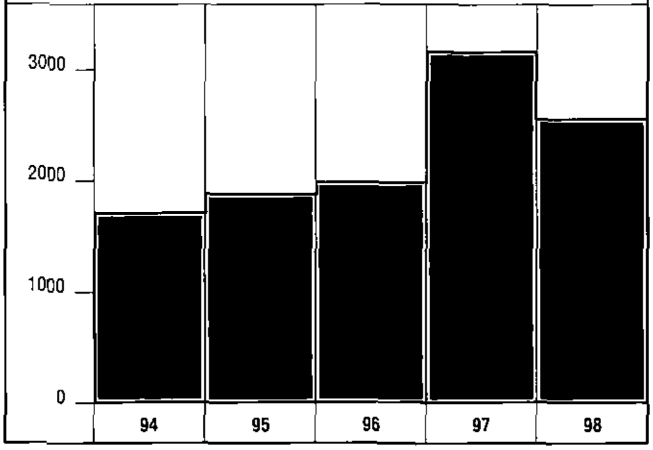
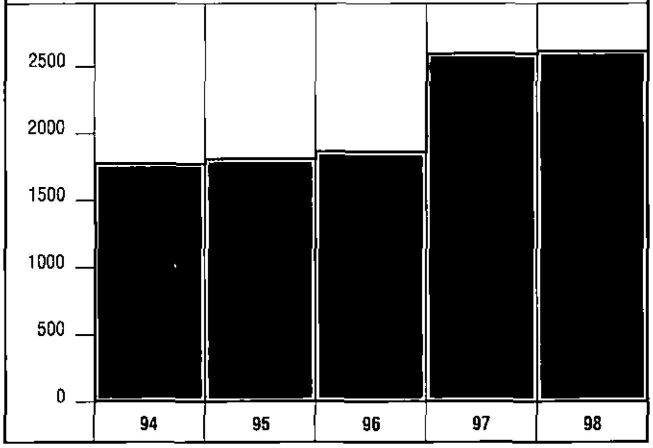
CAPITAL EXPENDITURES AND INVESTMENTS (MILLIONS OF DOLLARS)



Conoco's 1998 capital expenditures and investments were $2.5 billion, a decrease of 19 percent versus 1997's $3.1 billion, which included a $929 million acquisition of natural gas properties in the Lobo trend in South Texas.

PROVED RESERVES (MILLIONS BBL. OF OIL EQUIVALENT)



Conoco's proved reserves at year-end 1998 were 2,622 million BOE, consisting of 1,591 million barrels of petroleum liquids and 6,183 billion cubic feet of natural gas, representing a 48 percent increase on a BOE basis since 1994.

Management's Discussion and Analysis of Financial Condition and Results of Operations

General

References to "Conoco," "the Company," "we," or "us" are references to Conoco Inc. and its consolidated subsidiaries.

This annual report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify our forward-looking statements by the words "expects," "intends," "plans," "projects," "believes," "estimates" and similar expressions.

We have based the forward-looking statements relating to our operations on our current expectations, estimates and projections about us and the petroleum industry in general. We caution you that these statements are not guarantees of future performance and involve risks, uncertainties and assumptions that we cannot predict. In addition, we have based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. Accordingly, our actual outcomes and results may differ materially from what we have expressed or forecast in the forward-looking statements. Any differences could result from a variety of factors including the following:

- fluctuations in crude oil and natural gas prices
- refining and marketing margins
- failure or delays in achieving expected production from oil and gas development projects
- uncertainties inherent in predicting oil and gas reserves and oil and gas reservoir performance
- lack of exploration success
- disruption or interruption of our production facilities due to accidents or political events
- international monetary conditions and exchange controls
- liability for remedial actions under environmental regulations
- disruption to our operations due to untimely or incomplete resolution of Year 2000 issues by us or other entities
- liability resulting from litigation
- world economic and political conditions
- changes in tax and other laws applicable to our business

The discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements of Conoco included in this report.

On October 21, 1998, Conoco sold 191,456,427 shares of Class A Common Stock in initial public offerings (the "Offerings"). Prior to the Offerings, Conoco and DuPont entered into a Restructuring, Transfer and Separation Agreement (the "Separation Agreement"). Pursuant to the Separation Agreement, the operations of Conoco and DuPont were substantially reorganized and certain entities, assets, liabilities and related operations were transferred between the companies (the "Separation").

Effective at the time of the Offerings, Conoco's capital structure was established and the transfer to Conoco of certain subsidiaries previously owned by DuPont was substantially complete, resulting in direct ownership of those subsidiaries. Accordingly, for periods subsequent to the Offerings, financial information is presented on a consolidated basis.

Prior to the date of the Offerings, operations were conducted by Conoco Inc., subsidiaries of Conoco Inc. and, in some cases, subsidiaries of DuPont. The accompanying Consolidated Financial Statements for these periods are presented on a carve-out basis prepared from DuPont's historical accounting records, and include the historical operations of both entities owned by Conoco and operations transferred to Conoco by DuPont at the time of the Offerings. In this context, no direct ownership relationship existed among all the various units comprising Conoco. Accordingly, DuPont and its subsidiaries' net investment in Conoco ("Owner's Net Investment") is shown in lieu of Stockholders' Equity in the Consolidated Financial Statements.

The Consolidated Statement of Income includes all revenues and costs directly attributable to Conoco, including costs for facilities, functions and services used by Conoco at shared sites and costs for certain functions and services performed by centralized DuPont organizations and directly charged to Conoco based on usage. In addition, services performed by Conoco on DuPont's behalf are directly charged to DuPont. The results of operations also include allocations of DuPont's general corporate expenses through the date of the Offerings.

Prior to the date of the Offerings, all charges and allocations of cost for facilities, functions and services performed by DuPont organizations for Conoco have been deemed to have been paid by Conoco to DuPont, in cash, in the period in which the cost was recorded in the Consolidated Financial Statements. Allocations of current income taxes receivable or payable are similarly deemed to have been remitted, in cash, by or to DuPont in the period the related income taxes were recorded. Subsequent to the Offerings, such costs are billed directly under transitional service agreements, and income taxes are paid directly to the taxing authorities, or to DuPont, as appropriate.

Conoco has four reporting segments for its Upstream and Downstream operating segments, reflecting geographic division between the United States and International. Activities of the Upstream operating segment include exploring for, and developing, producing and selling, crude oil, natural gas and natural gas liquids. Activities of the Downstream operating segment include refining crude oil and other feedstocks into petroleum products, buying and selling crude oil and refined products and transporting, distributing and marketing petroleum products. Corporate and Other includes general corporate expenses, financing costs and other non-operating items, and results for electric power and related-party insurance operations.

Conoco considers portfolio optimization to be an ongoing business strategy and continuously seeks to rationalize its investment portfolio in order to maximize profitability. Over the past five years, Conoco has generated proceeds of approximately $2,126 million, averaging about $425 million a year, through the disposal of marginal and non-strategic producing properties, by upgrading and redirecting its exploration portfolio and by increasing its ownership in large scale properties. As a result, we have maintained production essentially constant on a BOE basis while undergoing this rationalization. Our policy is to report material gains and losses from individual asset sales as special items when reporting Consolidated Net Income.

Conoco conducts its activities through wholly and majority owned subsidiaries and, increasingly, through equity affiliates. This trend of conducting business in the petroleum industry through equity affiliates is expected to increase in the future as the Company attempts to minimize either the capital or political risks associated with new large-scale, high-impact projects.

Crude oil prices declined substantially in 1998, and we expect these depressed prices to continue in 1999. During 1998, West Texas Intermediate crude oil prices fell to 12-year lows as measured in absolute dollars (and 25-year lows as measured in inflation-adjusted dollars), and closed at $12.05 per barrel on December 31, 1998. These lower prices had a significant negative impact on the Company's financial results in 1998 and are expected to continue to negatively impact 1999 financial results. Conoco's profitability is determined in large part by the difference between the prices it receives for the crude oil, natural gas, natural gas liquids and refined products it produces and the costs of finding, developing, producing, refining and marketing these resources. Conoco has no control over many factors affecting prices for its products. Prices for crude oil, natural gas and refined products may fluctuate widely in response to changes in global and regional supply, political developments and the ability of the Organization of Petroleum Exporting Countries ("OPEC") and other producing nations to set and maintain production levels and prices. Prices for crude oil, natural gas and refined products are also affected by changes in demand for these products, which may result from global events, as well as supply and demand in industrial markets, such as the steel and aluminum markets.

Reduced Asian demand, as a result of the recent economic downturn in Asia, has negatively affected worldwide crude oil and product prices. Even small decreases in crude oil and natural gas prices and refined product margins may adversely affect Conoco. Lower crude oil and natural gas prices may reduce the amount of oil and natural gas reserves Conoco can produce economically, and existing contracts that Conoco has entered into may become uneconomic.

Local political and economic factors in international markets may have a material adverse effect on Conoco. There are many risks associated with operations in international markets, including changes in foreign governmental policies relating to crude oil, natural gas or refined product pricing and taxation, other political, economic or diplomatic developments, changing political conditions and international monetary fluctuations. Recent turmoil in regions such as Russia, Southeast Asia and South America has subjected Conoco's operations in these regions to increased risks. These risks include (i) the risk of political and economic instability, (ii) the risk of war, (iii) the risk that Conoco's property will be seized by a foreign government with or without compensation, (iv) the risk of confiscatory taxation, (v) the risk that the foreign governments will attempt to renegotiate or revoke existing contractual arrangements, and (vi) increased risks of fluctuating currency values, hard currency shortages and currency controls. Civil unrest and changes in government are also potential hazards.

Actions of the United States government can also expose Conoco's operations to risk. The United States government can use tax and other legislation, executive orders and commercial restrictions to prevent or restrict Conoco's doing business in foreign countries. These restrictions and those of foreign governments have in the past restricted Conoco's ability to operate in or gain attractive opportunities in various countries. Actions by both the United States and host governments have affected operations significantly in the past and will continue to do so in the future.

Liquidity and Capital Resources

Cash Provided by Operations

Cash provided by operations in 1998 decreased $1,503 million to $1,373 million versus $2,876 million in 1997. Cash provided by operations before changes in operating assets and liabilities decreased $303 million compared to 1997, primarily due to lower net realized crude oil and natural gas prices, partially offset by higher natural gas volumes and improved international Downstream margins. Negative changes to net operating assets and liabilities of $1,200 million were due to higher tax payments attributable to 1997 asset sales and a decrease in accounts payable, offset by a decrease in accounts receivable due to lower crude oil prices.

Cash provided by operations increased $480 million, or 20 percent, to $2,876 million during 1997 versus $2,396 million in 1996. Positive changes to net operating assets and liabilities of $446 million were principally due to the $303 million received from a contract for future sales of natural gas to Centrica, a United Kingdom gas marketing company.

Investment Activities

Capital Expenditures and Investments

	Year Ended December 31		
	1998	1997	1996
		(In millions)	
Upstream:			
United States	$ 788	$ 1,534	$ 400
International	1,177	999	864
Total Upstream	$ 1,965	$ 2,533	$ 1,264
Downstream:			
United States	$ 201	$ 227	$ 218
International	332	331	462
Total Downstream	$ 533	$ 558	$ 680
Corporate and Other	18	23	—
Total Capital Expenditures and Investments	$ 2,516	$ 3,114	$ 1,944
United States	$ 1,007	$ 1,761	$ 618
International	1,509	1,353	1,326
Total	$ 2,516	$ 3,114	$ 1,944

Total capital investments in 1998, including investments in affiliates and acquisitions, were $2,516 million, a decrease of 19 percent versus 1997 capital investments of $3,114 million, which included a $929 million acquisition of natural gas properties and transportation assets in the Lobo trend in South Texas (the "Lobo acquisition"). Approximately 60 percent of 1998 capital investments were outside the United States. About 78 percent of 1998 capital investments were spent in Upstream, with a majority of this devoted to development projects in South Texas, deepwater Gulf of Mexico, Venezuela, the United Kingdom and Norway. Approximately $312 million was spent on exploratory drilling and leasing. Downstream capital investments in 1998 included completion of the Melaka refinery, expansion of retail marketing operations, particularly in Europe, and upgrades and maintenance of existing facilities. The Company also spent approximately $18 million for corporate software in 1998.

Total capital investments, including investments in affiliates and acquisitions, were $3,114 million in 1997, a 60 percent increase over 1996 capital investments of $1,944 million. This increase primarily reflects the Lobo acquisition.

Upstream

Upstream capital investments totaled $1,965 million in 1998, a decrease of $568 million, or 22 percent, compared to $2,533 million in 1997, which included the $929 million Lobo acquisition.

Upstream capital investments totaled $2,533 million in 1997, an increase of $1,269 million, or 100 percent, compared to $1,264 million in 1996, primarily as a result of the Lobo acquisition. The Lobo acquisition added significant reserves and 1,150 miles of natural gas gathering and transportation pipeline, providing direct access to major Texas intrastate and interstate pipelines. As a result, the Company is the largest natural gas producer in the area and the second largest natural gas producer in Texas.

United States

In 1998, U.S. capital investments were $788 million, a decrease of $746 million, or 49 percent, compared to 1997 U.S. capital investments of $1,534 million. Expenditures in 1998 focused on continuing operations and development. This included the development of the Lobo field, the Ursa field in deepwater Gulf of Mexico, the construction of two deepwater drillships, the first of which went into service in January 1999 in the Gulf of Mexico, the acquisition of exploratory acreage, and the expansion of onshore natural gas operations. The Ursa field development represents a major development project in the Gulf of Mexico. The project involved installing a new generation tension leg platform in approximately 3,900 feet of water. First production is scheduled for 1999. The Company has increased its deepwater holdings in the Gulf of Mexico, and exploration within these holdings will be carried out by a deepwater drillship.

During 1997, the Company spent $1,534 million on capital projects in the United States, an increase of $1,134 million, or 284 percent, compared to 1996 U.S. capital investments of $400 million. Besides the $929 million Lobo acquisition and exploratory drilling, expenditures focused on development of the partner-operated Ursa field in deepwater Gulf of Mexico, construction of two deepwater drillships, acquisition of additional reserves and exploratory acreage in the San Juan Basin and expansion of onshore natural gas operations. In 1996, U.S. capital investments focused on continuing operations and development.

International

In 1998, international capital investments were $1,177 million, an increase of $178 million, or 18 percent, compared to $999 million in 1997. The 1998 increase reflects expenditures to complete the multi-year development program in the Britannia gas field in the U.K. North Sea, with first production in August 1998. Other significant capital investments were made for exploratory drilling and development projects, such as the Petrozuata joint venture in Venezuela, which also began production in August 1998, the

Visund field in the Norwegian North Sea and the Viking Phoenix project in the U.K. North Sea. Conoco increased its natural gas holdings in the U.K. sector of the North Sea through its acquisition of the British subsidiary of Canadian Occidental Petroleum Ltd., which held an interest in the South Valiant, Vulcan and Caister fields, as well as interests in the Murdoch and Esmond gas transportation systems.

International capital investments totaled $999 million in 1997, an increase of $135 million, or 16 percent, compared to international capital investments of $864 million in 1996. Conoco continued to develop the Britannia gas field in the U.K. North Sea. Other significant capital investments were made for exploratory drilling and development projects, such as the Petrozuata joint venture in Venezuela, the Ukpokiti field offshore Nigeria, the Visund field in the Norwegian North Sea, a methanol plant in Norway and the Boulton gas field in the U.K. North Sea. In 1996, international capital investments were $864 million, reflecting expenditures to develop the Britannia field and $67 million to fund the Company's share of losses incurred by a European gas marketing joint venture.

Downstream

Downstream capital investments were $533 million in 1998, a decrease of $25 million, or four percent, versus $558 million in 1997, primarily as a result of lower investments in equity affiliates.

Downstream capital investments totaled $558 million in 1997, a decrease of $122 million, or 18 percent, versus $680 million in 1996, primarily reflecting completion of the acidic crude vacuum unit at the Company's Humber refinery in the U.K., as well as the acquisition of an equity interest in two refineries in the Czech Republic during 1996.

United States

Investments in 1998 totaled $201 million, a decrease of $26 million, or 11 percent, versus 1997 investments of $227 million. Investments in 1998 included costs for continued operations and optimization of retail marketing operations. Conoco also invested $8 million for an increased ownership interest in Penreco, a joint venture with Pennzoil-Quaker State that produces and markets highly refined specialty petroleum products.

During 1997, Conoco spent $227 million on Downstream capital projects in the United States, an increase of $9 million, or four percent, compared to investments of $218 million in 1996. The majority of the 1997 funds were used to support continuing operations and optimization of retail marketing operations. The Company also invested funds for an initial equity interest in Penreco.

Capital investments in 1996 totaled $218 million. The most significant investments related to the completion of the 45,000 barrel per day expansion of the Lake Charles refinery's sour crude oil processing capability to support the Excel Paralubes lube oil hydrocracker joint venture with Pennzoil. The lube oil hydrocracker converts low-quality, high-sulphur vacuum gas oil into base oil of extremely high purity and enhances the value of the Company's finished lubricants business by producing improved motor oils, transmission fluids and industrial lubes blended from hydrocracked base oils.

International

In 1998, the Company made capital investments of $332 million including investments in the Company's retail marketing position in core markets, such as Germany and Austria, and newer retail markets, such as Thailand, as well as investments for completing the construction of the Melaka refinery, a joint venture with Petronas and Statoil, which began operation in the third quarter of 1998.

During 1997, the Company spent $331 million on Downstream international capital investments, a decrease of $131 million, or 28 percent, from 1996 capital investments of $462 million. The decrease was due to expenditures in 1996 relating to costs for the acidic crude vacuum unit at the Company's Humber refinery. The installation of the vacuum unit at the Humber refinery allowed the refinery to process acidic crude oil, including equity crude oil from the Heidrun field. Expenditures in 1997 focused on strengthening the Company's retail marketing position in core markets, such as Germany, Austria and the Nordic countries, expanding in targeted retail growth markets in Central and Eastern Europe, Spain, Turkey and the Asia Pacific region, and continuing the construction of the Melaka refinery.

Capital investments in 1996 totaled $462 million and included costs for the acidic crude vacuum unit at the Company's Humber refinery, construction expenditures related to the Melaka refinery, acquisition of equity interests in two Czech refineries, and expansion of retail marketing operations, particularly in Eastern Europe. The acquisition of the equity interests in the two Czech refineries supported the expansion of the Company's retail marketing operations in the emerging markets in Eastern Europe, including the Czech Republic, Poland, Hungary and Slovakia.

Corporate and Other

Capital investments in 1998 were $18 million and were primarily associated with corporate software.

Capital investments in 1997 were $23 million, most of which represent the Company's investment in electric power generation projects in international equity affiliates. Because of deregulation within this industry, the Company expects to continue to pursue projects which leverage the economic advantages of the Company's energy production activities and the demand for energy in DuPont or third-party manufacturing operations.

There were no capital investments in Corporate and Other during 1996.

Proceeds from Sales of Assets and Subsidiaries

Conoco's 1998 investment activities included proceeds of $721 million, a 28 percent increase over $565 million in 1997. The 1998 proceeds included $245 million from the sale of certain Upstream U.S. and North Sea properties, $156 million from the sale of various Downstream assets in the U.S., as well as $54 million from the sale of an office building in Europe. These and other proceeds are a result of the Company's ongoing strategic portfolio upgrading and rationalization efforts. 1997 proceeds were $565 million, an increase of $237 million versus 1996 proceeds of $328 million.

Financing Activities

Conoco's ability to maintain and grow its operating income and cash flow is dependent upon continued capital spending. We believe our future cash flow from operations and our borrowing capacity should be sufficient to fund dividends, debt service, capital expenditures and working capital requirements.

Prior to the Separation, the businesses transferred to Conoco were funded through DuPont. Apart from limited recourse project financing related to various joint ventures, equipment lease facilities and financing of certain refinery equipment and other small financings, the Company has had limited indebtedness to third parties. Since the time of the Offerings, Conoco's operations have been funded through internally generated funds and related party debt with DuPont.

In July 1998, Conoco issued a promissory note (the "Note") to DuPont in the aggregate principal amount of $7,500 million bearing interest at a rate of 6.0125 percent per annum. The Note has a maturity date of January 2, 2000. The Note may be voluntarily prepaid without penalty or premium. The Note also provides for mandatory prepayments in the event cash proceeds are realized by Conoco from the incurrence of indebtedness or the issuance of equity securities by Conoco or its subsidiaries. The Note includes certain covenants and customary events of default, including failure to pay interest when due, certain events of bankruptcy of the Company and change of control. The consent of DuPont is also required prior to the Company entering into certain transactions.

In October 1998, Conoco raised net proceeds of $4,228 million in the Offerings. The net proceeds from the Offerings were used to repay a portion of the $7,500 million promissory note and certain other intercompany notes with DuPont. Total indebtedness owed to DuPont, following application of the net proceeds of the Offerings and the determination of the Company's cash and cash equivalents in excess of $225 million, was $4,853 million, consisting of $4,846 million related to the $7,500 million promissory note described in the above paragraph and $7 million remaining on an $827 million promissory note, due January 2, 2000, and bearing interest at a rate equal to the six-month LIBOR plus 0.375 percent per annum. As of December 31, 1998, total indebtedness owed to DuPont was $4,596 million.

On October 27, 1998, the Company and DuPont entered into a Revolving Credit Agreement under which DuPont provides Conoco with a revolving credit facility in principal amount of up to $500 million. Loans under the Revolving Credit Agreement will be subject to mandatory prepayment to the extent the Company's cash and cash equivalents exceed $325 million or such higher amount as the Company and DuPont may agree. Loans under this facility will bear interest at a rate equal to 30-day LIBOR plus 0.20 percent per annum and may be voluntarily prepaid without penalty or premium. As of December 31, 1998, the outstanding balance under this credit facility was zero.

Conoco is obligated to repay all outstanding debt owed to DuPont at such time as DuPont's direct or indirect voting power in the Company falls below 50 percent of the outstanding voting power of the Company. The Company intends to refinance outstanding related party debt owed to DuPont with a combination of commercial paper and public debt in 1999. On February 12, 1999, Conoco filed a "shelf" registration statement under the Securities Act of 1933 pursuant to which it may issue debt securities. Conoco intends to use the proceeds from issuances of securities under the shelf registration statement to refinance a portion of the outstanding debt owed to DuPont. There can be no assurance that the Company will be able to refinance this debt on terms as favorable as those existing with respect to the debt owed to DuPont.

Results of Operations

Consolidated Results

	Year Ended December 31		
	1998	1997	1996
		(In millions)	
Sales and Other Operating Revenues			
Upstream			
United States	$ 3,200	$ 3,348	$ 2,783
International	1,601	1,906	1,943
Total Upstream	$ 4,801	$ 5,254	$ 4,726
Downstream			
United States	$ 8,949	$ 11,394	$ 10,545
International	8,297	8,639	8,880
Total Downstream	$ 17,246	$ 20,033	$ 19,425
Corporate and Other	749	509	79
Total Sales and Other Operating Revenues	$ 22,796	$ 25,796	$ 24,230
After-Tax Operating Income			
Upstream			
United States	$ 219	$ 445	$ 314
International	283	439	367
Total Upstream	$ 502	$ 884	$ 681
Downstream			
United States	$ 135	$ 216	$ 172
International	156	91	117
Total Downstream	$ 291	$ 307	$ 289
Corporate and Other	(271)	(82)	(74)
Total After-Tax Operating Income	$ 522	$ 1,109	$ 896
Interest and Other Non-Operating Expense Net of Tax	(72)	(12)	(33)
Consolidated Net Income	$ 450	$ 1,097	$ 863

Special Items

Consolidated net income includes the following non-recurring items ("Special Items") on an after-tax basis:

	Year Ended December 31		
	1998	1997	1996
		(In millions)	
Upstream			
Asset sales	$ 95	$ 240	$ 16
Property impairments	(38)	(112)	(63)
Tax rate changes	—	19	—
Employee separation costs	(42)	—	(11)
Inventory write-downs	(4)	—	—
Total Upstream Special Items	$ 11	$ 147	$ (58)
Downstream			
Asset sales	$ 12	$ —	$ 19
Property impairments	—	(55)	—
Tax rate changes	—	11	—
Environmental insurance litigation recoveries	—	—	44
Employee separation costs	(10)	—	(11)
Inventory write-downs	(59)	—	—
Environmental litigation charges	(28)	(23)	—
Total Downstream Special Items	$ (85)	$ (67)	$ 52
Corporate and Other			
Stock option provision	$ (183)	$ —	$ —
Environmental litigation charges	(14)	—	—
Total Corporate and Other Special Items	$ (197)	$ —	$ —
Total Special Items	$ (271)	$ 80	$ (6)

Special Items in 1998 include $107 million in gains from several unrelated asset sales. The gains consist of $54 million from the sale of producing and non-producing international Upstream properties, $41 million from U.S. Upstream producing properties and assets, and $12 million in Downstream from the sale of an office building in Europe. The Upstream sales are a normal part of the Company's portfolio rationalization program designed to improve profitability by disposing of marginal properties and concentrating operations on core properties. Offsetting the gains were property impairments of $38 million, of which $32 million were in the U.S., made in accordance with Conoco's policy on impairment of long-lived assets, inventory write-downs of $63 million to market prices, restructuring and employee separation costs of $52 million, and other losses of $42 million for environmental litigation charges. The $183 million stock option provision is a one-time non-cash charge for stock option employee compensation expenses related to the replacement of outstanding DuPont stock options held by Conoco employees with Conoco stock options in connection with the Offerings.

Upstream Special Items in 1997 include $240 million in gains from asset sales consisting of $191 million associated with producing and non-producing properties in the North Sea and $49 million in the United States. Such asset sales are part of the Company's rationalization program, designed to improve profitability by disposing of marginal properties and concentrating operations on core properties. A United Kingdom tax rate change also provided a $19 million benefit in 1997. Offsetting these benefits were property impairments of $112 million relating to certain international non-revenue producing properties. Downstream Special Items in 1997 include a United Kingdom tax rate change benefit of $11 million. Offsetting this benefit were property impairments of $55 million attributable to the write-down of an office building held for sale in Europe. Other losses of $23 million include environmental litigation charges.

Upstream Special Items in 1996 include a gain of $16 million from the sale of producing and non-producing properties in the United States. Offsetting this gain was a $63 million impairment associated with a write-down of an investment in a European gas marketing joint venture and employee separation costs of $11 million. Downstream Special Items in 1996 include a gain of $19 million associated with the sale of the Company's retail marketing business in Ireland. Environmental insurance litigation recoveries also resulted in a $44 million benefit. Offsetting these benefits were employee separation costs of $11 million.

Consolidated Net Income Before Special Items ("Earnings Before Special Items") was $721 million in 1998, $1,017 million in 1997 and $869 million in 1996.

1998 Versus 1997

Consolidated Net Income for 1998 of $450 million was down 59 percent from $1,097 million in 1997. The Company had Earnings Before Special Items of $721 million in 1998, down 29 percent from $1,017 million in 1997. Lower Earnings Before Special Items primarily reflect lower net realizable crude oil and natural gas prices and refined product prices. The lower prices were partly offset by higher natural gas volumes, lower exploration expenses, improved international Downstream marketing margins and the favorable resolution of certain tax issues.

Sales and Other Operating Revenues of $22,796 million in 1998 were down 12 percent compared to $25,796 million in 1997, primarily due to a decrease in worldwide crude oil and natural gas prices and lower refined product prices. Downstream Sales and Other Operating Revenues were $17,246 million, down 14 percent compared to $20,033 million in 1997. Crude oil and refined product buy/sell and natural gas and electric power resale activities in 1998 totaled $5,004 million, down 9 percent compared to $5,509 million in 1997.

Cost of Goods Sold and Other Operating Expenses in 1998 totaled $13,840 million, down 15 percent compared to $16,226 million in 1997. This reduction is primarily due to lower feedstock prices.

Selling, General and Administrative Expenses for 1998 totaled $736 million, an increase of $10 million, or one percent, compared to $726 million in 1997, primarily due to environmental litigation charges related to a discontinued business assumed by Conoco under the Separation Agreement with DuPont.

Included in 1998 is a pretax charge of $236 million, labeled "Stock Option Provision" on the Income Statement. This expense is a one-time non-cash charge for employee stock option compensation relating to the replacement of outstanding DuPont stock options held by Conoco employees with Conoco stock options in connection with the Offerings.

Exploration Expenses in 1998 totaled $380 million, a decline of $77 million, or 17 percent, compared to $457 million in 1997. The decrease is primarily a result of a more focused exploration program. Also contributing to the decrease were lower amortization of non-producing leasehold properties in the United States and lower exploration overhead and operating expenses compared to 1997, which included seismic surveys conducted in the Gulf of Paria, located between Venezuela and Trinidad, and in the Merida Andes foothills in Venezuela.

Depreciation, Depletion and Amortization for 1998 totaled $1,113 million, a decrease of $66 million, or six percent, compared to $1,179 million in 1997.

Provision for Income Taxes for 1998 totaled $244 million, down 76 percent, compared to $1,010 million for 1997. This reflects an effective tax rate of approximately 35 percent in 1998 compared to 48 percent in 1997. The lower effective tax rate in 1998 is due to the increased impact of the U.S. alternative fuels tax credit, realization of a tax benefit on the sale of a subsidiary and a greater percentage of earnings in countries with lower effective tax rates.

1997 versus 1996

Consolidated Net Income for 1997 of $1,097 million was up 27 percent from $863 million in the prior year. The Company had Earnings Before Special Items of $1,017 million in 1997, up 17 percent from $869 million in 1996. The increase was attributable to improved U.S. natural gas prices and higher international natural gas volumes, in addition to stronger worldwide Downstream product margins and increased worldwide refinery production.

Sales and Other Operating Revenues of $25,796 million in 1997 were up six percent compared to $24,230 million in the prior year, as higher Downstream product prices and volumes, increased international natural gas volumes and stronger domestic natural gas prices more than compensated for lower crude oil prices. Crude oil and refined product buy/sell and natural gas and electric power resale activities in 1997 totaled $5,509 million, up 32 percent compared to $4,167 million in 1996.

Cost of Goods Sold and Other Operating Expenses in 1997 totaled $16,226 million, up 11 percent compared to $14,560 million in 1996, due to higher refined product volumes and crude oil and refined product buy/sell contract activity and natural gas and electric power resale activities.

Selling, General and Administrative Expenses in 1997 totaled $726 million, a decrease of $29 million, or four percent, compared to $755 million in 1996, primarily due to one-time costs in 1996 for retail expansion activities in the U.S.

Exploration Expenses in 1997 totaled $457 million, an increase of $53 million, or 13 percent, compared to $404 million in 1996, due to higher international exploration overhead and operating costs primarily from seismic surveys conducted in the Gulf of Paria, located between Venezuela and Trinidad, and in the Merida Andes foothills in Venezuela, higher international dry hole costs and an adjustment of certain non-producing U.S. leasehold properties.

Depreciation, Depletion and Amortization in 1997 totaled $1,179 million, an increase of $94 million, or nine percent, compared to $1,085 million in 1996 due to higher depreciation resulting from a write-down of an office building held for sale in the United Kingdom and an impairment of certain international non-revenue producing properties, partially offset by lower depreciation in U.S. Downstream operations.

Provision for Income Taxes totaled $1,010 million in 1997, down three percent, compared to $1,038 million in 1996. The lower provision reflects an effective tax rate of approximately 48 percent in 1997, compared to 55 percent in 1996. The decrease in the effective tax rate was primarily due to a lower proportion of earnings from operations in countries with higher effective tax rates.

Upstream Segment Results

	Year Ended December 31		
	1998	1997	1996
	(In millions)		
After-Tax Operating Income			
United States	$ 219	$ 445	$ 314
International	283	439	367
After-Tax Operating Income	$ 502	$ 884	$ 681
Special Items			
United States	$ 14	$ (49)	$ (9)
International	(25)	(98)	67
Special Items	$ (11)	$ (147)	$ 58
Earnings Before Special Items			
United States	$ 233	$ 396	$ 305
International	258	341	434
Earnings Before Special Items	$ 491	$ 737	$ 739

1998 versus 1997

Upstream After-Tax Operating Income was $502 million in 1998, down 43 percent from $884 million in 1997, principally due to lower crude oil and natural gas prices. Upstream Earnings Before Special Items were $491 million in 1998, down 33 percent from $737 million in 1997.

The Company's worldwide net realized crude oil price was $12.37 per barrel for 1998, down $6.21 per barrel, or 33 percent, from $18.58 per barrel in 1997. Excess supply caused by weak Asian demand, higher crude oil production from OPEC producing countries and warmer winter weather caused the sharp drop in crude oil prices. Worldwide natural gas prices averaged $2.24 per thousand cubic feet (mcf) for 1998, compared with $2.44 per mcf in 1997, primarily because of warmer winter weather. Lower worldwide natural gas prices were primarily driven by lower natural gas prices inside the United States. In the U.S., natural gas prices averaged $1.96 per mcf, down 10 percent, while internationally they remained steady at $2.72 per mcf. Worldwide crude oil and condensate production in 1998 was 315,000 barrels per day versus 337,000 barrels per day in 1997. Worldwide natural gas production in 1998 was up 17 percent to 1,411 million cubic feet per day from 1,203 million cubic feet per day in 1997.

U.S. Upstream Earnings Before Special Items totaled $233 million in 1998, down 41 percent from $396 million in 1997. Lower U.S. Upstream Earnings Before Special Items were due to lower crude oil and natural gas prices and lower crude oil volumes resulting from asset dispositions and crude oil production declines. These reductions more than offset benefits from increased natural gas production, gains on property sales and lower exploration expenses. Natural gas volumes were up 22 percent as increased production from the holdings in the South Texas Lobo trend, acquired in 1997, more than offset the decline in natural gas production elsewhere. U.S. production costs were $3.69 per BOE, down $0.54 per BOE, or 13 percent, compared to $4.23 per BOE in 1997, due to lower production taxes and higher gas volumes.

Outside the United States, Upstream Earnings Before Special Items were $258 million, down 24 percent, from $341 million in the comparable period in 1997, primarily due to lower crude oil and natural gas prices, offset by higher natural gas volumes, lower exploration expenses and the favorable resolution of certain tax issues. International crude volumes, which comprise over 80 percent of Conoco's oil production, were down five percent to 265,000 barrels per day due to the sale of the Company's interest in the mature Ula and Gyda fields in Norway and natural production declines. However, earnings benefited from higher production in countries with relatively lower tax rates (primarily the United Kingdom and Nigeria). International gas volume was up nine percent. International production costs were $4.13 per BOE, down $0.06 per BOE, or one percent, compared to $4.19 per BOE in 1997, due to reduced costs from asset dispositions and other operating costs in 1998, partly offset by lower international crude oil production.

1997 versus 1996

Upstream After-Tax Operating Income was $884 million in 1997, up 30 percent, compared to $681 million in 1996. Upstream Earnings Before Special Items totaled $737 million in 1997, essentially unchanged from the previous year.

Worldwide natural gas prices were up 15 percent to $2.44 per mcf in 1997 from $2.12 per mcf in 1996, resulting primarily from higher U.S. industry demand. Worldwide net realized crude oil prices were $18.58 per barrel, down $1.53 per barrel, or eight percent, from $20.11 per barrel in 1996. Crude oil prices declined despite higher crude oil demand and strong crude oil production growth, which included initial exports of Iraqi crude oil. Worldwide crude oil and condensate production averaged 337,000 barrels per day for the year, up slightly versus 1996. Worldwide natural gas deliveries in 1997 of 1,203 million cubic feet per day were essentially unchanged from 1,211 million cubic feet per day in 1996, as higher international natural gas volumes were offset by lower domestic natural gas volumes.

U.S. Upstream Earnings Before Special Items totaled $396 million, up 30 percent from $305 million in 1996, due to higher gas prices which more than offset lower crude oil prices. U.S. production costs per BOE were $4.23, up $0.12 per BOE or 3 percent, compared to $4.11 per BOE in 1996, due to higher production taxes.

Outside the United States, Earnings Before Special Items were $341 million, down 21 percent from $434 million in 1996 due to lower crude oil prices, partly offset by increased crude oil and natural gas volumes associated with the first year of oil production from Nigeria and increased production from the Heidrun and Troll fields in Norway and the Canadian Foothills. International production costs per BOE were $4.19 per BOE, up $0.51 per BOE, or 14 percent, compared to $3.68 per BOE in 1996, resulting from floating production storage offtake ("FPSO") lease costs on new fields in the United Kingdom and costs incurred on development projects that had not yet begun production.

Downstream Segment Results

	Year Ended December 31		
	1998	1997	1996
		(In millions)	
After-Tax Operating Income			
United States	$ 135	$ 216	$ 172
International	156	91	117
After-Tax Operating Income	$ 291	$ 307	$ 289
Special Items			
United States	$ 73	$ 23	$ (36)
International	12	44	(16)
Special Items	$ 85	$ 67	$ (52)
Earnings Before Special Items			
United States	$ 208	$ 239	$ 136
International	168	135	101
Earnings Before Special Items	$ 376	$ 374	$ 237

1998 versus 1997

Downstream After-Tax Operating Income was $291 million in 1998, down five percent compared to $307 million in 1997. Downstream Earnings Before Special Items totaled $376 million in 1998, up one percent from $374 million in 1997.

United States Downstream Earnings Before Special Items were $208 million in 1998, compared to $239 million in 1997, a decrease of 13 percent. The decline was mainly attributable to weaker refinery margins, which were partly offset by record refinery runs, lower feedstock and operating costs and higher marketing margins.

International Downstream Earnings Before Special Items were $168 million in 1998, up 24 percent from $135 million in the comparable period in 1997, reflecting higher European marketing margins, lower costs, and 11 percent higher refinery runs.

The Company's refineries, excluding the Melaka refinery, operated at 95 percent capacity in 1998, four percent higher than 1997. The increase was primarily due to refinery upgrades in Europe in 1997, increased reliability throughout the system, and increased rates at the Lake Charles refinery subsequent to debottlenecking work completed in February 1998.

1997 versus 1996

Downstream After-Tax Operating Income was $307 million, up six percent from $289 million in 1996. Downstream Earnings Before Special Items increased 58 percent to $374 million in 1997, compared with $237 million in the prior year. Worldwide refined product sales volumes were 1,048,000 barrels per day in 1997, up five percent versus 1996.

In the United States, Downstream Earnings Before Special Items were $239 million versus $136 million in 1996, an increase of 76 percent. The improvement was attributable to strong refining margins, reduced operating costs and higher refined product volumes from the new Lake Charles, Louisiana, hydrocracker expansion project.

International Downstream Earnings Before Special Items were $135 million, up 34 percent from $101 million in the comparable period in 1996, primarily due to higher European refining margins and increased refinery production from the Humber refinery's new vacuum unit in the United Kingdom.

The Company's refineries operated at 91 percent capacity in 1997, ten percent higher than 1996. The increase was primarily due to less downtime incurred in 1997, compared to 1996 when major expansions were taking place at the Lake Charles and Humber refineries.

Corporate and Other Segment Results

Corporate and Other Operating

	Year Ended December 31		
	1998	1997	1996
		(In millions)	
After-Tax Operating Income	$ (271)	$ (82)	$ (74)
Special Items	197	—	—
Earnings Before Special Items	$ (74)	$ (82)	$ (74)

1998 versus 1997

Corporate and Other Segment After-Tax Operating Income was a loss of $271 million in 1998, an impairment of $189 million from a loss of $82 million in 1997, primarily as a result of the one-time stock option provision. Corporate and Other Earnings Before Special Items were a loss of $74 million, an improvement of $8 million from the 1997 loss of $82 million as a result of lower compensation costs.

1997 versus 1996

Corporate and Other Segment After-Tax Operating Income was a loss of $82 million, an impairment of $8 million from a loss of $74 million in 1996 due to higher compensation costs.

Interest and Other Corporate Non-Operating Expenses Net of Tax

	Year Ended December 31		
	1998	1997	1996
	(In millions)		
Net Interest Income (Expense)	$ (62)	$ 35	$ 28
Exchange Gains (Losses)	32	21	(7)
Other Corporate Expenses [1]	(42)	(68)	(54)
Total	$ (72)	$ (12)	$ (33)

(1) Includes financing costs and other non-operating items.

1998 versus 1997

Interest and Other Corporate Non-Operating Expenses for 1998 were $72 million, an increase of $60 million versus $12 million in 1997. The increase is primarily attributable to higher interest expense from debt incurred in the second half of the year, which more than offset interest income earned in the first half of the year.

1997 versus 1996

Interest and Other Corporate Non-Operating Expenses were a loss of $12 million in 1997, an improvement of $21 million from 1996 results. Net Interest Income (Expense) in 1997 was improved by $7 million versus 1996, primarily due to increased after-tax capitalized interest on major Upstream development projects. The Company incurred an after-tax exchange gain of $21 million in 1997 compared with a loss of $7 million in 1996, primarily reflecting the impact of Norwegian Kroner and British Pound exchange rate movements on U.S. dollar-denominated working capital balances. Other Corporate Expenses of $68 million in 1997 were $14 million higher than 1996.

Environmental Expenditures

The costs to comply with complex environmental laws and regulations, as well as internal voluntary programs, are significant and will continue to be so in the foreseeable future. The Company anticipates substantial expenditures will be necessary to comply with Maximum Achievable Control Technology ("MACT") standards to be promulgated by EPA under the Clean Air Act, and specifications for motor fuels designed to reduce emissions of certain pollutants from vehicles using such fuels. These costs may increase in the future, but are not expected to have a material adverse effect on the Company's financial condition, results of operations or liquidity.

Estimated pre-tax environmental expenses charged to current operations totaled about $131 million in 1998, as compared to approximately $136 million in 1997 and $162 million in 1996. These expenses include the remediation accruals discussed below, operating maintenance and depreciation costs for solid waste, air and water pollution control facilities and the costs of certain other environmental activities. The largest of these expenses resulted from the operation of wastewater treatment facilities and solid waste management facilities and facilities for the control and abatement of air emissions. Approximately 80 percent of 1998 total annual environmental expenses resulted from the operations of the Company's business in the United States.

Capital expenditures for environmental control facilities totaled approximately $53 million in 1998, as compared to approximately $50 million in 1997 and $78 million in 1996. The Company estimates that capital expenditures will increase by about $100 million in 1999 due to regulations in Europe requiring cleaner burning fuels.

Remediation Expenditures

The Resource Conservation and Recovery Act ("RCRA") extensively regulates the treatment, storage and disposal of hazardous waste and requires a permit to conduct such activities. RCRA requires permitted facilities to undertake an assessment of environmental conditions at the facility. If conditions warrant, the Company may be required to remediate contamination caused by prior operations. In contrast to the Comprehensive Environmental Response, Compensation, and Liability Act, as amended ("CERCLA"), often referred to as "Superfund," the cost of corrective action activities under the RCRA corrective action program is typically borne solely by the Company. The Company anticipates that significant ongoing expenditures for RCRA remediation activities may be required over the next decade, although annual expenditures for the near term are not expected to vary significantly from the range of such expenditures over the past few years. The Company's expenditures associated with RCRA and similar remediation activities conducted voluntarily or pursuant to state law were approximately $27 million in 1998, $31 million in 1997 and $34 million in 1996. In the long term, expenditures are subject to considerable uncertainty and may fluctuate significantly.

The Company from time to time receives requests for information or notices of potential liability from EPA and state environmental agencies alleging that the Company is a potentially responsible party ("PRP") under CERCLA or an equivalent state statute. The Company on occasion also has been made a party to cost recovery litigation by those agencies or by private parties. These requests, notices and lawsuits assert potential liability for remediation costs at various sites that typically are not Company owned but allegedly contain wastes attributable to the Company's past operations. As of December 31, 1998, the Company had been notified of potential liability under CERCLA or state law at about 13 sites around the United States, with active remediation under way at six of those sites. The Company received notice of potential liability at one new site during 1998, which was resolved, compared with four similar notices in 1997 and one in 1996. The Company's expenditures associated with CERCLA and similar state remediation activities were not significant in 1998, 1997 or 1996.

For most Superfund sites, the Company's potential liability will be significantly less than the total site remediation costs because the percentage of waste attributable to the Company versus that attributable to all other PRPs is relatively low. Other PRPs at sites where the Company is a party typically have had the financial strength to meet their obligations and, where they have not, or where PRPs could not be located, the Company's own share of liability has not materially increased. There are relatively few sites where the Company is a major participant, and neither the cost to the Company of remediation at those sites, nor at all CERCLA sites in the aggregate, is expected to have a material adverse effect on the competitive or financial condition of the Company.

Cash expenditures not charged against income for previously accrued remediation activities under CERCLA, RCRA and similar state and foreign laws were $17 million in 1998, $19 million in 1997 and $19 million in 1996. Although future remediation expenditures in excess of current reserves are possible, the effect of any such excess on future financial results is not subject to reasonable estimation because of the considerable uncertainty regarding the cost and timing of expenditures.

Remediation Accruals

The Company accrues for remediation activities when it is probable that a liability has been incurred and reasonable estimates of the liability can be made. These accrued liabilities exclude claims against the Company's insurers or other third parties and are not discounted. Many of these liabilities result from CERCLA, RCRA and similar state laws that require the Company to undertake certain investigative and remedial activities at sites where the Company conducts or once conducted operations or at sites where company-generated waste was disposed. The accrual also includes a number of sites identified by the Company that may require environmental remediation, but which are not currently the subject of CERCLA, RCRA or state enforcement activities. Over the next decade, the Company may incur significant costs under both CERCLA and RCRA. Considerable uncertainty exists with respect to these costs and under adverse changes in circumstances, potential liability may exceed amounts accrued as of December 31, 1998.

Remediation activities vary substantially in duration and cost from site to site depending on the mix of unique site characteristics, evolving remediation technologies, diverse regulatory agencies and enforcement policies and the presence or absence of potentially liable third parties. Therefore, it is difficult to develop reasonable estimates of future site remediation costs. At December 31, 1998, the Company's balance sheet included an accrued liability of $129 million as compared to $144 million at year-end 1997. Approximately 89 percent of the Company's environmental reserve at December 31, 1998, was attributable to RCRA and similar remediation liabilities (excluding voluntary remediations) and 11 percent to CERCLA liabilities. During 1998, remediation accruals resulted in a $2 million charge, compared to credits of $41 million and $70 million in 1997 and 1996, respectively, which resulted from insurance recoveries. No significant additional recoveries are expected.

Tax Matters

As a result of the Separation and the Offerings, the Company will no longer be able to combine the results of its operations with those of DuPont in reporting income for U.S. federal income tax purposes and for state and non-U.S. income tax purposes in certain states and countries. The Company believes this will not have a material adverse effect on its earnings.

As of December 31, 1998, the Company had deferred tax assets in the amount of $1,238 million. Of this amount, $496 million related to tax benefits from operating losses incurred in start-up operations, including exploration and U.S. foreign tax credit carry forwards. These benefits were substantially offset by a valuation reserve. The Company believes it is more likely than not the balance of the deferred tax assets will be realized in future years.

Year 2000

Historically, certain computerized systems have used two digits rather than four digits to define the applicable year, which could result in recognizing a date using "00" as the year 1900 rather than the year 2000. This could result in major failures or miscalculations and is generally referred to as the "Year 2000 issue."

The Company recognizes that the impact of the Year 2000 issue extends beyond traditional computer hardware and software to automated plant systems and instrumentation, as well as to third parties. The Year 2000 issue is being addressed within the Company by its individual business units, and progress is reported periodically to management and the Board of Directors.

The Company has committed resources to conduct risk assessments and to take corrective action, where required, within each of the following areas: information technology, plant systems and external parties. Information technology includes telecommunications, as well as traditional computer software and hardware in the mainframe, midrange and desktop environments. Plant systems include all automation and embedded chips used in plant operations. External parties include any third party with whom the Company interacts. Most of the resources committed to this work are internal.

Managing Year 2000 risk is being handled in three tiers – through Year 2000 Compliance Plans, Mitigation Plans and Emergency Recovery Plans. The Year 2000 Compliance Plans include inventorying and assessing risk, and outlining action to be taken for each of these items. Year 2000 Compliance Plans have been developed and are being implemented for all business units. Mitigation Plans outline a list of actions that will be taken on a specified date to further minimize risk. These plans will be developed for areas in which the Year 2000 Compliance Plans do not adequately address all of the relevant risk issues. For example, operations that rely heavily on external partners will develop Mitigation Plans. Mitigation Plans will be developed, as needed, for all business units by the third quarter of 1999. Emergency Recovery Plans already exist in many of the Company's operations to address other issues, such as oil tanker spills and plant explosions.

Typically, the Emergency Recovery Plans address the results of single events. These plans are designed to facilitate the resumption of normal operations following a disruption. In contrast to a "normal" disruption, the scope of Year 2000 issues may cause multiple concurrent events, which may have a longer duration. Accordingly, the Emergency Recovery Plans will be reviewed and supplemented to address Year 2000 risks for all business units by the third quarter of 1999. The progress reported below covers only the replacement or upgrade of existing non-compliant systems. Replacement projects planned and managed outside of the Year 2000 Program have been excluded. Approximately 73 percent of the work required to fix Year 2000 issues identified by the Year 2000 Program has been completed.

In the information technology area, inventory and assessment audits in the mainframe and midrange environments are completed. Excluding business applications, corrective action in the mainframe area will be completed by the end of the first quarter of 1999. Corrective action in the midrange area will be completed by the end of the first quarter of 1999 and business application software is expected to be completed by the fourth quarter of 1999. Inventory and assessment audits of telecommunications are completed, with corrective action expected to be completed by the second quarter of 1999. Finally, inventory and assessment audits in the desktop environment are completed, with corrective action expected to be completed by the end of the third quarter of 1999.

In the plant systems area, all but two of the Company's business units have completed their inventory and assessment audits; the remaining units are expected to complete this work by the end of the second quarter of 1999. The Company is relying on vendor testing and certification with validation through limited internal testing and/or industry test results. Downtime for normally scheduled plant maintenance will be used to conduct testing, with corrective action expected to be completed by the end of the third quarter of 1999.

With respect to external parties, the inventory of critical external parties is essentially complete. Risks are being assessed, and monitoring of risk in this area will continue throughout 1999, as many external parties will not have completed their work.

The total cost of Year 2000 activities is not expected to be material to the Company's operations, liquidity or capital resources. Costs are being managed within each business unit. The total estimated cost for the Company's Year 2000 work is $47 million. 1997 costs were $5 million, and 1998 costs were $25 million. This includes costs for the replacement or upgrade of existing non-compliant systems. Replacement projects planned and managed outside of the Year 2000 program have been excluded.

There can be no guarantee that third parties of business importance to Conoco will successfully reprogram or replace, and test, all of their own computer hardware, software and process control systems to ensure such systems are Year 2000 compliant. Failure to address a Year 2000 issue could result in business disruption that could materially affect the Company's operations, liquidity or capital resources. There is still uncertainty around the scope of the Year 2000 issue. At this time the Company cannot quantify the potential impact of these failures. The Company's Year 2000 program and contingency plans are being developed to address issues within the Company's control. The program minimizes, but does not eliminate, the issues of external parties.

European Monetary Union

Within Europe, the European Economic and Monetary Union (the "EMU") introduced a new currency, the Euro, on January 1, 1999. The new currency is in response to the EMU's policy of economic convergence to harmonize trade policy, eliminate business costs associated with currency exchange and to promote the free flow of capital, goods and services.

On January 1, 1999, 11 participating countries adopted the Euro as their local currency, initially available for currency trading on currency exchanges and non-cash (banking) transactions. The existing local currencies, or legacy currencies, will remain legal tender through January 1, 2002. Beginning on January 1, 2002, Euro-denominated notes and coins will be issued for cash transactions. For a period of six months from this date, both legacy currencies and the Euro will be legal tender. On or before July 1, 2002, the participating countries will withdraw all legacy currency and use the Euro exclusively.

The Company has recognized the introduction of the Euro as a significant event with potential implications for existing operations. Conoco currently operates in a number of countries which are participating in the EMU, including Austria, Belgium, Finland, Germany and Spain. The Company expects non-participating European Union countries, such as the United Kingdom, to eventually join the EMU.

The Company has committed resources to conduct risk assessments and to take corrective actions, where required, to ensure the Company is prepared for the introduction of the Euro. The Company has undertaken a review of the Euro implementation and has concentrated on areas such as operations, finance, treasury, legal, information management, procurement and others, both in participating and non-participating European Union countries where the Company operates. Also, existing legacy accounting and business systems and other business assets have been reviewed for Euro compliance, including assessing any risks from third parties. Progress regarding Euro implementation is reported periodically to management.

Because of the staggered introduction of the Euro regarding non-cash and cash transactions, the Company has developed its plans to address first its accounting and business systems and second, its business assets. The Company undertook steps to be Euro compliant within its accounting and business systems by the end of 1998 relative to the conversion rules when performing translations between EMU currencies. The Company has an implementation plan to convert its accounting and reporting systems from legacy currency to the Euro by January 1, 2002, for those operations that are in EMU countries. The plan also incorporates steps to ensure the corresponding business assets are fully compliant by that date, in preparation for being able to conduct business involving Euro notes and coins. Compliance in participating and nonparticipating countries will be achieved primarily through upgraded systems, which were previously planned to be upgraded. Remaining systems will be modified to achieve compliance. The Company does not currently expect to experience any significant operational disruptions or to incur any significant costs, including any currency risk, which could materially affect the Company's liquidity or capital resources. The Company is preparing plans to address issues within the transitional period when both legacy and Euro currencies may be tendered.

Because of the competitive business environment within the petroleum industry, the Company does not anticipate any long-term competitive implications or the need to materially change its mode of conducting business as a result of increased price transparency.

Restructuring

In December 1998, Conoco announced that as a result of a comprehensive review of assets and long-term strategy the Company was making organizational realignments consistent with furthering the efficiency of operations and taking advantage of synergies created by the upgrading of its asset portfolio. The announced plans will be implemented in 1999 and result in a reduction of approximately 775 Upstream positions and 200 Downstream positions worldwide. About three quarters of the Upstream positions and about half of the Downstream positions affected will be in the United States. These reductions largely reflect the elimination of redundancies at all levels resulting from past and ongoing consolidation of assets into operations requiring less employee support, as well as better sharing of common services and functions across regions. Implementation of the plans is being expedited in response to low oil prices and operating margins that lingered through the end of 1998 and are expected to continue in 1999. Associated with these announcements, the Company recorded a charge of $82 million pretax ($52 million after-tax), nearly all of which represents termination payments and related employee benefits to be made to persons affected. Payments will be made under existing company severance policies, generally based on years of service up to a maximum varying by country. On an after-tax basis, the charge is reflected as $19 million and $23 million in Upstream United States and International results, respectively, and $5 million each in Downstream United States and International results. The accrual is reflected in fourth quarter Cost of Goods Sold and Other Operating Expenses. As of December 31, 1998, none of the persons had yet been terminated and no related payments had been made.

New Accounting Standards

The Company adopted Statement No. 131 for the year ended December 31, 1998, and has disclosed segment information on the same basis used internally for evaluating segment performance and deciding how to allocate resources to segments. The Company has assessed the effect of the new disclosure, and adoption of Statement No. 131 had no financial impact on the Company.

In February 1998, the Financial Accounting Standards Board issued Statement No. 132, "Employers' Disclosure About Pension and Other Postretirement Benefits," which revised disclosure requirements for pension and other postretirement benefits. It does not affect the measurement of the expense of the Company's pension and other postretirement benefits. The Company adopted this Statement for the year ended December 31, 1998.

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires that companies recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. The Company is required to adopt this Statement by the first quarter of 2000 and is currently assessing the effect of the new standard.

Statement No. 133 provides, if certain conditions are met, that a derivative may be specifically designated as (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (fair value hedge), (2) a hedge of the exposure to variable cash flows of a forecasted transaction (cash flow hedge) or (3) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security or a foreign-currency-denominated forecasted transaction (foreign currency hedge).

Under Statement No. 133, the accounting for changes in fair value of a derivative depends on its intended use and designation. For a fair value hedge, the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item. For a cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings. For a foreign currency hedge, the gain or loss is reported in other comprehensive income as part of the cumulative translation adjustment. For all other items not designated as hedging instruments, the gain or loss is recognized in earnings in the period of change.

Quantitative and Qualitative Disclosures About Market Risk

Market Risks

Conoco operates in the worldwide crude oil, refined product, natural gas, natural gas liquids and electric power markets and is exposed to fluctuations in hydrocarbon prices, foreign currency rates, and interest rates that can affect the revenues and cost of operating, investing and financing. Conoco's management has used and intends to use financial and commodity-based derivative contracts to reduce the risk in overall earnings and cash flow when the benefits provided are anticipated to more than offset the risk management costs involved.

The Company has established a Financial Risk Management Policy Framework that provides guidelines for entering into contractual arrangements (derivatives) to manage the Company's commodity price, foreign currency rate, and interest rate risks. The Conoco Risk Management Committee has ongoing responsibility for the content of this policy and has principal oversight responsibility to ensure the Company is in compliance with the policy and that procedures and controls are in place for the use of commodity, foreign currency and interest rate instruments. These procedures clearly establish derivative control and valuation processes, routine monitoring and reporting requirements and counterparty credit approval procedures. Additionally, the Company's internal audit group conducts reviews of these risk management activities to assess the adequacy of internal controls. The audit results are reviewed by the Conoco Risk Management Committee and by management.

The counterparties to these contractual arrangements are limited to major financial institutions and other established companies in the petroleum industry. Although the Company is exposed to credit loss in the event of non-performance by these counterparties, this exposure is managed through credit approvals, limits and monitoring procedures, and limits to the period over which unpaid balances are allowed to accumulate. The Company has not experienced non-performance by counterparties to these contracts, and no material loss would be expected from any such non-performance.

Commodity Price Risk

The Company enters into energy-related futures, forwards, swaps and options in various markets to balance its physical systems, to meet customer needs and to manage its price exposure on anticipated crude oil, natural gas, refined product and electric power transactions. These instruments provide a natural extension of the underlying cash market and are used to physically acquire a portion of supply requirements, as well as to manage pricing of near term physical requirements. The commodity futures market has underlying principles of increased liquidity and longer trading periods than the cash market and is one method of managing price risk in the energy business.

Conoco policy is to generally be exposed to market pricing for commodity purchases and sales. From time to time, management may use derivatives to establish longer-term positions to hedge the price risk for the Company's equity crude oil and natural gas production, as well as refinery margins.

Under the Company's policy, hedging includes only those transactions that offset physical positions and reduce overall company exposure to price risk. Trading is defined as any transaction that does not meet the definition of hedging. After-tax gain/loss from risk trading has not been material.

The fair value gain (loss) of outstanding derivative commodity instruments and the change in fair value that would be expected from a ten percent adverse price change are shown in the table below:

	Fair Value	Change In Fair Value From 10% Adverse Price Change
	(In millions)	
At December 31, 1998		
Crude Oil and Refined Products		
Hedging	S (1)	$ (5)
Trading	3	3
Combined	$ 2	$ (2)
Natural Gas		
Hedging	$ (25)	$ (20)
Trading	(2)	(1)
Combined	$ (27)	$ (21)
At December 31, 1997		
Crude Oil and Refined Products		
Hedging	$ (3)	$ (8)
Trading	(6)	(18)
Combined	$ (9)	$ (26)
Natural Gas		
Hedging	$ 8	$ (9)
Trading	—	—
Combined	$ 8	$ (9)

The fair values of the futures contracts are based on quoted market prices obtained from the New York Mercantile Exchange or the International Petroleum Exchange of London. The fair values of swaps and other over-the-counter instruments are estimated based on quoted market prices of comparable contracts and approximate the gain or loss that would have been realized if the contracts had been closed out at year-end.

All hedge positions offset physical positions exposed to the cash market; none of these offsetting physical positions is included in the above table.

Price-risk sensitivities were calculated by assuming an across-the-board ten percent adverse change in prices regardless of term or historical relationships between the contractual price of the instrument and the underlying commodity price. In the event of an actual ten percent change in prompt month crude or natural gas prices, the fair value of the Company's derivative portfolio would typically change less than that shown in the table due to lower volatility in out-month prices.

Additional details regarding accounting policy for these financial instruments are set forth in Note 2 to the Consolidated Financial Statements.

Foreign Currency Risk

Conoco has foreign currency exchange rate risk resulting from operations in over 40 countries around the world. The Company does not comprehensively hedge its exposure to currency rate changes, although it may choose to selectively hedge exposure to foreign currency exchange rate risk. Examples include firm commitments for capital projects, certain local currency tax payments, and cash returns from net investments in foreign affiliates to be remitted within the coming year. At December 31, 1998, the Company had no open forward exchange contracts. At December 31, 1997, the Company had open forward exchange contracts designated as a hedge of firm foreign currency commitments. The notional amount of these contracts was $50 million and the estimated fair value was $38 million.

Interest Rate Risk

Prior to the Offerings, the Company had no material interest rate risk to manage. Subsequent to the Offerings, however, the Company intends to manage any material risk arising from exposure to interest rates by using a combination of financial derivative instruments as part of a program to manage the fixed and floating interest rate mix of the total debt portfolio and related overall cost of borrowing.

Risk of Refinancing Debt Owed to DuPont

Conoco is obligated to repay all outstanding debt owed to DuPont at such time as DuPont's direct or indirect voting power in Conoco falls below 50 percent of the outstanding voting power of Conoco. The Company intends to refinance outstanding related party debt owed to DuPont with a combination of commercial paper and public debt in 1999. On February 12, 1999, Conoco filed a "shelf" registration statement under the Securities Act of 1933 pursuant to which it may issue debt securities. Conoco intends to use the proceeds from issuances of securities under the shelf registration statement to refinance a portion of the outstanding debt owed to DuPont. There can be no assurance that the Company will be able to refinance this debt on terms as favorable as those existing with respect to the debt owed to DuPont.

Report of Management

Management is responsible for the Consolidated Financial Statements of Conoco Inc. (the "Company") and other information appearing in this annual report. The Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles considered by management to present fairly the Company's financial position, results of operations and cash flows. The Consolidated Financial Statements include some amounts that are based on management's best estimates and judgments.

The Company's system of internal controls is designed to provide reasonable assurance as to the protection of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The Company's business ethics policy is the cornerstone of the internal control system. This policy sets forth management's commitment to conduct business worldwide with the highest ethical standards and in conformity with applicable laws. The business ethics policy also requires that all documents supporting transactions clearly describe their true nature and that all transactions be properly reported and classified in the financial records. The system is monitored by an extensive program of internal audit, and management believes that the system of internal controls at December 31, 1998, meets the objective noted above.

The Consolidated Financial Statements have been audited by the Company's independent accountants, PricewaterhouseCoopers LLP. The purpose of their audit is to independently affirm the fairness of management's reporting of financial position, results of operations and cash flows. To express the opinion set forth in their report, they study and evaluate the internal controls to the extent they deem necessary. The adequacy of the Company's internal controls and the accounting principles employed in financial reporting are under the general oversight of the Audit and Compliance Committee of the Board of Directors. This committee also has responsibility for employing the independent accountants, subject to stockholder ratification. No member of this committee may be an officer or employee of the Company. The independent accountants and the internal auditors have direct access to the Audit and Compliance Committee, and they meet with the Audit and Compliance Committee from time to time, with and without management present, to discuss accounting, auditing and financial reporting matters.

Archie W. Dunham

Archie W. Dunham
President and Chief Executive Officer

R.W. Goldman

Robert W. Goldman
Senior Vice President, Finance, and Chief Financial Officer

W. David Welch

W. David Welch
Controller

Report of Independent Accountants

To the Stockholders and the Board of Directors of Conoco Inc.

In our opinion, the consolidated financial statements appearing on pages 45 through 71 of this annual report present fairly, in all material respects, the financial position of Conoco Inc. and its subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Houston, Texas
February 15, 1999

Consolidated Statement of Income

(In millions, except per share)

	Year Ended December 31		
	1998	1997	1996
Revenues			
Sales and Other Operating Revenues*	$ 22,796	$ 25,796	$ 24,230
Other Income (Note 4)	372	467	186
Total Revenues	23,168	26,263	24,416
Costs and Expenses			
Cost of Goods Sold and Other Operating Expenses	13,840	16,226	14,560
Selling, General and Administrative Expenses	736	726	755
Stock Option Provision (Note 22)	236	—	—
Exploration Expenses	380	457	404
Depreciation, Depletion and Amortization	1,113	1,179	1,085
Taxes Other Than on Income* (Note 5)	5,970	5,532	5,637
Interest and Debt Expense (Note 6)	199	36	74
Total Costs and Expenses	22,474	24,156	22,515
Income Before Income Taxes	694	2,107	1,901
Provision for Income Taxes (Note 7)	244	1,010	1,038
Net Income	$ 450	$ 1,097	$ 863
Earnings Per Share (Note 8)**			
Basic	$ .95	$ 2.51	$ 1.98
Diluted	$ .95	$ 2.51	$ 1.98
Weighted Average Shares Outstanding:			
Class A**	37	—	—
Class B	437	437	437
Total Basic	474	437	437
Stock Options**	1	—	—
Total Diluted	475	437	437
* Includes petroleum excise taxes	$ 5,801	$ 5,349	$ 5,461

** Earnings Per Share for the periods prior to the Offerings was calculated using only Class B Common Stock, as required by SFAS No. 128 (see Note 8).

See accompanying Notes to Consolidated Financial Statements

Consolidated Balance Sheet

(In millions)

	December 31 1998	December 31 1997
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 394	$ 1,147
Marketable Securities	—	7
Accounts and Notes Receivable (Note 9)	1,191	1,497
Notes Receivable — Related Parties (Note 3)	—	490
Inventories (Note 10)	807	830
Prepaid Expenses	378	236
Total Current Assets	2,770	4,207
Property, Plant and Equipment (Note 11)	22,094	21,229
Less: *Accumulated Depreciation, Depletion and Amortization*	(10,681)	(10,401)
Net Property, Plant and Equipment	11,413	10,828
Investment in Affiliates (Note 12)	1,363	1,085
Long-Term Notes Receivable — Related Parties (Note 3)	—	450
Other Assets (Note 13)	529	492
Total	$ 16,075	$ 17,062
LIABILITIES AND STOCKHOLDERS' EQUITY/OWNER'S NET INVESTMENT		
Current Liabilities		
Accounts Payable (Note 14)	$ 1,312	$ 1,090
Short-Term Borrowings — Related Parties (Note 3)	—	644
Other Short-Term Borrowings and Capital Lease Obligations (Note 15)	52	72
Income Taxes (Note 7)	199	545
Other Accrued Liabilities (Note 16)	1,162	1,289
Total Current Liabilities	2,725	3,640
Long-Term Borrowings — Related Parties (Note 3)	4,596	1,450
Other Long-Term Borrowings and Capital Lease Obligations (Note 17)	93	106
Deferred Income Taxes (Note 7)	1,714	1,739
Other Liabilities and Deferred Credits (Note 18)	2,200	1,922
Total Liabilities	11,328	8,857
Commitments and Contingent Liabilities (Note 26)		
Minority Interests (Note 19)	309	309
Owner's Net Investment	—	8,087
Stockholders' Equity (Note 20)		
Preferred Stock, $.01 par value:		
250,000,000 shares authorized; none issued	—	—
Class A Common Stock, $.01 par value:		
3,000,000,000 shares authorized; 191,497,821 shares issued	2	—
Class B Common Stock, $.01 par value:		
1,600,000,000 shares authorized; 436,543,573 shares issued and outstanding	4	—
Additional Paid-In Capital	4,955	—
Accumulated Deficit	(244)	—
Accumulated Other Comprehensive Loss (Note 21)	(274)	(191)
Treasury Stock, at cost (249,863 Class A shares)	(5)	—
Total Stockholders' Equity	4,438	(191)
Total Stockholders' Equity/Owner's Net Investment	4,438	7,896
Total	$ 16,075	$ 17,062

See accompanying Notes to Consolidated Financial Statements

Consolidated Statement of Stockholders' Equity/Owner's Net Investment and Accumulated Other Comprehensive Loss (Notes 20 and 21)

(In millions)

	Owner's Net Investment	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Comprehensive Income	Accumulated Other Comprehensive Loss	Treasury Stock
Balance January 1, 1996	$ 6,762					$ (8)	
Comprehensive Income							
Net Income	863				$ 863		
Other Comprehensive Income (Loss):							
Foreign Currency Translation Adjustment					(39)		
Minimum Pension Liability Adjustment					(10)		
Other Comprehensive Loss					(49)	(49)	
Comprehensive Income					$ 814		
Net Cash Contribution to Owner	(993)						
Other Transfer from Owner	4						
Balance December 31, 1996	6,636					(57)	
Comprehensive Income							
Net Income (Loss)	1,097				$ 1,097		
Other Comprehensive Income (Loss):							
Foreign Currency Translation Adjustment					(121)		
Minimum Pension Liability Adjustment					(13)		
Other Comprehensive Loss					(134)	(134)	
Comprehensive Income					$ 963		
Net Cash Contribution from Owner	360						
Other Transfers to Owner	(6)						
Balance December 31, 1997	8,087					(191)	
Comprehensive Income							
Net Income (Loss)	694			$ (244)	$ 450		
Other Comprehensive Income (Loss):							
Foreign Currency Translation Adjustment					(25)		
Minimum Pension Liability Adjustment					(58)		
Other Comprehensive Loss					(83)	(83)	
Comprehensive Income					$ 367		
Net Cash Contribution to Owner	(512)						
Dividends to Owner (Note 3)	(8,200)						
Other Transfers from Owner	433						
Capitalization from Owner at Offerings	(502)	$ 4	$ 498				
Initial Public Offerings		2	4,226				
Compensation Plans			(5)				
Treasury Stock Purchases							$ (5)
Stock Option Provision (Note 22)			236				
Balance December 31, 1998	$ —	$ 6	$ 4,955	$ (244)		$ (274)	$ (5)

See accompanying Notes to Consolidated Financial Statements

Consolidated Statement of Cash Flows
(In millions)

	Year Ended December 31 1998	1997	1996
Cash Provided by Operations			
Net Income	$ 450	$ 1,097	$ 863
Adjustments to Reconcile Net Income to Cash Provided by Operations:			
Depreciation, Depletion and Amortization	1,113	1,179	1,085
Dry Hole Costs and Impairment of Unproved Properties	163	169	137
Stock Option Provision (Note 22)	236	—	—
Inventory Write-down to Market (Note 10)	97	—	—
Deferred Income Taxes (Note 7)	(32)	16	10
Income Applicable to Minority Interests	21	24	19
Other Non-Cash Charges and Credits — Net	(137)	(271)	66
Decrease (Increase) in Operating Assets:			
Accounts and Notes Receivable	125	127	(280)
Inventories	(62)	(79)	22
Other Operating Assets	(172)	(96)	10
Increase (Decrease) in Operating Liabilities:			
Accounts Payable and Other Operating Liabilities	(85)	622	362
Accrued Interest and Income Taxes (Notes 6 and 7)	(344)	88	102
Cash Provided by Operations	1,373	2,876	2,396
Investing Activities (Note 24)			
Purchases of Property, Plant and Equipment	(1,965)	(2,644)	(1,616)
Investments in Affiliates	(385)	(339)	(326)
Proceeds from Sales of Assets and Subsidiaries	721	565	328
Net Decrease (Increase) in Short-Term Financial Instruments	31	381	(33)
Cash Used for Investing Activities	(1,598)	(2,037)	(1,647)
Financing Activities			
Short-Term Borrowings — Receipts	—	24	—
— Payments	(26)	(2)	(90)
Other Long-Term Borrowings — Receipts	—	33	38
— Payments	(4)	(3)	(1)
Proceeds from Initial Public Offerings (Notes 3 and 20)	4,228	—	—
Treasury Stock Purchases	(5)	—	—
Transactions with Related Parties:			
Notes Receivable — Receipts	444	9	402
— Payments	(152)	(617)	(9)
Borrowings — Receipts	927	413	706
— Payments	(5,434)	(695)	(520)
Net Cash Contribution From (To) Owner	(512)	360	(993)
Increase (Decrease) in Minority Interests (Note 19)	(21)	(21)	280
Cash Used for Financing Activities	(555)	(499)	(187)
Effect of Exchange Rate Changes on Cash	27	(39)	(2)
Increase (Decrease) in Cash and Cash Equivalents	(753)	301	560
Cash and Cash Equivalents at Beginning of Year	1,147	846	286
Cash and Cash Equivalents at End of Year	$ 394	$ 1,147	$ 846

	1998
Supplemental Schedule of Non-Cash Financing Activities:	
Transactions with Related Parties (Note 3):	
Dividends to Owner	$ (8,200)
Promissory Note Issued	7,500
Notes Receivable Reduced	700
Borrowings Contributed to Capital	(544)
Total Non-Cash Financing Activities	$ (544)

See accompanying Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

(Dollars in millions, except per share)

1. Basis of Presentation

Conoco Inc., including its consolidated subsidiaries, ("Conoco" or the "Company") is an integrated, global energy company that is involved in the Upstream and Downstream segments of the petroleum business. Activities of the Upstream operating segment include exploring for, and developing, producing and selling crude oil, natural gas and natural gas liquids. Activities of the Downstream operating segment include refining crude oil and other feedstocks into petroleum products, buying and selling crude oil and refined products and transporting, distributing and marketing petroleum products. The Company has four reporting segments for its Upstream and Downstream operating segments, reflecting geographic division between the United States and International. Corporate and Other includes general corporate expenses, financing costs and other non-operating items, and results for electric power and related-party insurance operations.

The initial public offerings (the "Offerings") of the Class A Common Stock of Conoco, a subsidiary of E.I. du Pont de Nemours and Company ("DuPont"), commenced on October 21, 1998, and the Class A Common Stock began trading on the New York Stock Exchange on October 22, 1998. The Offerings consisted of 191,456,427 shares of Class A Common Stock issued at a price of $23 per share, and represented DuPont's first step in the planned divestiture of its entire petroleum business. Through its ownership of 100% of the Company's Class B Common Stock (436,543,573 shares), DuPont owned approximately 70% of the Company's common stock representing approximately 92% of the combined voting power of all classes of voting stock of the Company at December 31, 1998. The holders of Class A Common Stock and Class B Common Stock generally have identical rights, except that holders of Class A Common Stock are entitled to one vote per share while holders of Class B Common Stock are entitled to five votes per share on matters to be voted on by stockholders.

Effective at the time of the Offerings, Conoco's capital structure was established and the transfer to Conoco of certain subsidiaries previously owned by DuPont was substantially complete, resulting in direct ownership of those subsidiaries. Accordingly, for periods subsequent to the Offerings, financial information is presented on a consolidated basis.

Prior to the date of the Offerings, operations were conducted by Conoco Inc., subsidiaries of Conoco Inc. and, in some cases, subsidiaries of DuPont. The accompanying Consolidated Financial Statements for these periods are presented on a carve-out basis prepared from DuPont's historical accounting records, and include the historical operations of both entities owned by Conoco and operations transferred to Conoco by DuPont at the time of the Offerings. In this context, no direct ownership relationship existed among all the various units comprising Conoco. Accordingly, DuPont and its subsidiaries' net investment in Conoco ("Owner's Net Investment") is shown in lieu of Stockholders' Equity in the Consolidated Financial Statements. Net Cash Contributions from/to Owner prior to the Offerings include funds transferred between Conoco and DuPont for operating needs, cash dividends paid and other equity transactions.

The Consolidated Statement of Income includes all revenues and costs directly attributable to Conoco, including costs for facilities, functions and services used by Conoco at shared sites and costs for certain functions and services performed by centralized DuPont organizations and directly charged to Conoco based on usage. In addition, services performed by Conoco on DuPont's behalf are directly charged to DuPont. The results of operations also include allocations of DuPont's general corporate expenses through the date of the Offerings.

Prior to the date of the Offerings, all charges and allocations of cost for facilities, functions and services performed by DuPont organizations for Conoco have been deemed to have been paid by Conoco to DuPont, in cash, in the period in which the cost was recorded in the Consolidated Financial Statements. Allocations of current income taxes receivable or payable are similarly deemed to have been remitted, in cash, by or to DuPont in the period the related income taxes were recorded. Subsequent to the Offerings, such costs are billed directly under transitional service agreements, and income taxes are paid directly to the taxing authorities, or to DuPont, as appropriate.

All of the allocations and estimates in the Consolidated Financial Statements are based on assumptions that management believes are reasonable under the circumstances. However, these allocations and estimates are not necessarily indicative of the costs and expenses that would have resulted if Conoco had been operated as a separate entity for periods prior to the Offerings.

Notes to Consolidated Financial Statements
(Dollars in millions, except per share)

2. Summary of Significant Accounting Policies

Basis of Consolidation

The accounts of wholly owned and majority-owned subsidiaries are included in the Consolidated Financial Statements. The equity method is used to account for investments in corporate entities, partnerships and limited liability companies in which the Company exerts significant influence, generally having a 20-50% ownership interest. The Company's 50.1 percent non-controlling interest in Petrozuata C.A. in Venezuela is accounted for using the equity method because the minority shareholder, a subsidiary of the national oil company of the Republic of Venezuela, has substantive participating rights. Undivided interests in oil and gas joint ventures and transportation assets are combined on a pro rata basis. Other investments, excluding marketable securities, are carried at cost.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results may differ from those estimates and assumptions.

Cash Equivalents

Cash equivalents represent investments with maturities of three months or less from time of purchase. They are carried at cost plus accrued interest, which approximates fair value.

Inventories

Inventories are carried at the lower of cost or market. Cost is determined under the last-in, first-out ("LIFO") method for inventories of crude oil and petroleum products. Cost for remaining inventories, principally materials and supplies, is generally determined by the average cost method. Market is determined on a regional basis and any lower of cost or market write-down is recorded as a permanent adjustment to the cost of inventory.

Property, Plant and Equipment ("PP&E")

PP&E is carried at cost. Depreciation of PP&E, other than oil and gas properties, is generally computed on a straight-line basis over the estimated economic lives of the facilities, which for major assets range from 14 to 25 years. When assets that are part of a composite group are retired, sold, abandoned or otherwise disposed of, the cost, net of sales proceeds or salvage value, is charged against the accumulated reserve for depreciation, depletion and amortization ("DD&A"). Where depreciation is accumulated for specific assets, gains or losses on disposal are included in period income.

Maintenance and repairs are charged to expense; replacements and improvements are capitalized.

Oil and Gas Properties

The Company follows the successful efforts method of accounting, under which the costs of property acquisitions, successful exploratory wells, development wells and related support equipment and facilities are capitalized. The costs of producing properties are amortized at the field level on a unit-of-production method.

Unproved properties which are individually significant are periodically assessed for impairment, whereas the impairment of individually insignificant properties is provided by amortizing the costs based on past experience and the estimated holding period. Exploratory well costs are expensed in the period the well is determined to be unsuccessful. All other exploration costs, including geological and geophysical costs, production costs and overhead costs, are expensed in the period incurred.

The estimated costs of dismantlement and removal of oil and gas related facilities are accrued over the properties' productive lives using the unit-of-production method and recognized as a liability as the amortization expense is recorded.

Impairment of Long-Lived Assets

Long-lived assets with recorded values that are not expected to be recovered through future cash flows are written down to current fair value through additional amortization or depreciation provisions. Fair value is generally determined from estimated discounted future net cash flows.

Environmental Costs

Environmental expenditures are expensed or capitalized, as appropriate, depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations, and that do not have future economic benefit, are expensed. Liabilities related to these future costs are recorded on an undiscounted basis when environmental assessments and/or remediation activities are probable and the costs can be reasonably estimated.

Stock Compensation

The Company applies Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for stock options. Pro forma information regarding changes in net income and earnings per share data if the accounting prescribed by Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," had been applied is presented in Note 22.

Income Taxes

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

Prior to the date of the Offerings, Conoco was included in the DuPont consolidated tax return and the provision for income taxes was determined using the loss benefit method. Under the loss benefit method, the current tax provision or benefit is allocated based on the amount expected to be paid or received from the consolidated group and benefits of losses and credit carry forwards are recorded when such benefits are expected to be realized by members of the consolidated group. The pro forma effect on the Consolidated Statement of Income reflecting the provision for income taxes on a separate return basis prior to the Offerings is not material. For periods ending after the Offerings, Conoco will file a separate tax return. Accordingly, for periods subsequent to the Offerings, the provision for income taxes has been determined on a separate tax return basis.

Provision has been made for income taxes on unremitted earnings of subsidiaries and affiliates, except in cases in which earnings are deemed to be permanently invested.

Foreign Currency Translation

Local currency is the functional currency for the Company's integrated Western European petroleum operations. For subsidiaries whose functional currency is the local currency, assets and liabilities denominated in local currency are translated into United States dollars at end-of-period exchange rates. The resultant translation adjustment is a component of Accumulated Other Comprehensive Loss (see Note 21). Assets and liabilities denominated in other than the local currency are remeasured into the local currency prior to translation into United States dollars, and the resultant exchange gains or losses, together with their related tax effects, are included in income in the period in which they occur. Income and expenses are translated into United States dollars at average exchange rates in effect during the period.

For subsidiaries where the United States dollar is the functional currency, all foreign currency asset and liability amounts are remeasured into United States dollars at end-of-period exchange rates, except for inventories, prepaid expenses and property, plant and equipment, which are remeasured at historical rates. Foreign currency income and expenses are remeasured at average exchange rates in effect during the year, except for expenses related to balance sheet amounts, which are remeasured at historical exchange rates. Exchange gains and losses arising from remeasurement of foreign currency-denominated monetary assets and liabilities are included in current period income.

Effective January 1, 1999, the Euro was adopted as the local currency by 11 countries participating in the European Economic and Monetary Union. For those countries in which the Company operates, the Euro concurrently became the functional currency.

Commodity Hedging and Trading Activities

The Company enters into energy-related futures, forwards, swaps, and options in various markets to balance its physical systems, to meet customer needs, and to manage its exposure to price fluctuations on anticipated crude oil, natural gas, refined product and electric power transactions.

Under the Company's policy, hedging includes only those transactions that offset physical positions and reduce overall Company exposure to price risk. Trading is defined as any transaction that does not meet the definition of hedging.

Gains and losses on hedging contracts are deferred and included in the measurement of the related transaction. Changes in market values of trading contracts are reflected in income in the period the change occurs.

In the event a derivative designated as a hedge is terminated prior to the maturation of the hedged transaction, gains or losses realized at termination are deferred and included in the measurement of the hedged transaction. If a hedged transaction matures, is sold, extinguished or terminated prior to the maturity of a derivative designated as a hedge of such transaction, gains or losses associated with the derivative through the date the transaction matured are included in the measurement of the hedged transaction and the derivative is reclassified as for trading purposes. Derivatives designated as a hedge of an anticipated transaction are reclassified as for trading purposes if the anticipated transaction is no longer likely to occur.

In the Consolidated Statement of Cash Flows, the Company reports the cash flows resulting from its hedging activities in the same category as the related item that is being hedged.

Recent Accounting Standards

In June 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which the Company has adopted for the year ended December 31, 1998. This standard requires disclosing segment information on the same basis used internally for evaluating segment performance and deciding how to allocate resources to segments. It also requires disclosure of revenue and long-lived assets attributed to operations in individual countries outside the United States for which such information is material. No substantive changes in segment reporting resulted from this standard. The Company has four reporting segments for its Upstream and Downstream operating segments, reflecting geographic division between the United States and International. In addition, geographic reporting changed with revenues and long-lived assets attributed to operations in the United Kingdom, Germany and Norway disclosed separately.

In February 1998, the FASB issued SFAS No. 132, "Employers' Disclosure About Pensions and Other Postretirement Benefits," that revised disclosure requirements for pension and other postretirement benefits. This statement did not affect measurement of the expense of the Company's pension and other postretirement benefits. The Company has adopted the disclosure requirements of this Statement for the year ended December 31, 1998.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires that companies recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. SFAS No. 133 provides, if certain conditions are met, that a derivative may be specifically designated as (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (fair value hedge), (2) a hedge of the exposure to variable cash flows of a forecasted transaction (cash flow hedge), or (3) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security or a foreign-currency-denominated forecasted transaction (foreign currency hedge). Under SFAS No. 133, the accounting for changes in fair value of a derivative depends on its intended use and designation. For a fair value hedge, the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item. For a cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings. For a foreign currency hedge, the gain or loss is reported in other comprehensive income as part of the cumulative translation adjustment. For all other items not designated as hedging instruments, the gain or loss is recognized in earnings in the period of change. The Company is required to adopt this Statement by the first quarter of 2000 and is currently assessing its effect on the Consolidated Financial Statements.

3. Related Party Transactions

The Consolidated Financial Statements include significant transactions with DuPont involving services (such as cash management, other financial services, purchasing, legal, computer and corporate aviation) and general corporate expenses that were provided between Conoco and centralized DuPont organizations. For periods prior to the Offerings, the costs of services have been directly charged or allocated between Conoco and DuPont using methods management believes are reasonable. These methods include negotiated usage rates, dedicated asset assignment and proportionate corporate formulas involving assets, revenues and employees. Such charges and allocations are not necessarily indicative of what would have been incurred if Conoco had been a separate entity.

Amounts charged and allocated to Conoco for these services were $121, $125 and $101 for the years 1998, 1997 and 1996, respectively, and are principally included in Selling, General and Administrative Expenses. Conoco provided DuPont services, such as computer, legal and purchasing, as well as certain technical and plant operating services, which amounted to $61, $62 and $66 in 1998, 1997 and 1996, respectively. These charges to DuPont were treated as reductions, as appropriate, of Cost of Goods Sold and Other Operating Expenses or Selling, General and Administrative Expenses.

Interest expense charged by DuPont was $264, $124 and $143 for the years 1998, 1997 and 1996, respectively, and reflects market-based interest rates. A portion of this and other interest and debt expense was capitalized as cost associated with major construction projects. Interest income from DuPont was $43, $11 and $57 for the same years and also reflects market-based interest rates.

Sales and Other Operating Revenues include sales of products from Conoco to DuPont, principally natural gas and gas liquids to supply several DuPont plant sites. These sales totaled $427, $420 and $413 for the years 1998, 1997 and 1996, respectively. Also included are revenues from insurance premiums charged to DuPont for property and casualty coverage outside the United States. These revenues totaled $20, $22 and $21 for the years 1998, 1997 and 1996, respectively. Purchases of products from DuPont during these periods were not material.

Subsequent to the Offerings, these intercompany arrangements between DuPont and Conoco, excluding insurance coverage provided to DuPont, are being provided under transition service agreements or other long-term agreements. It is not anticipated that a change, if any, in these costs and revenues would have a material effect on the Company's results of operations or consolidated financial position.

Accounts and Notes Receivable include amounts due from DuPont of $80 and $79 at December 31, 1998 and 1997, respectively, representing current month balances of transactions between Conoco and DuPont, mainly product sales and certain charges billed annually. Accounts Payable include amounts due DuPont of $52 and $4 at December 31, 1998 and 1997, respectively. Other Liabilities include accrued interest of $51 due DuPont at December 31, 1998.

Amounts representing notes receivable or borrowings from DuPont, including its subsidiary organizations, are identified as related parties and presented separately in the Consolidated Balance Sheet. The current portion of Notes Receivable represents the accumulation of a variety of cash transfers and operating transactions with DuPont. These balances are generally interest bearing and represent net amounts of cash transferred for funding and cash management purposes and amounts charged between the companies for certain product and service purchases. At December 31, 1997, the long-term portion of Notes Receivable and amounts shown for Short-Term and Long-Term Borrowings represent borrowings between Conoco and DuPont with established due dates at market-based interest rates, except for certain short-term non-interest bearing borrowings due DuPont of $492. At December 31, 1998, related balances only reflected long-term borrowings due DuPont as further described.

In July 1998, a dividend was declared and paid by the Company in the form of a promissory note (the "Note") to DuPont in the aggregate principal amount of $7,500 bearing interest at a rate of 6.0125 percent per annum and due on January 2, 2000. The Note may be voluntarily prepaid without penalty or premium. The Note also provides for mandatory prepayments in the event cash proceeds are realized by the Company from the incurrence of indebtedness or the issuance of equity securities by the Company or its subsidiaries. The Note includes certain covenants and customary events of default, including failure to pay interest when due, certain events of bankruptcy of the Company and change of control. The consent of DuPont is also required prior to the Company entering into certain transactions.

In September 1998, the Company declared a dividend of $700 paid through a reduction of notes receivable from DuPont and further certain intercompany notes were created.

The net proceeds from the Offerings referred to in Note 1 were $4,228, after deducting the underwriting discounts and commissions payable by the Company. The Company used these net proceeds to repay indebtedness owed to DuPont or purchase a portion of the indebtedness owed by certain subsidiaries of the Company to DuPont as follows:

(a) to pay accrued interest ($124) on the $7,500 Note and then to repay principal ($2,654) on such Note to the extent necessary to reduce the principal amount to $4,846;
(b) to purchase certain intercompany *notes* denominated in Norwegian Kroner with an aggregate principal amount of approximately $461 after conversion to U.S. dollars, together with accrued interest ($9);
(c) to pay accrued interest ($8) and a portion of the principal ($820) on a certain other intercompany note to the extent necessary to reduce the principal amount to $7;
(d) to pay a portion of the principal ($152) on an intercompany demand note which reduced the outstanding balance to $52.

During 1998, DuPont made capital contributions of $544 to the Company reflecting the retirement of certain non-interest bearing borrowings of $492 and the remaining balance of $52 on the foregoing demand note.

Subsequent to the Offerings, the Company made an additional principal payment of $257 on the Note reducing the outstanding balance to $4,589 at December 31, 1998. Aggregate borrowings from related parties at December 31, 1998, totaled $4,596 and reflected a weighted average interest rate of 6.0 percent with maturity on January 2, 2000.

On October 27, 1998, the Company and DuPont entered into a Revolving Credit Agreement under which DuPont will provide the Company with a revolving credit facility in principal amount of up to $500. Loans under the Revolving Credit Agreement will be subject to mandatory repayment to the extent the Company's cash and cash equivalents exceed $325 or such higher amount as the Company and DuPont may agree. Loans under this facility bear interest at a rate equal to 30-day LIBOR plus 0.20 percent per annum and may be voluntarily prepaid without penalty or premium. There was no outstanding debt under this facility on December 31, 1998.

Notes to Consolidated Financial Statements

(Dollars in millions, except per share)

The Company is obligated to repay all outstanding debt owed to DuPont at such time as DuPont's direct or indirect voting power in the Company falls below 50 percent of the outstanding voting power of the Company. The Company intends to refinance outstanding related party debt owed to DuPont with a combination of commercial paper and public debt in 1999.

4. Other Income

	1998	1997	1996
Interest income			
Related parties			
(see Note 3)	$ 43	$ 11	$ 57
Other, net of miscellaneous interest expense	46	66	67
	89	77	124
Equity in earnings of affiliates (see Note 12)	22 [1]	40	(25)
Gain on sales of assets [2]	206	314	84
Exchange gain (loss)	51	27	(5)
Other — net	4	9	8
	$ 372	$ 467	$ 186

(1) Includes a $5 charge for write-down of inventories to market in accordance with the Company's inventory valuation policy (see Note 2).

(2) 1998 includes a gain of $89 from sale of certain Upstream properties in the North Sea and the United States. 1997 includes a gain of $239 from sale of certain Upstream properties in the North Sea.

5. Taxes Other Than on Income

	1998	1997	1996
Petroleum excise taxes			
U.S.	$ 1,286	$ 1,201	$ 1,145
Non-U.S.	4,515	4,148	4,316
	5,801	5,349	5,461
Payroll taxes	42	43	48
Property taxes	64	63	55
Production and other taxes	63	77	73
	$ 5,970	$ 5,532	$ 5,637

6. *Interest and Debt Expense*

	1998	1997	1996
Interest and debt cost incurred			
Related parties			
(see Note 3)	$ 264	$ 124	$ 143
Other	7	6	6
	271	130	149
Less: Interest and debt cost capitalized	72	94	75
Interest and debt expense	$ 199	$ 36	$ 74

Interest paid (net of amounts capitalized) was $145 in 1998, $33 in 1997 and $77 in 1996.

7. Provision for Income Taxes

	1998	1997	1996
Current tax expense			
U.S. federal	$ (57)	$ 64	$ 155
U.S. state and local	10	5	8
Non-U.S.	323	925	865
Total	276	994	1,028
Deferred tax expense			
U.S. federal	(51)	80	(78)
U.S. state and local	(5)	8	—
Non-U.S.	24	(72)	88
Total	(32)	16	10
Provision for Income Taxes	244	1,010	1,038
Foreign Currency Translation [1]	(22)	—	—
Minimum Pension Liability [1]	(26)	(7)	(5)
Total Provision	$ 196	$ 1,003	$ 1,033

(1) Represents respective deferred tax provisions for adjustments included in other comprehensive loss (see Note 21).

Total income taxes paid worldwide were $714 in 1998, $935 in 1997 and $901 in 1996.

The significant components of deferred tax assets and liabilities at December 31, 1998 and 1997 are as follows:

	1998		1997	
	Asset	Liability	Asset	Liability
Property, plant and equipment	$ 233	$ 2,296	$ 182	$ 2,219
Employee benefits	247	—	166	—
Other accrued expenses	237	—	273	—
Inventories	—	90	—	102
Tax loss/tax credit carry forwards	496	—	417	—
Other	25	188	27	169
Total	$ 1,238	$ 2,574	$ 1,065	$ 2,490
Valuation allowances	(423)		(392)	
Net	$ 815		$ 673	

Valuation allowances, which reduce deferred tax assets to an amount that will more likely than not be realized, increased $31 in 1998, primarily reflecting increases in tax assets representing operating losses incurred in exploration and start-up operations. Valuation allowances decreased by $22 in 1997, principally reflecting a $37 decrease related to tax assets representing operating losses which the Company determined will more likely than not be realized in future years. This decrease was partially offset by an increase of $15 reflecting offsets to operating losses. Valuation allowances in 1996 increased by $52 to offset increases in deferred tax assets resulting primarily from operating losses incurred in exploration and start-up operations.

Under the tax laws of various jurisdictions in which the Company operates, deductions or credits that cannot be fully utilized for tax purposes during the current year may be carried forward, subject to statutory limitations, to reduce taxable income or taxes payable in a future year. At December 31, 1998, the tax effect of such carry forwards approximated $496. Of this amount, $312 has no expiration date, $3 expires in 1999, $5 expires in 2000, $75 expires in 2001, $46 expires in 2002, and $55 expires in 2003 and later years.

Current deferred tax liabilities (included in the Consolidated Balance Sheet caption "Income Taxes") were $76 and $122 at December 31, 1998 and 1997, respectively.

Current deferred tax assets included in Prepaid Expenses were $7 at December 31, 1997. In addition, Other Assets includes deferred tax assets of $31 and $37 at December 31, 1998 and 1997, respectively.

An analysis of the Company's effective income tax rate follows:

	1998	1997	1996
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
Higher effective tax rate on non-U.S. operations	7.8	13.9	21.6
Alternative fuels credit	(8.2)	(3.0)	(3.4)
Reduced tax benefit from Stock Option Provision	4.9	—	—
Realization of unbenefited loss from sale of subsidiary	(4.6)	—	—
Other — net	0.3	2.0	1.4
Effective income tax rate	35.2%	47.9%	54.6%

Earnings before income taxes shown below are based on the location of the corporate unit to which such earnings are attributable. However, since such earnings are often subject to taxation in more than one country, the income tax provision shown above as U.S. or non-U.S. does not correspond to the earnings set forth below.

	1998	1997	1996
U.S	$ (173)	$ 740	$ 563
Non-U.S.	867	1,367	1,338
	$ 694	$ 2,107	$ 1,901

At December 31, 1998 and 1997, respectively, unremitted earnings of non-U.S. subsidiaries totaling $1,536 and $1,645 were deemed to be permanently invested. No deferred tax liability has been recognized with regard to the remittance of such earnings. It is not practicable to estimate the income tax liability that might be incurred if such earnings were remitted to the United States.

8. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income (the numerator) by the weighted average number of common shares outstanding plus the effects of award and fee deferrals that are invested in Conoco stock units by certain employees and directors of the Company (the denominator). Diluted EPS is similarly computed, except that the denominator is increased to include the dilutive effects of outstanding stock options awarded under Conoco's compensation plans (see Note 22).

(Dollars in millions, except per share)

As described in Note 1, the Company's capital structure was established at the time of the Offerings. In accordance with SEC Staff Accounting Bulletin No. 98, the capitalization of Class B Common Stock has been retroactively reflected for the purposes of presenting earnings per share for periods prior to the Offerings. For the period subsequent to the Offerings, basic EPS reflects the Class B Common Stock plus the weighted average from the date of the Offerings of Class A Common Stock and deferred award units outstanding at the date of the Offerings. Corresponding diluted EPS for 1998 includes an additional 1,659,816 shares representing the weighted average dilutive effect of outstanding stock options that resulted from the concurrent cancellation of DuPont stock options at the date of the Offerings and issuance of options with respect to Class A Common Stock.

The denominator is based on the following weighted average number of common shares outstanding:

	1998	1997	1996
Basic	473,826,632	436,543,573	436,543,573
Diluted	475,486,448	436,543,573	436,543,573

Variable stock options for 1,724,146 shares of common stock were outstanding at December 31, 1998, but were not included in the computation of diluted EPS since the threshold price of $32.88 required for these options to be vested had not been reached.

Common shares held as Treasury Stock are deducted in determining the number of shares outstanding.

Management View

The substance of the Offerings was the sale by DuPont of approximately 30 percent ownership of Conoco. Therefore, management believes a more meaningful presentation of basic EPS is to divide historical net income for all periods presented by the total Class A and Class B Common Stock plus deferred award units outstanding immediately after the Offerings. For diluted EPS, weighted average shares have been adjusted to reflect the effect of outstanding stock options immediately after the offerings as though outstanding for all periods presented. Using this presentation, but excluding any pro forma adjustment for additional interest expense on the dividend Note (see Note 3), EPS would be as follows:

	1998	1997	1996
Basic	$ .72	$ 1.75	$ 1.37
Diluted	$ .71	$ 1.72	$ 1.36

9. Accounts and Notes Receivable

	December 31	
	1998	1997
Trade	$ 805	$ 916
Related parties (see Note 3)	80	79
Other	306	502
	$ 1,191	$ 1,497

See Note 27 for a description of operating segment markets and associated concentrations of credit risk.

10. Inventories

	December 31	
	1998	1997
Crude oil and petroleum products	$ 661	$ 675
Other merchandise	22	25
Materials and supplies	124	130
	$ 807	$ 830

As a result of reduced crude oil and petroleum product price levels, a write-down to market of $97 was made in the fourth quarter of 1998, in accordance with the Company's inventory valuation policy (see Note 2). At December 31, 1997, the excess of market over book value of inventories valued under the LIFO method was $152. Inventories valued at LIFO represented 82 percent and 81 percent of consolidated inventories at December 31, 1998 and 1997, respectively.

During 1998, 1997 and 1996, certain LIFO inventory quantities were reduced resulting in partial liquidation of the LIFO bases, with no material effect on net income.

11. Property, Plant and Equipment

	December 31			
	Gross		Net	
	1998	1997	1998	1997
Oil and Gas Properties				
Unproved	$ 1,159	$ 1,491	$ 942	$ 1,230
Proved	13,488	12,420	6,236	5,480
Other	1,280	1,316	845	871
Total Upstream	15,927	15,227	8,023	7,581
Refining	3,834	3,803	1,958	1,952
Marketing and Distribution	2,255	2,199	1,375	1,295
Total Downstream	6,089	6,002	3,333	3,247
Corporate [1]	78	—	57	—
	$ 22,094	$ 21,229	$ 11,413	$ 10,828

(1) *Includes aviation investment transferred from DuPont in 1998* and corporate software.

Property, Plant and Equipment includes Downstream gross assets acquired under capital leases of $41 at December 31, 1998 and 1997; related amounts included in Accumulated Depreciation, Depletion and Amortization were $12 and $10 at December 31, 1998 and 1997, respectively.

12. Summarized Financial Information for Affiliated Companies

Summarized consolidated financial information for affiliated companies for which Conoco uses the equity method of accounting (see Note 2, "Basis of Consolidation") is shown below on a 100 percent basis. The most significant of these affiliates are Malaysia Refining Company Sdn. Bhd. (40%), Petrozuata C.A. (50.1% – see Note 2), CFJ Properties (50%), Pocahontas Gas Partnership (50%), Excel Paralubes (50%), Polar Lights Company (50%), and Česká Rafinérská a.s. (16.33%).

Dividends received from equity affiliates were $105 in 1998, $58 in 1997 and $85 in 1996.

	Year Ended December 31		
	1998	1997	1996
Results of Operations			
Sales [(1)]	$ 6,744	$ 7,521	$ 6,622
Earnings before income taxes	358	556	305
Net income	252	345	140
Conoco's equity in earnings of affiliates (see Note 4)	22	40	(25)

(1) Includes sales to Conoco of $574 in 1998, $568 in 1997 and $359 in 1996.

	December 31	
	1998	1997
Financial Position		
Current assets	$ 2,771	$ 2,543
Non-current assets	8,682	6,826
Total assets	$ 11,453	$ 9,369
Short-term borrowings [(1)]	$ 897	$ 550
Other current liabilities	1,650	1,308
Long-term borrowings [(1)]	4,743	4,364
Other long-term liabilities	1,119	645
Total liabilities	$ 8,409	$ 6,867
Conoco's investment in affiliates (includes advances)	$ 1,363	$ 1,085

(1) Conoco's pro rata interest in total borrowings was $1,828 in 1998 and $1,586 in 1997, of which $967 in 1998 and $826 in 1997 were guaranteed by the Company or DuPont, on behalf of, and indemnified by, the Company. These amounts are included in the guarantees disclosed in Note 26.

At December 31, 1998, Conoco's equity in undistributed earnings of its affiliated companies was $114.

13. Other Assets

	December 31	
	1998	1997
Prepaid pension cost (see Note 23)	$ 50	$ 71
Long-term receivables	71	74
Other securities and investments [(1)]	116	100
Deferred pension transition obligation (see Note 23)	109	116
Other [(2)]	183	131
	$ 529	$ 492

(1) Includes $74 and $97 at December 31, 1998 and 1997, respectively, representing marketable securities classified as available for sale and reported at fair value. The remainder represents investments which are reported at cost.

(2) Includes intangible assets of $14 and $15 at December 31, 1998 and 1997, respectively.

14. Accounts Payable

	December 31	
	1998	1997
Trade	$ 906	$ 969
Payables to banks	124	85
Related parties (see Note 3)	52	4
Other	230 [(1)]	32
	$ 1,312	$ 1,090

(1) Includes $158 for property acquisitions.

Payables to banks represent checks issued on certain disbursement accounts but not presented to the banks for payment.

15. Other Short-Term Borrowings and Capital Lease Obligations

	December 31	
	1998	1997
Industrial development bonds	$ 24	$ 24
Bank borrowings (foreign currency)	—	21
Long-term borrowings payable within one year	26	25
Capital lease obligations	2	2
	$ 52	$ 72

(Dollars in millions, except per share)

The Company has uncommitted short-term bank credit lines of approximately $122 and $42 at December 31, 1998 and 1997, respectively. These lines are denominated in United States dollars or various foreign currencies to support general international operating needs. No significant advances were outstanding under these lines at these respective dates.

The weighted average interest rate on other short-term borrowings outstanding at December 31, 1998 and 1997 was 3.8 percent and 3.7 percent, respectively.

16. Other Accrued Liabilities

	December 31	
	1998	1997
Taxes other than on income	$ 354	$ 376
Operating expenses	293	343
Payroll and other employee-related costs	102	135
Restructuring costs [1]	82	—
Accrued postretirement benefits cost (see Note 23)	18	24
Other	313	411
	$ 1,162	$ 1,289

(1) Represents estimated charges associated with cost reduction program announced in December 1998. This program is focused on obtaining operational efficiencies,, mainly in the Upstream businesses, and was expedited in response to adverse changes in the current business environment. The program primarily involves the elimination of approximately 975 employee positions on a worldwide basis. The accrual is reflected in Cost of Goods Sold and Other Operating Expenses. At December 31, 1998, no persons had been terminated and no related payments had been made.

17. Other Long-Term Borrowings and Capital Lease Obligations

	December 31	
	1998	1997
5.75% notes due 2026	$ 16	$ 16
6.50% notes due 2008	7	7
Other loans (various currencies) due 1999-2007 [1]	29	30
Capitalization obligation to affiliate due 2008	11	—
Capitalization obligation to affiliate due 1999	—	20
Capital lease obligations	30	33
	$ 93	$ 106

(1) Weighted average interest rates were 7.3 percent at December 31, 1998 and 1997, respectively.

Maturities of long-term borrowings, together with sinking fund requirements for years ending after December 31, 1999, are $4 for each of the years 2000, 2001, 2002 and 2003.

18. Other Liabilities and Deferred Credits

	December 31	
	1998	1997
Deferred gas revenue	$ 371	$ 379 [1]
Accrued postretirement benefits cost (see Note 23)	331	318
Accrued pension liability (see Note 23)	320	230
Abandonment costs	297	310
Environmental remediation costs (see Note 26)	117	132
Related parties (see Note 3)	51	—
Other	713	553
	$ 2,200	$ 1,922

(1) 1997 includes $303 received from a contract for future sales of natural gas to Centrica, a United Kingdom gas marketing company.

19. Minority Interests

In 1996, certain upstream subsidiaries contributed assets with an aggregate fair value of $613 to Conoco Oil & Gas Associates L.P. (COGA) for a general partnership interest of 67 percent. The remaining 33 percent was purchased by Vanguard Energy Investors L.P. (Vanguard) as a limited partner. The net result of this transaction was to increase minority interests by $297.

Vanguard is entitled to a cumulative annual priority return on its investment and participation in residual earnings at rates established in the partnership agreement. The priority return rate, currently 6.52 percent, is scheduled to be renegotiated in the second half of 1999. In the event the parties are unable to agree on a new return rate, Vanguard has the option to call for liquidation of the partnership, which could take place before December 31, 1999. Cash outflows arising from such liquidation should not be materially different from the recorded amount of minority interest.

Vanguard's share of COGA's earnings was $22 or 25 percent in 1998 and $22 or 18 percent in 1997; the net minority interest in COGA held by Vanguard was $302 and $301 on December 31, 1998 and 1997, respectively.

20. Stockholders' Equity

As described in Note 1, the Company's capital structure was established at the time of the Offerings in October 1998.

At December 31, 1998, 4,600,000,000 shares of Class A and Class B Common Stock were authorized and 628,041,394 shares were issued, including 249,863 Class A shares held in the treasury. A summary of activity in common shares outstanding for the year 1998 is presented below:

	Class A	Class B	Total
Issued in connection with initial public offerings of Class A shares and recapitalization of DuPont ownership (Class B shares)	191,456,427	436,543,573	628,000,000
Purchase of shares for treasury (to offset dilution from issuances under compensation plans)	(250,000)	—	(250,000)
Issued on exercise of stock options (including 137 from treasury)	41,531	—	41,531
Common Shares Outstanding - December 31, 1998	191,247,958	436,543,573	627,791,531

At December 31, 1998, 250,000,000 shares of Preferred Stock were authorized, of which 1,000,000 shares were designated Series A Junior Participating Preferred Stock and reserved for issuance on exercise of preferred stock purchase rights under the Company's Share Purchase Rights Plan. Each issued share of Class A and Class B Common Stock has one preferred stock purchase Right attached to it. No preferred shares have been issued and the Rights are not currently exercisable.

Net proceeds received from the Offerings totaled $4,228, after deduction for underwriting discounts and commissions payable by the Company, and were used to reduce indebtedness owed to DuPont (see Note 3). In addition, Additional Paid-In Capital was increased by $236 during 1998 as a result of a corresponding non-cash charge to compensation expense associated with changes in certain outstanding compensation awards made at the time of the Offerings (see Note 22).

The Company declared a first quarter cash dividend on January 27, 1999, of $.14 per share on each outstanding share of Class A Common Stock and Class B Common Stock, payable March 12, 1999, to shareholders of record as of February 12, 1999. This initial dividend was determined on a pro rata basis covering the period from October 27, 1998, to December 31, 1998, and is equivalent to $.19 per share for a full quarter.

21. Accumulated Other Comprehensive Loss

Balances of related after-tax components comprising Accumulated Other Comprehensive Loss are summarized below:

	December 31	
	1998	1997
Foreign Currency Translation Adjustment	$ (185)	$ (160)
Minimum Pension Liability Adjustment (see Note 23)	(89)	(31)
	$ (274)	$ (191)

(Dollars in millions, except per share)

Changes in related components of other comprehensive income (loss) are reported net of associated income tax effects as summarized below:

	Year Ended December 31								
	1998			1997			1996		
	Pretax	Income tax	After-tax	Pretax	Income tax	After-tax	Pretax	Income tax	After-tax
Foreign Currency Translation Adjustment	$ (47)	$ (22)	$ (25)	$ (121)	$ —	$ (121)	$ (39)	$ —	$ (39)
Minimum Pension Liability Adjustment	(84)	(26)	(58)	(20)	(7)	(13)	(15)	(5)	(10)
Other Comprehensive Income (Loss)	$ (131)	$ (48)	$ (83)	$ (141)	$ (7)	$ (134)	$ (54)	$ (5)	$ (49)

22. Compensation Plans

Until the date of the Offerings, employees of Conoco participated in stock-based compensation plans administered through DuPont and involving options to acquire DuPont common stock. At the time of the Offerings, Conoco employees held a total of 10,964,917 stock options for DuPont common stock and 1,333,135 stock appreciation rights (SARs) with respect to DuPont common stock, and the Company gave those persons the option, subject to specific country tax and legal requirements, to participate in a program involving the cancellation of all or part of their DuPont stock options or SARs and the issuance by the Company, upon such cancellation, of comparable options to acquire Class A Common Stock or SARs with respect to Class A Common Stock. The substitute stock options and other awards have the same vesting provisions, option periods and other terms and conditions as the DuPont options and awards they replaced. The substitute stock options had the same ratio of the exercise price per share to the market value per share, and the same aggregated difference between market value and exercise price, as the DuPont stock options. A total of 8,921,508 DuPont stock options and 745,358 DuPont SARs were cancelled with Conoco issuing 24,275,690 stock options for Class A Common Stock and 2,279,834 SARs with respect to Class A Common Stock with comparable terms and conditions. The program was deemed a change in the terms of certain awards granted to Conoco employees. As a result, the Company incurred a non-cash charge to compensation expense of $236 in the fourth quarter of 1998, with a corresponding increase in Additional Paid-In Capital. DuPont retained responsibility for delivery of DuPont common stock to Conoco employees when DuPont stock options not cancelled are exercised.

Awards Under DuPont Plans

Stock option awards under the DuPont Stock Performance Plan were granted to key employees of the Company prior to the Offerings and were "fixed" and/or "variable." The purchase price of shares subject to option is the market price of DuPont stock at the date of grant. In January 1997, a reload feature was added to the Stock Performance Plan to accelerate stock ownership. Generally, fixed options granted under the DuPont Stock Performance Plan are fully exercisable one year after date of grant and expire ten years from date of grant. However, awards in 1998 vest over a three-year period and, except for the last six months of the ten-year option term, are exercisable when the market price of DuPont common stock exceeds the option grant price by 20 percent.

During 1997, variable stock option grants were made to certain senior management and subject to forfeiture if, within five years from the date of grant, the market price of DuPont common stock did not achieve a price of $75 per share for 50 percent of the options and $90 per share for the remaining 50 percent. During 1998, before the Offerings, the $75 price was reached and options with that hurdle became "fixed" and exercisable. All of the outstanding variable DuPont options with a $90 per share hurdle price at the time of the Offerings were cancelled and substituted with options for Conoco Class A Common Stock with a hurdle price of $32.88 per share.

From time to time, the DuPont Board of Directors has approved the adoption of a worldwide Corporate Sharing Program. Under these programs, a majority of the Company's employees received a one-time grant to acquire shares of DuPont common stock at the fair market value at the date of grant. Option terms are "fixed" and generally are exercisable one year after date of grant and expire ten years from date of grant.

Awards Under Conoco Plans

The 1998 Stock and Performance Incentive Plan provides incentives to certain corporate officers, non-employee directors and independent contractors who can contribute materially to the success and profitability of the Company and its subsidiaries and provides for substitution of certain existing DuPont awards in connection with the Offerings. Awards may be in the form of cash, stock, stock options or SARs with respect to Class A Common Stock. This plan also provides for the Conoco Global Variable Compensation Plan, which is an annual management incentive program for officers and certain non-officer employees with awards made in cash and stock. Stock options and SARs granted under the 1998 Stock and Performance Incentive Plan (except those granted to substitute for DuPont awards) are awarded at market price on the date of grant, have a ten year life, and generally vest one year from date of grant with one-third becoming exercisable each of the first three years. For certain senior management, shares otherwise receivable from the exercise of nonqualified options with respect to Class A Common Stock granted under the 1998 Stock and Performance Incentive Plan of Conoco to substitute for cancelled 1998 DuPont stock options, as well as incremental new Conoco stock options granted at the date of the Offerings, can be deferred as stock units for a designated future delivery. The maximum number of shares of common stock and stock options granted under the plan is limited to the higher of 20 million or 3.3 percent of outstanding shares of Class A and Class B Common Stock. Awards made in substitution for DuPont awards do not count against the number of shares available under the plan. At December 31, 1998, 16,850,266 shares of Class A Common Stock were available for issuance under the plan.

The Company adopted the 1998 Key Employee Stock Performance Plan to attract and retain employees by enhancing the proprietary and personal interests of employees in the success and profitability of the Company and to grant some awards in substitution for certain existing DuPont awards in connection with the Offerings. Awards to employees may be in the form of Company stock options or SARs, both with respect to Class A Common Stock. Such awards granted under this plan (except to substitute for DuPont awards) are awarded at market price on the date of grant, have a ten year life, and generally vest one year from date of grant with one-third becoming exercisable each of the first three years. The maximum number of shares of common stock and stock options granted under the plan is limited to the higher of 18 million or three percent of outstanding Class A and Class B Common Stock. Awards made in substitution for DuPont awards do not count against the number of shares available under the plan. At December 31, 1998, 14,484,936 shares of Class A Common Stock were available for issuance under the plan.

Persons electing to substitute Conoco stock options with respect to Class A Common Stock for DuPont stock options and persons receiving incremental new Conoco stock options with respect to Class A Common Stock at the date of the Offerings under the 1998 Stock and Performance Incentive Plan and the 1998 Key Employee Stock Performance Plan are eligible for reload options upon the exercise of stock options, with the condition that shares received from the exercise of the original option may not be sold for at least five years. Reloads are granted at the market price on the reload grant date and have a term equal to the remaining term of the original option. The number of new options granted under a reload option is equal to the number of shares required to satisfy the total exercise price of the original option.

The 1998 Global Performance Sharing Plan is a broad-based plan under which grants of stock options and SARs with respect to Class A Common Stock were made to certain non-officer employees on the date of the Offerings to encourage a sense of proprietorship and an active interest in the financial success of Conoco and its subsidiaries. The stock options and SARs were awarded at the price of the Offerings ($23 per share), have a ten year life, and become exercisable in one-third increments on the first, second and third anniversaries of the grant date. There are no additional shares available for issuance under this plan.

All stock options granted under Conoco plans are "fixed" and have no intrinsic value at grant date except for those granted to substitute for cancelled DuPont options. Accordingly, except for the fourth quarter 1998 charge related to the one-time offer to cancel DuPont options and substitute Conoco options, no compensation expense has been recognized for fixed options.

(Dollars in millions, except per share)

The following table summarizes activity for fixed and variable options for the last three years:

	Fixed		Variable	
	Number of Shares	Weighted-Average Price	Number of Shares	Weighted-Average Price
DuPont Options				
January 1, 1996	7,811,547	$ 24.27	—	—
Granted	1,140,780	39.20	—	—
Exercised	(1,781,277)	23.33	—	—
Forfeited	(95,330)	26.38	—	—
December 31, 1996	7,075,720	$ 26.88	—	—
Granted	2,761,416	52.90	1,259,600	$ 52.50
Exercised	(730,383)	23.97	—	—
Forfeited	(116,325)	50.44	—	—
December 31, 1997	8,990,428	$ 35.14	1,259,600	$ 52.50
Granted	1,241,055	59.53	—	—
Reclassified	629,800	52.50	(629,800)	52.50
Exercised	(460,314)	24.64	—	—
Forfeited	(65,852)	50.68	—	—
October 21, 1998 (Offerings date)	10,335,117	$ 39.50	629,800	$ 52.50
Cancelled for Conoco options	(8,291,708)		(629,800)	
Retained by DuPont	2,043,409		—	
Conoco Options				
Granted at Offerings date:				
For cancelled DuPont options	22,551,544	$ 14.62	1,724,146	$ 19.18
New awards	9,721,750	23.00	—	—
Exercised	(41,531)	14.18	—	—
Forfeited	(53,840)	23.00	—	—
December 31, 1998	32,177,923	$ 17.14	1,724,146	$ 19.18

The following table summarizes information concerning outstanding and exercisable fixed Conoco options at December 31, 1998. For total variable options outstanding at December 31, 1998, the weighted-average remaining contractual life was 3.1 years.

	Exercise Price			
	$5.89 – $8.41	$ 8.90 – $12.80	$14.47 – $21.64	$21.73 – $29.58
Options outstanding	2,766,632	7,335,094	9,281,970	12,794,227
Weighted-average remaining contractual life (years)	2.9	5.5	7.8	9.6
Weighted-average price	$ 7.60	$ 10.02	$ 17.94	$ 22.70
Options exercisable	2,766,632	7,335,094	9,281,970	42,204
Weighted-average price	$ 7.60	$ 10.02	$ 17.94	$ 24.22

Fixed options exercisable at the end of the last three years and the weighted-average fair value of fixed options granted are as follows:

	Conoco Options	DuPont Options		
	1998	1998*	1997	1996
Options exercisable at year-end:				
Number of shares	19,425,900	9,113,046	6,229,012	5,934,940
Weighted-average price	$ 13.49	$ 36.81	$ 27.26	$ 24.51
Weighted-average fair value of options granted during the year:				
New options	$ 4.15	$ 13.85	$ 12.84	$ 9.01
Options substituted for DuPont options	$ 9.22			

*As of the date of the Offerings rather than year-end.

The fair value of Conoco variable options with a hurdle price of $32.88 per share granted as substitutes for DuPont variable options was assumed to be zero.

The fair value of options is calculated using the Black-Scholes option pricing model. Assumptions used were as follows:

	Conoco Options		DuPont Options			
		1998		1997		
	New	Fixed Substitutes	1998 Fixed	Fixed	Variable	1996 Fixed
Dividend yield	3.3%	3.3%	2.1%	2.2%	2.2%	2.6%
Volatility	20.0%*	20.0%*	19.9%	18.6%	18.6%	21.0%
Risk-free interest rate	4.6%	4.4%	5.5%	6.4%	6.4%	5.4%
Expected life (years)	5.8*	3.9*	5.8	5.6	5.7	6.0

* Due to insufficient history, DuPont experience trends have been used to estimate the volatility of Conoco stock and the expected life for exercise of Conoco stock options.

The following table sets forth pro forma information as if the Company had adopted the optional recognition provisions of SFAS No. 123:

	1998	1997	1996
Increase (Decrease) in:			
Net income	$ 157	$ (28)	$ (6)
Earnings per share			
Basic	$ .33	$ (.06)	$ (.01)
Diluted	$ .33	$ (.06)	$ (.01)

Total fair value underpinning the pro forma disclosure for 1998 presented above includes the fair value of new DuPont grants and a pro rata portion of new Conoco grants made at the Offerings date, plus incremental fair value of the Conoco stock options that were substituted for DuPont stock options granted after the adoption of SFAS No. 123. The incremental fair value for cancellation and substitution of stock options originally granted before adoption of SFAS No. 123 is zero because intrinsic value exceeds fair value.

Compensation expense recognized in income for stock-based employee compensation awards was $229, $26 and $13 for 1998, 1997 and 1996, respectively, with 1998 including a one-time charge of $236 for the cancellation of DuPont stock options described above.

Prior to the Offerings, the Conoco Unit Option Plan awarded SARs with respect to DuPont common stock to key salaried employees in certain grade levels who showed early evidence of ability to assume significant responsibility and leadership. At the time of the Offerings, 1,131,494 unit options were outstanding of which 593,722 were cancelled and substituted with comparable SARs with respect to Conoco Class A Common Stock under the 1998 Key Employee Stock Performance Plan of Conoco. Effective with the Offerings, no new grants were made or are planned out of the Conoco Unit Option Plan. At December 31, 1998, outstanding unit options based on Conoco Class A Common Stock were 1,605,614. At December 31, 1998 and 1997, outstanding unit options based on DuPont common stock were 545,724 and 908,532, respectively. At these same dates, related liability provisions totaled $22 and $27, respectively.

Through the date of the Offerings, certain Conoco employees who participated in the DuPont Variable Compensation Plan received grants of stock and cash. Overall amounts were dependent on financial performance of DuPont and Conoco and other factors, and were subject to maximum limits as defined by the plan. Amounts charged against earnings in anticipation of awards to be made later were $39 in 1998, $38 in 1997 and $38 in 1996. Awards made for plan years 1998, 1997 and 1996 were $24, $45 and $38, respectively, with awards distributed in 1999 for the 1998 plan year made out of the 1998 Stock and Performance Incentive Plan of Conoco based on performance standards set previously in the DuPont Variable Compensation Plan. Both the DuPont Variable Compensation Plan and the 1998 Stock and Performance Incentive Plan of Conoco allow future delivery of stock awards. Employees were offered the opportunity to cancel DuPont shares granted under previous awards and receive substitute shares of Conoco Class A Common Stock for designated future delivery under the 1998 Stock and Performance Incentive Plan of Conoco. At December 31, 1998, 72,345 shares of DuPont stock and 199,268 shares of Conoco Class A Common Stock are awaiting delivery. A liability of $4 has been recognized for delivery of DuPont shares.

Awards under the separate Conoco Challenge Program may be granted in cash to employees not covered by the Variable Compensation Plan. This plan provides awards based on meeting financial goals and upholding Conoco's core values. Overall amounts are dependent on Company earnings and cash provided by operations and are subject to maximum limits as defined by the plan. Amounts charged against earnings in anticipation of awards to be made later were $22 in 1998, $49 in 1997 and $47 in 1996. Awards made for plan years 1998, 1997 and 1996 were $19, $47 and $47, respectively.

23. Pensions and Other Postretirement Benefits

The Company participates in the DuPont U.S. defined benefit pension plan, which covers substantially all U.S. employees and has separate defined benefit pension plans covering certain U.S. and non-U.S. employees. The benefits for these plans are based primarily on years of service and employees' pay near retirement. The Company's funding policy is consistent with the funding requirements of federal laws and regulations.

With respect to the DuPont U.S. defined benefit pension plan, the Company and DuPont agreed upon an amount of approximately $820 at the date of the Offerings that will eventually be transferred to a separate trust for the Company's pension plan. Ninety percent of this amount, adjusted for benefit payments and investment return from the date of the Offerings, will be transferred to the Company within six months following the date on which DuPont owns neither 80 percent of the voting power nor 80 percent of the economic value of the Common Stock, assuming certain conditions are satisfied. The remainder will be transferred within a further 90-day period. The adjusted value subject to transfer was approximately $878 at December 31, 1998. DuPont allocated the pension obligations based on the Company's individual employees covered and allocated the unrecognized prior service cost and unrecognized net gain in proportion to the Company's projected benefit obligation to the total projected benefit obligation of the DuPont plan. The projected benefit obligation approximates $871 and $723 at December 31, 1998 and 1997, respectively, and the prepaid pension asset recognized in the Consolidated Balance Sheet (see Note 13) is $50 and $71 at December 31, 1998 and 1997, respectively. The net periodic pension cost components included in the table on page 65 are also based on the foregoing allocation factors.

Pension coverage for employees of the Company's non-U.S. subsidiaries is provided, to the extent deemed appropriate, through separate plans. Obligations under such plans are systematically provided for by depositing funds with trustees, under insurance policies or by book reserves.

Conoco and certain subsidiaries also provide medical and life insurance benefits to retirees and survivors. The associated plans, principally health, are unfunded, and approved claims are paid from Company funds. Under the terms of these plans, the Company reserves the right to change, modify or discontinue the plans. Conoco has communicated to plan participants that any increase in the annual health care escalation rate above 4.5 percent will be borne by the participants and, therefore, result in no increase to the accumulated postretirement benefit obligation or the other postretirement benefits cost.

Net Periodic Benefit Cost	Pension Benefits 1998	Pension Benefits 1997	Pension Benefits 1996	Other Postretirement Benefits 1998	Other Postretirement Benefits 1997	Other Postretirement Benefits 1996
Service cost	$ 65	$ 60	$ 55	$ 7	$ 6	$ 7
Interest cost	94	88	76	21	18	16
Expected return on plan assets	(105)	(98)	(91)	—	—	—
Amortization of prior service cost (credit)	9	2	2	(4)	(4)	(4)
Recognized actuarial loss (gain)	(4)	1	(5)	—	(1)	(1)
Net periodic benefit cost	$ 59	$ 53	$ 37	$ 24	$ 19	$ 18

Information concerning benefit obligations, plan assets, funded status and recorded values for these plans (excluding the DuPont U.S. defined benefit plan) follows:

	Pension Benefits 1998	Pension Benefits 1997	Other Postretirement Benefits 1998	Other Postretirement Benefits 1997
Change in Benefit Obligation				
Benefit obligation at beginning of year	$ 682	$ 533	$ 301	$ 242
Service cost	33	28	7	6
Interest cost	44	39	21	18
Amendments	(4)	—	—	—
Participant contributions	—	—	3	3
Actuarial (gain) loss	160	113	43	58
Divestitures and other	(17)	(2)	—	—
Benefits paid	(32)	(29)	(25)	(26)
Benefit obligation at end of year	$ 866	$ 682	$ 350	$ 301
Change in Plan Assets				
Fair Value of plan assets at beginning of year	$ 386	$ 323	$ —	$ —
Actual return on plan assets	61	48	—	—
Employer contribution	26	28	22	23
Participant contributions	—	—	3	3
Divestitures and other	(14)	—	—	—
Benefits paid	(21)	(13)	(25)	(26)
Fair Value of plan assets at end of year	$ 438	$ 386	$ —	$ —
Funded status of plans at end of year	$ (428)	$ (296)	$ (350)	$ (301)
Unrecognized actuarial loss	240	109	53	14
Unrecognized prior service cost (credit)	109	121	(52)	(55)
Net amount recognized at end of year	$ (79)	$ (66)	$ (349)	$ (342)
Amounts Recognized in Consolidated Balance Sheet at End of Year				
Accrued benefit liability:				
Short-term (see Note 16)	$ —	$ —	$ (18)	$ (24)
Long-term (see Note 18)	(320)	(230)	(331)	(318)
Deferred pension cost (see Note 13)	109	116	—	—
Accumulated other comprehensive loss [1]	132	48	—	—
Net amount recognized	$ (79)	$ (66)	$ (349)	$ (342)

(1) Before reduction for associated deferred tax savings of $43 and $17 at December 31, 1998 and 1997, respectively (see Note 21).

(Dollars in millions, except per share)

Weighted-Average Assumptions at End of Year	Pension Benefits 1998	Pension Benefits 1997	Other Postretirement Benefits 1998	Other Postretirement Benefits 1997
Discount rate [1]	6.50%	7.00%	6.50%	7.00%
Rate of compensation increase [1]	5.15%	5.15%	5.15%	5.15%
Expected return on plan assets [1]	9.00%	9.00%	—	—
Health care escalation rate	—	—	4.50%	4.50%

(1) Represents rates for U.S. plans; similar economic assumptions were used for non-U.S. plans, with the exception of the United Kingdom where discount rates of 6 percent and 7.25 percent were used at year-end 1998 and 1997, respectively.

At December 31, 1998, U.S. defined benefit plan assets consisted principally of common stocks, including 471,667 shares of DuPont.

24. Investing Activities

Purchases of property, plant and equipment in 1997 include $929 for Upstream natural gas properties in South Texas (see Supplementary Petroleum Data).

Non-cash additions to property, plant and equipment totaled $162 and $127 for the years 1998 and 1997, respectively.

Proceeds from sales of assets in 1998 include $245 from the sale of certain Upstream properties in the U.S. and North Sea, $156 for various U.S. Downstream assets, and $54 from sale of a Downstream office building in Europe. Proceeds in 1997 include $272 from the sale of certain Upstream North Sea properties.

25. Financial Instruments and Other Risk Management Activities

Conoco operates in the worldwide crude oil, refined product, natural gas, natural gas liquids and electric power markets and is exposed to fluctuations in hydrocarbon prices, foreign currency rates and interest rates that can affect the revenues and cost of operating, investing and financing. Conoco's management has used and intends to use financial and commodity-based derivative contracts to reduce the risk in overall earnings and cash flow when the benefits provided are anticipated to more than offset the risk management costs involved.

The Company has established a Financial Risk Management Policy Framework that provides guidelines for entering into contractual arrangements (derivatives) to manage the Company's commodity price, foreign currency rate and interest rate risks. The Conoco Risk Management Committee has ongoing responsibility for the content of this policy and has principal oversight responsibility to ensure the Company is in compliance with the policy and that procedures and controls are in place for the use of commodity, foreign currency and interest rate instruments. These procedures clearly establish derivative control and valuation processes, routine monitoring and reporting requirements, and counterparty credit approval procedures. Additionally, the Company's internal audit group conducts reviews of these risk management activities to assess the adequacy of internal controls. The audit results are reviewed by the Conoco Risk Management Committee and by management.

The counterparties to these contractual arrangements are limited to major financial institutions and other established companies in the petroleum industry. Although the Company is exposed to credit loss in the event of non-performance by these counterparties, this exposure is managed through credit approvals, limits and monitoring procedures and limits to the period over which unpaid balances are allowed to accumulate. The Company has not experienced non-performance by counterparties to these contracts, and no material loss would be expected from any such non-performance.

Commodity Price Risk

The Company enters into energy-related futures, forwards, swaps and options in various markets to balance its physical systems, to meet customer needs and to manage its price exposure on anticipated crude oil, natural gas, refined product and electric power transactions.

These instruments provide a natural extension of the underlying cash market and are used to physically acquire a portion of supply requirements, as well as to manage pricing of near-term physical requirements. The commodity futures market has underlying principles of increased liquidity and longer trading periods than the cash market and is one method of managing price risk in the energy business.

Conoco's policy is to generally be exposed to market pricing for commodity purchases and sales. From time to time, management may use derivatives to establish longer-term positions to hedge the price risk for the Company's equity crude oil and natural gas production, as well as refinery margins.

Under the Company's policy, hedging includes only those transactions that offset physical positions and reduce overall Company exposure to price risk. Trading is defined as any transaction that does not meet the definition of hedging. After-tax gain/loss from risk trading has not been material.

Foreign Currency Risk

Conoco has foreign currency exchange rate risk resulting from operations in over 40 countries around the world. The Company does not comprehensively hedge its exposure to currency rate changes, although it may choose to selectively hedge exposures to foreign currency rate risk. Examples include firm commitments for capital projects, certain local currency tax payments, and cash returns from net investments in foreign affiliates to be remitted within the coming year.

At December 31, 1998, the Company had no open forward exchange contracts. At December 31, 1997, the Company had open forward exchange contracts designated as a hedge of firm foreign currency commitments. The notional amount of these contracts was $50 and the estimated fair value was $38.

Interest Rate Risk

Prior to the Offerings, the Company had no significant interest rate risk to manage. Subsequent to the Offerings, however, the Company intends to manage any material risk arising from exposure to interest rates by using a combination of financial derivative instruments as part of a program to manage the fixed and floating interest rate mix of the total debt portfolio and related overall cost of borrowing.

Fair Values of Financial Instruments

The carrying values of most financial instruments are based on historical costs. The carrying values of marketable securities, receivables, payables and short-term obligations approximate their fair value because of their short maturity. Long-term receivables from and long-term borrowings due to related parties approximate fair value because associated interest rates are market based. At December 31, 1998, however, long-term borrowings due related parties included $4,589 at a fixed rate with fair value estimated at $4,624. Excluding amounts due related parties, the estimated fair value of other long-term borrowings outstanding at December 31, 1998 and 1997 of $93 and $106, respectively, was $96 and $108, respectively. These estimates were based on quoted market prices for the same or similar issues, or the current rates offered to the Company for issues with the same remaining maturities.

Summary of Outstanding Derivative Financial Instruments

Set forth below is a summary of the fair values, carrying amounts and notional values of outstanding commodity financial instruments at December 31, 1998 and 1997.

Notional amounts represent the face amount of the contractual arrangements and are not a measure of market or credit exposure. The fair value of swaps and other over-the-counter instruments are estimated based on quoted market prices of comparable contracts and approximate the gain or (loss) that would have been realized if the contracts had been closed out at the balance sheet date. Carrying amounts represent the receivable (payable) recorded in the Consolidated Balance Sheet.

Commodity Derivatives	Fair Value	Carrying Amount	Notional Value
December 31, 1998:			
Hedging	$ (10)	$ (6)	$ 422
Trading	2	—	330
December 31, 1997:			
Hedging	$ 10	$ 12	$ 1,037
Trading	(2)	(1)	1,089

Estimated fair values for hedging instruments only represent the value of the hedge component of the transactions and, thus, are not indicative of the fair value of the Company's overall hedged position.

26. Commitments and Contingent Liabilities

The Company uses various leased facilities and equipment in its operations. Future minimum lease payments under noncancelable operating leases are $246, $226, $216, $199 and $194 for the years 1999, 2000, 2001, 2002 and 2003, respectively, and $580 for subsequent years, and are not reduced by noncancelable minimum sublease rentals due in the future in the amount of $69. Rental expense under operating leases was $198 in 1998, $132 in 1997 and $118 in 1996.

The Company has various purchase commitments for materials, supplies, services and items of permanent investment incident to the ordinary conduct of business. In the aggregate, such commitments are not at prices in excess of current market. In addition, at December 31, 1998, the Company has obligations under international contracts to purchase, over periods up to 20 years, natural gas at prices that were in excess of year-end 1998 market prices. No material annual loss is expected from these long-term commitments.

The Company is subject to various lawsuits and claims involving a variety of matters including, along with other oil companies, actions challenging oil and gas royalty payments, severance tax payments and other payments, including claims based on posted prices, and claims for damages resulting from leaking underground storage tanks. As a result of the Separation Agreement with DuPont, the Company has assumed responsibility for current and future claims related to certain discontinued chemicals and agricultural chemicals businesses operated by Conoco in the past. In general, the effect on future financial results is not subject to reasonable estimation because considerable uncertainty exists. The Company believes the ultimate liabilities resulting from such lawsuits and claims may be material to results of operations in the period in which they are recognized but will not materially affect the consolidated financial position of the Company.

The Company is also subject to contingencies pursuant to environmental laws and regulations that in the future may require the Company to take further action to correct the effects on the environment of prior disposal practices or releases of petroleum substances by the Company or other parties. The Company has accrued for certain environmental remediation activities consistent with the policy set forth in Note 2. The Company has assumed environmental remediation liabilities from DuPont related to certain discontinued chemicals and agricultural chemicals businesses operated by Conoco in the past that are included in the environmental accrual. At December 31, 1998 and 1997, such accrual amounted to $129 and $144, respectively, and, in management's opinion, was appropriate based on existing facts and circumstances. Under adverse changes in circumstances, potential liability may exceed amounts accrued. In the event future monitoring and remediation expenditures are in excess of amounts accrued, they may be significant to results of operations in the period recognized but management does not anticipate they will have a material adverse effect on the consolidated financial position of the Company.

The Company has indirectly guaranteed various debt obligations under agreements with certain affiliated and other companies to provide specified minimum revenues from shipments or purchases of products. These indirect guarantees totaled $18 and $19 at December 31, 1998 and 1997, respectively. The Company, as of August 1, 1998, terminated a multiparty account banking agreement that provided for the indirect guarantee of bank account overdrafts of certain European DuPont subsidiaries. The Company now has a new multiparty banking agreement that provides for the indirect guarantee of bank account overdrafts for itself and its subsidiaries. Management believes the exposure under this agreement is not material. In addition, the Company or DuPont, on behalf of, and indemnified by, the Company, had directly guaranteed obligations of certain affiliated companies and others. These guarantees totaled $1,353 and $1,131 at December 31, 1998 and 1997, respectively. The increase in 1998 is primarily related to additional financing associated with the construction of drillships and cogeneration facilities in South Texas. The balance at December 31, 1998, includes a drillship construction guarantee of $260 that was eliminated through successful completion in early 1999. No material loss is anticipated by reason of such agreements and guarantees.

The Company's operations, particularly oil and gas exploration and production, can be affected by changing economic, regulatory and political environments in the various countries, including the United States, in which it operates. In certain locations, host governments have imposed restrictions, controls and taxes, and in others, political conditions have existed that may threaten the safety of employees and the Company's continued presence in those countries. Internal unrest or strained relations between a host government and the Company or other governments may affect the Company's operations. Those developments have, at times, significantly affected the Company's operations and related results and are carefully considered by management when evaluating the level of current and future activity in such countries.

Areas in which the Company has significant operations include the United States, the United Kingdom, Norway, Germany, Venezuela, the United Arab Emirates, Indonesia, Russia, Canada, the Czech Republic, Malaysia and Nigeria.

27. Operating Segment and Geographic Information

Conoco is involved in both the Upstream and Downstream operating segments of the petroleum business that comprise the structure used by senior management to make key operating decisions and assess performance. Activities of the Upstream operating segment include exploring for, and developing, producing and selling, crude oil, natural gas and natural gas liquids. Activities of the Downstream operating segment include refining crude oil and other feedstocks into petroleum products, buying and selling crude oil and refined products and transporting, distributing and marketing petroleum products. The Company has four reporting segments for its Upstream and Downstream operating segments, reflecting geographic division between the United States and International. Corporate and Other includes general corporate expenses, financing costs and other non-operating items, and results for electric power and related-party insurance operations. The Company sells its products worldwide; however, in 1998, about 57 percent and 39 percent of sales were made in the United States and Europe, respectively. Major products include crude oil, natural gas and refined products that are sold primarily in the energy and transportation markets. The Company's sales are not materially dependent on a single customer or small group of customers. Transfers between segments are on the basis of estimated market values.

Segment Information

	Upstream		Downstream			
	United States	International	United States	International	Corporate And Other	Consolidated
1998						
Sales and Other Operating Revenues [2]						
Refined Products	$ —	$ —	$ 6,082	$ 7,647	$ —	$ 13,729
Crude Oil	14	774	2,650	299	—	3,737
Natural Gas	2,416	723	—	—	—	3,139
Other	770	104	217	351	749	2,191
Total	3,200	1,601	8,949	8,297	749	22,796
Transfers Between Segments	308	378	89	181	—	—
Total Operating Revenues	$ 3,508	$ 1,979	$ 9,038	$ 8,478	$ 749	$ 22,796
Operating Profit	$ 223	$ 482	$ 149	$ 256	$ (379)	$ 731
Equity in Earnings of Affiliates	1	(14)	56	(20)	(1)	22
Corporate Non-Operating Items:						
Interest and Debt Expense					(199)	(199)
Interest Income (net of misc. interest expense)					89	89
Other					51	51
Provision for Income Taxes	(5)	(185)	(70)	(80)	96	(244)
Net Income (Loss) [1]	$ 219	$ 283	$ 135	$ 156	$ (343)	$ 450
Capital Employed at December 31:						
Excluding Investment in Affiliates	$ 2,349	$ 2,849	$ 1,245	$ 989	$ 384	$ 7,816
Investment in Affiliates	191	371	248	531	22	1,363
Total [3]	$ 2,540	$ 3,220	$ 1,493	$ 1,520	$ 406	$ 9,179
Depreciation, Depletion and Amortization	$ 383	$ 457	$ 139	$ 133	$ 1	$ 1,113
Dry Hole Costs and Impairment of Unproved Properties	$ 59	$ 104				$ 163
Other Significant Non-Cash Items:						
Stock Option Provision					$ 236	$ 236
Inventory Write-down to Market	$ 6		$ 63	$ 28		$ 97
Capital Expenditures and Investments [4]	$ 788	$ 1,177	$ 201	$ 332	$ 18	$ 2,516
1997						
Sales and Other Operating Revenues [2]						
Refined Products	$ —	$ —	$ 7,664	$ 8,165	$ —	$ 15,829
Crude Oil	24	1,191	3,483	181	—	4,879
Natural Gas	2,415	556	—	—	—	2,971
Other	909	159	247	293	509	2,117
Total	3,348	1,906	11,394	8,639	509	25,796
Transfers Between Segments	599	622	115	191	—	—
Total Operating Revenues	$ 3,947	$ 2,528	$ 11,509	$ 8,830	$ 509	$ 25,796
Operating Profit	$ 489	$ 1,174	$ 287	$ 185	$ (132)	$ 2,003
Equity in Earnings of Affiliates	18	(7)	30	(1)		40
Corporate Non-Operating Items:						
Interest and Debt Expense					(36)	(36)
Interest Income (net of misc. interest expense)					77	77
Other					23	23
Provision for Income Taxes	(62)	(728)	(101)	(93)	(26)	(1,010)
Net Income (Loss) [1]	$ 445	$ 439	$ 216	$ 91	$ (94)	$ 1,097
Capital Employed at December 31:						
Excluding Investment in Affiliates	$ 2,390	$ 2,299	$ 1,421	$ 1,130	$ 903	$ 8,143
Investment *in Affiliates*	155	256	226	425	23	1,085
Total [3]	$ 2,545	$ 2,555	$ 1,647	$ 1,555	$ 926	$ 9,228
Depreciation, Depletion and Amortization	$ 268	$ 578	$ 145	$ 188		$ 1,179
Dry Hole Costs and Impairment of Unproved Properties	$ 63	$ 106				$ 169
Capital Expenditures and Investments [4]	$ 1,534	$ 999	$ 227	$ 331	$ 23	$ 3,114

Notes to Consolidated Financial Statements

(Dollars in millions, except per share)

Segment Information (continued)

	Upstream United States	Upstream International	Downstream United States	Downstream International	Corporate And Other	Consolidated
1996						
Sales and Other Operating Revenues[2]						
Refined Products	$ —	$ —	$ 7,355	$ 8,598	$ —	$ 15,953
Crude Oil	29	1,359	2,897	1	—	4,286
Natural Gas	1,907	471	—	—	—	2,378
Other	847	113	293	281	79	1,613
Total	2,783	1,943	10,545	8,880	79	24,230
Transfers Between Segments	587	572	125	151	—	—
Total Operating Revenues	$ 3,370	$ 2,515	$ 10,670	$ 9,031	$ 79	$ 24,230
Operating Profit	$ 328	$ 1,231	$ 244	$ 202	$ (118)	$ 1,887
Equity in Earnings of Affiliates	11	(41)	8	(3)		(25)
Corporate Non-Operating Items:						
Interest and Debt Expense					(74)	(74)
Interest Income (net of misc. interest expense)					124	124
Other					(11)	(11)
Provision for Income Taxes	(25)	(823)	(80)	(82)	(28)	(1,038)
Net Income (Loss)[1]	$ 314	$ 367	$ 172	$ 117	$ (107)	$ 863
Capital Employed at December 31:						
Excluding Investment in Affiliates	$ 1,371	$ 3,042	$ 1,538	$ 1,195	$ 995	$ 8,141
Investment in Affiliates	105	129	154	315	—	703
Total[3]	$ 1,476	$ 3,171	$ 1,692	$ 1,510	$ 995	$ 8,844
Depreciation, Depletion and Amortization	$ 307	$ 485	$ 156	$ 137		$ 1,085
Dry Hole Costs and Impairment of Unproved Properties	$ 65	$ 72				$ 137
Capital Expenditures and Investments[4]	$ 400	$ 864	$ 218	$ 462		$ 1,944

(1) Includes After-Tax Benefits (Charges) from Special Items:

	Upstream United States	Upstream International	Downstream United States	Downstream International	Corporate And Other	Consolidated
1998						
Asset Sales	$ 41	$ 54	$ —	$ 12	$ —	$ 107
Property Impairments	(32)	(6)	—	—	—	(38)
Inventory Write-downs	(4)	—	(40)	(19)	—	(63)
Employee Separation Costs	(19)	(23)	(5)	(5)	—	(52)
Environmental Litigation Charges	—	—	(28)	—	(14)	(42)
Stock Option Provision	—	—	—	—	(183)	(183)
Total	$ (14)	$ 25	$ (73)	$ (12)	$ (197)	$ (271)
1997						
Asset Sales	$ 49	$ 191	$ —	$ —	$ —	$ 240
Property Impairments	—	(112)	—	(55)	—	(167)
Environmental Litigation Charges	—	—	(23)	—	—	(23)
Tax Rate Changes	—	19	—	11	—	30
Total	$ 49	$ 98	$ (23)	$ (44)	$ —	$ 80
1996						
Asset Sales	$ 16	$ —	$ —	$ 19	$ —	$ 35
Property Impairments	—	(63)	—	—	—	(63)
Employee Separation Costs	(7)	(4)	(8)	(3)	—	(22)
Environmental Litigation Insurance Recoveries	—	—	44	—	—	44
Total	$ 9	$ (67)	$ 36	$ 16	$ —	$ (6)

Segment Information (continued)

(2) Includes sales of purchased products substantially at cost:

	1998	1997	1996
Buy/sell supply transactions settled in cash:			
Crude oil	$ 2,728	$ 3,566	$ 2,820
Refined products	438	683	729
Natural gas resales	1,109	773	560
Electric power resales	729	487	58

(3) Capital Employed is equivalent to the sum of Stockholders' Equity/Owner's Net Investment and Borrowings (both short-term and long-term portions). Borrowings include amounts due related parties, net of associated Notes Receivable. Amounts identified for operating segments comprise those assets and liabilities not deemed to be of a general corporate nature, such as cash and cash equivalents, financing-oriented items and aviation investment.

(4) Includes investments in affiliates.

Geographic Information	United States	United Kingdom	Germany	Norway	Other Countries	Consolidated
1998						
Sales and Other Operating Revenues (1)	$ 12,878	$ 4,305	$ 2,881	$ 289	$ 2,443	$ 22,796
Long-Lived Assets at December 31 (2)	$ 5,122	$ 3,577	$ 195	$ 1,547	$ 972	$ 11,413
1997						
Sales and Other Operating Revenues (1)	$ 15,229	$ 4,480	$ 3,007	$ 406	$ 2,674	$ 25,796
Long-Lived Assets at December 31 (2)	$ 4,956	$ 3,284	$ 168	$ 1,559	$ 861	$ 10,828
1996						
Sales and Other Operating Revenues (1)	$ 13,386	$ 4,241	$ 3,260	$ 508	$ 2,835	$ 24,230
Long-Lived Assets at December 31 (2)	$ 4,086	$ 3,201	$ 203	$ 1,757	$ 835	$ 10,082

(1) Revenues are attributed to countries based on location of the selling entity.

(2) Represents Net Property, Plant and Equipment.

28. Other Financial Information

Research and development expenses were $42, $44 and $41 for the years 1998, 1997 and 1996, respectively.

Supplemental Petroleum Data

(Unaudited) (Dollars in millions)

Oil and Gas Producing Activities

Supplemental Petroleum Data disclosures are presented in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 69, "Disclosures About Oil and Gas Producing Activities."

Accordingly, volumes of reserves and production exclude royalty interests of others, and royalty payments are reflected as reductions in revenues.

Results of Operations for Oil and Gas Producing Activities

	Total Worldwide			United States			Europe			Other Regions		
	1998	1997	1996	1998	1997	1996	1998	1997	1996	1998	1997	1996
Consolidated Companies												
Revenues:												
Sales	$1,938	$2,603	$2,479	$ 643	$ 787	$ 621	$ 831	$1,181	$1,204	$ 464	$ 635	$ 654
Transfers	646	849	927	272	272	363	374	577	566	—	—	(2)
Exploration [1]	(380)	(457)	(404)	(128)	(134)	(151)	(108)	(131)	(159)	(144)	(192)	(94)
Production	(806)	(854)	(755)	(303)	(320)	(297)	(382)	(409)	(372)	(121)	(125)	(86)
DD&A	(799)	(827)	(770)	(345)	(246)	(282)	(372)	(419)	(440)	(82)	(162) [2]	(48)
Other [3]	148	321	69	104	106	48	48	215	(1)	(4)	—	22
Income taxes	(201)	(847)	(912)	(36)	(109)	(47)	(100)	(393)	(436)	(65)	(345)	(429)
Results of operations	546	788	634	207	356	255	291	621	362	48	(189)	17
Equity Affiliates												
Results of operations	(4)	30	32	4	7	7	5	29	25	(13)	(6)	—
Total	*$ 542*	*$ 818*	*$ 666*	*$ 211*	*$ 363*	*$ 262*	*$ 296*	*$ 650*	*$ 387*	*$ 35*	*$ (195)*	*$ 17*

(1) Includes exploration operating expenses, dry hole costs, impairment of unproved properties and depreciation.

(2) Includes charges of $112 for impairment of non-revenue producing properties.

(3) Includes gain/(loss) on disposal of fixed assets and other miscellaneous revenues and expenses.

Costs Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities[1]

	Total Worldwide			United States			Europe			Other Regions		
	1998	1997	1996	1998	1997	1996	1998	1997	1996	1998	1997	1996
Consolidated Companies												
Property acquisitions												
Proved[2]	$ 254	$ 152	$ 21	$ 24	$ 148	$ 14	$ 230[3]	$ —	$ —	$ —	$ 4	$ 7
Unproved	93	831	42	55	723[4]	41	25	95	—	13	13	1
Exploration	436	450	445	119	107	144	114	135	169	203	208	132
Development	1,019	921	828	542	289	203	403	568	543	74	64	82
Total	1,802	2,354	1,336	740	1,267	402	772	798	712	290	289	222
Equity Affiliates												
Total Equity Affiliates	564	263	19	30	12	5	2	2	14	532[5]	249[5]	—
Total	$2,366	$2,617	$1,355	$ 770	$1,279	$ 407	$ 774	$ 800	$ 726	$ 822	$ 538	$ 222

(1) These data comprise all costs incurred in the activities shown, whether capitalized or charged to expense at the time they were incurred.

(2) Does not include properties acquired through property trades.

(3) Includes acquisition costs associated with petroleum reserves acquired in the North Sea.

(4) Includes acquisition costs associated with gas reserves acquired in the South Texas Lobo trend.

(5) Represents Conoco's equity share of the Petrozuata heavy oil venture in Venezuela.

Capitalized Costs Relating to Oil and Gas Producing Activities

	Total Worldwide			United States			Europe			Other Regions		
	1998	1997	1996	1998	1997	1996	1998	1997	1996	1998	1997	1996
Consolidated Companies												
Gross costs:												
Proved properties	$13,488	$12,420	$11,914	$ 5,013	$ 4,676	$ 4,255	$ 6,942[1]	$ 6,276	$ 6,268	$ 1,533	$ 1,468	$ 1,391
Unproved properties	1,159	1,491	913	634	774[2]	262	262	432	444	263	285	207
Less:												
Accumulated DD&A	7,469	7,201	6,886	2,983	2,907	2,816	3,182	3,008	2,954	1,304	1,286	1,116
Total net costs	7,178	6,710	5,941	2,664	2,543	1,701	4,022	3,700	3,758	492	467	482
Equity Affiliates												
Net costs of equity affiliates	976	441	199	66	45	37	132	147	162	778[3]	249[3]	—
Total	$ 8,154	$ 7,151	$ 6,140	$ 2,730	$ 2,588	$ 1,738	$ 4,154	$ 3,847	$ 3,920	$ 1,270	$ 716	$ 482

(1) Includes acquisition costs associated with petroleum reserves acquired in the North Sea.

(2) Includes acquisition costs associated with gas reserves acquired in the South Texas Lobo trend.

(3) Represents Conoco's equity share of the Petrozuata heavy oil venture in Venezuela.

Supplemental Petroleum Data
(Unaudited)

Estimated Proved Reserves of Oil [1]
(In millions of barrels)

	Total Worldwide			United States			Europe			Other Regions		
	1998	1997	1996	1998	1997	1996	1998	1997	1996	1998	1997	1996
Proved Reserves of Consolidated Companies												
Beginning of year	893	926	933	277	299	294	421	413	408	195	214	231
Revisions and other changes	42	54	55	14	3	11	20	43	36	8	8	8
Extensions and discoveries	41	62	75	15	12	31	6	44	35	20	6	9
Improved recovery	14	3	4	—	3	4	11	—	—	3	—	—
Purchase of reserves [2]	8	5	(1)	—	4	(1)	8	1	—	—	—	—
Sale of reserves [3]	(16)	(27)	(12)	(16)	(11)	(10)	—	(16)	—	—	—	(2)
Production	(119)	(130)	(128)	(29)	(33)	(30)	(56)	(64)	(66)	(34)	(33)	(32)
End of year [4]	863	893	926	261	277	299	410	421	413	192	195	214
Proved Reserves of Equity Affiliates												
Beginning of year	731	47	44	—	—	—	51	47	44	680	—	—
Revisions and other changes	5	10	8	—	—	—	5	10	8	—	—	—
Extensions and discoveries	—	680	—	—	—	—	—	—	—	—	680 [5]	—
Production	(8)	(6)	(5)	—	—	—	(6)	(6)	(5)	(2)	—	—
End of year	728	731	47	—	—	—	50	51	47	678	680	—
Total	1,591	1,624	973	261	277	299	460	472	460	870	875	214
Proved Developed Reserves of Consolidated Companies												
Beginning of year	600	630	684	242	258	265	174	185	217	184	187	202
End of year	622	600	630	222	242	258	228	174	185	172	184	187
Proved Developed Reserves of Equity Affiliates												
Beginning of year	43	39	32	—	—	—	43	39	32	—	—	—
End of year	92	43	39	—	—	—	42	43	39	50	—	—

(1) Oil reserves comprise crude oil and condensate and natural gas liquids expected to be removed for the Company's account from its natural gas deliveries.

(2) Includes reserves acquired through property trades.

(3) Includes reserves disposed of through property trades.

(4) Includes reserves of 123, 87 and 89 at year-end 1998, 1997 and 1996, respectively, attributable to Conoco Oil & Gas Associates L.P., in which there is a minority interest with an approximate 20 percent average revenue share (see Note 19).

(5) Represents Conoco's equity share of the Petrozuata heavy oil venture in Venezuela.

Estimated Proved Reserves of Gas

(In billion cubic feet)

	Total Worldwide			United States			Europe			Other Regions		
	1998	1997	1996	1998	1997	1996	1998	1997	1996	1998	1997	1996
Proved Reserves of Consolidated Companies												
Beginning of year	5,491	5,063	4,709	2,235	1,822	1,891	3,060	3,068	2,649	196	173	169
Revisions and other changes	25	134	41	18	—	79	(20)	97	(39)	27	37	1
Extensions and discoveries	961	518	780	624	453	176	111	59	574	226	6	30
Improved recovery	—	1	—	—	1	—	—	—	—	—	—	—
Purchase of reserves[1]	116	270	41	4	264[2]	3	112	—	36	—	6	2
Sale of reserves[3]	(281)	(62)	(71)	(243)	(46)	(57)	(38)	(7)	—	—	(9)	(14)
Production	(510)	(433)	(437)	(319)	(259)	(270)	(172)	(157)	(152)	(19)	(17)	(15)
End of year[4]	5,802	5,491	5,063	2,319	2,235	1,822	3,053	3,060	3,068	430	196	173
Proved Reserves of Equity Affiliates												
Beginning of year	370	333	339	370	333	339	—	—	—	—	—	—
Revisions and other changes	(12)	(6)	—	(12)	(6)	—	—	—	—	—	—	—
Extensions and discoveries	1	49	—	1	49	—	—	—	—	—	—	—
Purchase of reserves	27	—	—	27	—	—	—	—	—	—	—	—
Production	(5)	(6)	(6)	(5)	(6)	(6)	—	—	—	—	—	—
End of Year	381	370	333	381	370	333	—	—	—	—	—	—
Total	6,183	5,861	5,396	2,700	2,605	2,155	3,053	3,060	3,068	430	196	173
Proved Developed Reserves of Consolidated Companies												
Beginning of year	3,061	2,843	2,933	1,801	1,672	1,733	1,091	1,041	1,071	169	130	129
End of year	3,991	3,061	2,843	1,828	1,801	1,672	1,954	1,091	1,041	209	169	130
Proved Developed Reserves of Equity Affiliates												
Beginning of year	40	36	40	40	36	40	—	—	—	—	—	—
End of year	66	40	36	66	40	36	—	—	—	—	—	—

(1) Includes reserves acquired through property trades.

(2) Includes reserves acquired in the South Texas Lobo trend.

(3) Includes reserves disposed of through property trades.

(4) Includes reserves of 121, 115 and 104 at year-end 1998, 1997 and 1996, respectively, attributable to Conoco Oil & Gas Associates L.P., in which there is a minority interest with an approximate 20 percent average revenue share (see Note 19).

Supplemental Petroleum Data
(Unaudited)

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves

The information on the following page has been prepared in accordance with SFAS No. 69, which requires the standardized measure of discounted future net cash flows to be based on year-end sales prices, costs and statutory income tax rates and a 10 percent annual discount rate. Specifically, the per-barrel oil sales prices used to calculate the December 31, 1998, data averaged $9.40 for the United States, $10.69 for Europe and $10.67 for Other Regions, and the gas prices per thousand cubic feet averaged approximately $1.70 for the United States, $2.29 for Europe and $1.90 for Other Regions. Because prices used in the calculation are as of December 31, the standardized measure could vary significantly from year to year based on market conditions at that specific date.

The projections should not be viewed as realistic estimates of future cash flows nor should the "standardized measure" be interpreted as representing current value to the Company. Material revisions to estimates of proved reserves may occur in the future, development and production of the reserves may not occur in the periods assumed, actual prices realized are expected to vary significantly from those used and actual costs may also vary. The Company's investment and operating decisions are not based on the information presented on the following page, but on a wide range of reserve estimates that includes probable as well as proved reserves, and on different price and cost assumptions from those reflected in this information.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves

(Unaudited) (Dollars in millions)

	Total Worldwide			United States			Europe			Other Regions		
	1998	1997	1996	1998	1997	1996	1998	1997	1996	1998	1997	1996
Consolidated Companies												
Future cash flows:												
Revenues	$20,340	$26,666	$34,366	$ 6,148	$ 8,355	$10,044	$11,376	$15,119	$19,364	$ 2,816	$ 3,192	$ 4,958
Production costs	(8,271)	(9,251)	(10,406)	(2,665)	(2,997)	(3,085)	(4,742)	(5,387)	(6,378)	(864)	(867)	(943)
Development costs	(1,548)	(1,586)	(1,669)	(370)	(446)	(283)	(823)	(1,094)	(1,294)	(355)	(46)	(92)
Income tax expense	(3,904)	(6,822)	(10,364)	(546)	(1,175)	(2,041)	(2,239)	(3,921)	(5,179)	(1,119)	(1,726)	(3,144)
Future net cash flows	6,617	9,007	11,927	2,567	3,737	4,635	3,572	4,717	6,513	478	553	779
Discounted to present value at a 10% annual rate	(2,414)	(3,384)	(4,638)	(1,055)	(1,552)	(2,088)	(1,151)	(1,679)	(2,317)	(208)	(153)	(233)
Total[1]	4,203	5,623	7,289	1,512	2,185	2,547	2,421	3,038	4,196	270	400	546
Equity Affiliates												
Future cash flows:												
Revenues	5,327	8,520	1,971	1,001	893	968	427	651	1,003	3,899	6,976	—
Production costs	(2,228)	(2,640)	(597)	(346)	(267)	(242)	(266)	(315)	(355)	(1,616)	(2,058)	—
Development costs	(1,086)	(1,300)	(180)	(191)	(174)	(157)	(28)	(30)	(23)	(867)	(1,096)	—
Income tax expense	(425)	(1,090)	(496)	(166)	(161)	(193)	(63)	(170)	(303)	(196)	(759)	—
Future net cash flows	1,588	3,490	698	298	291	376	70	136	322	1,220	3,063	—
Discounted to present value at a 10% annual rate	(1,327)	(2,886)	(398)	(220)	(226)	(277)	(9)	(44)	(121)	(1,098)	(2,616)	—
Total	261	604	300	78	65	99	61	92	201	122	447	—
Total	$ 4,464	$ 6,227	$ 7,589	$ 1,590	$ 2,250	$ 2,646	$ 2,482	$ 3,130	$ 4,397	$ 392	$ 847	$ 546

(1) Includes $263, $372 and $686 at year-end 1998, 1997 and 1996, respectively, attributable to Conoco Oil & Gas Associates L.P., in which there is a minority interest with an approximate 20 percent average revenue share (see Note 19).

Summary of Changes in Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves

	Consolidated Companies			Equity Affiliates		
	1998	1997	1996	1998	1997	1996
Balance at January 1	$ 5,623	$ 7,289	$ 5,158	$ 604	$ 300	$ 151
Sales and transfers of oil and gas produced, net of production costs	(1,778)	(2,583)	(2,647)	(2)	(56)	(73)
Development costs incurred during the period	1,019	921	828	555	218	20
Net changes in prices and in development and production costs	(3,948)	(4,974)	2,525	(1,155)	(1,242)	119
Extensions, discoveries and improved recovery, less related costs	838	818	1,630	1	1,181	4
Revisions of previous quantity estimates	189	439	553	2	37	83
Purchases (sales) of reserves in place — net	(92)	36	(54)	18	—	—
Accretion of discount	916	1,312	931	84	55	25
Net change in income taxes	1,541	2,285	(1,676)	128	16	(152)
Other	(105)	80	41	26	95	123
Balance at December 31	$ 4,203	$ 5,623	$ 7,289	$ 261	$ 604	$ 300

Consolidated Quarterly Financial Data

(Unaudited) (Dollars in millions, except per share)

	Quarter Ended			
	March 31	June 30	September 30	December 31
1998				
Sales and Other Operating Revenues[1]	$ 5,736	$ 5,612	$ 5,916	$ 5,532
Cost of Goods Sold and Other Expenses[2]	5,327	5,374	5,620	5,954
Interest and Debt Expense	1	—	107	91
Net Income (Loss)	316[5]	214[6]	183	(263)[7]
Earnings Per Share				
Basic[3]	$ .72	$ .49	$ .42	$ (.45)
Diluted[3]	$ .72	$ .49	$ .42	$ (.45)
Market Price of Common Stock[4]				
High				$ 25¾
Low				$ 19⅜
1997				
Sales and Other Operating Revenues[1]	$ 6,560	$ 5,915	$ 6,671	$ 6,650
Cost of Goods Sold and Other Expenses[2]	5,898	5,501	6,269	6,452
Interest and Debt Expense	15	9	7	5
Net Income	341	246[8]	289[9]	221[10]
Earnings Per Share				
Basic[3]	$ .78	$ .56	$ .66	$ .51
Diluted[3]	$ .78	$ .56	$ .66	$ .51

(1) Excludes other income of $98, $40, $113 and $121 in each of the quarters in 1998 and $55, $70, $28 and $314 in each of the quarters in 1997.

(2) Excludes provision for income taxes.

(3) Earnings per share for the year may not equal the sum of the quarterly earnings per share due to changes in average shares outstanding. Earnings per share for the periods prior to the Offerings was calculated using only Class B Common Stock, as required by SFAS No. 128 (see Note 8 to the Consolidated Financial Statements). Management believes, considering the substance of the Offerings, a more meaningful presentation of EPS would be to reflect, as if outstanding for all periods presented, both Class A and Class B Common Stock and certain dilutive effects. Using this presentation, but excluding any pro forma adjustment for additional interest expense on the dividend Note (see Note 3 to the Consolidated Financial Statements), quarterly EPS would be as follows:

	Quarter Ended			
	March 31	June 30	September 30	December 31
1998				
Basic	$ .50	$ .34	$ .29	$ (.42)
Diluted	$ .50	$ .34	$ .29	$ (.42)
1997				
Basic	$ .54	$ .39	$ .46	$ .35
Diluted	$ .54	$ .39	$ .45	$ .35

(4) The Company's Class A Common Stock is listed on the New York Stock Exchange (trading symbol: COC) and commenced trading on October 22, 1998. Prices are as reported in the New York Stock Exchange, Inc. Composite Transactions Tape.

(5) Includes gain of $23 ($.04 per share-diluted) from sale of certain Upstream properties.

(6) Includes net benefit of $3 ($.01 per share-diluted) reflecting: tax benefit of $31 from sale of an international Upstream subsidiary and a $28 charge for U.S. Downstream environmental litigation.

(7) Includes net charge of $297 ($.47 per share-diluted) reflecting: charges of $183 for non-cash stock option compensation expense related to the Offerings, $63 for write-down of inventories to market, $52 principally for employee separation costs, $38 for impairment of long-lived Upstream properties and $14 for environmental litigation charges; and gains of $41 from the sale of U.S. producing properties and $12 from sale of an office building.

(8) Includes gain of $24 ($.04 per share-diluted) from sale of U.S. producing properties.

(9) Includes net benefit of $37 ($.05 per share-diluted) reflecting: gain of $30 from sale of North Sea properties, benefit of $30 from foreign tax rate changes, and charge of $23 for environmental litigation charges.

(10) Includes a net benefit of $19 ($.03 per share-diluted) reflecting: a gain of $186 from the sale of North Sea and U.S. Upstream properties, a charge of $112 for impairment of non-revenue producing properties, and a charge of $55 for write-down of an office building held for sale.

Five-Year Financial Review[1]

(Dollars in millions, except per share)

	1998	1997	1996	1995	1994
Summary of Operations					
Revenues	$ 23,168	$ 26,263	$ 24,416	$ 20,518	$ 19,433
Income Before Income Taxes	$ 694	$ 2,107	$ 1,901	$ 1,349	$ 973
Provision for Income Taxes	$ 244	$ 1,010	$ 1,038	$ 774	$ 551
Net Income	$ 450	$ 1,097	$ 863	$ 575	$ 422
Earnings Per Share of Common Stock[2]					
Basic	$ .95	$ 2.51	$ 1.98		
Diluted	$ .95	$ 2.51	$ 1.98		
Financial Position at Year-End					
Total Assets	$ 16,075	$ 17,062	$ 15,226	$ 14,229	$ 15,271
Borrowings and Capital Lease Obligations	$ 4,741	$ 2,272	$ 2,596	$ 2,340	$ 2,985
Stockholders' Equity/Owner's Net Investment	$ 4,438	$ 7,896	$ 6,579	$ 6,754	$ 7,274
Ratios					
Return on Capital Employed[3]	10.3%	12.7%	11.7%	9.4%	6.5%
Return on Stockholders' Equity[4]	11.7%				
Interest Coverage Ratio[5]	5.2				
Total Debt as Percent of Total Capitalization[6]	52%				
General					
For the Year:					
Capital Expenditures and Investments	$ 2,516	$ 3,114	$ 1,944	$ 1,837	$ 1,665
Depreciation, Depletion and Amortization	$ 1,113	$ 1,179	$ 1,085	$ 1,067	$ 1,244
Weighted Average Number of Shares (millions)[2]					
Basic	474	437	437		
Diluted	475	437	437		
Common Stock Prices:[7]					
High	$ 25¾				
Low	$ 19⅜				
Year-End Close	$ 20⅞				
At Year-End:					
Employees (thousands)	16	15	14	15	15

(1) See Management's Discussion and Analysis, Consolidated Financial Statements and Quarterly Financial Data for information relating to significant items affecting the results of operations and financial position.

(2) Conoco's capital structure was established at the time of the Offerings. EPS for the periods prior to the Offerings was calculated using only Class B Common Stock, as required by SFAS No. 128 (see Note 8).

(3) Net Income Before Special Items excluding after-tax interest and debt cost incurred as a percent of two-year average Capital Employed.

(4) Net Income Before Special Items as a percent of two-year average Stockholders' Equity/Owner's Net Investment.

(5) Pretax Income Before Special Items, excluding interest and debt cost incurred and equity earnings, divided by interest and debt cost incurred.

(6) Total borrowings as a percent of total borrowings and Stockholders' Equity/Owner's Net Investment.

(7) Common stock began trading on October 22, 1998.

1998 Board of Directors*


Edgar S. Woolard, Jr.


Archie W. Dunham


Ruth R. Harkin


Frank A. McPherson


Gary M. Pfeiffer


William K. Reilly


William R. Rhodes


Franklin A. Thomas

Edgar S. Woolard, Jr., 64, retired as Chairman of the Board of Directors of DuPont in 1997, having served since 1989. He was named Chairman of the Board of Conoco in July 1998. Woolard also is a director of DuPont, Citigroup Inc. and Apple Computer, Inc. (2)

Archie W. Dunham, 60, President and CEO of Conoco since 1996. Dunham joined Conoco in 1966 and has held a number of commercial and managerial positions with Conoco and DuPont. He is a director of both companies, as well as Louisiana-Pacific Corporation and Phelps Dodge Corporation.

Ruth R. Harkin, 54, Senior Vice President, International Affairs and Government Relations for United Technologies Corporation and former President and CEO of the Overseas Private Investment Corporation (OPIC). She also sits on the boards of the Center for National Policy, the National Association of Manufacturers and the U.S.-Russia Business Council. (1)

Frank A. McPherson, 65, retired as Chairman and CEO of Kerr-McGee Corporation in 1997, having served since 1983. McPherson also is a director of Kimberly-Clark Corp., Bank of Oklahoma, Tri-Continental Corporation, Seligman Quality Fund, Inc., Seligman Select Municipal Fund, Inc., and Seligman Group of Mutual Funds. (1)

Gary M. Pfeiffer, 49, Senior Vice President, Finance, and Chief Financial Officer of DuPont since 1997. Pfeiffer joined DuPont in 1974 and has held a variety of managerial positions. Pfeiffer serves on the board of the Hagley Museum and Library. (1)

William K. Reilly, 59, President and CEO of Aqua International Partners, an investment group that finances water improvements in developing countries. Reilly also is a director of DuPont, Royal Caribbean International and Evergreen Holdings, and is chairman of the board of American Farmland Trust. (2)

William R. Rhodes, 63, Vice Chairman of Citibank, a principal subsidiary of Citigroup. Rhodes is Vice Chairman of the Institute of International Finance and a director of the Private Export Funding Corporation. (1)

Franklin A. Thomas, 64, Consultant to the TFF Study Group, a non-profit initiative assisting development in southern Africa. Previously, Thomas was President and CEO of The Ford Foundation. He is a director of ALCOA, Citigroup Inc., Cummins Engine Company, Inc., Lucent Technologies, Inc., and PepsiCo, Inc. (2)

* Conoco's Board of Directors was formed in 1998. (1) Member Audit and Compliance Committee (2) Member Compensation Committee

Executive Officers

Archie Dunham, President and Chief Executive Officer (see Board of Directors listing for biographical information).

Gary W. Edwards, 57, Executive Vice President, Refining, Marketing, Supply and Transportation. Previously, Vice President, Refining and Marketing - Europe. Joined Conoco in 1963.

Robert E. McKee, III, 52, Executive Vice President, Exploration and Production. Previously, Executive Vice President, Corporate Strategy and Development. Joined Conoco in 1967.

Robert W. Goldman, 56, Senior Vice President, Finance, and Chief Financial Officer. Previously, Vice President and Controller. Joined Conoco in 1988 after 23 years with DuPont.

Rick A. Harrington, 54, Senior Vice President, Legal, and General Counsel. Previously, Vice President and General Counsel. Joined Conoco in 1994 after 15 years with DuPont.

Other Officers

Mario Rocconi, Senior Vice President, Human Resources

J. Michael Stinson, Senior Vice President, Government Affairs, Corporate Strategy and Communications

T. E. Davis, President, Exploration and Production - Africa, Asia Pacific and Middle East

D. O. Kem, President, Refining and Marketing - Europe

J. R. Kemp, III, President, Exploration and Production - Americas

T. C. Knudson, President, Exploration and Production - Europe

P. W. Lashbrooke, President, Refining and Marketing - Asia Pacific

J. W. Nokes, President, Refining and Marketing - North America

P. L. Frederickson, Vice President, Business Development

T. R. Henkel, Vice President, Investor Relations

J. R. Hopkins, Vice President, Exploration and Production - Technology

M. L. Johnson, Vice President and General Manager, Natural Gas and Gas Products

E. L. Oshlo, Vice President and General Manager, Supply and Trading / Materials and Services

D. R. Parker, Vice President, Safety, Health and Environmental Affairs

G. E. Watkins, Vice President and General Manager, Exploration and Production / Chairman and Managing Director - Conoco (U.K.) Limited

L. D. Wilson, Vice President, Refining, Marketing, Supply and Transportation - Technology

M. W. Espinosa, Treasurer

W. D. Welch, Controller

R. A. Sherry, General Manager, Tax, and Chief Tax Officer

M. A. Gist, Corporate Secretary

Stockholder Information

Internet Web Site

Conoco's site on the World Wide Web can be found at: www.conoco.com

Financial results, news and other information about Conoco, including SEC filings, can be found on the site. In addition, the site's Investor Information Center includes a Fact Book for Analysts containing financial and operating data.

Additional copies of this annual report may be requested through the site.

Annual Meeting

Conoco's annual meeting of stockholders is scheduled to be held at 10:30 a.m. on May 12, 1999, at the Houston Marriott Westside, 13210 Katy Freeway, Houston, Texas.

Stock Exchange

Conoco's Class A Common Stock is listed on the New York Stock Exchange (symbol: COC). The number of record holders of Class A Common Stock was 1,650 and Class B Common Stock was one at Feb. 19, 1999.

Conoco Shareholder Relations

To contact the Shareholder Relations office:

Conoco Inc.
Shareholder Relations
P.O. Box 2197
Houston, TX 77252-2197

Phone: (281) 293-6800
Fax: (281) 293-2819
E-mail: shareholder.relations@usa.conoco.com

Stock Transfer and Recordkeeping Agent

For questions or comments about stockholder accounts, please contact:

First Chicago Trust Company of New York, a division of EquiServe
P.O. Box 2500
Jersey City, NJ 07303-2500

Toll-free telephone number:
(800) 317-4445
Outside the U.S. and Canada:
(201) 324-0313
TDD: (201) 222-4955

Internet: www.equiserve.com
E-mail: fctc@em.fcnbd.com

Stockholders are encouraged to keep their addresses current and promptly cash their dividend checks to avoid eventual surrender of these funds to their respective states under state law.

You may contact First Chicago Trust to obtain information regarding features / plans that may be offered currently or in the future.

Annual Report on Form 10-K

Conoco's 1998 Annual Report on Form 10-K, as filed with the SEC, is available free to interested shareholders by writing to Shareholder Relations at the address provided in this listing.

Dividends

Declared dividends on shares of common stock are normally paid in mid- March, June, September and December. For dividend related questions, contact the Stock Transfer and Recordkeeping Agent listed here.

Investor Relations

Conoco's contacts with the security analyst community are through the Investor Relations office, headed by Thomas R. Henkel, Vice President, Investor Relations.

Bondholder Relations

Conoco Inc.
Treasury – Capital Markets
P.O. Box 2197
Houston, TX 77252-2197

Phone: (281) 293-2648
Fax: (281) 293-2819

Independent Accountants

PricewaterhouseCoopers LLP
1201 Louisiana, Suite 2900
Houston, TX 77002-5678

conoco

Conoco Inc.
P. O. Box 2197
Houston, TX 77252-2197
USA

This annual report is printed on recycled paper.

corpco

ORIGINAL

Alliance Energy Services

CERTIFIED MAIL

November 2, 2000

RECEIVED

NOV 02 2000

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Ms. Linda Fahnestock
Secretary's Bureau
Commonwealth of Pennsylvania
Pennsylvania Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

A-125095

Dear Ms. Fahnestock:

In reference to a letter from James J. McNulty dated 10/12/2000, I am sending to you the following:

- A Certificate of Service attesting that copies of the application and attachments have been served on the Office of Consumer Advocate, Office of Attorney General, Office of Small Business Advocate, and Department of Revenue, as well as all appropriate natural gas distribution companies through whose transmission and distribution facilities Alliance Energy Services intends to supply customers along with copies of cover letters sent to the above-referenced entities.

- A Tax Certification Statement

If you have any questions or need additional information, please let me know. I can be reached at the above address or at (502) 426-4500.

Thank you for your assistance.

Sincerely,

Cherri Burch
Market Support Analyst

DOCKETED
NOV 08 2000

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 1830)

DOCUMENT
FOLDER

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

Certificate of Service

A-125095

I hereby certify that I have this day served a true copy of the foregoing document upon the participants, listed below, in accordance with the requirements of §1.54.

Irwin A. Popowsky
Office of Consumer Advocate
5th Floor, Forum Place
555 Walnut Street
Harrisburg, PA 17120-1921

Bernard A. Ryan, Jr.
Commerce Building, Suite 1102
Small Business Advocate
300 North Second Street
Harrisburg, PA 17101

Office of the Attorney General
Bureau of Consumer Protection
Strawberry Square, 14th Floor
Harrisburg, PA 17120

Commonwealth of Pennsylvania
Department of Revenue
Bureau of Compliance
Harrisburg, PA 17128-0946

NUI Valley Cities Gas
Mike Vogel
PO Box 3175
Union, NJ 07083-1975

Penn Fuel
Jim Evans
2 North 9th Street
GENA94
Allentown, PA 18101

T.W. Phillips Gas and Oil Company
Robert M. Hovanec
205 North Main Street
Butler, PA 16001

PG Energy
Richard N. Marshall
One PEI Cente
Wilkes-Barre, PA 18711-0601

Carnegie Natural Gas Company
Donald A. Melzer
800 Regis Avenue
Pittsburgh, PA 19236

National Fuel Gas Distribution Corp.
James E. Patterson
10 Lafayette Square
Buffalo, NY 14203

The Peoples Natural Gas Company
Joe Gregorini
625 Liberty Avenue
Pittsburgh, PA 15222

UGI
David Beaston
PO Box 12677
Reading, PA 15222

Equitable Gas Company
Ationette Litchy
200 Allegheny Center Mall
Pittsburgh, PA 15212-5352

Columbia Gas of PA, Inc
Paula Frauen
650 Washington Road
Pittsburgh, PA 15228

PECO
Kevin Carrabine
300 Front Street, Building 2
Conshohocken, PA 19428

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NOV 02 2000
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

DOCUMENT
FOLDER

Dated this second day of November 2000.

Cherri Burch
Alliance Energy Services

Sworn and subscribed before me this 2nd day of November, 2000.

Debra L. Carroll
Notary Public

My commission expires 3-3-2001.

conoco

Alliance Energy Services

CERTIFIED

November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Irwin A. Popowsky
Office of Consumer Advocate
5th Floor, Forum Place
555 Walnut Street
Harrisburg, PA 17120-1921

Dear Mr. Popowsky:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0135 7543)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Bernard A Ryan, Jr.
Commerce Building, Suite 1002
Small Business Advocate
300 North Second Street
Harrisburg, PA 17101

Dear Mr. Ryan:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0135 7512)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

CERTIFIED

November 2, 2000

Office of the Attorney General
Bureau of Consumer Protection
Strawberry Square, 14th Floor
Harrisburg, PA 17120

Gentlemen:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

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NOV 02 2000
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0135 7482)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Commonwealth of Pennsylvania
Department of Revenue
Bureau of Compliance
Harrisburg, PA 17128-0946

Gentlemen:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0135 7451)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

conoco

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

NUI Valley Cities Gas
Mike Vogel
PO Box 3175
Union, NJ 07083-1975

Dear Mr. Vogel:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0135 7420)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

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Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Penn Fuel
Jim Evans
2 North 9th Street
GENA94
Allentown, PA 18101

Dear Mr. Evans:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0135 7390)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

conoco

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

T.W. Phillips Gas and Oil Company
Robert M. Hovanec
205 North Main Street
Butler, PA 16001

Dear Mr. Hovanec:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 2103)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

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Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

PG Energy
Richard N. Marshall
One PEI Center
Wilkes-Barre, PA 18711-0601

Dear Mr. Marshall:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 2073)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

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Alliance Energy Services

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Carnegie Natural Gas Company
Donald A. Melzer
800 Regis Avenue
Pittsburgh, PA 19236

Dear Mr. Melzer:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 2042)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

National Fuel Gas Distribution Corp.
James E. Patterson
10 Lafayette Square
Buffalo, NY 14203

Dear Mr. Patterson:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 2011)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

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Alliance Energy Services

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

The Peoples Natural Gas Company
Joe Gregorini
625 Liberty Avenue
Pittsburgh, PA 15222

Dear Mr. Gregorini:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 1984)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

UGI
Davis Beaston
PO Box 12677
Reading, PA 15222

Dear Mr. Beaston:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 1953)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Equitable Gas Company
Antionette Litchy
200 Allegheny Center Mall
Pittsburgh, PA 15212-5352

Dear Ms. Litchy:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 1922)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

CONOCO

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Columbia Gas of PA, Inc.
Paula Frauen
650 Washington Road
Pittsburgh, PA 15228

Dear Ms. Frauen:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 1892)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

conoco

Alliance Energy Services

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November 2, 2000

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

PECO
Kevin Carrabine
300 Front Street Building 2
Conshohocken, PA 19428

Dear Mr. Carrabine:

Alliance Energy Services Partnership has filed an application to provide natural gas services as a broker/marketer to the public in the Commonwealth of Pennsylvania. Enclosed within please find a copy of the application and attachments for your record.

If you have questions or need additional information, please let me know.

Sincerely,

Cherri Burch
Market Support Analyst

Enclosures

(Certified Receipt No. 7099 3400 0004 0136 1861)

9300 Shelbyville Road, Suite 810
Louisville, Kentucky 40222
(502) 426-4500 Fax (502) 426-8800

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

APPENDIX A

COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

TAX CERTIFICATION STATEMENT
A-125095

A completed Tax Certification Statement must accompany all applications for new licenses, renewals or transfers. Failure to provide the requested information and/or any outstanding state income, corporation, and sales (including failure to file or register) will cause your application to be rejected. If additional space is needed, please use white 8 1/2" x 11" paper. Type or print all information requested.

1. CORPORATE OR APPLICANT NAME: Alliance Energy Services Partnership

2. BUSINESS PHONE NO. (502) 426-4500
CONTACT PERSON(S) FOR TAX ACCOUNTS: Melissa Bell

3. TRADE/FICTITIOUS NAME (IF ANY):

4. LICENSED ADDRESS (STREET, RURAL ROUTE, P.O. BOX NO.) (POST OFFICE) STATE) (ZIP)
9300 Shelbyville Road, Suite 810, Louisville, KY 40222

5. TYPE OF ENTITY ☐ SOLE PROPRIETOR ☑ PARTNERSHIP ☐ CORPORATION

8. LIST OWNER(S), GENERAL PARTNERS, OR CORPORATE OFFICER(S)

NAME (PRINT)	~~SOCIAL SECURITY NUMBER (OPTIONAL)~~ / SOCIAL SECURITY NUMBER (OPTIONAL)
Alliance Gas Services	~~SOCIAL SECURITY NUMBER (OPTIONAL)~~ Fed. ID# 61-1123-69123
Conoco, Inc.	~~SOCIAL SECURITY NUMBER (OPTIONAL)~~ Fed. ID# 730-119-600

9. LIST THE FOLLOWING STATE TAX IDENTIFICATION NUMBERS. **(ALL ITEMS: A, B, AND C MUST BE COMPLETED)**.

A. SALES TAX LICENSE (8 DIGITS) — APPLICATION PENDING ☐ N/A ☑

C. CORPORATE BOX NUMBER (7 DIGITS) — APPLICATION PENDING ☐ N/A ☐

B. EMPLOYER ID (EIN) (9 DIGITS: 61-1129216 — APPLICATION PENDING ☐ N/A ☐

10. Do you have PA employees either resident or non-resident? ☐ YES ☑ NO

11. Do you own any assets or have an office in PA? ☐ YES ☑ NO

NAME AND PHONE NUMBER OF PERSON(S) RESPONSIBLE FOR FILING TAX RETURNS

PA SALES AND USE TAX	EMPLOYER TAXES	CORPORATE TAXES
PHONE	PHONE	PHONE

Telephone inquiries about this form may be directed to the Pennsylvania Department of Revenue at the following numbers: (717) 772-2673, TDD# (717) 772-2252 (Hearing Impaired Only)

ORIGINAL

COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P. O. BOX 3265, HARRISBURG PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE
Secretary
717-772-7777

November 8, 2000

A-125095

KENNEDY HELM ESQ
STITES & HARBISON
400 W MARKET ST
SUITE 1800
LOUISVILLE KY 40202-3352

Dear Mr. Helm:

The Application and $350.00 filing fee of Alliance Energy Services Partnership, filed in this Office on September 26, 2000, for approval to supply Natural Gas Services as a Broker/Marketer engaged in the business of supplying natural gas is hereby acknowledged.

Pursuant to the Commission's Final Order, entered July 16, 1999, at M-00991249F0002, all entities wishing to engage in the business of a natural gas supplier must hold a license issued by the Commission, in order to provide services starting November 1, 1999.

The application will receive the attention of the Commission, and you will be advised of any further necessary procedure.

Sincerely,

James J. McNulty

James J. McNulty
Secretary

DOCKETED
NOV 08 2000

JJM: laf

Cc: DEB CARROLL - OPERATIONS
ALLIANCE ENERGY SERVICES PARTNERSHIP
9300 SHELBYVILLE RD SUITE 810
LOUISVILLE KY 40222

DOCUMENT
FOLDER

COMMONWEALTH OF PENNSYLVANIA

DATE: November 8, 2000

SUBJECT: A-125095

TO: Bureau of Fixed Utility Services

FROM: James J. McNulty, Secretary

LAF

Attached is a copy of the Application of Alliance Energy Services Partnership, for a license to supply Natural Gas Services as a Broker/Marketer engaged in the business of supplying natural gas.

This matter is assigned to your Bureau for appropriate action.

Attachment

cc: LAW
BCS
OTS
CEEP

laf

DOCKETED
NOV 08 2000

DOCUMENT
FOLDER