

# BAKER HUGHES INC

## FORM 10-Q (Quarterly Report)

Filed 07/29/08 for the Period Ending 06/30/08

Address	2929 ALLEN PARKWAY SUITE 2100 HOUSTON, TX 77019-2118
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Sector	Energy
Fiscal Year	12/31

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

**Form 10-Q**

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

For the quarterly period ended June 30, 2008

OR

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

Commission File Number 1-9397

**Baker Hughes Incorporated**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**76-0207995**

(I.R.S. Employer Identification No.)

**2929 Allen Parkway, Suite 2100, Houston, Texas**

(Address of principal executive offices)

**77019-2118**

(Zip Code)

Registrant's telephone number, including area code: **(713) 439-8600**

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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As of July 24, 2008, the registrant has outstanding 308,234,395 shares of Common Stock, \$1 par value per share.

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**PART I — FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**Baker Hughes Incorporated**  
**Consolidated Condensed Statements of Operations**  
*(In millions, except per share amounts)*  
*(Unaudited)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Sales	\$1,465.0	\$1,259.0	\$2,718.3	\$2,459.9
Services and rentals	1,532.5	1,278.5	2,949.6	2,550.4
Total revenues	2,997.5	2,537.5	5,667.9	5,010.3
<b>Costs and expenses:</b>				
Cost of sales	1,054.5	873.6	1,919.9	1,693.3
Cost of services and rentals	942.1	798.0	1,846.1	1,578.4
Research and engineering	106.4	92.7	208.7	184.3
Marketing, general and administrative	269.9	236.1	520.4	457.0
Litigation settlement	62.0	—	62.0	—
Total costs and expenses	2,434.9	2,000.4	4,557.1	3,913.0
Operating income	562.6	537.1	1,110.8	1,097.3
Equity in income of affiliates	1.2	0.2	1.7	0.4
Gain on sale of product line	—	—	28.2	—
Interest expense	(17.1)	(16.2)	(32.8)	(33.0)
Interest and dividend income	4.2	10.7	12.2	22.2
Income before income taxes	550.9	531.8	1,120.1	1,086.9
Income taxes	(171.6)	(182.2)	(345.8)	(362.6)
Net income	\$ 379.3	\$ 349.6	\$ 774.3	\$ 724.3
Basic earnings per share	\$ 1.24	\$ 1.10	\$ 2.51	\$ 2.27
Diluted earnings per share	\$ 1.23	\$ 1.09	\$ 2.50	\$ 2.26
Cash dividends per share	\$ 0.13	\$ 0.13	\$ 0.26	\$ 0.26

See accompanying notes to unaudited consolidated condensed financial statements.

**Baker Hughes Incorporated**  
**Consolidated Condensed Balance Sheets**  
*(In millions)*

	June 30, 2008 <i>(Unaudited)</i>	December 31, 2007
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 1,071.7	\$1,054.4
Accounts receivable, net	2,710.9	2,382.9
Inventories	1,906.6	1,714.4
Deferred income taxes	197.5	181.5
Other current assets	175.3	122.4
Total current assets	6,062.0	5,455.6
Property, plant and equipment	2,536.2	2,344.6
Goodwill	1,390.2	1,354.2
Intangible assets, net	188.7	176.6
Other assets	530.9	525.6
Total assets	\$10,708.0	\$9,856.6
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 855.5	\$ 704.2
Short-term borrowings and current portion of long-term debt	581.4	15.4
Accrued employee compensation	472.9	456.8
Income taxes payable	123.2	190.9
Other accrued liabilities	251.3	250.6
Total current liabilities	2,284.3	1,617.9
Long-term debt	1,039.8	1,069.4
Deferred income taxes and other tax liabilities	424.6	415.6
Liabilities for pensions and other postretirement benefits	330.9	332.1
Other liabilities	103.1	116.0
Commitments and contingencies		
Stockholders' Equity:		
Common stock	308.3	315.4
Capital in excess of par value	738.8	1,216.1
Retained earnings	5,512.1	4,818.3
Accumulated other comprehensive loss	(33.9)	(44.2)
Total stockholders' equity	6,525.3	6,305.6
Total liabilities and stockholders' equity	\$10,708.0	\$9,856.6

See accompanying notes to unaudited consolidated condensed financial statements.

**Baker Hughes Incorporated**  
**Consolidated Condensed Statements of Cash Flows**  
*(In millions)*  
*(Unaudited)*

	Six Months Ended June 30,	
	2008	2007
<b>Cash flows from operating activities:</b>		
Net income	\$ 774.3	\$ 724.3
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:		
Depreciation and amortization	302.5	245.9
Amortization of net deferred gains on derivatives	(2.5)	(2.5)
Stock-based compensation costs	29.1	24.1
Provision for deferred income taxes	1.0	3.3
Gain on disposal of assets	(33.7)	(41.5)
Equity in income of affiliates	(1.7)	(0.4)
Gain on sale of product line	(28.2)	—
Changes in operating assets and liabilities:		
Accounts receivable	(283.3)	(87.8)
Inventories	(171.8)	(152.4)
Accounts payable	138.4	(74.4)
Accrued employee compensation and other accrued liabilities	(16.8)	(253.5)
Income taxes payable	(110.2)	13.4
Income taxes paid on sale of interest in affiliate	—	(98.2)
Other	(40.1)	16.0
<b>Net cash flows from operating activities</b>	<b>557.0</b>	<b>316.3</b>
<b>Cash flows from investing activities:</b>		
Expenditures for capital assets	(539.0)	(538.4)
Proceeds from disposal of property, plant and equipment	96.6	90.7
Proceeds from sale of product line	31.0	—
Acquisition of businesses, net of cash acquired	(71.7)	—
Purchase of short-term investments	—	(1,733.5)
Proceeds from maturities of short-term investments	—	1,902.0
<b>Net cash flows from investing activities</b>	<b>(483.1)</b>	<b>(279.2)</b>
<b>Cash flows from financing activities:</b>		
Net borrowings of commercial paper and other short-term debt	537.4	1.1
Repurchases of common stock	(572.2)	(98.8)
Proceeds from issuance of common stock	51.3	31.0
Dividends	(80.5)	(83.1)
Excess tax benefits from stock-based compensation	1.4	5.3
<b>Net cash flows from financing activities</b>	<b>(62.6)</b>	<b>(144.5)</b>
Effect of foreign exchange rate changes on cash	6.0	12.0
Increase (decrease) in cash and cash equivalents	17.3	(95.4)
Cash and cash equivalents, beginning of period	1,054.4	750.0
Cash and cash equivalents, end of period	\$1,071.7	\$ 654.6
Income taxes paid (net of refunds)	\$ 432.6	\$ 440.0
Interest paid	\$ 41.2	\$ 37.7

See accompanying notes to unaudited consolidated condensed financial statements.

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements**

**NOTE 1. GENERAL**

**Nature of Operations**

Baker Hughes Incorporated (“we,” “our” or “us”) is engaged in the oilfield services industry. We are a major supplier of wellbore related products and technology services and systems and provide products and services for drilling, formation evaluation, completion and production and reservoir technology and consulting to the worldwide oil and natural gas industry.

**Basis of Presentation**

Our unaudited consolidated condensed financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted. We believe that the presentations and disclosures herein are adequate to make the information not misleading. The unaudited consolidated condensed financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the interim periods. These unaudited consolidated condensed financial statements should be read in conjunction with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

In the notes to the unaudited consolidated condensed financial statements, all dollar and share amounts in tabulations are in millions of dollars and shares, respectively, unless otherwise indicated.

**Reclassifications**

During the fourth quarter of 2007, we began classifying certain expenses as cost of sales and cost of services and rentals that were previously classified as selling, general and administrative expenses. The change was the result of an internal review to improve management reporting. The reclassified expenses relate to selling and field service costs which are closely related to operating activities. In addition, we have renamed selling, general and administrative expenses on the statement of operations to marketing, general and administrative expenses to more accurately describe the costs included therein. The impact of these reclassifications for the three months ended June 30, 2007 is to increase cost of sales by \$90.9 million; increase cost of services and rentals by \$25.9 million and decrease marketing, general and administrative expenses by \$116.8 million and for the six months ended June 30, 2007 is to increase cost of sales by \$177.2 million; increase cost of services and rentals by \$56.0 million and decrease marketing, general and administrative expenses by \$233.2 million. These reclassifications had no impact on total costs and expenses as these changes offset one another. All prior periods have been reclassified to conform to this new presentation.

**New Accounting Standards**

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements* (“SFAS 157”), which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value and expanding disclosures about fair value measurements. SFAS 157 was originally effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In November 2007, the FASB placed a one year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities; however, SFAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities. We adopted all requirements of SFAS 157 on January 1, 2008, except as they relate to nonfinancial assets and liabilities, which will be adopted on January 1, 2009, as allowed under SFAS 157. See Note 9 for further information on the impact of this standard to financial assets and liabilities. We have not yet determined the impact, if any, on our consolidated condensed financial statements for nonfinancial assets and liabilities.

In September 2006, the FASB issued SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (“SFAS 158”). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Additionally, it requires an employer to measure the funded status of a plan as of the date of its year end statement of financial position, with limited exceptions. SFAS 158 is effective as of the end of the fiscal year ending after December 15, 2006; however, the requirement to measure plan assets and benefit obligations as of the date of the employer’s fiscal year end statement of financial position is effective for fiscal years ending after December 15, 2008. We adopted all requirements of SFAS 158 on

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

December 31, 2006, except for the funded status measurement date requirement, which will be adopted on December 31, 2008, as allowed under SFAS 158. We currently do not expect there to be a material impact on our consolidated condensed financial statements as a result of the adoption of the funded status measurement date requirement.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose to measure eligible financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS 159 on January 1, 2008, and there was no impact on our consolidated condensed financial statements as we did not choose to measure any eligible financial assets or liabilities at fair value.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* (“SFAS 160”). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary in an effort to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We will adopt SFAS 160 on January 1, 2009, and have not yet determined the impact, if any, on our consolidated condensed financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (“SFAS 141R”). SFAS 141R replaces FASB Statement No. 141, *Business Combinations* (“SFAS 141”). The statement retains the purchase method of accounting used in business combinations but replaces SFAS 141 by establishing principles and requirements for the recognition and measurement of assets, liabilities and goodwill, including the requirement that most transaction and restructuring costs related to the acquisition be expensed. In addition, the statement requires disclosures to enable users to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will adopt SFAS 141R on January 1, 2009 for acquisitions on or after this date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (“SFAS 161”). SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. The statement also requires enhanced disclosures regarding how and why entities use derivative instruments, how derivative instruments and related hedged items are accounted and how derivative instruments and related hedged items affect entities’ financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008. We will adopt the new disclosure requirements of SFAS 161 in the first quarter of 2009.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3, *Determination of the Useful Life of Intangible Assets* (“FSP SFAS 142-3”). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, *Business Combinations*, and other U.S. GAAP principles. FSP SFAS 142-3 is effective for fiscal years beginning after December 15, 2008. We will adopt FSP SFAS 142-3 on January 1, 2009 and have not yet determined the impact, if any, on our consolidated condensed financial statements.

**NOTE 2. GAIN ON SALE OF PRODUCT LINE**

In February 2008, we sold the assets associated with the Completion and Production segment’s Surface Safety Systems (“SSS”) product line and received cash proceeds of \$31.0 million. The SSS assets sold included hydraulic and pneumatic actuators, bonnet assemblies and control systems. We recorded a pre-tax gain of \$28.2 million (\$18.4 million after-tax).

**NOTE 3. ACQUISITIONS**

In April 2008, we acquired two reservoir consulting firms – Gaffney, Cline & Associates (“GCA”) and GeoMechanics International (“GMI”) – for \$76.9 million in cash, including \$3.5 million of direct transaction costs. These firms provide consulting services related to reservoir engineering, technical and managerial advisory services and reservoir geomechanics. As a result of these acquisitions, we recorded \$37.6 million of goodwill and \$22.1 million of intangibles, both subject to final purchase accounting adjustments. Pro forma results of operations have not been presented because the effect of this acquisition was not material to our

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

consolidated condensed financial statements. Under the terms of the purchase agreements, the Company may be required to make additional payments of up to approximately \$46.0 million based on the performance of the businesses during 2008, 2009 and 2010.

**NOTE 4. STOCK-BASED COMPENSATION**

We grant various forms of equity based awards to directors, officers and other key employees. These equity based awards consist primarily of stock options, restricted stock awards and restricted stock units. We also have an Employee Stock Purchase Plan available for eligible employees to purchase shares of our common stock at a 15% discount. We recorded total stock-based compensation expense of \$14.0 million and \$11.5 million for the three months ended June 30, 2008 and 2007, respectively, and \$29.1 million and \$24.1 million for the six months ended June 30, 2008 and 2007, respectively.

**Stock Options**

Our stock option plans provide for the issuance of incentive and non-qualified stock options to directors, officers and other key employees at an exercise price equal to the fair market value of the stock at the date of grant. We typically grant options twice a year in January and July.

The fair value of each stock option granted is estimated on the date of grant using a Black-Scholes option pricing model. The following table presents the weighted-average assumptions used in the option pricing model for the six months ended June 30, 2008 and 2007.

	2008	2007
Expected life (years)	5.5	5.1
Risk-free interest rate	2.8%	4.8%
Volatility	30.1%	29.6%
Dividend yield	0.7%	0.8%
Weighted-average fair value per share at grant date	\$21.35	\$22.33

We granted 349,943 options during the six months ended June 30, 2008 at a weighted-average exercise price per option of \$69.90.

**Restricted Stock Awards and Units**

In addition to stock options, directors, officers, and other key employees may be granted restricted stock awards (“RSA”), which is an award of common stock with no exercise price, or restricted stock units (“RSU”), where each unit represents the right to receive at the end of a stipulated period one unrestricted share of stock with no exercise price. We typically grant RSAs and RSUs once a year in January. We determine the fair value of restricted stock awards and restricted stock units based on the market price of our common stock on the date of grant.

We granted 417,459 RSAs and 233,513 RSUs during the six months ended June 30, 2008 at a weighted-average price per award or unit of \$71.66 and \$75.79, respectively.

**Employee Stock Purchase Plan**

Our Employee Stock Purchase Plan (“ESPP”) allows eligible employees to elect to contribute on an after-tax basis between 1% and 10% of their annual pay to purchase our common stock; provided, however, an employee may not contribute more than \$25,000 annually to the plan pursuant to Internal Revenue Service restrictions. Shares are purchased at a 15% discount of the fair market value of our common stock on January 1<sup>st</sup> or December 31<sup>st</sup>, whichever is lower. We determined the fair value of our ESPP shares using the Black-Scholes option pricing model with the following assumptions.

	2008	2007
Expected life (years)	1.0	1.0
Risk-free interest rate	3.2%	4.9%
Volatility	32.8%	30.5%
Dividend Yield	0.6%	0.7%
Weighted-average fair value per share	\$11.43	\$10.39

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

Based on contributions as currently elected by eligible employees and our stock price on January 1, 2008, we estimate we will issue approximately 591,000 shares under the ESPP on or around January 1, 2009.

**NOTE 5. EARNINGS PER SHARE**

A reconciliation of the number of shares used for the basic and diluted EPS calculation is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Weighted average common shares outstanding for basic EPS	306.7	319.1	308.2	319.1
Effect of dilutive securities — stock plans	1.7	2.2	1.6	2.1
Adjusted weighted average common shares outstanding for diluted EPS	308.4	321.3	309.8	321.2

Future potentially dilutive shares excluded from diluted EPS:

Options with an exercise price greater than the average market price for the period	0.3	0.3	0.6	0.6
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**NOTE 6. INVENTORIES**

Inventories are comprised of the following:

	June 30, 2008	December 31, 2007
Finished goods	\$1,582.5	\$1,414.0
Work in process	191.0	177.5
Raw materials	133.1	122.9
Total	\$1,906.6	\$1,714.4

**NOTE 7. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment are comprised of the following:

	June 30, 2008	December 31, 2007
Land	\$ 71.0	\$ 62.0
Buildings and improvements	827.6	774.7
Machinery and equipment	2,930.2	2,745.0
Rental tools and equipment	1,875.6	1,739.3
Subtotal	5,704.4	5,321.0
Accumulated depreciation	(3,168.2)	(2,976.4)
Total	\$ 2,536.2	\$ 2,344.6

**NOTE 8. GOODWILL AND INTANGIBLE ASSETS**

The changes in the carrying amount of goodwill are detailed below by segment:

	Drilling and Evaluation	Completion and Production	Total
Balance as of December 31, 2007	\$914.0	\$440.2	\$1,354.2
Goodwill from acquisitions during the period	37.6	—	37.6
Translation adjustments and other	(1.4)	(0.2)	(1.6)
Balance as of June 30, 2008	\$950.2	\$440.0	\$1,390.2

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

Intangible assets are comprised of the following:

	June 30, 2008			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Technology-based	\$251.0	\$(113.6)	\$137.4	\$240.6	\$(105.1)	\$135.5
Contract-based	15.2	(10.0)	5.2	15.1	(9.2)	5.9
Marketing-related	10.1	(5.9)	4.2	5.7	(5.7)	—
Customer-based	20.8	(4.4)	16.4	13.6	(3.8)	9.8
Other	0.3	(0.3)	—	0.3	(0.3)	—
Total amortizable intangible assets	297.4	(134.2)	163.2	275.3	(124.1)	151.2
Marketing-related intangible assets with indefinite useful lives	25.5	—	25.5	25.4	—	25.4
<b>Total</b>	<b>\$322.9</b>	<b>\$(134.2)</b>	<b>\$188.7</b>	<b>\$300.7</b>	<b>\$(124.1)</b>	<b>\$176.6</b>

Intangible assets with finite useful lives are amortized either on a straight-line basis with estimated useful lives ranging from 1 to 20 years, or on a basis that reflects the pattern in which the estimated economic benefits of the intangible assets are consumed, which range from 15 to 30 years.

Amortization expense for intangible assets included in net income for the three months and six months ended June 30, 2008 was \$5.2 million and \$10.1 million, respectively, and is estimated to be \$20.0 million for 2008. Estimated amortization expense for each of the subsequent five fiscal years is expected to be as follows: 2009 – \$18.3 million; 2010 – \$14.8 million; 2011 – \$13.2 million; 2012 – \$11.9 million; and 2013 – \$11.6 million.

#### NOTE 9. FAIR VALUE OF CERTAIN FINANCIAL ASSETS AND LIABILITIES

On January 1, 2008, we adopted the methods of fair value as described in SFAS 157 to value certain of our financial assets and liabilities. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The statement establishes consistency and comparability by providing a fair value hierarchy that prioritizes the inputs to valuation techniques into three broad levels, which are described below:

- Level 1 inputs are quoted market prices in active markets for identical assets or liabilities (these are observable market inputs).
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability (includes quoted market prices for similar assets or identical or similar assets in markets in which there are few transactions, prices that are not current or vary substantially).
- Level 3 inputs are unobservable inputs that reflect the entity's own assumptions in pricing the asset or liability (used when little or no market data is available).

SFAS 157 requires the use of observable market inputs (quoted market prices) when measuring fair value and requires a Level 1 quoted price be used to measure fair value whenever possible.

Financial assets and liabilities included in our financial statements and measured at fair value as of June 30, 2008 are classified based on the valuation technique level in the table below:

Description	Total	Fair Value Measurement at June 30, 2008		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Auction rate securities	\$ 28.1	\$ —	\$ —	\$28.1
Non-qualified defined contribution plan assets	131.8	131.8	—	—
<b>Total assets at fair value</b>	<b>\$159.9</b>	<b>\$131.8</b>	<b>\$ —</b>	<b>\$28.1</b>
<b>Liabilities:</b>				
Non-qualified defined contribution plan liabilities	\$131.8	\$131.8	\$ —	\$ —

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

The following is a reconciliation of the activity for the three months ended June 30, 2008 for our auction rate securities measured at fair value based on significant unobservable Inputs (Level 3).

Carrying Value as of April 1, 2008	\$ 35.6
Total unrealized losses included in other comprehensive loss	(7.5)
Carrying Value as of June 30, 2008	\$ 28.1

### Auction Rate Securities

Our auction rate securities (“ARS”) have been designated as “available-for-sale” securities. Our ARS investments are AAA rated credit linked notes, which generally combine low risk assets and credit default swaps (“CDS”) to create a security that pays interest from the coupon payments of the low risk assets and the periodic proceeds from the sale of the CDS. Our ARS investments do not include any mortgage-backed securities. Since September 2007, we have been unable to sell our ARS investments at auctions. As a result of the unsuccessful auctions, the interest rate resets every 28 days at one month LIBOR plus 50 basis points and the liquidity of these investments has been diminished.

We utilized Level 3 inputs to estimate the fair value of our ARS investments based on the underlying structure of each security and their collateral values, including assessments of counterparty credit quality, default risk underlying the security, expected cash flows, discount rates and overall capital market liquidity. Based on this analysis, we estimate the fair value of our ARS investments to be \$28.1 million as of June 30, 2008, and accordingly, we recorded a temporary impairment of \$7.5 million. The temporary impairment is recorded as an unrealized loss in accumulated other comprehensive loss, a component of stockholders’ equity. The valuation of our ARS investments is subject to uncertainties that are difficult to predict and require significant judgment. The fair value of our ARS investments could change significantly in the future based on various factors including changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates and counterparty risk. Based on our ability and intent to hold such investments for a period of time sufficient to allow for any anticipated recovery in the fair value, we have classified all of our auction rate securities as noncurrent investments.

### Non-qualified Defined Contribution Plan Assets and Liabilities

We have a non-qualified defined contribution plan that provides basically the same benefit as our Thrift Plan for certain non-U.S. employees who are not eligible to participate in the Thrift Plan. In addition, we provide a non-qualified supplemental retirement plan for certain officers and employees whose benefits under the Thrift Plan and/or U.S. defined benefit pension plan are limited by federal tax law. The assets of both plans consist primarily of mutual funds and to a lesser extent equity securities. We hold the assets of these plans under a grantor trust and have recorded the assets along with the related deferred compensation liability at fair value. The assets and liabilities were valued using Level 1 inputs at the reporting date and were based on quoted market prices from various major stock exchanges.

### Nonfinancial Assets and Liabilities

In November 2007, the FASB placed a one year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities. Accordingly, we will adopt the methods of fair value described in SFAS 157 for nonfinancial assets and liabilities on January 1, 2009. We have not yet determined the impact, if any, on our consolidated condensed financial statements for these nonfinancial assets and liabilities, which include, but are not limited to, goodwill, assets held for sale and asset retirement obligations.

## NOTE 10. FINANCIAL INSTRUMENTS

### Foreign Currency Forward Contracts

At June 30, 2008, we had entered into several foreign currency forward contracts with notional amounts aggregating \$135.0 million to hedge exposure to currency fluctuations in various foreign currencies, including British Pound Sterling, Euro, Norwegian Krone and the Brazilian Real. These contracts are designated and qualify as fair value hedging instruments. Based on quoted market prices as of June 30, 2008 for contracts with similar terms and maturity dates, we recorded a gain of \$0.1 million to adjust these foreign currency forward contracts to their fair market value. This gain offsets designated foreign exchange losses resulting from the underlying exposures and is included in marketing, general and administrative expenses in our consolidated condensed statement of operations.

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

**NOTE 11. INDEBTEDNESS**

On March 3, 2008, we initiated a commercial paper program (the “Program”) under which we may issue from time to time unsecured commercial paper notes up to a maximum aggregate amount outstanding at any time of \$500.0 million. On April 2, 2008, we increased the Program to an aggregate of \$1.0 billion. The proceeds of the Program will be used for general corporate purposes, including working capital, capital expenditures, acquisitions and share repurchases. Commercial paper issued under the Program is scheduled to mature within approximately 270 days of issuance. The commercial paper is not redeemable prior to maturity and will not be subject to voluntary prepayment. At June 30, 2008, we had \$544.8 million outstanding in commercial paper at a weighted average interest rate of 2.19%.

On April 1, 2008, we entered into a credit agreement (the “2008 Credit Agreement”) for a committed \$500.0 million revolving credit facility that expires in March 2009. The 2008 Credit Agreement contains certain covenants, which, among other things, require the maintenance of a funded indebtedness to total capitalization ratio (a defined formula per the agreement) of less than or equal to 0.60, restrict certain merger transactions or the sale of all or substantially all of our assets or a significant subsidiary and limit the amount of subsidiary indebtedness. Upon the occurrence of certain events of default, our obligations under the 2008 Credit Agreement may be accelerated. Such events of default include payment defaults to lenders under the 2008 Credit Agreement, covenant defaults and other customary defaults.

At June 30, 2008, we had \$1,515.2 million of credit facilities with commercial banks, of which \$1.0 billion are committed revolving credit facilities. The committed facilities expire in March 2009 (\$500.0 million) and in July 2012 (\$500.0 million). There were no direct borrowings under the facilities during the six months ended June 30, 2008; however, to the extent we have outstanding commercial paper, our ability to borrow under the facilities is reduced.

At June 30, 2008, we have short-term borrowings and current portion of long-term debt of \$1,081.4 million. When applicable, based on our liquidity and other requirements, we classify short-term borrowings and current portion of long-term debt as long-term to the extent of our long-term committed facility that expires in 2012 because we have the ability under this facility and the intent to maintain these obligations for longer than one year. Accordingly, we have classified \$500.0 million as long-term debt and \$581.4 million as short-term debt at June 30, 2008.

**NOTE 12. SEGMENT AND RELATED INFORMATION**

We are a major supplier of wellbore related products and technology services and systems and provide products and services for drilling, formation evaluation, completion and production and reservoir technology and consulting to the worldwide oil and natural gas industry. We report results for our product-line focused divisions under two segments: the Drilling and Evaluation segment and the Completion and Production segment. We have aggregated the divisions within each segment because they have similar economic characteristics and because the long-term financial performance of these divisions is affected by similar economic conditions. They also operate in the same markets, which includes all of the major oil and natural gas producing regions of the world. The results of each segment are evaluated regularly by our chief operating decision maker in deciding how to allocate resources and in assessing performance.

- The Drilling and Evaluation segment consists of the Baker Hughes Drilling Fluids (drilling fluids), Hughes Christensen (oilfield drill bits), INTEQ (drilling, measurement-while-drilling and logging-while-drilling) and Baker Atlas (wireline formation evaluation and wireline completion services) divisions and also includes GCA and GMI, our newly acquired reservoir consulting firms. The Drilling and Evaluation segment provides products and services used to drill and evaluate oil and natural gas wells as well as consulting services used in the analysis of oil and gas reservoirs.
- The Completion and Production segment consists of the Baker Oil Tools (workover, fishing and completion equipment), Baker Petrolite (oilfield specialty chemicals), Centrilift (electric submersible pumps and progressing cavity pumps) divisions, the ProductionQuest (production optimization and permanent monitoring) business unit, and Integrated Operations and Project Management. The Completion and Production segment provides equipment and services used from the completion phase through the productive life of oil and natural gas wells.

The performance of our segments is evaluated based on segment profit (loss), which is defined as income before income taxes, interest expense, and interest and dividend income. The “Corporate and Other” segment loss includes corporate expenses, interest expense, interest and dividend income and certain gains and losses not allocated to the segments. During the fourth quarter of 2007, we started allocating certain expenses, previously reported in “Corporate and Other” to the Drilling and Evaluation and Completion and Production segments. These expenses consist of administrative operations support costs that are more closely related to operating

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

activities. The impact of this allocation was a reduction to “Corporate and Other” segment loss of \$3.6 million for the three months ended June 30, 2007 and \$6.5 million for the six months ended June 30, 2007. All prior periods have been reclassified to conform to this new presentation.

	Drilling and Evaluation	Completion and Production	Total Oilfield	Corporate and Other	Total
<b>Revenues</b>					
Three months ended June 30, 2008	\$1,527.1	\$1,470.4	\$2,997.5	\$ —	\$ 2,997.5
Three months ended June 30, 2007	1,278.7	1,258.7	2,537.4	0.1	2,537.5
Six months ended June 30, 2008	\$2,918.0	\$2,749.9	\$5,667.9	\$ —	\$ 5,667.9
Six months ended June 30, 2007	2,567.2	2,442.9	5,010.1	0.2	5,010.3
<b>Segment profit (loss)</b>					
Three months ended June 30, 2008	\$ 366.9	\$ 322.6	\$ 689.5	\$ (138.6)	\$ 550.9
Three months ended June 30, 2007	326.6	265.2	591.8	(60.0)	531.8
Six months ended June 30, 2008	\$ 716.4	\$ 585.7	\$1,302.1	\$ (182.0)	\$ 1,120.1
Six months ended June 30, 2007	691.7	510.2	1,201.9	(115.0)	1,086.9
<b>Total assets</b>					
As of June 30, 2008	\$5,219.9	\$4,391.5	\$9,611.4	\$1,096.6	\$10,708.0
As of December 31, 2007	4,720.4	4,095.9	8,816.3	1,040.3	9,856.6

The following table presents the details of the segment profit (loss) for “Corporate and Other”:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Corporate and other expenses	\$ (63.7)	\$(54.5)	\$(127.6)	\$(104.2)
Litigation settlement	(62.0)	—	(62.0)	—
Gain on sale of product line	—	—	28.2	—
Interest expense	(17.1)	(16.2)	(32.8)	(33.0)
Interest and dividend income	4.2	10.7	12.2	22.2
<b>Total</b>	<b>\$(138.6)</b>	<b>\$(60.0)</b>	<b>\$(182.0)</b>	<b>\$(115.0)</b>

### NOTE 13. EMPLOYEE BENEFIT PLANS

We have noncontributory defined benefit pension plans (“Pension Benefits”) covering employees primarily in the U.S., the U.K. and Germany. We also provide certain postretirement health care benefits (“other postretirement benefits”), through an unfunded plan, to substantially all U.S. employees who retire and have met certain age and service requirements.

The components of net periodic benefit cost are as follows for the three months ended June 30:

	U.S. Pension Benefits		Non-U.S. Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007	2008	2007
Service cost	\$ 7.6	\$ 7.9	\$ 0.7	\$ 0.7	\$2.1	\$1.9
Interest cost	4.3	3.9	4.4	4.4	2.3	2.2
Expected return on plan assets	(9.6)	(8.6)	(5.5)	(4.8)	—	—
Amortization of prior service cost	0.1	0.2	—	—	0.3	0.3
Amortization of net loss	0.1	0.1	0.3	0.7	—	—
<b>Net periodic benefit cost/(income)</b>	<b>\$ 2.5</b>	<b>\$ 3.5</b>	<b>\$(0.1)</b>	<b>\$ 1.0</b>	<b>\$4.7</b>	<b>\$4.4</b>

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

The components of net periodic benefit cost are as follows for the six months ended June 30:

	U.S. Pension Benefits		Non-U.S. Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007	2008	2007
Service cost	\$ 15.2	\$ 15.8	\$ 1.4	\$ 1.4	\$4.2	\$3.8
Interest cost	8.6	7.8	8.8	8.8	4.6	4.4
Expected return on plan assets	(19.2)	(17.2)	(11.0)	(9.6)	—	—
Amortization of prior service cost	0.2	0.4	—	—	0.6	0.6
Amortization of net loss	0.2	0.2	0.6	1.4	—	—
Net periodic benefit cost/(income)	\$ 5.0	\$ 7.0	\$ (0.2)	\$ 2.0	\$9.4	\$8.8

**NOTE 14. GUARANTEES**

In the normal course of business with customers, vendors and others, we have entered into off-balance sheet arrangements, such as surety bonds, performance letters of credit and other bank issued guarantees, which totaled approximately \$581.9 million at June 30, 2008. None of the off-balance sheet arrangements either has, or is likely to have, a material effect on our consolidated condensed financial statements.

We sell certain products with a product warranty that provides that customers can return a defective product during a specified warranty period following the purchase in exchange for a replacement product, repair at no cost to the customer or the issuance of a credit to the customer. We accrue amounts for estimated warranty claims based upon current and historical product sales data, warranty costs incurred and any other related information known to us.

The changes in the aggregate product warranty liabilities for the six months ended June 30, 2008 are as follows:

Balance as of December 31, 2007	\$14.8
Claims paid or settled	(4.0)
Additional warranties issued	2.5
Revisions in estimates of previously issued warranties	(0.1)
Balance as of June 30, 2008	\$13.2

**NOTE 15. COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) includes all changes in equity during a period except those resulting from investments by and distributions to owners. The components of our comprehensive income (loss), net of related tax, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	\$379.3	\$349.6	\$774.3	\$724.3
Other comprehensive income (loss):				
Foreign currency translation adjustments during the period	(7.5)	34.8	19.9	41.1
Pension and other postretirement benefits	2.4	(0.3)	(2.1)	(0.6)
Unrealized loss on available-for-sale securities	(7.5)	—	(7.5)	—
Total comprehensive income	\$366.7	\$384.1	\$784.6	\$764.8

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

Total accumulated other comprehensive loss consisted of the following:

	June 30, 2008	December 31, 2007
Foreign currency translation adjustments	\$ 31.8	\$ 11.9
Pension and other postretirement benefits	(58.2)	(56.1)
Unrealized loss on available-for-sale securities	(7.5)	—
Total accumulated other comprehensive loss	\$(33.9)	\$(44.2)

**NOTE 16. LITIGATION**

We are involved in litigation or proceedings that have arisen in our business activities. We insure against these risks to the extent deemed prudent by our management and to the extent insurance is available, but no assurance can be given that the nature and amount of that insurance will be sufficient to fully indemnify us against liabilities arising out of pending and future legal proceedings. Many of these insurance policies contain deductibles or self-insured retentions in amounts we deem prudent and for which we are responsible for payment. In determining the amount of self-insurance, it is our policy to self-insure those losses that are predictable, measurable and recurring in nature, such as claims for automobile liability, general liability and workers compensation. We record accruals for the uninsured portion of losses. The accruals for losses are calculated by estimating losses for claims using historical claim data, specific loss development factors and other information as necessary.

On March 29, 2002, we announced that we had been advised that the SEC and the Department Of Justice (“DOJ”) were conducting investigations into allegations of violations of law relating to Nigeria and other related matters. The SEC issued a formal order of investigation into possible violations of provisions under the Foreign Corrupt Practices Act (“FCPA”) regarding antibribery, books and records and internal controls. In connection with the investigations, the SEC issued subpoenas seeking information about our operations in Angola (subpoena dated August 6, 2003) and Kazakhstan (subpoenas dated August 6, 2003 and April 22, 2005) as part of its ongoing investigation. We provided documents to and cooperated fully with the SEC and DOJ. In addition, we conducted internal investigations into these matters. Our internal investigations identified issues regarding the propriety of certain payments and apparent deficiencies in our books and records and internal controls with respect to certain operations in Angola, Kazakhstan and Nigeria, as well as potential liabilities to government authorities in Nigeria. Evidence obtained during the course of the investigations was provided to the SEC and DOJ.

On April 26, 2007, the United States District Court, Southern District of Texas, Houston Division (the “Court”) unsealed a three-count criminal information that had been filed against us as part of the execution of a Deferred Prosecution Agreement (the “DPA”) between us and the DOJ. The three counts arise out of payments made to an agent in connection with a project in Kazakhstan and include conspiracy to violate the FCPA, a substantive violation of the antibribery provisions of the FCPA, and a violation of the FCPA’s books-and-records provisions. All three counts relate to our operations in Kazakhstan during the period from 2000 to 2003. Although we did not plead guilty to that information, we face prosecution under that information, and possibly under other charges as well, if we fail to comply with the terms of the DPA. Those terms include, for the two-year term of the DPA, full cooperation with the government; compliance with all federal criminal law, including but not limited to the FCPA; and adoption of a Compliance Code containing specific provisions intended to prevent violations of the FCPA. The DPA also requires us to retain an independent monitor for a term of three years to assess and make recommendations about our compliance policies and procedures and our implementation of those procedures. Provided that we comply with the DPA, the DOJ has agreed not to prosecute us for violations of the FCPA based on information that we have disclosed to the DOJ regarding our operations in Nigeria, Angola, Kazakhstan, Indonesia, Russia, Uzbekistan, Turkmenistan, and Azerbaijan, among other countries.

On the same date, the Court also accepted a plea of guilty by our subsidiary Baker Hughes Services International, Inc. (“BHSII”) pursuant to a plea agreement between BHSII and the DOJ (the “Plea Agreement”) based on similar charges relating to the same conduct. Pursuant to the Plea Agreement, BHSII agreed to a three-year term of organizational probation. The Plea Agreement contains provisions requiring BHSII to cooperate with the government, to comply with all federal criminal law, and to adopt a Compliance Code similar to the one that the DPA requires of the Company.

Also on April 26, 2007, the SEC filed a Complaint (the “SEC Complaint”) and a proposed order (the “SEC Order”) against us in the Court. The SEC Complaint and the SEC Order were filed as part of a settled civil enforcement action by the SEC, to resolve the civil portion of the government’s investigation of us. As part of our agreement with the SEC, we consented to the filing of the SEC Complaint without admitting or denying the allegations in the SEC Complaint, and also consented to the entry of the SEC Order. The SEC Complaint alleges civil violations of the FCPA’s antibribery provisions related to our operations in Kazakhstan, the FCPA’s books-and-records and internal-controls provisions related to our operations in Nigeria, Angola, Kazakhstan, Indonesia, Russia, and

**Baker Hughes Incorporated**  
**Notes to Unaudited Consolidated Condensed Financial Statements (continued)**

Uzbekistan, and the SEC's cease and desist order of September 12, 2001. The SEC Order became effective on May 1, 2007, which is the date it was confirmed by the Court. The SEC Order enjoins us from violating the FCPA's antibribery, books-and-records, and internal-controls provisions. As in the DPA, it requires that we retain the independent monitor to assess our FCPA compliance policies and procedures for the three-year period.

Under the terms of the settlements with the DOJ and the SEC, the Company and BHSII paid in the second quarter of 2007, \$44.1 million (\$11 million in criminal penalties, \$10 million in civil penalties, \$19.9 million in disgorgement of profits and \$3.2 million in pre-judgment interest) to settle these investigations. In the fourth quarter of 2006, we recorded a financial charge for the potential settlement.

We retained in 2007 and the SEC and DOJ approved an independent monitor to assess our FCPA compliance policies and procedures for the specified three-year period. During March 2008, the independent monitor provided us with his initial recommendations relating to our compliance policies and procedures, primarily in the areas of internal controls, internal audit, agent due diligence, customs, training, human resources, and related matters. Consistent with the monitor's recommendations, we are continuing the comprehensive compliance activities we already have in place, enhancing and streamlining some of those activities, initiating additional activities and expediting the introduction of certain previously planned compliance related activities.

On May 4, 2007 and May 15, 2007, The Sheetmetal Workers' National Pension Fund and Chris Larson, respectively, instituted shareholder derivative lawsuits for and on the Company's behalf against certain current and former members of the Board of Directors and certain current and former officers, and the Company as a nominal defendant, following the Company's settlement with the DOJ and SEC in April 2007. On August 17, 2007, the Alaska Plumbing and Pipefitting Industry Pension Trust also instituted a shareholder derivative lawsuit for and on the Company's behalf against certain current and former members of the Board of Directors and certain current and former officers, and the Company as a nominal defendant. On June 6, 2008, the Midwestern Teamsters Pension Trust Fund and Oppenheim Kapitalanlagegesellschaft Mbh instituted a shareholder derivative lawsuit for and on the Company's behalf against certain current and former members of the Board of Directors and certain current and former officers, and the Company as a nominal defendant. The complaints in all four lawsuits allege, among other things, that the individual defendants failed to implement adequate controls and compliance procedures to prevent the events addressed by the settlement with the DOJ and SEC. The relief sought in the lawsuits includes a declaration that the defendants breached their fiduciary duties, an award of damages sustained by the Company as a result of the alleged breach and monetary and injunctive relief, as well as attorneys' and experts' fees. On May 15, 2008, the consolidated complaint of the Sheetmetal Workers' National Pension Fund and The Alaska Plumbing and Pipefitting Industry Pension Trust was dismissed for lack of subject matter jurisdiction by the Houston Division of the United States District Court for the Southern District of Texas. The lawsuit brought by the Midwestern Teamsters Pension Trust Fund and Oppenheim Kapitalanlagegesellschaft Mbh is pending in the Houston Division of the United States District Court for the Southern District of Texas. The lawsuit brought by Chris Larson is pending in the 215th District Court of Harris County, Texas. We do not expect these lawsuits to have a material adverse effect on our consolidated condensed financial statements.

On May 12, 2006, Baker Hughes Oilfield Operations, Inc. ("BHOO"), a subsidiary of the Company, was named as a defendant in a lawsuit in the United States District Court, Eastern District of Texas brought by ReedHycalog against BHOO and other third parties arising out of alleged patent infringement relating to the sale of certain diamond drill bits utilizing certain types of polycrystalline diamond cutters sold by our Hughes Christensen division (the "ReedHycalog Claims"). On May 22, 2008, we reached an agreement for reciprocal licenses with ReedHycalog, now a division of National Oilwell Varco, Inc. regarding the ReedHycalog Claims and related Baker Hughes counter-claims. As part of the agreement, the Company and ReedHycalog have agreed to a cross-license of the disputed technologies. As a result, in June 2008 the Company paid ReedHycalog \$70.0 million in royalties for prior use of certain patented technologies, and ReedHycalog paid the Company \$8.0 million in royalties for the license of certain Company patented technologies. The net charge of \$62.0 million for the settlement of this litigation is reflected in the consolidated condensed statement of operations. In addition, the Company will pay a minimum of \$30.0 million in royalties for future use. Pursuant to the agreement, BHOO is dismissed from all claims and has released ReedHycalog from all counter-claims, in connection with the previously disclosed litigation.

**NOTE 17. SUBSEQUENT EVENTS**

On July 24, 2008, our Board of Directors authorized a program to repurchase up to \$1.0 billion of our common stock (the "2008 Repurchase Program") in addition to the existing stock repurchase authorization. As of July 24, 2008, we had authorization remaining to repurchase approximately \$1.246 billion of common stock, including the 2008 Repurchase Program. We may repurchase our common stock depending on market conditions, applicable legal requirements, our liquidity and other considerations. On July 24, 2008, our Board of Directors also authorized a dividend of \$0.15 per share, an increase from the previous quarterly dividend of \$0.13 per share.

**ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) should be read in conjunction with our consolidated condensed financial statements and the related notes thereto, as well as our Annual Report on Form 10-K for the year ended December 31, 2007 (“2007 Annual Report”).

**EXECUTIVE SUMMARY**

We are a major supplier of wellbore related products and technology services and systems and provide products and services for drilling, formation evaluation, completion and production and reservoir technology and consulting to the worldwide oil and natural gas industry. We report our results under two segments – Drilling and Evaluation and Completion and Production – which are aligned by product line based upon the types of products and services provided to our customers and upon the business characteristics of the divisions during business cycles. In April 2008, we acquired two reservoir consulting firms – Gaffney, Cline & Associates (“GCA”) and GeoMechanics International (“GMI”). These firms provide consulting services related to reservoir engineering, technical and managerial advisory services and reservoir geomechanics and are included in the Drilling and Evaluation segment.

- The Drilling and Evaluation segment consists of the Baker Hughes Drilling Fluids (drilling fluids), Hughes Christensen (oilfield drill bits), INTEQ (drilling, measurement-while-drilling and logging-while-drilling) and Baker Atlas (wireline formation evaluation and wireline completion services) divisions and also includes GCA and GMI, our newly acquired reservoir consulting firms. The Drilling and Evaluation segment provides products and services used to drill and evaluate oil and natural gas wells as well as consulting services used in the analysis of oil and gas reservoirs.
- The Completion and Production segment consists of the Baker Oil Tools (workover, fishing and completion equipment), Baker Petrolite (oilfield specialty chemicals), Centrilift (electric submersible pumps and progressing cavity pumps) divisions, the ProductionQuest (production optimization and permanent monitoring) business unit, and Integrated Operations and Project Management. The Completion and Production segment provides equipment and services used from the completion phase through the productive life of oil and natural gas wells.

The business operations of our divisions are organized around four primary geographic regions: North America; Latin America; Europe, Africa, Russia and the Caspian; and Middle East, Asia Pacific. Each region has a council comprised of regional vice presidents from each division and representatives from various functions as deemed necessary. The regional vice presidents report directly to each division president. Through this structure, we have placed our management close to our customers, improving our customer relationships and allowing us to react more quickly to local market conditions and needs.

We operate in over 90 countries around the world and our corporate headquarters are in Houston, Texas. We have significant manufacturing operations in various countries, including, but not limited to, the United States (Texas, Oklahoma and Louisiana), the U.K. (Aberdeen, East Kilbride and Belfast), Germany (Celle), and Venezuela (Maracaibo). As of June 30, 2008, we had approximately 36,500 employees. Approximately 57% of our employees work outside the U.S.

**BUSINESS ENVIRONMENT**

Our business environment and its corresponding operating results are significantly affected by the level of energy industry spending for the exploration, development, and production of oil and natural gas reserves. Spending by oil and natural gas exploration and production companies is dependent upon their forecasts regarding the expected future supply and future demand for oil and natural gas products and their estimates of risk-adjusted costs to find, develop, and produce reserves. Changes in oil and natural gas exploration and production spending will normally result in increased or decreased demand for our products and services, which will be reflected in the rig count and other measures.

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### Oil and Natural Gas Prices

Oil (West Texas Intermediate (WTI) Cushing Crude Oil Spot Price) and natural gas (Henry Hub Natural Gas Spot Price) prices are summarized in the table below as averages of the daily closing prices during each of the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Oil prices (\$/Bbl)	\$123.80	\$64.95	\$111.14	\$61.58
Natural gas prices (\$/mmBtu)	11.36	7.53	10.03	7.36

Oil prices averaged \$123.80/Bbl in the second quarter of 2008. Prices ranged from a low of \$100.98/Bbl in early April to a quarter high of \$140.21/Bbl in late June. The increase in oil prices continues to reflect strong worldwide demand, relatively low levels of spare production capacity and the weakening of the U.S. Dollar relative to other currencies. There is growing concern that slowing worldwide economic growth could negatively impact demand, particularly in the U.S. In its June 2008 Oil Market Report, the International Energy Agency (“IEA”) provided a downward revision in its estimate for 2008 worldwide demand due to concerns that record oil prices and reduced subsidies in several Non-OECD (Organization for Economic Co-operation and Development) countries will impact worldwide demand growth. The IEA now expects global oil demand to increase 1% to 86.8 million barrels per day in 2008, up from an estimated 86.0 million barrels per day in 2007.

Natural gas prices averaged \$11.36/mmBtu in the second quarter of 2008. Natural gas prices increased from a low of \$9.36/mmBtu in early April to a high of \$13.18/mmBtu at June quarter end. The increase reflects a number of factors including high oil prices, increased demand, lower imports of liquefied natural gas (“LNG”) and lower levels of natural gas in storage compared to 2007.

### Rig Counts

We have been providing rig counts to the public since 1944. We gather all relevant data through our field service personnel, who obtain the necessary data from routine visits to the various rigs, customers, contractors or other outside sources. This data is then compiled and distributed to various wire services and trade associations and is published on our website. Rig counts are compiled weekly for the U.S. and Canada and monthly for all international and U.S. workover rigs. Published international rig counts do not include rigs drilling in certain locations, such as Russia, the Caspian and onshore China, because this information cannot be readily obtained.

Rigs in the U.S. are counted as active if, on the day the count is taken, the well being drilled has been started but drilling has not been completed and the well is anticipated to be of sufficient depth, which may change from time to time and may vary from region to region, to be a potential consumer of our drill bits. Rigs in Canada are counted as active if data obtained by the Canadian Association of Oilwell Drillers and Contractors indicates that drilling operations have occurred during the week and we are able to verify this information. In most international areas, rigs are counted as active if drilling operations have taken place for at least 15 days during the month. In some active international areas where better data is available, a weekly or daily average of active rigs is taken. In those international areas where there is poor availability of data, the rig counts are estimated from third party data. The rig count does not include rigs that are in transit from one location to another, rigging up, being used in non-drilling activities, including production testing, completion and workover, or not significant consumers of drill bits.

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Our rig counts are summarized in the table below as averages for each of the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
U.S. – land and inland waters	1,797	1,680	1,755	1,666
U.S. – offshore	67	77	62	80
Canada	166	144	341	333
North America	2,030	1,901	2,158	2,079
Latin America	382	355	377	354
North Sea	46	54	43	51
Other Europe	51	26	51	27
Africa	68	62	67	64
Middle East	278	262	275	260
Asia Pacific	259	243	252	237
Outside North America	1,084	1,002	1,065	993
Worldwide	3,114	2,903	3,223	3,072

### *Second Quarter of 2008 Compared to the Second Quarter of 2007*

In North America, the rig count increased 7%. The U.S. – land and inland waters rig count increased 7% due to the increase in drilling for oil and natural gas. The U.S. – offshore rig count decreased 13% primarily due to the ongoing migration of rigs out of the Gulf of Mexico to more attractive international markets. The Canadian rig count was up 15% as increases in natural gas prices provided improved economics for natural gas producers.

Outside North America, the rig count increased 8%. The rig count in Latin America increased 8% with activity increases in Mexico, Brazil and Colombia. The North Sea rig count decreased 15% due to activity declines in the U.K. sector. The rig count in Africa increased 10% driven primarily by activity increases in Libya and West Africa. Activity in the Middle East continued to expand, with a 6% increase in the rig count driven primarily by activity increases in Egypt and Oman. The rig count in the Asia Pacific region was up 7% primarily due to increased activity in Australia and Indonesia.

## RESULTS OF OPERATIONS

The discussions below relating to significant line items from our consolidated condensed statements of operations are based on available information and represent our analysis of significant changes or events that impact the comparability of reported amounts. Where appropriate, we have identified specific events and changes that affect comparability or trends and, where possible and practical, have quantified the impact of such items. The discussions are based on our consolidated financial results, as individual segments do not contribute disproportionately to our revenues, profitability or cash requirements. In addition, the discussions below for revenues and cost of revenues are on a combined basis as the business drivers for the individual components of product sales and services and rentals are similar.

The table below details certain consolidated condensed statement of operations data and their percentage of revenues for the three months and six months ended June 30, 2008 and 2007, respectively.

	Three Months Ended June 30,			
	2008		2007	
Revenues	\$2,997.5	100%	\$2,537.5	100%
Cost of revenues	1,996.6	67%	1,671.6	66%
Research and engineering	106.4	4%	92.7	4%
Marketing, general and administrative	269.9	9%	236.1	9%
	Six Months Ended June 30,			
	2008		2007	
Revenues	\$5,667.9	100%	\$5,010.3	100%
Cost of revenues	3,766.0	66%	3,271.7	65%
Research and engineering	208.7	4%	184.3	4%
Marketing, general and administrative	520.4	9%	457.0	9%

Revenues

	Three Months Ended June 30,		Increase (decrease)	% Change
	2008	2007		
<b>Geographic Revenues:</b>				
North America	\$1,263.8	\$1,055.8	\$208.0	20%
Latin America	281.1	232.1	49.0	21%
Europe, Africa, Russia, and the Caspian	905.4	765.0	140.4	18%
Middle East Asia Pacific	547.2	484.5	62.7	13%
Oilfield Operations	2,997.5	2,537.4	460.1	18%
Other revenues	—	0.1	(0.1)	—
<b>Total revenues</b>	<b>\$2,997.5</b>	<b>\$2,537.5</b>	<b>\$460.0</b>	<b>18%</b>

	Six Months Ended June 30,		Increase (decrease)	% Change
	2008	2007		
<b>Geographic Revenues:</b>				
North America	\$2,425.4	\$2,129.6	\$295.8	14%
Latin America	531.1	460.1	71.0	15%
Europe, Africa, Russia, and the Caspian	1,667.8	1,474.2	193.6	13%
Middle East Asia Pacific	1,043.6	946.2	97.4	10%
Oilfield Operations	5,667.9	5,010.1	657.8	13%
Other revenues	—	0.2	(0.2)	—
<b>Total revenues</b>	<b>\$5,667.9</b>	<b>\$5,010.3</b>	<b>\$657.6</b>	<b>13%</b>

*Second Quarter of 2008 Compared to the Second Quarter of 2007*

Revenues for the three months ended June 30, 2008 increased 18% compared with the three months ended June 30, 2007, primarily due to increases in activity in certain geographic areas, price improvement and net changes in market share in selected product lines and geographic areas.

Revenues in North America, which accounted for 42% of total revenues, increased 20% for the three months ended June 30, 2008 compared with the three months ended June 30, 2007. Revenues from our U.S. land and inland waters operations increased 24% compared to a 7% increase in the rig count due to the increase in drilling for oil and natural gas. U.S. offshore revenues increased 10% despite a 13% decrease in the U.S. offshore rig count. The U.S. offshore rig count continues to decline due to the ongoing migration of rigs out of the Gulf of Mexico to more attractive international markets. Canada revenues increased 13% compared to a 15% increase in the rig count as increases in natural gas prices provided improved economics for natural gas producers.

Revenues outside North America, which accounted for 58% of total revenues, increased 17% for the three months ended June 30, 2008 compared with the three months ended June 30, 2007. This increase reflects the improvement in international drilling activity, as evidenced by the 8% increase in the rig count outside North America. Latin America revenues increased 21% compared to an 8% increase in the rig count, with revenues increasing primarily in Brazil, Colombia and Mexico. Europe, Africa, Russia and the Caspian (“EARC”) revenues increased 18% compared with the second quarter of 2007. The areas with the strongest revenue increases include Africa, where revenues increased 27% compared to a 10% increase in the rig count, as well as the Russia and Caspian area, where revenues increased 39%. Activity in the Middle East Asia Pacific (“MEAP”) region continued to expand, reflected by a 13% increase in revenues. Middle East revenues increased 13% compared to a 6% increase in the rig count, with revenues increasing primarily in Saudi Arabia and Oman. Asia Pacific revenues were up 13% compared to a 6% increase in the rig count. The increase in revenues was driven by increases in Saudi Arabia and Oman for the Middle East area and in China and Australia for the Asia Pacific area.

*First Six Months of 2008 Compared to the First Six Months of 2007*

Revenues for the six months ended June 30, 2008 increased 13% compared with the six months ended June 30, 2007 driven primarily by both activity increases, and price improvement and net changes in market share. Revenues in North America increased 14% as they were positively impacted by the increased activity from land rigs drilling for oil and natural gas in the U.S., driven by continued investment in drilling for oil and natural gas prospects. Revenues outside North America increased 13% reflecting increased activity in all three regions. Latin America revenues increased 15%; EARC revenues increased 13% and MEAP revenues increased 10%.

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### Cost of Revenues

Cost of revenues for the three months ended June 30, 2008 increased 19% compared with the three months ended June 30, 2007. Cost of revenues as a percentage of consolidated revenues was 67% and 66% for the three months ended June 30, 2008 and 2007, respectively. Cost of revenues for the six months ended June 30, 2008 increased 15% compared with the six months ended June 30, 2007. Cost of revenues as a percentage of consolidated revenues was 66% and 65% for the six months ended June 30, 2007 and 2006, respectively. The increase in cost of revenues as a percentage of consolidated revenues resulted primarily from a change in the geographic and product mix from the sale of our products and services and higher raw material and labor costs which were not fully offset by pricing increases.

### Research and Engineering

Research and engineering expenses increased 15% in the three months ended June 30, 2008 compared with the three months ended June 30, 2007 and increased 13% in the six months ended June 30, 2008 compared with the six months ended June 30, 2007. The increase reflects our continued commitment to developing and commercializing new technologies as well as investing in our core product offerings.

### Marketing, General and Administrative

Marketing, general and administrative expenses increased 14% in the three months ended June 30, 2008 compared with the three months ended June 30, 2007 and increased 14% in the six months ended June 30, 2008 compared with the six months ended June 30, 2007. The increase corresponds with increased activity and resulted primarily from higher employee related costs including compensation, training and benefits, higher marketing expenses as a result of increased activity, and an increase in legal, tax and other compliance-related expenses.

### Litigation Settlement

In connection with the settlement of litigation with ReedHycalog, in June 2008, the Company paid ReedHycalog \$70.0 million in royalties for prior use of certain patented technologies, and ReedHycalog paid the Company \$8.0 million in royalties for the license of certain Company patented technologies. The net charge of \$62.0 million for the settlement of this litigation is reflected in the consolidated condensed statement of operations.

### Interest and Dividend Income

Interest and dividend income decreased \$6.5 million in the three months ended June 30, 2008 compared with the three months ended June 30, 2007 and decreased \$10.0 million in the six months ended June 30, 2008 compared with the six months ended June 30, 2007. The decrease was primarily due to lower interest rates on our short-term investments in 2008 compared to 2007.

### Income Taxes

Our effective tax rate in the second quarter of 2008 is 31.2%, which is lower than the U.S. statutory income tax rate of 35% due to lower rates of tax on certain international operations, a decrease in tax reserves as a result of favorable audit settlements and the expiration of statute of limitations in various taxing jurisdictions, offset by state income taxes. The tax rate for the year 2008 is expected to be between 31.5% and 32.0%.

Our effective tax rate in the second quarter of 2007 was 34.3%, which is lower than the U.S. statutory income tax rate of 35% due to lower rates of tax on certain international operations offset by state income taxes. During the second quarter of 2007, we provided \$9.3 million of additional taxes, and related interest and penalties associated with disallowed tax deductions taken in previous years, arising from the resolution of investigations with the Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") in 2007.

Our tax filings for various periods are subject to audit by the tax authorities in most jurisdictions where we conduct business. These audits may result in assessment of additional taxes that are resolved with the authorities or through the courts. We believe these assessments may occasionally be based on erroneous and even arbitrary interpretations of local tax law. We have received tax assessments from various taxing authorities and are currently at varying stages of appeals and/or litigation regarding these matters. We believe we have substantial defenses to the questions being raised and will pursue all legal remedies should an unfavorable outcome result. However, resolution of these matters involves uncertainties and there are no assurances that the outcomes will be

favorable. We provide for uncertain tax positions pursuant to Financial Interpretation (“FIN”) 48, *Accounting for Uncertainty in Income Taxes: an Interpretation of FASB Statement No. 109*.

## OUTLOOK

### Worldwide Oil and Natural Gas Industry Outlook

This section should be read in conjunction with the factors described in “Part II, Item 1A. Risk Factors” and in the “Forward-Looking Statements” section in this Part I, Item 2, both contained herein. These factors could impact, either positively or negatively, our expectation for: oil and natural gas demand; oil and natural gas prices; exploration and development spending and drilling activity; and production spending.

Our outlook for exploration and development spending is based upon our expectations for customer spending in the markets in which we operate, and is driven primarily by our perception of industry expectations for oil and natural gas prices and their likely impact on customer capital and operating budgets as well as other factors that could impact the economic return oil and gas companies expect for developing oil and gas reserves. Our energy price forecasts below are based on information provided by our customers as well as market research and analyst reports including the Short Term Energy Outlook (“STEO”) published by the Energy Information Administration of the U.S. Department of Energy (“DOE”), the Oil Market Report published by the IEA and the Monthly Oil Market Report published by the Organization for Petroleum Exporting Countries (“OPEC”). Our outlook for production spending is based primarily on energy price forecasts and forecasts of expected oil and natural gas production levels.

Our outlook for activity outside of North America is heavily influenced by our expectations for oil prices and our outlook for activity in North America is heavily influenced by our expectations for North American natural gas prices.

**Expectations for Oil Prices – Demand for oil is expected to increase 0.8 to 1.0 million barrels per day in 2008 compared to 2007. Non-OPEC supply is expected to increase 0.4 to 0.6 million barrels per day. The gap between increased demand and non-OPEC supply is expected to be met with increased OPEC supply and decreases in oil inventories. Inventories and spare productive capacity, which buffer oil markets from supply disruptions, are expected to remain relatively low reflecting the continuing tight balance between supply and demand. In its June 2008 STEO, the DOE forecasted oil prices to average \$122/Bbl in 2008 and given the relatively low levels of inventory and spare productive capacity, prices are expected to remain volatile. The DOE expects oil prices to average \$126/Bbl in 2009. Delays in either OPEC or non-OPEC supply additions could impact this forecast.**

We believe that these forecasts are similar to the forecasts our customers are using to plan their current spending levels. Our customers are likely to reduce their capital budgets if they expect oil prices to decline significantly. The risks to oil prices falling significantly include: (1) a significant economic recession in either the U.S. and/or China, developing Asia and the Middle East; (2) increases in non-OPEC production; (3) any significant disruption to worldwide demand; (4) reduced geo-political tensions; (5) poor OPEC quota discipline; or (6) other factors that result in spare productive capacity and higher oil inventory levels or decreased demand. If oil prices rise significantly there is a risk that the high energy price environment could destroy demand and significantly slow economic growth. This risk is higher for the economies that are most closely tied to the U.S. Dollar. If worldwide economic growth were to slow significantly, our customers would likely decrease their capital spending from current levels. The primary risk of oil prices increasing significantly are a supply disruption in a major oil exporting country including Iran, Saudi Arabia, Iraq, Venezuela, Nigeria or Norway and continued weakening of the U.S. Dollar.

**Expectations for North American Natural Gas Prices – In its June 2008 STEO, the DOE forecasted that U.S. natural gas demand would increase 2.2% in 2008 compared to 2007 assuming normal weather. The demand for U.S. natural gas is expected to be met by production from fields in the U.S., pipeline imports from Canada, and imports of LNG with natural gas storage buffering demand and supply. At current U.S. drilling activity levels, additions of new supply are expected to offset production declines and U.S. supply is expected to increase 6.0% in 2008 compared to 2007. Canadian imports are expected to decrease as a result of lower activity levels in Canada over the past two years and increased demand within Canada. LNG imports are dependent on global demand for LNG with the U.S. playing the role of the market of last resort, accepting gas into storage if it is not needed in other international markets. As a result of increasing worldwide demand for LNG cargoes, U.S. imports of LNG in 2008 are expected to decline by approximately 30% relative to 2007 levels. In its June 2008 STEO, the DOE forecasted that U.S. natural gas prices are expected to average approximately \$11/mmBtu in 2008.**

We believe that our customers’ forecasts are similar to the DOE’s. Prices are expected to remain volatile through 2008 with weather-driven demand, imports of Canadian gas, LNG imports and production from lower 48 gas fields playing significant roles in determining price volatility. Variations in the supply demand balance will be reflected in gas storage levels. Based on industry data

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regarding production decline rates, we believe that a significant reduction in drilling activity in the U.S. or Canada would result in decreased production within one or two quarters helping to rebalance supply and demand quickly.

Industry Activity and Customer Spending – Based upon our discussions with major customers, review of published industry reports and our outlook for oil and natural gas prices described above, our outlook for drilling activity, as measured by the Baker Hughes rig count and anticipated customer spending trends are as follows:

- Outside North America – Customer spending, primarily directed at developing oil supplies, is expected to increase approximately 15% to 20% in 2008 compared with 2007. Drilling activity outside of North America is expected to increase approximately 8% to 10% in 2008 compared with 2007. Our assumptions regarding overall growth in customer spending outside of North America assume stable economic growth in the U.S., China and the balance of the world outside of North America. Our expectations for spending could decrease if there are disruptions in key oil and natural gas production markets or significant weakening of the economies in the U.S., China or other significant consumers of oil and natural gas.
- North America – Customer spending in North America, primarily towards developing natural gas supplies, is expected to increase 15% to 20% in 2008 compared to 2007. Drilling activity is expected to increase 7% or more in the U.S. on land; decrease 10% to 15% offshore U.S.; and increase 8% to 10% in Canada with customer spending trends in each market reflecting these drilling activity trends. Production-oriented spending is expected to increase 15% to 20% reflecting increases in oil and gas production. Our expectations for spending and revenue growth in North America assume normal winter and summer weather, modest growth in energy demand and a reduction in U.S. LNG imports relative to 2007.

For additional risk factors and cautions regarding forward-looking statements, see “Part II, Item 1A. Risk Factors” and the “Forward-Looking Statements” section in this Part I, Item 2, both contained herein. This list of risk factors is not intended to be all inclusive.

### Company Outlook

This section should be read in conjunction with the factors described in “Part II, Item 1A. Risk Factors” and in the “Forward-Looking Statements” section in this Part I, Item 2, both contained herein. These factors could impact, either positively or negatively, our expectation for oil and natural gas demand, oil and natural gas prices and drilling activity.

*Outside North America* – In 2008, we expect revenues outside North America to increase 14% to 16% compared with 2007, continuing the multi-year trend of growth in customer spending. Spending on large projects by NOCs are expected to reflect established seasonality trends, resulting in softer revenues in the first half of the year and stronger revenues in the second half. In the second quarter of 2008, we were awarded more than \$1.6 billion in project awards and extensions in Brazil and Mexico. We will incur incremental start up costs in the next two quarters as we invest to support these projects.

Other factors that could have a significant positive impact on profitability include: increasing prices for our products and services; lower than expected raw material and labor costs; and/or higher than planned activity. Conversely, less than expected price increases or price deterioration, higher than expected raw material and labor costs and/or lower than expected activity would have a negative impact on profitability. Our ability to improve pricing is dependent on demand for our products and services and our competitors’ strategies of managing capacity. While the commercial introduction of new technology is an important factor in realizing pricing improvement, without capital discipline throughout the industry as a whole, meaningful improvements in our prices are not likely to be realized.

Our 2008 capital budget supports the continuation of the infrastructure expansion we began in late 2006 and early 2007. In 2007, we opened new or expanded facilities in many regions and/or countries including Latin America, the Middle East, and Russia. In addition, we opened the first phase of our Center for Technology Innovation in Houston, a research and engineering facility to design advanced completion systems for high pressure, high temperature hostile environments. In early 2008, we opened our new campus in Dubai which includes our Middle East and Asia Pacific region headquarters, a regional operations center, and a training center which expands our Eastern Hemisphere training capabilities. Capital expenditures are expected to be approximately \$1.3 billion for 2008, including approximately \$250 million to \$300 million that we expect to spend on infrastructure, primarily outside of North America.

The execution of our 2008 business plan and the ability to meet our 2008 financial objectives are dependent on a number of factors. Key factors include: the strength of the oilfield services market outside North America and our ability to realize price increases commensurate with the value we provide to our customers and in excess of the increase in raw material and labor costs; our ability to meet our growth objectives in areas where the lack of transparency in the market makes operating under the Deferred Prosecution Agreement between us and the DOJ more difficult; and the strength of the North American markets and our ability to

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maintain pricing in markets in which demand for oilfield services and industry capacity are more closely balanced. Other factors include, but are not limited to, our ability to: recruit, train and retain the skilled and diverse workforce necessary to meet our business needs; expand our business in areas that are growing rapidly with customers whose spending is expected to increase substantially (such as NOCs), and in areas where we have market share opportunities (such as the Middle East, Russia and the Caspian area and India); manage increasing raw material and component costs (especially steel alloys, chromium, copper, tungsten carbide, lead, nickel, titanium, beryllium, synthetic and natural diamonds, chemicals, barite and electronic components); continue to make ongoing improvements in the productivity of our manufacturing organization and manage our spending in the North American market depending on the relative strength or weakness of this market.

### Compliance

In connection with our settlements with the DOJ and SEC, we retained an independent monitor to assess and make recommendations about our compliance policies and procedures. In response to the monitor's initial recommendations, we are continuing our reduction of the use of commercial sales representatives ("CSRs") and processing agents, including the reduction of customs agents. We are also enhancing our channels of communication regarding agents while streamlining our compliance due diligence process for agents, including more clearly delineating the responsibilities of participants in the compliance due diligence process. We are adopting a risk-based compliance due diligence procedure for professional agents, enhancing our process for classifying distributors and creating a formal policy to guide business personnel in determining when subcontractors should be subjected to compliance due diligence. We are also instituting a program to ensure that each of our internal sponsors regularly reviews their CSRs, including a review with senior management.

In addition, we are reviewing and expanding the use of our centralized finance organization including further implementation of our enterprise-wide accounting system and company-wide policies regarding expense reporting, petty cash, the approval of invoice payments and general ledger account coding. We also have consolidated our divisional audit functions and redeployed some of these resources for corporate audits. Further, we have restructured our corporate audit function, and are incorporating additional anti-corruption procedures into some of our audits, which are applied on a country-wide basis. We are also continuing to refine and enhance our procedures for Foreign Corrupt Practices Act ("FCPA") compliance reviews, risk assessments, and legal audit procedures.

Further, we are working to ensure that we have adequate legal compliance coverage around the world, including the coordination of compliance advice and training across the divisions in each of our regions. We are also creating simplified summaries, flow charts, and FAQs (Frequently Asked Questions) to accompany each of our compliance related policies and we are supplementing our existing policies. At the same time, we are taking steps to achieve further centralization of our customs and logistics function including the development of uniform and simplified customs policies and procedures. We are also developing uniform procedures for the verification and documentation of services provided by customs agents and a training program in which customs and logistics personnel receive specialized training focused specifically on risks associated with the customs process. We are also adopting a written plan for reviewing and reducing the number of our customs agents and freight forwarders.

We are continuing to centralize our human resources function, including creating consistent standards for pre-hire screening of employees, the screening of existing employees prior to promoting them to positions where they may be exposed to corruption-related risks, and creating a uniform policy for on-boarding training. We are implementing a training program that identifies employees for compliance training and sets appropriate training schedules based on job function and risk profile in addition to employment grade. Further, the contents of our training programs will be tailored to address the different risks posed by different categories of employees. We are supplementing our FCPA electronic training module while taking steps to ensure that training is available in the principal local languages of our employees and that local anti-corruption laws are discussed as part of our compliance training. We are also working to ensure that our helpline is easily accessible to employees in their own language as well as taking actions to counter any cultural norms that might discourage employees from using the helpline. We continue to provide a regular and consistent message from senior management of zero tolerance for FCPA violations, and emphasize that compliance is a positive factor in the continued success of our business.

For a further description of our compliance programs see, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations--Compliance in our 2007 Annual Report.

### LIQUIDITY AND CAPITAL RESOURCES

Our objective in financing our business is to maintain adequate financial resources and access to additional liquidity. During the six months ended June 30, 2008, cash flows from operations were the principal sources of funding. We anticipate that cash flows from operations will be sufficient to fund our liquidity needs in 2008. At June 30, 2008, we had cash and cash equivalents of

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\$1,071.7 million, \$1.0 billion of committed revolving credit facilities and a commercial paper program that provides additional liquidity. We also may access the capital markets for debt or to issue additional equity securities. See further discussion below under “Available Credit Facilities.”

Our capital planning process is focused on utilizing our cash and cash flows generated from operations in ways that enhance the value of our company. During the six months ended June 30, 2008, we used cash for a variety of activities including working capital needs, acquisition of businesses, payment of dividends, share repurchases and capital expenditures.

### Cash Flows

Cash flows provided (used) by continuing operations by type of activity were as follows for the six months ended June 30:

	2008	2007
Operating activities	\$ 557.0	\$ 316.3
Investing activities	(483.1)	(279.2)
Financing activities	(62.6)	(144.5)

Statements of cash flows for entities with international operations that are local currency functional exclude the effects of the changes in foreign currency exchange rates that occur during any given period, as these are noncash charges. As a result, changes reflected in certain accounts on the consolidated condensed statements of cash flows may not reflect the changes in corresponding accounts on the consolidated condensed balance sheets.

#### *Operating Activities*

Cash flows from operating activities of continuing operations provided \$557.0 million in the six months ended June 30, 2008 compared with \$316.3 million in the six months ended June 30, 2007. This increase in cash flows of \$240.7 million is primarily due to an increase in net income plus the change in net operating assets and liabilities that used less cash in the six months ended June 30, 2008 compared to the same period in 2007.

The underlying drivers of the changes in net operating assets and liabilities are as follows:

- An increase in accounts receivable in the six months ended June 30, 2008 used \$283.3 million in cash compared with using \$87.8 million in cash in the six months ended June 30, 2007. This increase was primarily due to the increase in revenues and an increase in the quarterly days sales outstanding of approximately five days.
- An increase in accounts payable in the six months ended June 30, 2008 provided \$138.4 million in cash compared with using \$74.4 million in cash in the six months ended June 30, 2007. This increase in accounts payable was primarily due to an increase in operating assets to support increased activity.
- Inventory used \$171.8 million in cash in the six months ended June 30, 2008 compared with using \$152.4 million in cash in the six months ended June 30, 2007 due to activity increases.
- Accrued employee compensation and other accrued liabilities used \$16.8 million in cash in the six months ended June 30, 2008 compared with using \$253.5 million in cash in the six months ended June 30, 2007. The decrease was primarily due to payments made in the first six months of 2007 that were greater than payments made in the first six months of 2008 including payments related to employee bonuses, non income tax liabilities and the payment of \$44.1 million related to the settlement of the investigations by the SEC and DOJ.

#### *Investing Activities*

Our principal recurring investing activity is the funding of capital expenditures to ensure that we have the appropriate levels and types of rental tools in place to generate revenues from operations. Expenditures for capital assets totaled \$539.0 million and \$538.4 million for the six months ended June 30, 2008 and 2007, respectively. While the majority of these expenditures were for rental tools, including wireline tools, and machinery and equipment, we have also increased our spending on new facilities, expansions of existing facilities and other infrastructure projects.

Proceeds from the disposal of assets were \$96.6 million and \$90.7 million for the six months ended June 30, 2008 and 2007, respectively. These disposals relate to rental tools that were lost-in-hole, as well as machinery, rental tools and equipment no longer used in operations that were sold throughout the period.

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We routinely evaluate potential acquisitions of businesses of third parties that may enhance our current operations or expand our operations into new markets or product lines. We may also from time to time sell business operations that are not considered part of our core business.

In February 2008, we sold the assets associated with the Completion and Production segment's Surface Safety Systems product line and received cash proceeds of \$31.0 million.

In April 2008, we acquired two reservoir consulting firms – Gaffney, Cline & Associates and GeoMechanics International and paid cash of \$71.7 million, including \$3.5 million of direct transaction costs, and net of cash acquired of \$5.2 million. As a result of the acquisition, we recorded \$37.6 million of goodwill and \$22.1 million of intangible assets.

During the six months ended June 30, 2007, we purchased \$1,733.5 million of and received proceeds of \$1,902.0 million from maturing auction rate securities ("ARS"), which are variable-rate debt securities. While the underlying security has a long-term maturity, the interest rate is reset through Dutch auctions that are typically held every 7, 28 or 35 days. We discontinued additional investments in auction rate securities in September 2007.

At June 30, 2008 and at December 31, 2007, the fair value of the ARS investments we still hold is \$28.1 million and \$35.6 million, respectively. The change of \$7.5 million reflects a temporary impairment recorded as an unrealized loss in accumulated other comprehensive loss, a component of stockholders' equity, in the three months ended June 30, 2008. Since September 2007, we have been unable to sell our ARS investment at auctions. As a result of the unsuccessful auctions, the interest rate resets every 28 days at one month LIBOR plus 50 basis points and the liquidity of these investments has been diminished. Based on our ability to access our cash and cash equivalents, our expected operating cash flows, and our other sources of cash including our credit facilities with commercial banks, we do not anticipate that the lack of liquidity on these investments will affect our ability to operate our business. Based on our ability and intent to hold such investments for a period of time sufficient to allow for any anticipated recovery in the fair value, we have classified all of our auction rate securities as noncurrent investments.

### *Financing Activities*

We had net borrowings of commercial paper and other short-term debt of \$537.4 million and \$1.1 million in the six months ended June 30, 2008 and 2007, respectively. Total debt outstanding at June 30, 2008 was \$1,621.2 million, an increase of \$536.4 million compared with December 31, 2007. The total debt to total capitalization (defined as total debt plus stockholders' equity) ratios was 0.20 at June 30, 2008 and 0.15 at December 31, 2007. The increase in short-term debt was to fund expenses, capital expenditures and additional stock repurchases in the U.S. until cash can be cost effectively transferred to the U.S. from our international operations.

We received proceeds of \$51.3 million and \$31.0 million in the six months ended June 30, 2008 and 2007, respectively, from the issuance of common stock from the exercise of stock options.

Our Board of Directors has authorized a program to repurchase our common stock from time to time. During the six months ended June 30, 2008, we repurchased 8.3 million shares of our common stock at an average price of \$69.09 per share for a total of \$572.2 million. At June 30, 2008, we had authorization remaining to repurchase up to a total of \$251.7 million of our common stock.

We paid dividends of \$80.5 million and \$83.1 million in the six months ended June 30, 2008 and 2007, respectively.

### **Available Credit Facilities**

On March 3, 2008, we initiated a commercial paper program (the "Program") under which we may issue from time to time unsecured commercial paper notes up to a maximum aggregate amount outstanding at any time of \$500.0 million. On April 2, 2008, we increased the Program to an aggregate of \$1.0 billion. The proceeds of the Program will be used for general corporate purposes, including working capital, capital expenditures, acquisitions and share repurchases. Commercial paper issued under the Program is scheduled to mature within approximately 270 days of issuance. The commercial paper is not redeemable prior to maturity and will not be subject to voluntary prepayment. At June 30, 2008, we had \$544.8 million outstanding in commercial paper at a weighted average interest rate of 2.19%.

At June 30, 2008, we had \$1,515.2 million of credit facilities with commercial banks, of which \$500.0 million is a committed revolving credit facility (the "2005 Facility"), which expires in July 2012 and \$500.0 million is a committed revolving credit facility which expires in March 2009 (the "2008 Credit Agreement"). The 2005 Facility provides for a one year extension, subject to the approval and acceptance by the lenders, among other conditions. In addition, the 2005 Facility contains a provision to allow for an increase of an additional \$500.0 million, subject to the approval and acceptance by the lenders, among other conditions. The 2005

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Facility contains certain covenants which, among other things, require the maintenance of a funded indebtedness to total capitalization ratio (a defined formula per the 2005 Facility) of less than or equal to 0.60, restrict certain merger transactions or the sale of all or substantially all of the assets of the company or a significant subsidiary and limit the amount of subsidiary indebtedness. Upon the occurrence of certain events of default, our obligations under the 2005 Facility may be accelerated. Such events of default include payment defaults to lenders under the 2005 Facility, covenant defaults and other customary defaults.

The 2008 Credit Agreement, which we entered into on April 1, 2008, contains certain covenants, which, among other things, require the maintenance of a funded indebtedness to total capitalization ratio (a defined formula per the agreement) of less than or equal to 0.60, restrict certain merger transactions or the sale of all or substantially all of our assets or a significant subsidiary and limit the amount of subsidiary indebtedness. Upon the occurrence of certain events of default, our obligations under the 2008 Credit Agreement may be accelerated. Such events of default include payment defaults to lenders under the 2008 Credit Agreement, covenant defaults and other customary defaults.

At June 30, 2008, we were in compliance with all of the covenants of both facilities. Additionally, there were no direct borrowings under either facility during the six months ended June 30, 2008; however, to the extent we have outstanding commercial paper, our ability to borrow under these facilities is reduced.

If market conditions were to change and revenues were to be significantly reduced or operating costs were to increase, our cash flows and liquidity could be reduced. Additionally, it could cause the rating agencies to lower our credit rating. We do not have any ratings triggers in the facilities that would accelerate the maturity of any borrowings under the facilities. However, a downgrade in our credit ratings could increase the cost of borrowings under the facilities and could also limit or preclude our ability to issue commercial paper. Should this occur, we would seek alternative sources of funding, including borrowing under the facilities.

We believe our credit ratings and relationships with major commercial and investment banks would allow us to obtain interim financing over and above our existing credit facilities for any currently unforeseen significant needs or growth opportunities. We also believe that such interim financings could be funded with subsequent issuances of long-term debt or equity, if necessary.

### Cash Requirements

In 2008, we believe cash and cash flows generated from operations will provide us with sufficient capital resources and liquidity to manage our working capital needs, meet contractual obligations, fund capital expenditures, pay dividends, repurchase common stock and support the development of our short-term and long-term operating strategies.

In 2008, we expect capital expenditures to be approximately \$1.3 billion excluding acquisitions. The expenditures are expected to be used primarily for normal, recurring items necessary to support the growth of our business and operations.

In 2008, we expect to make interest payments of between \$73.0 million and \$75.0 million. This is based on our current expectations of debt levels during 2008. We also anticipate making income tax payments of between \$810.0 million and \$860.0 million in 2008.

As of June 30, 2008, we had authorization remaining to repurchase up to \$251.7 million in common stock. On July 24, 2008, our Board of Directors authorized a program to repurchase up to \$1.0 billion of our common stock (the "2008 Repurchase Program") in addition to the existing stock repurchase authorization. As of July 24, 2008, we had authorization remaining to repurchase approximately \$1.246 billion of common stock, including the 2008 Repurchase Program. We may repurchase our common stock in the open market, in privately negotiated transactions or block transactions from time to time depending on market conditions, applicable legal requirements, our liquidity and other considerations. We may enter into Rule 10b5-1 plans to facilitate repurchases under the programs. A Rule 10b5-1 plan would generally permit us to repurchase the shares at any time when we might otherwise be prevented from doing so under certain securities laws. Shares repurchased under the programs will be retired. The programs do not require us to acquire any particular amounts of common stock and may be suspended or discontinued at any time.

On July 24, 2008, our Board of Directors also authorized a dividend of \$0.15 per share, an increase from the previous quarterly dividend of \$0.13 per share. We now anticipate paying dividends of between \$170.0 million and \$175.0 million in 2008; however, our Board of Directors can change the dividend policy at anytime.

We expect to contribute between \$2.0 million and \$3.0 million to our nonqualified U.S. pension plans and between \$13.0 million and \$15.0 million to the non-U.S. pension plans. We will also make benefit payments related to postretirement welfare plans of between \$13.0 million and \$15.0 million, and we estimate we will contribute between \$142.0 million and \$153.0 million to our defined contribution plans.

Other than previously discussed, we do not believe there are any other material trends, demands, commitments, events or uncertainties that would have, or are reasonably likely to have, a material impact on our financial condition and liquidity. Other than previously discussed, we currently have no information that would create a reasonable likelihood that the reported levels of revenues and cash flows from operations in the first half of 2008 are not indicative of what we can expect in the near term.

### NEW ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements* (“SFAS 157”), which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value and expanding disclosures about fair value measurements. SFAS 157 was originally effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In November 2007, the FASB placed a one year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities; however, SFAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities. We adopted all requirements of SFAS 157 on January 1, 2008, except as they relate to nonfinancial assets and liabilities, which will be adopted on January 1, 2009, as allowed under SFAS 157. See Note 9 for further information on the impact of this standard to financial assets and liabilities. We have not yet determined the impact, if any, on our consolidated condensed financial statements for nonfinancial assets and liabilities.

In September 2006, the FASB issued SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—An Amendment of FASB Statements No. 87, 88, 106, and 132(R)* (“SFAS 158”). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Additionally, it requires an employer to measure the funded status of a plan as of the date of its year end statement of financial position, with limited exceptions. SFAS 158 is effective as of the end of the fiscal year ending after December 15, 2006; however, the requirement to measure plan assets and benefit obligations as of the date of the employer’s fiscal year end statement of financial position is effective for fiscal years ending after December 15, 2008. We adopted all requirements of SFAS 158 on December 31, 2006, except for the funded status measurement date requirement, which will be adopted on December 31, 2008, as allowed under SFAS 158. We currently do not expect there to be a material impact on our consolidated condensed financial statements as a result of the adoption of the funded status measurement date requirement.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose to measure eligible financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS 159 on January 1, 2008, and there was no impact on our consolidated condensed financial statements as we did not choose to measure any eligible financial assets or liabilities at fair value.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* (“SFAS 160”). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary in an effort to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We will adopt SFAS 160 on January 1, 2009, and have not yet determined the impact, if any, on our consolidated condensed financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (“SFAS 141R”). SFAS 141R replaces FASB Statement No. 141, *Business Combinations* (“SFAS 141”). The statement retains the purchase method of accounting used in business combinations but replaces SFAS 141 by establishing principles and requirements for the recognition and measurement of assets, liabilities and goodwill, including the requirement that most transaction and restructuring costs related to the acquisition be expensed. In addition, the statement requires disclosures to enable users to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will adopt SFAS 141R on January 1, 2009 for acquisitions on or after this date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (“SFAS 161”). SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. The statement also requires enhanced disclosures regarding how and why entities use derivative instruments, how derivative instruments and related hedged items are accounted and how derivative instruments and related

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hedged items affect entities' financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008. We will adopt the new disclosure requirements of SFAS 161 in the first quarter of 2009.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3 ("FSP SFAS 142-3"), *Determination of the Useful Life of Intangible Assets*. FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, *Business Combinations*, and other U.S. GAAP principles. FSP SFAS 142-3 is effective for fiscal years beginning after December 15, 2008. We will adopt FSP SFAS 142-3 on January 1, 2009 and have not yet determined the impact, if any, on our consolidated condensed financial statements.

### FORWARD-LOOKING STATEMENTS

MD&A and certain statements in the Notes to Consolidated Condensed Financial Statements include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, (each a "forward-looking statement"). The words "anticipate," "believe," "ensure," "expect," "if," "intend," "estimate," "project," "forecasts," "predict," "outlook," "aim," "will," "could," "should," "would," "may," "likely" and similar expressions, and the negative thereof, are intended to identify forward-looking statements. Our forward-looking statements are based on assumptions that we believe to be reasonable but that may not prove to be accurate. The statements do not include the potential impact of future transactions, such as an acquisition, disposition, merger, joint venture or other transaction that could occur. We undertake no obligation to publicly update or revise any forward-looking statement. Our expectations regarding our business outlook, including changes in revenue, pricing, expenses, capital spending, backlogs, profitability, tax rates, strategies for our operations, impact of our common stock repurchases, oil and natural gas market conditions, market share and contract terms, costs and availability of resources, economic and regulatory conditions, and environmental matters are only our forecasts regarding these matters.

All of our forward-looking information is subject to risks and uncertainties that could cause actual results to differ materially from the results expected. Although it is not possible to identify all factors, these risks and uncertainties include the risk factors and the timing of any of those risk factors identified in "Part II, Item 1A. Risk Factors" section contained herein, as well as the risk factors described in our 2007 Annual Report, the Company's Form 10-Q for the quarter ended March 31, 2008, this filing and those set forth from time to time in our filings with the SEC. These documents are available through our web site or through the SEC's Electronic Data Gathering and Analysis Retrieval System ("EDGAR") at <http://www.sec.gov>.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We conduct operations around the world in a number of different currencies. The majority of our significant foreign subsidiaries have designated the local currency as their functional currency. As such, future earnings are subject to change due to changes in foreign currency exchange rates when transactions are denominated in currencies other than our functional currencies. To minimize the need for foreign currency forward contracts to hedge this exposure, our objective is to manage foreign currency exposure by maintaining a minimal consolidated net asset or net liability position in a currency other than the functional currency.

#### Foreign Currency Forward Contracts

At June 30, 2008, we had entered into several foreign currency forward contracts with notional amounts aggregating \$135.0 million to hedge exposure to currency fluctuations in various foreign currencies, including British Pound Sterling, Euro, Norwegian Krone and the Brazilian Real. These contracts are designated and qualify as fair value hedging instruments. Based on quoted market prices as of June 30, 2008 for contracts with similar terms and maturity dates, we recorded a gain of \$0.1 million to adjust these foreign currency forward contracts to their fair market value. This gain offsets designated foreign exchange losses resulting from the underlying exposures and is included in marketing, general and administrative expenses in our consolidated condensed statement of operations.

The counterparties to the forward contracts are major financial institutions. The credit ratings and concentration of risk of these financial institutions are monitored on a continuing basis. In the unlikely event that the counterparties fail to meet the terms of a foreign currency contract, our exposure is limited to the foreign currency rate differential.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this quarterly report, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based on this evaluation, these officers have concluded that, as of June 30, 2008, our disclosure controls and procedures are effective at a reasonable assurance level in ensuring that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. There has been no change in our internal controls over financial reporting during the quarter ended June 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, such as this quarterly report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

We are subject to a number of lawsuits, investigations and claims (some of which involve substantial amounts) arising out of the conduct of our business. During the second quarter of 2008, the lawsuit filed against Baker Hughes Oilfield Operations, Inc. by ReedHycalog was dismissed in connection with the settlement of that litigation. In addition, On May 15, 2008, the consolidated complaint of the Sheetmetal Workers' National Pension Fund and The Alaska Plumbing and Pipefitting Industry Pension Trust was dismissed for lack of subject matter jurisdiction by the Houston Division of the United States District Court for the Southern District of Texas. On June 6, 2008, the Midwestern Teamsters Pension Trust Fund and Oppenheim Kapitalanlagegesellschaft Mbh instituted a shareholder derivative lawsuit for and on the Company's behalf against certain current and former members of the Board of Directors and certain officers, and the Company as a nominal defendant in the Houston Division of the United States District Court for the Southern District of Texas. See a further discussion of litigation matters in Note 16 of Notes to Unaudited Consolidated Condensed Financial Statements.

For additional information see also, "Item 2 -- Management's Discussion and Analysis of Financial Condition and Results of Operations -- Outlook" of this Form 10-Q and Item 3 of Part I of our 2007 Annual Report for additional discussion of legal proceedings.

### **ITEM 1A. RISK FACTORS**

As of the date of this filing, there have been no material changes from the risk factors previously disclosed in our "Risk Factors" in the 2007 Annual Report and the Form 10-Q for the period ended March 31, 2008.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table contains information about our purchases of equity securities during the three months ended June 30, 2008.

**Issuer Purchases of Equity Securities**

Period	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid Per Share <sup>(1)</sup>	Total Number of Shares Purchased as Part of a Publicly Announced Program <sup>(2)</sup>	Average Price Paid Per Share <sup>(3)</sup>	Total Number of Shares Purchased in the Aggregate	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Program <sup>(4)</sup>
April 1-30, 2008	7,442	\$80.21	—	\$ —	7,442	—
May 1-31, 2008	—	—	—	—	—	—
June 1-30, 2008	2,119	88.48	51,000	87.08	53,119	—
<b>Total</b>	<b>9,561</b>	<b>\$82.04</b>	<b>51,000</b>	<b>\$87.08</b>	<b>60,561</b>	<b>\$251,742,066</b>

- (1) Represents shares purchased from employees to pay the option exercise price related to stock-for-stock exchanges in option exercises or to satisfy the tax withholding obligations in connection with the vesting of restricted stock awards and restricted stock units.
- (2) Repurchases were made under a Stock Purchase Plan with an agent that complied with the requirements of Rule 10b5-1 of the Exchange Act (the “Plan”) as well as open market purchases that complied with Rule 10b-18 of the Exchange Act. We entered into a Plan as of May 23, 2008 that ran from June 2, 2008 through July 24, 2008. Under the Plan, the agent repurchased a number of shares of our common stock determined under the terms of the Plan each trading day based on the trading price of the stock on that day. Shares were repurchased under the Plan by the agent at the prevailing market prices, in open market transactions which complied with Rule 10b-18 of the Exchange Act.
- (3) Average price paid includes commissions.
- (4) Our Board of Directors has authorized programs to repurchase our common stock from time to time. During the second quarter of 2008, we repurchased 51,000 shares of our common stock at an average price of \$87.08 per share, for a total of \$4.4 million with authorization remaining to repurchase up to a total of \$251.7 million of our common stock. On July 24, 2008, our Board of Directors authorized a program to repurchase up to \$1.0 billion of our common stock (the “2008 Repurchase Program”) in addition to the existing stock repurchase program. As of July 24, 2008, we had authorization remaining to repurchase approximately \$1.246 billion of common stock, including the 2008 Repurchase Program.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On April 24, 2008, we held our Annual Meeting of Stockholders. Information regarding our meeting is included under Item 4 of Part II of our Quarterly Report of Baker Hughes Incorporated on Form 10-Q for the quarter ended March 31, 2008.

**ITEM 5. OTHER INFORMATION**

The following events occurred subsequent to the period covered by this Form 10-Q and are reportable under Form 8-K:

**Item 5. 02(e) - Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.**

*Amended and Restated Supplemental Retirement Plan.* On July 24, 2008, we amended and restated the Baker Hughes Incorporated Supplemental Retirement Plan (the “SRP”). The amendments were undertaken primarily to simplify the administrative procedures applicable to certain distributions under the SRP and to provide for accelerated vesting of SRP benefits in the event of a change in control of our company, as defined in our individual change of control agreements and other compensatory arrangements. A copy of the SRP is attached hereto as Exhibit 10.1.

*Amended and Restated Director Compensation Deferral Plan.* On July 24, 2008, we amended and restated the Baker Hughes Director Compensation Deferral Plan (the “DCDP”). The amendments were undertaken primarily to comply with Section 409A of the Internal Revenue Code of 1986, as amended (“Section 409A”), and to clarify a change in the existing change in

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control definition to be consistent with the definition used in our change in control agreements. A copy of the DCDP is attached hereto as Exhibit 10.2.

*Amendment to Director and Officer Long-Term Incentive Plan*. On July 24, 2008, we amended the Baker Hughes Incorporated 2002 Director & Officer Long-Term Incentive Plan (the “D&O Plan”). The Amendment was undertaken primarily to comply with Section 409A and to clarify a change in the existing change in control definition to be consistent with the definition used in our change in control agreements. A copy of the Amendment to the D&O Plan is attached as Exhibit 10.3.

*Amendment to Employee Long-Term Incentive Plan*. On July 24, 2008, we amended the Baker Hughes Incorporated 2002 Employee Long-Term Incentive Plan (the “Employee Plan”). The Amendment was undertaken primarily to comply with Section 409A and to clarify a change in the existing change in control definition to be consistent with the definition used in our change in control agreements. A copy of the Amendment to the Employee Plan is attached as Exhibit 10.4.

The foregoing descriptions of the plans and amendments do not purport to be complete and are qualified in their entirety by reference to such plans and amendments, which are filed with this Form 10-Q as Exhibits 10.1 through 10.4, respectively, and incorporated herein by reference.

### **Item 8.01 - Other Events**

On July 24, 2008, the Company issued a news release announcing that its Board of Directors authorized a regular dividend of \$0.15 per share, an increase from the previous regular quarterly dividend of \$0.13 per share. The Company also announced that its Board of Directors authorized a program to repurchase up to \$1.0 billion of the Company’s common stock in addition to the existing stock repurchase program. A copy of the news release is incorporated herein by reference and attached hereto as Exhibit 99.1.

## **ITEM 6. EXHIBITS**

Each exhibit identified below is filed as a part of this report. Exhibits designated with a “+” are identified as management contracts or compensatory plans or arrangements. Exhibits previously filed as indicated below are incorporated by reference.

- 10.1+ Baker Hughes Incorporated Supplemental Retirement Plan, as amended and restated effective as of January 1, 2009.
- 10.2+ Baker Hughes Incorporated Director Compensation Deferral Plan, as amended and restated effective as of January 1, 2009.
- 10.3+ Amendment to Baker Hughes Incorporated 2002 Director & Officer Long-Term Incentive Plan, effective July 24, 2008.
- 10.4+ Amendment to Baker Hughes Incorporated 2002 Employee Long-Term Incentive Plan, effective July 24, 2008.
- 10.5 Credit Agreement dated as of April 1, 2008, among Baker Hughes Incorporated, JPMorgan Chase Bank, N.A., as Administrative Agent, and fifteen lenders for \$500 million, in the aggregate for all banks (filed as Exhibit 10.1 to Current Report of Baker Hughes Incorporated on Form 8-K filed April 2, 2008).
- 10.6 Third Amendment to Credit Agreement dated as of April 1, 2008, among Baker Hughes Incorporated, JPMorgan Chase Bank, N.A., as Administrative Agent, and fifteen lenders for \$500 million, in the aggregate for all banks (filed as Exhibit 10.2 to Current Report of Baker Hughes Incorporated on Form 8-K filed April 2, 2008).
- 31.1 Certification of Chad C. Deaton, Chief Executive Officer, dated July 29, 2008, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Peter A. Ragauss, Chief Financial Officer, dated July 29, 2008, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32 Statement of Chad C. Deaton, Chief Executive Officer, and Peter A. Ragauss, Chief Financial Officer, dated July 29, 2008, furnished pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.
- 99.1 News release dated July 24, 2008 to announce an increase in the quarterly dividend and an additional stock repurchase program.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**BAKER HUGHES INCORPORATED  
(Registrant)**

Date: July 29, 2008

By: /s/ PETER A. RAGAUSS

Peter A. Ragauss  
Senior Vice President and Chief Financial Officer

Date: July 29, 2008

By: /s/ ALAN J. KEIFER

Alan J. Keifer  
Vice President and Controller

**EXHIBIT INDEX**

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- 99.1 News release dated July 24, 2008 to announce an increase in the quarterly dividend and an additional stock repurchase program.

**BAKER HUGHES INCORPORATED  
SUPPLEMENTAL RETIREMENT PLAN**

*( As Amended and Restated  
Effective January 1, 2009)*

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**BAKER HUGHES INCORPORATED  
SUPPLEMENTAL RETIREMENT PLAN**

*(As Amended and Restated  
Effective January 1, 2009)*

**WITNESSETH :**

**WHEREAS** , Baker Hughes Incorporated and other adopting entities have heretofore adopted the Baker Hughes Incorporated Supplemental Retirement Plan, hereinafter referred to as the "Plan," for the benefit of their eligible employees; and

**WHEREAS** , Baker Hughes Incorporated desires to amend and restate the Plan, on behalf of itself and on behalf of the other adopting entities;

**NOW THEREFORE**, the Plan is hereby restated in its entirety as follows, effective as of January 1, 2009 except to the extent that an earlier effective date is specified.

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**BAKER HUGHES INCORPORATED  
SUPPLEMENTAL RETIREMENT PLAN**

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**BAKER HUGHES INCORPORATED  
SUPPLEMENTAL RETIREMENT PLAN**

**(As Amended and Restated  
Effective January 1, 2009)**

**ARTICLE I  
DEFINITIONS AND CONSTRUCTION**

1.01 **Definitions.** The words and phrases defined in this Article shall have the meaning set out in the definition unless the context in which the word or phrase appears reasonably requires a broader, narrower or different meaning.

“*Account(s)*” means all ledger accounts pertaining to a Participant or former Participant which are maintained by the Plan Administrator or Plan recordkeeper to reflect the Company’s obligation to the Participant or former Participant under the Plan. The Plan Administrator or Plan recordkeeper shall establish the following subaccounts and any additional subaccounts that the Plan Administrator considers necessary to reflect the entire interest of the Participant or former Participant under the Plan. Each of the subaccounts listed below and any additional subaccounts established by the Plan Administrator shall reflect credits and debits made to such subaccounts for earnings, losses, distributions and forfeitures.

(a) *Participant Deferral Account* — the Participant’s or former Participant’s deferrals, if any, made pursuant to Section 3.01.

(b) *Company Matching Deferral Account* — the credits on behalf of a Participant or former Participant made pursuant to Section 4.01.

(c) *Company Base Thrift Deferral Account* — the credits on behalf of a Participant or former Participant, if any, made pursuant to Section 4.02.

(d) *Company Pension Deferral Account* — the credits on behalf of a Participant or former Participant, if any, made pursuant to Section 4.03.

(e) *Company Discretionary Deferral Account* — the credits on behalf of a Participant or former Participant, if any, made pursuant to Section 4.04.

The Plan Administrator or Plan recordkeeper shall also maintain records that reflect a Participant’s or former Participant’s Grandfathered Amounts.

“*Affiliate*” means any entity which is a member of the same controlled group of corporations within the meaning of section 414(b) of the Code, or which is a trade or business (whether or not incorporated) which is under common control (within the meaning of section 414(c) of the Code), or which is a member of an affiliated service group (within the meaning of section 414(m) of the Code), with Baker Hughes.

“**Annual Incentive Plan**” means Baker Hughes Incorporated 1995 Employee Annual Incentive Compensation Plan, as amended from time to time, or any successor annual bonus program that is exempt from section 162(m) of the Code.

“**Assets**” means assets of any kind owned by Baker Hughes, including but not limited to securities of Baker Hughes’ direct and indirect subsidiaries and Affiliates.

“**Baker Hughes**” means Baker Hughes Incorporated, a Delaware corporation.

“**Base Compensation**” means a Participant’s base salary or wages measured on an annual basis (as defined in section 3401(a) of the Code for purposes of federal income tax withholding) from the Company, modified by *including* any portion thereof that such Participant could have received in cash in lieu of (a) Participant Deferrals pursuant to Section 3.01 or (b) elective contributions made on his behalf by the Company pursuant to a qualified cash or deferred arrangement described in section 401(k) of the Code and any elective contributions under a cafeteria plan described in section 125, and modified further by *excluding* any bonus; incentive compensation; commissions; expense reimbursements or other expense allowances; fringe benefits (cash and noncash); moving expenses; deferred compensation (other than (a) Participant Deferrals pursuant to Section 3.01 or (b) elective contributions to the Company’s qualified cash or deferred arrangement described in section 401(k) of the Code); welfare benefits as defined in the Employee Retirement Income Security Act of 1974, as amended; overtime pay; special performance compensation amounts and severance compensation.

“**Beneficial Owner**” or “**Beneficial Ownership**” shall have the meaning ascribed to the term in Rule 13d-3 of the General Rules and Regulations under the Exchange Act.

“**Board**” means the Board of Directors of Baker Hughes.

“**Bonus**” means the Employee’s incentive bonus earned under the Annual Incentive Plan for services rendered or labor performed by the Employee during the applicable Plan Year. An Employee’s Bonus shall be determined by *including* any portion thereof that such Employee could have received in cash in lieu of (a) any Participant Deferrals pursuant to Section 3.01 or (b) elective contributions made on his behalf by the Company pursuant to a qualified cash or deferred arrangement (as defined in section 401(k) of the Code) or pursuant to a plan maintained under section 125 of the Code.

“**Change in Control**” means the occurrence of any of the following events:

- (a) the individuals who are Incumbent Directors cease for any reason to constitute a majority of the members of the Board;
- (b) the consummation of a Merger of Baker Hughes or an Affiliate of Baker Hughes with another Entity, *unless* the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of

the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger;

(c) any Person, other than a Specified Owner, becomes a Beneficial Owner, directly or indirectly, of securities of Baker Hughes representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities;

(d) a sale, transfer, lease or other disposition of all or substantially all of Baker Hughes' Assets is consummated (an "Asset Sale"), unless :

(i) the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes immediately prior to such Asset Sale own, directly or indirectly, 50 percent or more of the combined voting power of the Voting Securities of the Entity that acquires such Assets in such Asset Sale or its parent immediately after such Asset Sale in substantially the same proportions as their ownership of Baker Hughes' Voting Securities immediately prior to such Asset Sale; or

(ii) the individuals who comprise the Board immediately prior to such Asset Sale constitute a majority of the board of directors or other governing body of either the Entity that acquired such Assets in such Asset Sale or its parent (or a majority plus one member where such board or other governing body is comprised of an odd number of directors); or

(e) The stockholders of Baker Hughes approve a plan of complete liquidation or dissolution of Baker Hughes.

"Code" means the Internal Revenue Code of 1986, as amended from time to time.

"Committee" means the Administrative Committee or the Investment Committee that may be appointed by the Board as a Plan Administrator.

"Company" means Baker Hughes or an Employer.

"Company Base Thrift Deferrals" means credits to a Participant's Account pursuant to Section 4.02.

"Company Deferrals" means, collectively or individually, any of the deferrals made by the Company pursuant to Sections 4.01, 4.02, 4.03 and 4.04.

"Company Discretionary Deferrals" means credits, if any, to a Participant's Account pursuant to Section 4.04.

"Company Matching Deferrals" means credits to a Participant's Account pursuant to Section 4.01.

"Company Pension Deferrals" means credits to a Participant's Account pursuant to Section 4.03.

**“Deferral Period”** means the period of deferral selected by a Participant pursuant to Section 3.06 or Section 4.05.

**“Domestic Relations Order”** has the meaning ascribed to that term in section 414(p) of the Code.

**“Eligible Employee”** means any individual who, on the date he commences participation in the Plan, is employed by the Company on the active payroll and who is also an executive salary grade system employee (under the Company’s then current payroll system categories), or any comparable executive designations in any system that replaces the executive salary grade system. Once an individual commences participation in the Plan, he may continue participation even if his payroll system status changes to a level that is below the executive salary grade system, *provided* that the individual continues to remain a member of a select group of management or a highly compensated employee, as determined by the Plan Administrator.

**“Employer”** means any Affiliate that adopts the Plan pursuant to the provisions of Article XII.

**“Entity”** means any corporation, partnership, association, joint-stock company, limited liability company, trust, unincorporated organization or other business entity.

**“Entry Date”** means the first day of each Plan Year.

**“Exchange Act”** means the Securities Exchange Act of 1934, as amended from time to time, or any successor act.

**“Funds”** means the investment funds designated from time to time for the deemed investment of Accounts pursuant to Article VI.

**“Grandfathered Amounts”** means amounts credited under the Plan that were earned and vested as of December 31, 2004 within the meaning of Section 409A, and earnings and losses thereon.

**“Incumbent Director”** means —

(a) a member of the Board on July 24, 2008, or

(b) an individual —

(i) who becomes a member of the Board after July 24, 2008;

(ii) whose appointment or election by the Board or nomination for election by Baker Hughes’ stockholders is approved or recommended by a vote of at least two-thirds of the then serving *Incumbent Directors* (as defined herein); and

(iii) whose initial assumption of service on the Board is not in connection with an actual or threatened election contest.

**“Ineligible Pension Plan Compensation”** means with respect to each Participant and each payroll period, the amount of the Participant’s compensation not taken into account under the Pension Plan benefit formula solely because (a) such Participant deferred such compensation as a Participant Deferral pursuant to Section 3.01 and/or (b) such compensation exceeded the maximum dollar limitation of section 401(a)(17) of the Code.

**“Ineligible Thrift Plan Compensation”** means with respect to each Participant and each payroll period, the amount of such Participant’s compensation for such payroll period that is not considered “Compensation” under the Thrift Plan for such payroll period solely because (a) such Participant deferred such compensation as a Participant Deferral pursuant to Section 3.01 and/or (b) such compensation exceeded the maximum dollar limitation of section 401(a)(17) of the Code.

**“Merger”** means a merger, consolidation or similar transaction.

**“Participant”** means each Eligible Employee who has met the eligibility requirements for participation in the Plan specified in Article II.

**“Participant Deferral”** means any deferral made by a Participant pursuant to Section 3.01.

**“Pay”** means the sum of a Participant’s Base Compensation and Bonus.

**“Pension Plan”** means the Baker Hughes Incorporated Pension Plan, as amended from time to time.

**“Person”** shall have the meaning ascribed to the term in Section 3(a)(9) of the Exchange Act and used in Sections 13(d) and 14(d) thereof, including a “group” as defined in Section 13(d) thereof, except that the term shall not include (a) the Company or any of its Affiliates, (b) a trustee or other fiduciary holding Company securities under an employee benefit plan of the Company or any of its Affiliates, (c) an underwriter temporarily holding securities pursuant to an offering of those securities or (d) a corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company.

**“Plan”** means the Baker Hughes Incorporated Supplemental Retirement Plan, as amended from time to time.

**“Plan Administrator”** means Baker Hughes, acting through its delegates. Such delegates shall include the Administrative Committee, the Investment Committee and any individual Plan Administrator appointed by the Board with respect to the employee benefit plans of Baker Hughes and its Affiliates, each of which shall have the duties and responsibilities assigned to it from time to time by the Board. As used in the Plan, the

term “Plan Administrator” shall refer to the applicable delegate of Baker Hughes as determined pursuant to the actions of the Board.

“**Plan Year**” means the twelve-consecutive month period commencing January 1 of each year.

“**Pre-2009 Accounts**” means the Employee’s Accounts under the Plan attributable to deferrals and credits made with respect to Plan Years prior to 2009, and earnings and losses thereon.

“**Retirement**” means the Employee’s voluntary termination of his employment when the Employee has attained at least 55 years of age and has at least ten (10) years of service with the Company and the Affiliates.

“**Retirement Date**” means a Participant’s or former Participant’s “Retirement Date” as defined under the Thrift Plan.

“**Section 409A**” means section 409A of the Code and the Department of Treasury rules and regulations issued thereunder.

“**Separation from Service**” has the meaning ascribed to that term in Section 409A.

“**Specified Owner**” means any of the following:

(a) Baker Hughes;

(b) an Affiliate of Baker Hughes;

(c) an employee benefit plan (or related trust) sponsored or maintained by Baker Hughes or any Affiliate of Baker Hughes;

(d) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes’ then outstanding Voting Securities as a result of the acquisition of securities directly from Baker Hughes and/or its Affiliates; or

(e) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes’ then outstanding Voting Securities as a result of a Merger if the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger in substantially the same proportions as their ownership of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger.

**“Termination of Employment”** means, with respect to each Participant or former Participant, the termination of such Participant’s or former Participant’s employment with the Company and all Affiliates for any reason whatsoever.

**“Thrift Plan”** means the Baker Hughes Incorporated Thrift Plan, as amended from time to time.

**“Trust”** means the trust, if any, established under the Trust Agreement.

**“Trust Agreement”** means the agreement, if any, entered into between the Company and the Trustee pursuant to Article XIII, as amended from time to time.

**“Trust Fund”** means the funds and properties, if any, held pursuant to the provisions of the Trust Agreement, together with all income, profits, and increments thereto.

**“Trustee”** means the trustee or trustees qualified and acting under the Trust Agreement at any time.

**“Unforeseeable Financial Emergency”** means a severe financial hardship of the Participant resulting from an illness or accident of the Participant or of the Participant’s spouse or dependent (as defined in section 152(a) of the Code), loss of the Participant’s property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by insurance), or other similar extraordinary and unforeseeable circumstance arising as a result of events beyond the control of the Participant. The circumstances that will constitute an Unforeseeable Financial Emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that the emergency is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Participant’s assets, to the extent the liquidation of such assets will not itself cause severe financial hardship. Such foreseeable needs for funds as the desire to send a Participant’s child to college or to purchase a home will not be considered to be unforeseeable emergencies. Whether an Unforeseeable Financial Emergency exists and the amount reasonably needed to satisfy the emergency will be determined by the Committee.

**“Vested Interest”** means the portion of a Participant’s or former Participant’s Accounts which, pursuant to the Plan, is nonforfeitable.

**“ Voting Securities ”** means the outstanding securities entitled to vote generally in the election of directors or other governing body.

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

1.03 **Headings.** The headings of Articles and Sections herein are included solely for convenience, and if there is any conflict between such headings and the text of the Plan, the text shall control.

## **ARTICLE II PARTICIPATION**

### **2.01 Eligibility.**

(a) Each Eligible Employee shall be eligible to become a Participant for a Plan Year by electing to make Participant Deferrals pursuant to Section 3.01(a).

(b) Each Eligible Employee who is a participant in the Thrift Plan during a Plan Year shall be eligible to become a Participant for such Plan Year by electing to make Participant Deferrals pursuant to Section 3.01(b).

(c) Each Eligible Employee who is a participant in the Thrift Plan during a Plan Year shall be a Participant for such Plan Year with respect to Company Deferrals pursuant to Section 4.02.

(d) Each Eligible Employee who is a participant in the Pension Plan during a Plan Year shall be a Participant for such Plan Year with respect to Company Deferrals pursuant to Section 4.03.

(e) Notwithstanding any other provision of the Plan, in the case of a person who is not a Participant on the date of the adoption of this Agreement, such person shall not be eligible to participate in the Plan until the Plan Administrator selects him or her for participation in the Plan.

**2.02 Commencement of Participation.** Prior to each Entry Date, the Plan Administrator shall notify those Eligible Employees who are determined by the Plan Administrator to be eligible to participate in the Plan as of such Entry Date. Any such Eligible Employee may elect to make Participant Deferrals beginning on such Entry Date by effecting, prior to such Entry Date and within the time period prescribed by the Plan Administrator, the Participant Deferral election in the form prescribed by the Plan Administrator. Notwithstanding any provision herein to the contrary, an Eligible Employee who first becomes an Eligible Employee on other than the first day of a Plan Year may elect to make Participant Deferrals commencing on the date the Plan Administrator selects him for participation in the Plan by effecting, prior to or within 30 days after the date he first becomes eligible to participate and within the time period prescribed by the Plan Administrator, the Participant Deferral election in the form prescribed by the Plan Administrator.

**2.03 Cessation of Participation Upon Plan Administrator Determination.** Notwithstanding any provision herein to the contrary, the Plan Administrator may determine that an Eligible Employee who has become a Participant of the Plan shall cease to be entitled to make Participant Deferrals hereunder or receive credits under Article IV effective as of the first day of the Plan Year that commences subsequent to the determination. Any such Plan Administrator action shall be communicated to the affected individual prior to the effective date of such action.

Any such Eligible Employee may again become entitled to make Participant Deferrals hereunder and to receive credits under Article IV beginning on any subsequent Entry Date selected by the Plan Administrator in its sole discretion.

**2.04 Suspension of Participation Due to Certain Distributions.** To the extent and for the period of time specified in Section 3.09, a Participant's participation in the Plan shall be suspended upon his making a withdrawal under Section 8.02.

### **ARTICLE III PARTICIPANT DEFERRALS**

#### **3.01 Amount of Participant Deferrals.**

- (a) A Participant meeting the eligibility requirements of Section 2.01(a) may, prior to the applicable Plan Year:
  - (i) elect to defer an integral percentage of from 1% to 60% of his Base Compensation for the Plan Year; and/or
  - (ii) elect to defer an integral percentage of from 1% to 100% of his Bonus earned during the Plan Year.

Notwithstanding the foregoing, with respect to an Eligible Employee who first becomes a Participant on a date other than an Entry Date, any such Participant Deferrals pursuant to Section 3.01(a)(i) shall apply only for the portion of such Plan Year commencing with the date he first becomes a Participant and ending on the last day of such Plan Year. An Eligible Employee who first becomes a Participant during a Plan Year may not elect to defer any portion of his Bonus earned during such Plan Year.

(b) If a Participant meets the eligibility requirements of Section 2.01(b), the Participant may elect for a Plan Year to defer the applicable percentage of his Base Compensation for the remaining portion of the Plan Year following the date his pre-tax elective deferrals under the Thrift Plan are reduced under section 402(g) or section 401(a)(17) of the Code and that is not deferred on a pre-tax basis under the Thrift Plan or under Section 3.01(a)(i) of the Plan. For purposes of this Section 3.01(b), the term "applicable percentage" means the percentage of compensation that the Participant specifies that he will defer on a pre-tax basis under the Thrift Plan in his election in effect on December 31 immediately prior to such Plan Year (or on the first day the Participant becomes a participant in the Thrift Plan during such Plan Year, if later). Except as specified below, a Participant's deferrals under Section 3.01(b) shall commence effective for the period that begins when the Participant's pre-tax elective deferrals under the Thrift Plan are reduced as a result of the limitations contained in section 402(g) or section 401(a)(17) of the Code. Notwithstanding the foregoing, if a Participant reduces his pre-tax elective deferrals under the Thrift Plan during a Plan Year, any attendant decrease in his Participant Deferrals under Section 3.01(b) will not be recognized under the Plan to the extent that the decrease exceeds the amount of the limitation applicable to the Participant for the Plan Year under section 402(g) of the Code. If a Participant increases

his pre-tax elective deferrals under the Thrift Plan during a Plan Year, the Participant's deferrals pursuant to this Section 3.01(b) shall commence and be computed in the same manner as if no change had been made in the Participant's pre-tax deferrals under the Thrift Plan.

**3.02 Participant Deferral Elections.** Pay for a Plan Year that is not deferred pursuant to an election under Sections 3.01(a) and (b) shall be received by such Participant in cash. A Participant's election to defer an amount of his Pay pursuant to this Section shall be made by effecting, in the form prescribed by the Plan Administrator, a Participant Deferral election pursuant to which the Participant authorizes the Company to reduce his Pay in the elected amount and the Company, in consideration thereof, agrees to credit an equal amount to his Participant Deferral Account maintained under the Plan. The reduction in a Participant's Pay pursuant to his Participant Deferral election shall be effected by Pay reductions each payroll period as determined by the Plan Administrator following the effective date of such election. Participant Deferrals made by a Participant shall be credited to his Participant Deferral Account as of a date determined in accordance with procedures established from time to time by the Plan Administrator; *provided, however*, that such Participant Deferrals shall be credited to his Participant Deferral Account no later than 30 days after the date upon which the Pay deferred would have been received by such Participant in cash had he not elected to defer such amount pursuant to Section 3.01.

**3.03 Period of Effectiveness of Participant Deferral Elections.** A Participant Deferral election pursuant to Sections 3.01(a) and (b) shall become effective as of the Entry Date (or later initial eligibility date, if applicable) which is on or after the date the election is effected by the Participant. With respect to an Eligible Employee who first becomes a Participant on other than an Entry Date, any such Participant Deferrals pursuant to Sections 3.01(a)(i) or 3.01(b) shall apply only to Base Compensation earned during such Plan Year commencing after his deferral election for such Plan Year. A Participant Deferral election pursuant to Section 3.01(a)(ii) shall become effective as of the first day of the Plan Year following the date the election is effected by the Participant. A Participant Deferral election shall remain in force and effect for the entire (or partial, if applicable) Plan Year to which such election relates. A Participant Deferral election shall be made for each Plan Year, or partial Plan Year, in which the Participant is eligible to participate. Plan provisions to the contrary notwithstanding, a Participant Deferral election shall be suspended during any period of unpaid leave of absence from the Company.

**3.04 Changes to Participant Deferral Election.** A Participant who makes a Participant Deferral election may change his election for future Participant Deferrals, as of the Entry Date of any subsequent Plan Year, by effecting such change in the annual election *prior* to the Entry Date of such Plan Year, in the form and within the time period prescribed by the Plan Administrator. Any such change shall be effective as of the Entry Date of such Plan Year.

**3.05 Cancellation of Participant Deferral Election.** A Participant who has made a Participant Deferral election may cancel his election for future Participant Deferrals, as of the Entry Date of any subsequent Plan Year, by effecting such cancellation in the annual election *prior* to the Entry Date of such Plan Year, in the form and within the time period prescribed by the Plan Administrator. Any such change shall be effective as of the Entry Date of such Plan Year. A Participant who so cancels his Participant Deferral election may again make a new

Participant Deferral election for a subsequent Plan Year, if he satisfies the eligibility requirements set forth in Article II, by effecting a new Participant Deferral election *prior* to the Entry Date of such Plan Year, in the form and within the time period prescribed by the Plan Administrator.

**3.06 Time and Form of Payment Specified in Participant Deferral Election.** A Participant Deferral election shall indicate the applicable time and form of payment, as provided in Sections 9.02, 9.03, 9.04 and 9.05 for the Pay deferred under the election for such Plan Year and the net income (or net loss) allocated with respect thereto. Such time and form of payment election for such Plan Year shall also apply to any Company Deferrals for such Plan Year and the earnings and losses allocated with respect thereto. Each Participant's Accounts shall be divided into subaccounts to reflect the Participant's various elections respecting time and form of payment. Notwithstanding the foregoing, with respect to the portion of a Participant's Account attributable to the amount, if any, credited to his Account on December 31, 1994, under the Plan as in effect immediately prior to the January 1, 1995 restatement of the Plan, such portion and the net income (or net loss) allocated with respect thereto shall be allocated to a subaccount which shall be payable at the time and in the form provided under the Plan as in effect immediately prior to such restatement. In accordance with procedures established by the Plan Administrator, a Participant may elect to have his Account or subaccount balance paid or commence to be paid (i) upon the expiration of a specified term following the Participant's Separation from Service, (ii) as soon as administratively practicable after December 31 of the Plan Year in which the Participant's Separation From Service occurs, (iii) on a date specified by the Participant that is at least 18 months following the end of the Plan Year for which the deferral election is made, or (iv) upon the earlier to occur of the date specified in clause (iii) or the date specified in clause (ii) (the "*Deferral Period*"). The Plan Administrator is authorized to establish written guidelines concerning limitations on the number of subaccounts respecting time and form of payment that may be maintained under the Plan for any given Participant. Any such written guidelines shall be deemed to be incorporated by reference in the Plan. Once an election as to time and form of payment has been made for a Plan Year, the election may not be changed by the Participant or former Participant except as specified in Sections 3.07 and 3.08.

**3.07 Irrevocable Change of Election of Time and/or Form of Payment for Grandfathered Amounts.** In accordance with procedures established by the Plan Administrator, a Participant or former Participant may make a one-time irrevocable election to change the time and/or form of payment he previously selected for all of the Grandfathered Amounts credited to his Account. Any such change election must be made no later than 18 months before the date on which such amounts were scheduled to be paid or commence to be paid under the Participant's or former Participant's original election. In addition, any such change election may not provide for a payment or commencement of payment that is earlier than 18 months after the date on which the change election is made. For purposes of calculating the 18-month period, such period will commence on the first day of the month immediately following the month in which the election is made.

**3.08 Change of Time and Form of Payment for Amounts Other Than Grandfathered Amounts.** In accordance with procedures established by the Plan Administrator, a Participant or former Participant may make an election to change the time and/or form of payment he previously selected for the amounts credited to his Account other

than Grandfathered Amounts. Any such change election must be made no later than 12 months before the date on which such amounts were scheduled to be paid or commence to be paid under the Participant's or former Participant's original election. In addition, any such change election may not provide for a payment or commencement of payment that is earlier than five years after the date on which the amounts were originally scheduled to be paid or commence to be paid. For purposes of this Section 3.08, installment payments shall be treated as a single payment.

**3.09 Suspension of Participant Deferrals Due to Withdrawal for Unforeseeable Financial Emergency.** Upon written petition of a Participant, in the event that the Plan Administrator determines in its sole discretion that such Participant has suffered an Unforeseeable Financial Emergency or that such Participant will, absent termination of such Participant's Participant Deferral election then in effect, suffer an Unforeseeable Financial Emergency, then the Participant Deferral election of such Participant then in effect, if any, shall be terminated as soon as administratively practicable after such determination. A Participant whose Participant Deferral election has been so terminated may again make a new Participant Deferral election for a subsequent Plan Year that commences at least twelve months after the effective date of such termination, if he satisfies the eligibility requirements set forth in Article II and by effecting a new Participant Deferral election for such Plan Year, in the form and within the time period prescribed by the Plan Administrator.

#### **ARTICLE IV COMPANY DEFERRALS**

**4.01 Company Matching Deferrals .** If the Participant makes the maximum pre-tax elective deferral under the Thrift Plan permitted under section 402(g) of the Code (or other applicable legal limitation) and the Participant elects to defer pursuant to Section 3.01(a) or Section 3.01 (b), the Company shall make a Company Matching Deferral on his behalf in an amount equal to (A) minus (B) where (A) is five percent of the Participant's Base Compensation and Bonus scheduled to be paid for the Plan Year (whether or not deferred under the Plan or the Thrift Plan) and (B) is the amount of matching contributions made for the Participant for the Plan Year under the Thrift Plan. If the Participant does not make the maximum pre-tax elective deferral under the Thrift Plan permitted under section 402(g) of the Code (or other applicable legal limitation) and the Participant elects to defer pursuant to Section 3.01(a) or Section 3.01(b), the Company shall make a Company Matching Deferral on his behalf in an amount equal to (A) minus (B) where (A) is five percent of the Participant's Base Compensation and Bonus for the Plan Year (whether or not deferred under the Plan or the Thrift Plan) and (B) is the maximum amount of matching contributions that would have been made for the Participant for the Plan Year had he contributed the maximum pre-tax deferral under the Thrift Plan permitted under section 402(g) of the Code (or other applicable legal limitation). Company Matching Deferrals made on a Participant's behalf pursuant to this Section 4.01 shall be credited to such Participant's Company Matching Deferral Account in one or more installments, as determined by the Plan Administrator, as of a date or dates within the Plan Year.

**4.02 Company Base Thrift Deferrals.** For each payroll period, the Company shall defer an amount on behalf of each Participant who is entitled to an allocation of "Company Base Contributions" under the Thrift Plan for such payroll period. The amount of each such Company

Deferral shall be a percentage of the Participant's Ineligible Thrift Plan Compensation, if any, for such payroll period, with such percentage being equal to the percentage utilized under the Thrift Plan to determine the Participant's "Company Base Contribution" for such payroll period under the Thrift Plan. Company Base Thrift Deferrals on behalf of a Participant pursuant to this Section 4.02 shall be credited to such Participant's Company Base Thrift Deferral Account in accordance with the procedures established from time to time by the Plan Administrator.

**4.03 Company Pension Deferrals.** For each payroll period, the Company shall defer an amount on behalf of each Participant equal to the percentage of such Participant's Ineligible Pension Plan Compensation, if any, for such payroll period. Company Pension Deferrals on behalf of a Participant pursuant to this Section 4.03 shall be credited to such Participant's Company Pension Deferral Account in accordance with the procedures established from time to time by the Plan Administrator.

**4.04 Company Discretionary Deferrals.** As of any date selected by the Company, the Company may credit a Participant's Company Discretionary Deferral Account with Company Discretionary Deferrals in such amount, if any, as the Company shall determine in its sole discretion. Such credits may be made on behalf of some Participants but not others, and such credits may vary in amount among individual Participants.

**4.05 Time and Form of Payment Elections for Company Deferrals.** A Participant who does not have a time and form of payment election in effect pursuant to Section 3.06 for a given Plan Year shall make a time and form of payment election, as provided in Sections 9.03 and 9.05 (Sections 9.02 and 9.04 with respect to Grandfathered Amounts), for Company Base Thrift Deferrals, Company Pension Deferrals, and Company Discretionary Deferrals for such Plan Year. Such election shall be made in accordance with the same procedures as apply to Participant Deferral elections under Section 3.06. A Participant who had made a time and form of payment election pursuant to this Section 4.05 may change his election for future Company Base Thrift Deferrals, Company Pension Deferrals, and Company Discretionary Deferrals as of the Entry Date of any subsequent Plan Year, by effecting a new election *prior* to the Entry Date of such Plan Year, in the form and within the time period prescribed by the Plan Administrator. Each Participant's Accounts shall be divided into subaccounts to reflect the Participant's various elections respecting time and form of payment. Once an election as to time and form of payment has been made for a Plan Year, the election may not be changed by the Participant or former Participant except as specified in Section 3.07, or Section 3.08, as applicable.

## ARTICLE V VALUATION OF ACCOUNTS

All amounts allocated to the Accounts of a Participant shall be deemed to be invested as of the date of such allocation, and the balance of each Account shall reflect the result of daily pricing of the assets in which such Account is deemed to be invested from the time of such allocation until the time of distribution.

**ARTICLE VI**  
**DEEMED INVESTMENT OF FUNDS**

Participants' and former Participants' Accounts shall be deemed to be credited with earnings and losses. For the purpose of determining the earnings or losses to be credited to the Participant's or former Participant's Accounts under the Plan, the Plan Administrator shall assume that the Participant's or former Participant's Accounts are invested in units or shares of the Funds in the proportions selected by the Participant or former Participant in accordance with procedures established by the Plan Administrator. This amount accrued by the Plan Administrator as additional deferred compensation shall be a part of the Company's obligation to the Participant or former Participant. The determination of deemed earnings and losses on amounts deemed credited to the Participant's or former Participant's Account shall in no way affect the ability of the general creditors of the Company to reach the assets of the Company (including any rabbi trust maintained in connection with the Plan) in the event of the insolvency or bankruptcy of the Company or place the Participants or former Participants in a secured position ahead of the general creditors of the Company. Although a Participant's or former Participant's investment selections made in accordance with the terms of the Plan and such procedures as may be established by the Plan Administrator shall be relevant for purposes of determining the Company's obligation to the Participant or former Participant under the Plan, there is no requirement that any assets of the Company (including those held in any rabbi trust) shall be invested in accordance with the Participant's or former Participant's investment selections.

Each Participant or former Participant shall designate, in accordance with the procedures established from time to time by the Plan Administrator, the manner in which the amounts allocated to his Accounts shall be deemed to be invested from among the Funds made available from time to time for such purpose by the Plan Administrator. Such Participant or former Participant may designate one of such Funds for the deemed investment of all such amounts allocated to his Accounts or he may split the deemed investment of such amounts allocated to his Accounts among such Funds in such increments as the Plan Administrator may prescribe. If a Participant or former Participant fails to make a proper designation, then his Accounts shall be deemed to be invested in the Fund or Funds designated in a uniform and nondiscriminatory manner by the Plan Administrator from time to time.

A Participant may change his deemed investment designation for future deferrals to be allocated to his Accounts. Any such change shall be made in accordance with the procedures established by the Plan Administrator, and the frequency of such changes may be limited by the Plan Administrator.

A Participant or former Participant may elect to convert his deemed investment designation with respect to the amounts already allocated to his Accounts. Any such conversion shall be made in accordance with the procedures established by the Plan Administrator, and the frequency of such conversions may be limited by the Plan Administrator.

**ARTICLE VII  
DETERMINATION OF VESTED INTEREST AND FORFEITURES**

7.01 **Vested Interest.** A Participant or former Participant shall have a 100% Vested Interest in amounts credited to his Participant Deferral Account and his Company Matching Deferral Account at all times. A Participant or former Participant shall have a Vested Interest in the amounts credited to his Company Base Thrift Deferral Account and Company Discretionary Deferral Account equal to his nonforfeitable interest in his "Company Non-Matching Accounts" under the Thrift Plan. A Participant or former Participant shall have a Vested Interest in the amounts credited to his Company Pension Deferral Account equal to his nonforfeitable interest in his account under the Pension Plan. Further, a Participant or former Participant shall have a 100% Vested Interest in amounts credited to his Company Base Thrift Deferral Account, Company Pension Deferral Account, and Company Discretionary Deferral Account upon such Participant's or former Participant's Termination of Employment after attainment of his Retirement Date or by reason of death. Effective July 24, 2008, if a Change in Control occurs, a Participant who has not incurred a Separation From Service prior to the date of the Change in Control shall have a 100% Vested Interest in amounts credited to his Company Base Thrift Deferral Account, Company Pension Deferral Account, Company Discretionary Deferral Account and Company Pension Deferral Account upon the occurrence of the Change in Control.

7.02 **Forfeitures.** A Participant or former Participant who incurs a Termination of Employment with a Vested Interest in amounts credited to his Company Base Thrift Deferral Account, Company Pension Deferral Account, and Company Discretionary Deferral Account that is less than 100% (determined after giving effect to any provision in Section 7.01 that may provide for an increase in such Participant's Vested Interest upon a Termination of Employment) shall forfeit to the Company the nonvested portion of amounts credited to his Company Base Thrift Deferral Account, Company Pension Deferral Account, and Company Discretionary Deferral Account as of the date of such Termination of Employment.

**ARTICLE VIII  
ACCELERATED DISTRIBUTIONS**

8.01 **Restrictions on In-Service Distributions and Loans.** Except as provided in Section 8.02, or as elected by a Participant pursuant to Section 3.06 or Section 4.05 (as such election may be changed pursuant to Section 3.07 or Section 3.08) Participants shall not be permitted to make withdrawals from, or to receive distributions under, the Plan while they are employed by the Company or an Affiliate. Participants shall not, at any time, be permitted to borrow from the Trust Fund. Except as provided in Sections 8.02 and 14.04, all benefits under the Plan shall be paid in accordance with the provisions of Article IX.

8.02 **Emergency Benefit.** In the event that the Plan Administrator, upon written petition of a Participant who has not incurred a Termination of Employment, determines in its sole discretion that such Participant has suffered an Unforeseeable Financial Emergency, such Participant shall be entitled to a distribution in an amount not to exceed the lesser of (a) the amount determined by the Plan Administrator as necessary to meet such Participant's needs created by the Unforeseeable Financial Emergency or (b) the then value of such Participant's

Vested Interest in his Accounts. Such benefit shall be paid in a single lump sum payment as soon as administratively practicable after the Plan Administrator has made its determinations with respect to the availability and amount of such benefit. If a Participant's Accounts are deemed to be invested in more than one Fund, such benefit shall be distributed pro rata from each Fund in which such Accounts are deemed to be invested. If a Participant's Accounts contain more than one distribution subaccount, such benefit shall be considered to have been distributed, first, from the subaccount with respect to which the earliest distribution would be made, then, from the subaccount with respect to which the next earliest distribution would be made, and continuing in such manner until the amount of such distribution has been satisfied.

## **ARTICLE IX PAYMENT OF BENEFITS**

**9.01 Amount of Benefit.** Upon the expiration of the Deferral Period, the Participant (or, in the event of the death of the Participant while employed by the Company or an Affiliate, the Participant's designated beneficiary) or former Participant shall be entitled to a benefit equal in value to the Participant's or former Participant's Vested Interest in the balance in his Accounts as of the date the payment of such benefit is to commence pursuant to Section 9.02 and/or Section 9.03 (adjusted for subsequent deemed investment gains or losses in the case of benefits paid in the form of installments).

**9.02 Time of Payment of Grandfathered Amounts.** Payment of a Participant's or former Participant's benefit under Section 9.01 shall be made or shall commence, with respect to such Participant's or former Participant's Accounts, or with respect to such Participant's or former Participant's subaccounts established pursuant to Section 3.06 and/or Section 4.05 separately and respectively, as follows. To the extent that the Participant or former Participant elected to have his Accounts or subaccounts paid upon his Termination of Employment, the Participant's or former Participant's benefit shall be paid or commence to be paid as soon as administratively practicable after the last day of the calendar year coincident with or next following the date the Participant or former Participant incurs a Termination of Employment. To the extent that the Participant or former Participant elected to have his Accounts or subaccounts paid after a specified term, the Participant's or former Participant's benefit shall be paid or commence to be paid as soon as administratively practicable after the expiration of such specified term. With respect to any portion of a Participant's or former Participant's benefit for which no time of payment election is in effect, payment of such amount shall be made or commence as soon as administratively practicable after the last day of the calendar year coincident with or next following the date the Participant or former Participant incurs a Termination of Employment. A Participant's or former Participant's benefit shall not, however, be paid or commence prior to the date that all Participant Deferrals and Company Deferrals made pursuant to the Plan have been allocated to such Participant's or former Participant's Accounts.

**9.03 Time of Payment of Amounts Other Than Grandfathered Amounts.** Payment of a Participant's or former Participant's benefit under Section 9.01 shall be made or shall commence, with respect to such Participant's or former Participant's Accounts, or with respect to such Participant's or former Participant's subaccounts established pursuant to Section 3.06 and/or Section 4.05 separately and respectively, as follows. To the extent that the Participant or

former Participant elected to have his Accounts or subaccounts paid upon his Separation From Service, the Participant's or former Participant's benefit shall be paid or commence to be paid on the later of (1) the first day of the month coincident with or next following the date that is six months after the date of the Separation From Service or (2) the first day of the Plan Year next following the date of the Participant's or former Participant's Separation From Service. To the extent that the Participant or former Participant elected to have his Accounts or subaccounts paid after a specified term, the Participant's or former Participant's benefit shall be paid or commence to be paid upon the expiration of such specified term. With respect to any portion of a Participant's or former Participant's benefit for which an election was not made in accordance with Section 3.06 or Section 4.05, payment of such amount shall be made or commence on the later of (1) the first day of the month coincident with or next following the date that is six months after the date of the Participant's or former Participant's Separation From Service or (2) the first day of the Plan Year next following the date of the Participant's or former Participant's Separation From Service.

**9.04 Alternative Forms of Benefit Payments for Grandfathered Amounts.** A Participant's or former Participant's benefit under Section 9.01 shall be paid, with respect to such Participant's or former Participant's Grandfathered Amounts, or with respect to such Participant's or former Participant's subaccounts established pursuant to Section 3.06 and/or Section 4.05 that are attributable to his Grandfathered Amounts separately and respectively, in one of the following forms irrevocably elected by such Participant or former Participant pursuant to Section 3.06 and/or Section 4.05:

(a) A single lump sum payment; or

(b) Any number (from two to 20 as designated by such Participant or former Participant) of annual installment payments and, in the event of such Participant's or former Participant's death prior to the receipt of all of the elected installment payments, the remaining installments shall be paid to such Participant's or former Participant's designated beneficiary as provided in Section 9.08. The amount of each annual installment shall be computed by dividing the Vested Interest in the unpaid balance in the Participant's or former Participant's Accounts as of the date of payment of such annual installment by the number of annual installments remaining.

With respect to any portion of a Participant's or former Participant's benefit attributable to his Pre-2009 Accounts for which an election was not made in accordance with Section 3.06 or Section 4.05, such amount shall be paid in the form of 15 annual installment payments to such Participant or former Participant or, in the event of such Participant's or former Participant's death prior to his receipt of all such installments, to his designated beneficiary as provided in Section 9.08; *provided, however*, that with respect to Grandfathered Amounts, the Plan Administrator may, in its sole discretion, elect to make such benefit payment in any other available form. If a Participant or former Participant dies prior to the date the payment of his benefit begins and if no form of payment election is in effect for any portion of such Participant's or former Participant's benefit, such amount shall be paid to the Participant's or former Participant's designated beneficiary in the form described in the preceding sentence. If a Participant or former Participant dies prior to the date the payment of his benefit begins with a form of

payment election in effect, then benefit payments shall be made to the Participant's or former Participant's designated beneficiary in the form elected by the Participant or former Participant.

**9.05 Alternative Forms of Benefit Payments for Amounts Other Than Grandfathered Amounts.**

A Participant's or former Participant's benefit under Section 9.01 shall be paid, with respect to such Participant's or former Participant's Accounts other than his Grandfathered Amounts, or with respect to such Participant's or former Participant's subaccounts established pursuant to Section 3.06 and/or Section 4.05 that are not attributable to his Grandfathered Amounts separately and respectively, in one of the following forms irrevocably elected by such Participant or former Participant pursuant to Section 3.06 and/or Section 4.05:

(a) A single lump sum payment; or

(b) Any number (from two to 20 as designated by such Participant or former Participant) of annual installment payments and, in the event of such Participant's or former Participant's death prior to the receipt of all of the elected installment payments, the remaining installments shall be paid to such Participant's or former Participant's designated beneficiary as provided in Section 9.08. The amount of each annual installment shall be computed by dividing the Vested Interest in the unpaid balance in the Participant's or former Participant's Accounts as of the date of payment of such annual installment by the number of annual installments remaining.

With respect to any portion of a Participant's or former Participant's benefit for which an election was not made in accordance with Section 3.06 or Section 4.05, other than amounts attributable to his Pre-2009 Accounts, such amount shall be paid in the form of single sum payment to such Participant or former Participant. If no form of payment election is in effect for any portion of such Participant's or former Participant's benefit, and the Participant or former Participant dies prior to the date such amount is paid, such amount shall be paid to the Participant's or former Participant's designated beneficiary in the form described in the preceding sentence. If a Participant or former Participant dies prior to the date the payment of his benefit begins with a form of payment election in effect, then benefit payments shall be made to the Participant's or former Participant's designated beneficiary in the form elected by the Participant or former Participant.

**9.06 Accelerated Pay-Out of Certain Grandfathered Amounts.** Notwithstanding any provision of the Plan to the contrary, if a Participant's or former Participant's benefit payments respecting Grandfathered Amounts credited to any one subaccount established pursuant to Section 3.06 or Section 4.05 are to be paid in a form other than a single lump sum payment and the aggregate Grandfathered Amounts credited to such subaccount at the time of commencement of such payments is less than \$50,000, then the Plan Administrator may, in its sole discretion, elect to cause such Grandfathered Amounts credited to such subaccount to be paid in a single lump sum payment.

**9.07 Accelerated Pay-Out of Certain Amounts Including Grandfathered Amounts.** Effective January 1, 2009, notwithstanding any other provision of the Plan to the contrary, if the aggregate amount of the Participant's or former Participant's Account balances under the Plan (including Grandfathered Amounts) does not exceed the Cashout Amount (as defined below), the amounts credited to the Participant's or former Participant's Account shall be distributed to him immediately in the form of a single lump sum payment; *provided, however*, that no such payment shall be made to a Participant or former Participant prior to the later of (1) the first day of the month coincident with or next following the date that is six months after the date of the Participant's or former Participant's Separation From Service and (2) the first day of the Plan Year next following the date of the Participant's or former Participant's Separation From Service; and provided further that the payment results in the termination and liquidation of the entirety of the Participant's or former Participant's interest under the Plan and all arrangements that are treated as having been deferred under a single nonqualified deferred compensation plan under Department of Treasury Regulation section 1.409A-1(c)(2). For purposes of this Section 9.07, the term "Cashout Amount" means the applicable dollar amount under section 402(g)(1)(B) of the Code in effect during the Plan Year.

**9.08 Designation of Beneficiaries.**

(a) Each Participant or former Participant shall have the right to designate the beneficiary or beneficiaries to receive payment of his benefit in the event of his death. Each such designation shall be made by executing the beneficiary designation form prescribed by the Plan Administrator and filing same with the Plan Administrator. Any such designation may be changed at any time by execution of a new designation in accordance with this Section.

(b) If no such designation is on file with the Plan Administrator at the time of the death of the Participant or former Participant or such designation is not effective for any reason as determined by the Plan Administrator, then the designated beneficiary or beneficiaries to receive such benefit shall be as follows:

(i) If a Participant or former Participant leaves a surviving spouse, his benefit shall be paid to such surviving spouse;

(ii) If a Participant or former Participant leaves no surviving spouse, his benefit shall be paid to such Participant's or former Participant's executor or administrator, or to his heirs at law if there is no administration of such Participant's or former Participant's estate.

**9.09 Payment of Benefits.** To the extent the Trust Fund has sufficient assets, the Trustee shall pay benefits to Participants or former Participants or their respective beneficiaries, except to the extent the Company pays the benefits directly and provides adequate evidence of such payment to the Trustee. To the extent the Trustee does not or cannot pay benefits out of the Trust Fund, the benefits shall be paid by the Company. Any benefit payments made to a Participant, or former Participant, or for his benefit pursuant to any provision of the Plan shall be debited to such Participant's or former Participant's Accounts. All benefit payments shall be made in cash to the fullest extent practicable.

**9.10 Unclaimed Benefits.** In the case of a benefit payable on behalf of a Participant or former Participant, if the Plan Administrator is unable, after reasonable efforts, to locate the Participant, the former Participant or the beneficiary to whom such benefit is payable, upon the Plan Administrator's determination thereof, such benefit shall be forfeited to the Company. Notwithstanding the foregoing, if subsequent to any such forfeiture the Participant, the former Participant or beneficiary to whom such benefit is payable makes a valid claim for such benefit, such forfeited benefit (without any adjustment for earnings or loss) shall be restored to the Plan by the Company and paid in accordance with the Plan.

**9.11 Plan Administrator Determination of Pay-Out of Certain Benefits.** Notwithstanding any provision in Section 3.06 to the contrary, the form of payment of a Participant's or former Participant's benefits with respect to the portion of his Account attributable to the amount, if any, credited to his Account on December 31, 1994, under the Plan as in effect immediately prior to the January 1, 1995 restatement of the Plan, and the earnings and losses allocated with respect thereto may, in the sole discretion of the Plan Administrator, be changed from the form elected by such Participant or former Participant pursuant to the provisions of the Plan as in effect immediately prior to the January 1, 1995 restatement of the Plan to one or more other forms provided in Section 9.04. In making its determination as to the form(s) of payment, the Plan Administrator may consider the age, family status, health, financial status, or such other facts as it deems relevant respecting the Participant or former Participant. The Participant or former Participant may, but shall not be required to, express his preference to the Plan Administrator as to such form(s) of payment, but the Plan Administrator shall be under no obligation to follow such preference. Any such change shall be prior to the time such portion becomes payable to such Participant or former Participant.

**9.12 Statutory Benefits.** If any benefit obligations are required to be paid under the Plan to a Participant or former Participant in conjunction with severance of employment under the laws of the country where the Participant or former Participant is employed or under federal, state or local law, the benefits paid to a Participant or former Participant pursuant to the provisions of the Plan will be deemed to be in satisfaction of any statutorily required benefit obligations.

**9.13 Payment to Alternate Payee Under Domestic Relations Order.** Plan benefits that are awarded to an Alternate Payee in a Domestic Relations Order shall be paid to the Alternate Payee at the time and in the form directed in the Domestic Relations Order. The Domestic Relations Order may provide for an immediate lump sum payment to an Alternate Payee. A Domestic Relations Order may not otherwise provide for a time or form of payment that is not permitted under the Plan. A Domestic Relations Order will be disregarded to the extent it awards an Alternate Payee benefits in excess of the applicable Participant's or former Participant's Vested Interest.

**ARTICLE X**  
**ADMINISTRATION OF THE PLAN**

10.01 **Plan Administrator.** Baker Hughes shall be the “Plan Administrator” and the “named fiduciary” for purposes of ERISA and shall be subject to service of process on behalf of the Plan.

10.02 **Resignation and Removal.** The members of a Committee serving as Plan Administrator shall serve at the pleasure of the Board; they may be officers, directors, or Employees of the Company or any other individuals. At any time during his term of office, any member of a Committee or any individual serving as Plan Administrator may resign by giving written notice to the Board, such resignation to become effective upon the appointment of a substitute or, if earlier, the lapse of thirty days after such notice is given as herein provided. At any time during its term of office, and for any reason, any member of a Committee or any individual serving as Plan Administrator may be removed by the Board.

10.03 **Records and Procedures.** The Plan Administrator shall keep appropriate records of its proceedings and the administration of the Plan and shall make available for examination during business hours to any Participant, former Participant or the beneficiary of any Participant or former Participant such records as pertain to that individual’s interest in the Plan. If a Committee is performing duties as the Plan Administrator, the Committee shall designate the individual or individuals who shall be authorized to sign for the Plan Administrator and, upon such designation, the signature of such individual or individuals shall bind the Plan Administrator.

10.04 **Self-Interest of Plan Administrator.** Neither the members of a Committee nor any individual Plan Administrator shall have any right to vote or decide upon any matter relating solely to himself under the Plan or to vote in any case in which his individual right to claim any benefit under the Plan is particularly involved. In any case in which any Committee member or individual Plan Administrator is so disqualified to act, the other members of the Committee shall decide the matter in which the Committee member or individual Plan Administrator is disqualified.

10.05 **Compensation and Bonding.** Neither the members of a Committee nor any individual Plan Administrator shall receive compensation with respect to their services on the Committee or as Plan Administrator. To the extent required by applicable law, or required by the Company, neither the members of a Committee nor any individual Plan Administrator shall furnish bond or security for the performance of their duties hereunder.

10.06 **Plan Administrator Powers and Duties.** The Plan Administrator shall supervise the administration and enforcement of the Plan according to the terms and provisions hereof and shall have all powers necessary to accomplish these purposes, including, but not by way of limitation, the right, power, and authority:

- (a) to make rules, regulations, and bylaws for the administration of the Plan that are not inconsistent with the terms and provisions hereof, and to enforce the terms of the Plan and the rules and regulations promulgated thereunder by the Plan Administrator;

(b) to construe in its discretion all terms, provisions, conditions, and limitations of the Plan;

(c) to correct any defect or to supply any omission or to reconcile any inconsistency that may appear in the Plan in such manner and to such extent as it shall deem in its discretion expedient to effectuate the purposes of the Plan;

(d) to employ and compensate such accountants, attorneys, investment advisors, and other agents, employees, and independent contractors as the Plan Administrator may deem necessary or advisable for the proper and efficient administration of the Plan;

(e) to determine in its discretion all questions relating to eligibility;

(f) to determine whether and when a Participant has incurred a Separation From Service or Termination of Employment, and the reason for such termination;

(g) to make a determination in its discretion as to the right of any individual to a benefit under the Plan and to prescribe procedures to be followed by distributees in obtaining benefits hereunder;

(h) to receive and review reports from the Trustee as to the financial condition of the Trust Fund, including its receipts and disbursements; and

(i) to establish or designate Funds as deemed investment options as provided in Article VI.

**10.07 Reliance on Documents, Instruments, etc.** The Plan Administrator may rely on any certificate statement or other representation made on behalf of the Company, any Employee or any Participant, which the Plan Administrator in good faith believes to be genuine, and on any certificate, statement, report or other representation made to it by any agent or any attorney, accountant or other expert retained by it or the Company in connection with the operation and administration of the Plan.

**10.08 Claims Review Procedures; Claims Appeals Procedures.**

(a) *Claims Review Procedures*. When a benefit is due, the Participant, or the person entitled to Benefits under Section 9.06, should submit a claim to the office designated by the Plan Administrator to receive claims. Under normal circumstances, the Plan Administrator will make a final decision as to a claim within 90 days after receipt of the claim. If the Plan Administrator notifies the claimant in writing during the initial 90-day period, it may extend the period up to 180 days after the initial receipt of the claim. The written notice must contain the circumstances necessitating the extension and the anticipated date for the final decision. If a claim is denied during the claims period, the Plan Administrator must notify the claimant in writing, and the written notice must set forth in a manner calculated to be understood by the claimant:

(1) the specific reason or reasons for the denial;

- (2) specific reference to the Plan provisions on which the denial is based;
- (3) a description of any additional material or information necessary for the claimant to perfect the claim and an explanation of why such material or information is necessary; and
- (4) an explanation of the Plan claims review procedures and time limits, including a statement of the claimant's right to bring a civil action under section 502(a) of ERISA.

If a decision is not given to the Participant within the claims review period, the claim is treated as if it were denied on the last day of the claims review period.

(b) *Claims Appeals Procedures*. For purposes of this section the Participant or the person entitled to Benefits under Section 10 is referred to as the "claimant." If a claimant's claim made pursuant to Section 10.08(a) is denied and he wants a review, he must apply to the Plan Administrator in writing. That application can include any arguments, written comments, documents, records, and other information relating to the claim for benefits. In addition, the claimant is entitled to receive on request and free of charge reasonable access to and copies of all information relevant to the claim. For this purpose, "relevant" means information that was relied on in making the benefit determination or that was submitted, considered or generated in the course of making the determination, without regard to whether it was relied on, and information that demonstrates compliance with the Plan's administrative procedures and safeguards for assuring and verifying that Plan provisions are applied consistently in making benefit determinations. The Plan Administrator must take into account all comments, documents, records, and other information submitted by the claimant relating to the claim, without regard to whether the information was submitted or considered in the initial benefit determination. The claimant may either represent himself or appoint a representative, either of whom has the right to inspect all documents pertaining to the claim and its denial. The Plan Administrator can schedule any meeting with the claimant or his representative that it finds necessary or appropriate to complete its review.

The request for review must be filed within 90 days after the denial. If it is not, the denial becomes final. If a timely request is made, the Plan Administrator must make its decision, under normal circumstances, within 60 days of the receipt of the request for review. However, if the Plan Administrator notifies the claimant prior to the expiration of the initial review period, it may extend the period of review up to 120 days following the initial receipt of the request for a review. All decisions of the Plan Administrator must be in writing and must include the specific reasons for its action, the Plan provisions on which its decision is based, and a statement that the claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claimant's claim for benefits, and a statement of the claimant's right to bring an action under section 502(a) of ERISA. If a decision is not given to the claimant within the review period, the claim is treated as if it were denied on the last day of the review period.

Within 60 days of receipt by a claimant of a notice denying a claim under the preceding paragraph, the claimant or his or her duly authorized representative may request in writing a full and fair review of the claim by the Plan Administrator. The Plan Administrator may extend the 60-day period where the nature of the benefit involved or other attendant circumstances make such extension appropriate. In connection with such review, the claimant or his or her duly authorized representative may review pertinent documents and may submit issues and comments in writing. The Plan Administrator shall make a decision promptly, and not later than 60 days after the Plan's receipt of a request for review, unless special circumstances (such as the need to hold a hearing) require an extension of time for processing, in which case a decision shall be rendered as soon as possible, but not later than 120 days after receipt of a request for review. The decision on review shall be in writing and shall include specific reasons for the decision, written in a manner calculated to be understood by the claimant, and specific references to the pertinent Plan provisions on which the decision is based.

**10.09 Company to Supply Information** . The Company shall supply full and timely information to the Plan Administrator, including, but not limited to, information relating to each Participant's Base Compensation, Bonus, Ineligible Thrift Plan Compensation, Ineligible Pension Plan Compensation, age, Retirement, death, or other cause of Termination of Employment and such other pertinent facts as the Plan Administrator may require. The Company shall advise the Trustee of such of the foregoing facts as are deemed necessary for the Trustee to carry out the Trustee's duties under the Plan and the Trust Agreement. When making a determination in connection with the Plan, the Plan Administrator shall be entitled to rely upon the aforesaid information furnished by the Company.

**10.10 Indemnity**. To the extent permitted by applicable law, the Company shall indemnify and save harmless the Board, each member of the Committee, each delegate of the Committee or the Board and the Plan Administrator against any and all expenses, liabilities and claims (including legal fees incurred to investigate or defend against such liabilities and claims) arising out of their discharge in good faith of responsibilities under or incident to the Plan. Expenses and liabilities arising out of willful misconduct shall not be covered under this indemnity. This indemnity shall not preclude such further indemnities as may be available under insurance purchased by the Company or provided by the Company under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, as such indemnities are permitted under applicable law.

## **ARTICLE XI ADMINISTRATION OF FUNDS**

**11.01 Payment of Expenses**. All expenses incident to the administration of the Plan and Trust, including but not limited to, legal, accounting, Trustee fees, and expenses of the Plan Administrator, may be paid by the Company and, if not paid by the Company, shall be paid by the Trustee from the Trust Fund, if any.

**11.02 Trust Fund Property**. All income, profits, recoveries, contributions, forfeitures and any and all moneys, securities and properties of any kind at any time received or held by the

Trustee, if any, shall be held for investment purposes as a commingled Trust Fund pursuant to the terms of the Trust Agreement. The Plan Administrator shall maintain one or more Accounts in the name of each Participant or former Participant, but the maintenance of an Account designated as the Account of a Participant or former Participant shall not mean that such Participant or former Participant shall have a greater or lesser interest than that due him by operation of the Plan and shall not be considered as segregating any funds or property from any other funds or property contained in the commingled fund. No Participant or former Participant shall have any title to any specific asset in the Trust Fund, if any.

## **ARTICLE XII ADOPTION OF PLAN BY OTHER EMPLOYERS**

### **12.01 Adoption Procedure.**

(a) With the written approval of the Plan Administrator, any entity that is an Affiliate may adopt the Plan by appropriate action of its board of directors or noncorporate counterpart, as evidenced by a written instrument executed by an authorized officer of such entity or an executed adoption agreement (approved by the board of directors or noncorporate counterpart of the Affiliate), agreeing to be bound by all the terms, conditions and limitations of the Plan except those, if any, specifically described in the adoption instrument, and providing all information required by the Plan Administrator. The Plan Administrator and the adopting Affiliate may agree to incorporate specific provisions relating to the operation of the Plan that apply to the adopting Affiliate only and shall become, as to such adopting Affiliate and its employees, a part of the Plan.

(b) The provisions of the Plan may be modified so as to increase the obligations of an adopting Affiliate *only* with the consent of such Affiliate, which consent shall be conclusively presumed to have been given by such Affiliate unless the Affiliate gives the Company written notice of its rejection of the amendment within 30 days after the adoption of the amendment.

(c) The provisions of the Plan shall apply separately and equally to each adopting Affiliate and its employees in the same manner as is expressly provided for the Company and its employees, except that the power to appoint or otherwise affect the Plan Administrator and the power to amend or terminate the Plan shall be exercised by the Company. The Plan Administrator shall act as the agent for each Affiliate that adopts the Plan for all purposes of administration thereof.

(d) Any adopting Affiliate may, by appropriate action of its board of directors or noncorporate counterpart, terminate its participation in the Plan. Moreover, the Plan Administrator may, in its discretion, terminate an Affiliate's participation in the Plan at any time.

(e) The Plan will terminate with respect to any Affiliate that has adopted the Plan pursuant to this Section if the Affiliate ceases to be an Affiliate or revokes its

adoption of the Plan by resolution of its board of directors or noncorporate counterpart evidenced by a written instrument executed by an authorized officer of the Affiliate. If the Plan terminates with respect to any Affiliate, the employees of that Affiliate will no longer be eligible to be Participants in the Plan.

(f) For purposes of the Code and ERISA, the Plan as adopted by the Affiliates shall constitute a single plan rather than a separate plan of each Affiliate.

**12.02 No Joint Venture Implied** . The document which evidences the adoption of the Plan by an Affiliate shall become a part of the Plan. However, neither the adoption of the Plan by an Affiliate nor any act performed by it in relation to the Plan shall ever create a joint venture or partnership relation between it and any other Affiliate.

**ARTICLE XIII  
NATURE OF THE PLAN  
AND ESTABLISHMENT OF THE TRUST**

**13.01 Nature of the Plan.** The Company intends and desires by the adoption of the Plan to recognize the value to the Company of the past and present services of employees covered by the Plan and to encourage and assure their continued service with the Company by making more adequate provision for their future retirement security. The establishment of the Plan is, in part, made necessary by certain benefit limitations which are imposed on the Thrift Plan and the Pension Plan by the Code. The Plan is intended to constitute an unfunded, unsecured plan of deferred compensation for a select group of management or highly compensated employees of the Company. Plan benefits herein provided are a contractual obligation of the Company which shall be paid out of the Company's general assets. Nevertheless, subject to the terms hereof and of the Trust Agreement, the Company may transfer money or other property to the Trustee to provide Plan benefits hereunder, and the Trustee shall pay Plan benefits to Participants, former Participants and their beneficiaries out of the Trust Fund. To the extent the Company transfers assets to the Trustee pursuant to the Trust Agreement, the Plan Administrator may, but need not, establish procedures for the Trustee to invest the Trust Fund in accordance with each Participant's or former Participant's designated deemed investments pursuant to Article VI respecting the portion of the Trust Fund assets equal to such Participant's or former Participant's Accounts.

**13.02 Establishment of the Trust.** The Board, in its sole discretion, may establish the Trust and direct Baker Hughes, for and on behalf of each Company, to enter into the Trust Agreement. In such event, the Company shall remain the owner of all assets in the Trust Fund and the assets shall be subject to the claims of the Company's creditors if the Company ever becomes insolvent. For purposes hereof, the Company shall be considered "insolvent" if (a) the Company is unable to pay its debts as they become due or (b) the Company is subject to a pending proceeding as a debtor under the United States Bankruptcy Code (or any successor federal statute). The chief executive officer of the Company and its board of directors shall have the duty to inform the Trustee in writing if the Company becomes insolvent. Such notice given under the preceding sentence by any party shall satisfy all of the parties' duty to give notice. When so informed, the Trustee shall suspend payments to the Participants and former

Participants and hold the assets for the benefit of the Company's general creditors. If the Company subsequently alleges that it is no longer insolvent or if the Trustee receives a written allegation from a third party that the Company is insolvent, the Trustee shall suspend payments to the Participants and former Participants and hold the Trust Fund for the benefit of the Company's general creditors, and shall determine in accordance with the Trust Agreement whether the Company is insolvent. If the Trustee determines that the Company is not insolvent, the Trustee shall resume payments to the Participants and former Participants. No Participant, former Participant or beneficiary shall have any preferred claim to, or any beneficial ownership interest in, any assets of the Trust Fund, and, upon commencement of participation in the Plan, each Participant and former Participant shall have agreed to waive his priority credit position, if any, under applicable state law with respect to the assets of the Trust Fund.

#### **ARTICLE XIV MISCELLANEOUS**

**14.01 Plan Not Contract of Employment.** The adoption and maintenance of the Plan shall not be deemed to be a contract between the Company and any individual or to be consideration for the employment of any individual. Nothing herein contained shall be deemed to (a) give any individual the right to be retained in the employ of the Company, (b) restrict the right of the Company to discharge any individual at any time, (c) give the Company the right to require any individual to remain in the employ of the Company, or (d) restrict any individual's right to terminate his employment at any time.

**14.02 Alienation of Interest Forbidden.** The interest of a Participant, former Participant or his beneficiary or beneficiaries hereunder may not be sold, transferred, assigned, or encumbered in any manner, either voluntarily or involuntarily, and any attempt so to anticipate, alienate, sell, transfer, assign, pledge, encumber, or charge the same shall be null and void; neither shall the benefits hereunder be liable for or subject to the debts, contracts, liabilities, engagements or torts of any individual to whom such benefits or funds are payable, nor shall they be an asset in bankruptcy or subject to garnishment, attachment or other legal or equitable proceedings. The provisions of this Section 14.02 shall not apply to a Domestic Relations Order.

**14.03 Withholding.** All credits to a Participant's or former Participant's Accounts and payments provided for hereunder shall be subject to applicable withholding and other deductions as shall be required of the Company under any applicable local, state or federal law.

**14.04 Amendment and Termination.** The Board, may from time to time, in its discretion, amend, in whole or in part, any or all of the provisions of the Plan on behalf of any Company; *provided, however*, that no amendment may be made that would impair the rights of a Participant or former Participant with respect to amounts already credited to his Accounts. The Board may terminate the Plan at any time. If the Plan is terminated, (a) the Grandfathered Amounts credited to a Participant's or former Participant's Account shall be paid to such Participant, or former Participant, or his designated beneficiary in the manner specified by the Plan Administrator, which may include the payment of a single lump sum payment in full satisfaction of all of such Participant's, former Participant's or beneficiary's benefits hereunder, and (b) any other amounts credited to the Participant's or former Participant's Account shall be

paid to such Participant, or former Participant, or his designated beneficiary at the time(s) and in the form(s) elected by the Participant or former Participant under Sections 3.06 and 4.05 (as such elections may have been changed pursuant to Section 3.07).

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

**14.06 Arbitration.** Any controversy arising out of or relating to the Plan, including without limitation, any and all disputes, claims (whether in tort, contract, statutory or otherwise) or disagreements concerning the interpretation or application of the provisions of the Plan, the Company's employment of the Participant, or former Participant, and the termination of that employment, shall be resolved by arbitration in accordance with the Employee Benefit Plan Claims Arbitration Rules of the American Arbitration Association (the "AAA") then in effect. No arbitration proceeding relating to the Plan may be initiated by either the Company or the Participant, or former Participant, unless the claims review and appeals procedures specified in Section 10.08 have been exhausted. Within ten (10) business days of the initiation of an arbitration hereunder, the Company and the Participant, or former Participant, will each separately designate an arbitrator, and within twenty (20) business days of selection, the appointed arbitrators will appoint a neutral arbitrator from the panel of AAA National Panel of Employee Benefit Plan Claims Arbitrators. The arbitrators shall issue their written decision (including a statement of finding of facts) within thirty (30) days from the date of the close of the arbitration hearing. The decision of the arbitrators selected hereunder will be final and binding on both parties. This arbitration provision is expressly made pursuant to and shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16 (or replacement or successor statute). Pursuant to Section 9 of the Federal Arbitration Act, the Company and any Participant agrees that any judgment of the United States District Court for the District in which the headquarters of Baker Hughes is located at the time of initiation of an arbitration hereunder shall be entered upon the award made pursuant to the arbitration. Nothing in this Section 14.06 shall be construed to, in any way, limit the scope and effect of Article X. In any arbitration proceeding full effect shall be given to the rights, powers, and authorities of the Plan Administrator under Article X.

**14.07 Compliance With Section 409A.** Except with respect to Grandfathered Amounts, the Plan is intended to comply with Section 409A and the Plan shall be interpreted and operated in a manner consistent with this intention.

**14.08 Governing Law.** All provisions of the Plan shall be construed in accordance with the laws of Texas, except to the extent preempted by federal law and except to the extent that the conflicts of laws provisions of the State of Texas would require the application of the relevant law of another jurisdiction, in which event the relevant law of the State of Texas will nonetheless apply, with venue for litigation being in Houston, Texas.

**IN WITNESS WHEREOF** , the Company has caused this instrument to be executed by its duly authorized officer this \_\_\_\_ day of \_\_\_\_\_, 2008.

**BAKER HUGHES INCORPORATED**

By: \_\_\_\_\_  
Title: Vice President, Human Resources

**BAKER HUGHES INCORPORATED  
DIRECTOR COMPENSATION DEFERRAL PLAN  
(Amendment and Restatement  
Effective January 1, 2009)**

**Adopted by the Board of Directors on July 24, 2008**

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**BAKER HUGHES INCORPORATED**  
**DIRECTOR COMPENSATION DEFERRAL PLAN**  
**(Amendment and Restatement**  
**Effective January 1, 2009)**

**1. Purposes of the Plan; Definitions; Interpretation and Construction.**

1.1 **General** . The Baker Hughes Incorporated Director Compensation Deferral Plan, as amended and restated (the “ *Plan* ”), is intended to provide a means whereby non-employee directors of Baker Hughes Incorporated (the “ *Company* ”) may defer compensation otherwise payable and provide flexibility respecting the Company’s compensation policies.

1.2 **Definitions** .

“*Account(s)*” means all ledger accounts pertaining to a Participant or former Participant which are maintained by the Committee or Plan recordkeeper to reflect the Company’s obligation to the Participant or former Participant under the Plan. The Committee or Plan recordkeeper shall establish any subaccounts that the Committee or Plan recordkeeper consider necessary to reflect the entire interest of the Participant or former Participant under the Plan. Each of the subaccounts established by the Committee or Plan recordkeeper shall reflect credits and debits made to such subaccounts for earnings, losses, and distributions.

The Committee or Plan recordkeeper shall also maintain records that reflect a Participant’s or former Participant’s Grandfathered Amounts.

“*Affiliate* ” means any entity which is a member of (i) the same controlled group of corporations within the meaning of section 414(b) of the Code with Baker Hughes, (ii) a trade or business (whether or not incorporated) which is under common control (within the meaning of section 414(c) of the Code) with Baker Hughes or (iii) an affiliated service group (within the meaning of section 414(m) of the Code) with Baker Hughes.

“*Assets* ” means assets of any kind owned by Baker Hughes, including but not limited to securities of Baker Hughes’ direct and indirect subsidiaries and Affiliates.

“*Baker Hughes* ” means Baker Hughes Incorporated, a Delaware corporation, and any successor by merger or otherwise.

“*Beneficial Owner*” or “*Beneficial Ownership*” shall have the meaning ascribed to the term in Rule 13d-3 of the General Rules and Regulations under the Exchange Act.

“*Board*” or “*Board of Directors*” means the Board of Directors of the Company.

“*Change in Control*” means the occurrence of any of the following events:

(a) the individuals who are Incumbent Directors cease for any reason to constitute a majority of the members of the Board;

(b) the consummation of a Merger of Baker Hughes or an Affiliate with another Entity, unless the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger;

(c) any Person, other than a Specified Owner, becomes a Beneficial Owner, directly or indirectly, of securities of Baker Hughes representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities;

(d) a sale, transfer, lease or other disposition of all or substantially all of Baker Hughes' Assets is consummated (an "Asset Sale"), unless :

(1) the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes immediately prior to such Asset Sale own, directly or indirectly, 50 percent or more of the combined voting power of the Voting Securities of the Entity that acquires such Assets in such Asset Sale or its parent immediately after such Asset Sale in substantially the same proportions as their ownership of Baker Hughes' Voting Securities immediately prior to such Asset Sale; or

(2) the individuals who comprise the Board immediately prior to such Asset Sale constitute a majority of the board of directors or other governing body of either the Entity that acquired such Assets in such Asset Sale or its parent (or a majority plus one member where such board or other governing body is comprised of an odd number of directors); or

(e) The stockholders of Baker Hughes approve a plan of complete liquidation or dissolution of Baker Hughes.

"**Committee**" means the Compensation Committee of the Board or such other committee of the Board or the entire Board as the Board designates to administer the terms and provisions of the Plan, as specified in Section 2.

"**Common Stock**" means the Company's common stock, \$1.00 par value.

"**Compensation**" means a Director's annual retainer.

"**Deferral Vehicles**" has the meaning specified in Section 5.

"**Deferred Compensation**" means the Compensation and Retirement Income deferred by a Participant with respect to any calendar year pursuant to an election as provided in Section 4.

**“Designated Date”** has the meaning specified in Section 5.2.

**“Directors”** means all non-employee directors of the Company.

**“Disability”** means the inability of the Participant to engage in any substantial activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months.

**“Entity”** means any corporation, partnership, association, joint-stock company, limited liability company, trust, unincorporated organization or other business entity.

**“Exchange Act”** means the Securities Exchange Act of 1934, as amended.

**“Fair Market Value”** means the price per share of Common Stock, based on the composite transactions in the Common Stock as reported by The Wall Street Journal, and shall be equal to the per share price of the last sale of Common Stock on the trading day prior to the date of grant of the Stock Option.

**“Grandfathered Amounts”** means amounts deferred under the Plan that were earned and vested within the meaning of Section 409A prior to January 1, 2005 and earnings thereon.

**“Incumbent Director”** means —

(a) a member of the Board on July 24, 2008 or

(b) an individual —

(1) who becomes a member of the Board after July 24, 2008;

(2) whose appointment or election by the Board or nomination for election by Baker Hughes’ stockholders is approved or recommended by a vote of at least two-thirds of the then serving Incumbent Directors (as defined herein); and

(3) whose initial assumption of service on the Board is not in connection with an actual or threatened election contest.

**“Merger”** means a merger, consolidation or similar transaction.

**“Option Expiration Date”** has the meaning specified in Section 7.2.

**“Participant”** means an eligible Director who elects to become a participant in the Plan.

**“Person”** shall have the meaning ascribed to the term in Section 3(a)(9) of the Exchange Act and used in Sections 13(d) and 14(d) thereof, including a “group” as defined in Section 13(d) thereof, except that the term shall not include (a) Baker Hughes

or any of the Affiliates, (b) a trustee or other fiduciary holding Baker Hughes securities under an employee benefit plan of Baker Hughes or any of the Affiliates, (c) an underwriter temporarily holding securities pursuant to an offering of those securities or (d) a corporation owned, directly or indirectly, by the stockholders of Baker Hughes in substantially the same proportions as their ownership of stock of Baker Hughes.

**“Prime Rate Equivalents”** has the meaning specified in Section 5.2.

**“Retirement Income”** means retirement benefits pursuant to the Company’s Director Retirement Policy.

**“Section 409A”** means section 409A of the Internal Revenue Code of 1986, as amended and Department of Treasury and Internal Revenue Service rules and regulations issued thereunder.

**“Separation from Service”** has the meaning ascribed to that term in Section 409A.

**“S&P 500 Equivalents”** has the meaning specified in Section 5.2.

**“Shares”** means the shares of Common Stock reserved for issuance under the Plan.

**“Specified Owner”** means any of the following:

Baker Hughes;

(a) an Affiliate of Baker Hughes;

(b) an employee benefit plan (or related trust) sponsored or maintained by Baker Hughes or any Affiliate of Baker Hughes;

(c) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes’ then outstanding Voting Securities as a result of the acquisition of securities directly from Baker Hughes and/or its Affiliates; or

(d) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes’ then outstanding Voting Securities as a result of a Merger if the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger in substantially the same proportions as their ownership of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger.

**“Stock Option”** or **“Stock Options”** are the stock options issued to Participants in exchange for Deferred Compensation pursuant to Section 7, or if permitted by the Committee, pursuant to any other plan that would permit the grant of options under the Plan.

**“Stock Option Price”** means the price at which a Participant may purchase a Share pursuant to a Stock Option.

**“Unforeseeable Financial Emergency”** means a severe financial hardship of the Participant resulting from an illness or accident of the Participant or of the Participant’s spouse or dependent (as defined in section 152(a) of the Code), loss of the Participant’s property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by insurance), or other similar extraordinary and unforeseeable circumstance arising as a result of events beyond the control of the Participant. The circumstances that will constitute an Unforeseeable Financial Emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that the emergency is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Participant’s assets, to the extent the liquidation of such assets will not itself cause severe financial hardship. Such foreseeable needs for funds as the desire to send a Participant’s child to college or to purchase a home will not be considered to be unforeseeable emergencies. Whether an Unforeseeable Financial Emergency exists and the amount reasonably needed to satisfy the emergency will be determined by the Committee.

**“Voting Securities”** means the outstanding securities entitled to vote generally in the election of directors or other governing body.

**1.3 Interpretation and Construction** . As used in the Plan, unless the context otherwise expressly requires to the contrary, references to the singular include the plural, and vice versa; references to the masculine include the feminine and neuter; references to “including” mean “including (without limitation),” and references to Sections mean the sections of the Plan.

## **2. Administration .**

The Plan shall be administered by the Committee. The Committee is authorized to interpret the Plan and may, from time to time, adopt such rules and regulations, consistent with the provisions of the Plan, as it may deem advisable to carry out the Plan. All determinations made by the Committee shall be final. No member of the Committee shall have any right to vote or decide upon any matter relating to himself under the Plan or to vote in any case in which his individual right to claim any benefit under the Plan is particularly involved. The Committee may delegate to the Vice President of Human Resources or other officer of the Company its duties for the day-to-day administration of the Plan, including accepting deferral elections and accounting for deferrals and distributions under the Plan. All expenses incurred in connection with the administration of the Plan shall be borne by the Company.

All determinations and decisions made by the Committee and the Board pursuant to the provisions of the Plan and all related orders and resolutions of the Committee and the Board shall be final, conclusive and binding on all persons, including the Company, its stockholders, Directors, Participants and the estates and beneficiaries of Directors and Participants.

### **3. Participation in the Plan.**

**3.1 Eligibility** . Directors shall be eligible to participate in the Plan. An individual shall be considered to be a Director until the close of business on the day preceding the earlier of the first date the individual (1) becomes a common-law employee of the Company or its subsidiaries or (2) ceases to be a member of the Board for any reason whatsoever.

**3.2 Election to Participate** . An eligible Director may elect to become a Participant by electing to defer an integral percentage (from 1% to 100%) of his Compensation. All elections shall be made in the form and manner prescribed by the Committee.

### **4. Compensation Deferrals.**

**4.1 Time of Elections.** Compensation deferral elections shall be made with respect to each calendar year. Except as specified in the following paragraph, any election by a Participant to defer Compensation under the Plan must be made on or before the December 31st preceding the calendar year to which the election relates or such earlier date as the Committee may determine. Any such election shall apply to the Participant's Compensation for the period commencing on January 1st of the applicable calendar year and ending upon December 31st of such calendar year.

If a directorship commences during a calendar year, any deferral election with respect to the first year of the directorship must be made by the Director within thirty (30) days of the date he or she first becomes a Director. Any such deferral election will apply commencing on the date he or she first becomes a Director to the Participant's Compensation for services performed subsequent to the election during the calendar year in which he or she first becomes a Director.

**4.2 Irrevocability of Elections.** Any election to defer Compensation which may be made by a Participant shall be irrevocable once made with respect to the calendar year. Any election to defer Compensation made by a Participant with respect to any calendar year shall be deemed to have been made with respect to each subsequent calendar year, unless the Participant changes such election prior to the expiration of the time for making the election with respect to the subsequent calendar year.

**4.3 Retirement Income Deferrals** . Deferrals of Retirement Income were allowed prior to January 1, 2002. Amounts attributable to such deferrals shall be paid in accordance with the Participants' Retirement Income deferral elections made hereunder prior to January 1, 2002.

## 5. Election of Deferral Vehicles.

At the time of making a deferral election, a Participant shall select one or more deferral vehicles (“*Deferral Vehicles*”) for the Participant’s Deferred Compensation respecting the applicable calendar year or years as described in Sections 5.1 and 5.2.

**5.1 Stock Option-Related Deferral Vehicles** . The Participant’s Deferred Compensation shall be exchanged for Stock Options. All Stock Options granted in exchange for Deferred Compensation under the Plan shall be subject to all of the applicable terms and provisions of the Plan or such other plan from which the Stock Option is granted.

If Stock Options are elected, the Participant’s aggregate Deferred Compensation as of the last day of each calendar quarter which would otherwise have been paid during such quarter shall be increased by a multiplier of 4.4 and then divided by the Fair Market Value of the Company’s Common Stock on the last day of such quarter to determine the number of Stock Options to be granted in exchange for the Deferred Compensation.

**5.2 Cash-Based Deferral Vehicles** . The Participant’s Deferred Compensation shall be credited to an Account established by the Committee as of the date or dates the Deferred Compensation would otherwise have been paid. A Participant who elects a Cash-Based Deferral Vehicle shall also elect whether to receive Prime Rate Equivalents or S&P 500 Equivalents for the deferral period that commences on the date or dates such Deferred Compensation is credited to the Account and ending on the Designated Date. All Deferred Compensation and interest and earnings equivalents credited to an Account shall be nonforfeitable pending payment as of the Designated Date.

(a) Prime Rate Equivalents . To the extent Prime Rate Equivalents are elected, interest equivalents will be credited to the Participant’s Account as of the last day of each calendar month based upon the average daily balance in the Account for the month and the prime lending rate as declared by Citibank, or such other lending institution as is selected by the Committee, to be in effect from time to time.

(b) S&P 500 Equivalents . To the extent S&P 500 Equivalents are elected, the earnings (or loss) equivalents will be credited (or debited) to the Participant’s Account as of the last day of each calendar quarter based upon the balance in the Account as of the last day of the quarter and the returns realized by the Standard & Poor’s 500 Index for the quarter.

(c) Designated Date . At the time of making a deferral election, a Participant shall specify the applicable time of payment of the Deferred Compensation (a “*Designated Date*”).

(1) Any Designated Date respecting Deferred Compensation subject to Prime Rate Equivalents shall be as of the last day of a calendar month.

(2) Any Designated Date respecting Deferred Compensation subject to S&P 500 Equivalents shall be as of the last day of a calendar quarter.

(3) Except with respect to Grandfathered Amounts, a Designated Date must be either (a) a specified date or (b) a date that follows the occurrence of the Participant's Separation from Service; provided, however, that in no event shall a Designated Date be more than ten years from the date of the Participant's Separation from Service.

## **6. Shares Available for Stock Options .**

**6.1 Number of Shares Available for Stock Options .** Subject to adjustment as provided in Section 6.2, the number of Shares of Common Stock reserved for issuance to Participants under the Plan shall be up to 500,000. These Shares may consist of authorized but unissued Shares or previously issued Shares reacquired by the Company as treasury shares. The number of Shares that are the subject of Stock Options under this Plan that are forfeited or terminated or expire unexercised shall again immediately become available to be issued as Stock Options under this Plan. Shares approved pursuant to the Long Term Incentive Plan of Baker Hughes Incorporated, as amended, and the Baker Hughes Incorporated 1998 Employee Stock Option Plan, as amended, that have not been awarded under such plans, including Shares that are canceled, terminated, expired unexercised, settled in cash in lieu of Shares or in a manner such that all or some of the Shares covered thereby are not issued to a participant or are exchanged for a consideration that does not involve Shares, and Shares that are so canceled, terminated, expired unexercised, settled in cash in lieu of Shares or in a manner such that all or some of the Shares covered thereby are not issued to a participant or are exchanged for a consideration that does not involve Shares, and Shares that are so canceled, terminated, expired unexercised, settled in cash in lieu of Shares or in a manner such that all or some of the Shares covered thereby are not issued to a participant or are exchanged for a consideration that does not involve Shares, will immediately become available for Stock Options under this Plan. The Shares described in the foregoing sentence shall be included in the up to 500,000 Shares reserved for issuance under this Plan. The Committee shall determine the appropriate methodology for calculating the number of Shares issued pursuant to this Plan.

**6.2 Adjustments in Authorized Shares .** The existence of outstanding Stock Options shall not affect in any manner the right or power of the Company or its stockholders to make or authorize any or all adjustments, recapitalizations, reorganizations or other changes in the capital stock of the Company or its business or any merger or consolidation of the Company, or any issue of bonds, debentures, preferred or prior preference stock (whether or not such issue is prior to, on a parity with or junior to the Shares) or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business or any other corporate act or proceeding of any kind, whether or not of a character similar to that of the acts or proceedings enumerated above.

If there shall be any change in the Shares of the Company or the capitalization of the Company through merger, consolidation, reorganization, recapitalization, stock dividend, stock split, reverse stock split, split up, spin-off, combination of shares, exchange of shares, dividend in kind or other like change in capital structure or distribution (other than normal cash dividends) to stockholders of the Company, the

Board, in its sole discretion, to prevent dilution or enlargement of Participants' rights under the Plan, shall adjust, in an equitable manner, as applicable, the number and kind of Shares that may be issued under the Plan, the number and kind of Shares subject to outstanding Stock Options and other value determinations applicable to outstanding Stock Options. In the event of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation, the Board shall be authorized to issue or assume Stock Options by means of substitution of new Stock Options, as appropriate, for previously issued Stock Options.

## **7. Stock Options .**

**7.1 Calculation of Exercise Price .** The exercise price to be paid for each share of Common Stock deliverable upon exercise of each Stock Option granted shall be equal to the Fair Market Value per share of Common Stock at the time of grant as determined by the Committee. The exercise price for each Stock Option shall be subject to adjustment as provided in Section 6.2.

**7.2 Terms and Conditions of Options .** Stock Options shall be in such form as the Committee may from time to time approve and shall be subject to the following terms and conditions:

(a) **Exercise Periods for Stock Options .** Each Stock Option shall vest and become exercisable on the first anniversary of the date of grant. Each Stock Option shall be exercisable from time to time, in whole or in part, at any time after one year from the date of grant and prior to the date which is ten years after the date of grant, subject to the provisions of clause (b) of this Section 7.2 (the "*Option Expiration Date*").

(b) **Exercise Periods in the Event of Directorship Termination .** A Director's directorship shall terminate at the close of business on the day preceding the day he or she ceases to be a member of the Board for any reason whatsoever. When a Director's directorship is terminated, each of his or her Stock Options and all rights thereunder shall expire three years after the Director's directorship terminates for any reason. Any Stock Options unexercised at the time of the Director's death (including the Director's death which results in termination of his or her directorship or the Director's death during the three-year period after his or her directorship terminates) may be exercised by the Director's estate or by the Person or Persons who acquire the right to exercise his or her Stock Option by bequest or inheritance.

(c) **Transferability of Stock Options .** Except as otherwise provided in the Stock Option agreement, no Stock Option may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution. Further, except as otherwise provided in the Stock Option agreement, all Stock Options granted under the Plan shall be exercisable during his or her lifetime only by the Participant. Any attempted assignment of a Stock Option in violation of this Section shall be null and void.

(d) **Payment of Stock Option Price** . Stock Options granted under the Plan shall be exercised in the form and manner as the Committee shall determine from time to time.

Upon the exercise of any Stock Option, the Stock Option Price shall be payable to the Company in full either (i) in cash or its equivalent; (ii) by tendering previously acquired Shares having an aggregate fair market value at the time of exercise equal to the total Stock Option Price (provided that the Shares that are tendered must have been held by the Participant for at least six months prior to their tender to satisfy the Stock Option Price); (iii) by a combination of (i) and (ii); or (iv) any other method approved by the Committee in its sole discretion at the time of grant and as set forth in the Stock Option.

Subject to any governing rules or regulations, after the exercise of the Stock Option and full payment of the Stock Option Price in the form and manner as the Committee shall determine, the Director may pay the required fee and request a Share certificate based upon the number of Shares purchased under the Stock Option through the third-party administrator designated by the Committee to have this administrative duty. In addition, the Company may, at its option, issue or cause to be issued Share certificates.

Unless otherwise determined by the Committee, all payments under all of the methods indicated above shall be paid in United States dollars.

(e) **Listing and Registration of Shares** . Each Stock Option shall be subject to the requirement that if at any time the Committee determines, in its discretion, that the listing, registration or qualification under the regulations of any securities exchange or under any state or federal law of the Shares subject to the Stock Option, or the consent or approval of any governmental regulatory body, is necessary or desirable as a condition of, or in connection with, the issue or purchase of the Shares under such Stock Option, the Stock Option may not be exercised in whole or in part unless such listing, registration, qualification, consent or approval shall have been effected or obtained and the same shall have been free of any conditions not acceptable to the Committee.

(f) **Amendment** . The Committee may, with the consent of the Person or Persons entitled to exercise any outstanding Stock Option, amend such Stock Option; provided, however, that any such amendment shall be subject to stockholder approval when required. No amendment shall be made to an Option to extend the period of exercisability of the Option if such amendment would cause the Participant to become subject to taxation under Section 409A.

(g) **Investment Representations** . As a condition to the exercise of a Stock Option, the Company may require the person exercising such Stock Option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

(h) **Uncertificated Shares** . To the extent that the Plan provides for issuance of certificates to reflect the transfer of Shares, the transfer of such Shares may be effected on a noncertificated basis, to the extent not prohibited by applicable law or the rules of any stock exchange.

(i) **No Fractional Shares** . No fractional Shares shall be issued or delivered pursuant to the Plan or any Stock Option agreement. The Committee shall determine whether cash or other property shall be issued or paid in lieu of fractional Shares or whether such fractional Shares or any rights thereto shall be forfeited or otherwise eliminated.

(j) **Other Provisions** .

(i) The person or persons entitled to exercise, or who have exercised, a Stock Option shall not be entitled to any rights as a stockholder of the Company with respect to any Shares subject to such Stock Option until he or she shall have become the holder of record of such Shares.

(ii) No Stock Option shall be construed as limiting any right which either the Company's stockholders or the Board of Directors may have to remove at any time from the Board of Directors, with or without cause, any person to whom such Stock Option has been granted.

(iii) Notwithstanding any provision of the Plan or the terms of any Stock Option agreement, the Company shall not be required to issue any Shares hereunder if such issuance would, in the judgment of the Committee, constitute a violation of any state or federal law or of the rules or regulations of any governmental regulatory body.

(iv) Notwithstanding any provision of the Plan, the Committee may not exercise any discretion with respect to this Section 7 which would be inconsistent with the intent that the Plan meet the requirements of Rule 16b-3 promulgated by the Securities Exchange Commission under the Exchange Act.

**8. Payment of Amounts in Accounts** .

**8.1 Payment Generally** . Except as otherwise provided in this Section 8, the Deferred Compensation and interest and earnings equivalents credited to a Participant's Account(s) with respect to a calendar year or years, as applicable, shall be paid in cash to the Participant in one lump sum as of the Designated Date elected by the Participant. In the absence of a valid election of a Designated Date by the Participant, effective as of the date of the Participant's deferral election for the applicable calendar year, the Participant's Designated Date for such calendar year shall be deemed to be the date of the Participant's Separation From Service.

**8.2 Payment of Simultaneous Amounts** . It is recognized that a Participant may elect to defer Compensation with respect to more than one calendar year, so that Deferred Compensation and interest and earnings equivalents are credited to the Participant's Accounts with respect to more than one calendar year, and the payment of such amounts with respect to more than one calendar year may, but need not, become payable to the Participant as of the same Designated Date.

**8.3 Unforeseeable Financial Emergency** . In the event that the Committee, upon written petition of a Participant, determines in its sole discretion that such Participant has suffered an Unforeseeable Financial Emergency, such Participant shall be entitled to a distribution in an amount not to exceed the lesser of (a) the amount determined by the Committee as necessary to meet such Participant's needs created by the Unforeseeable Financial Emergency or (b) the then value of such Participant's interest in his or her Accounts. Such benefit shall be paid in a single lump sum payment as soon as administratively practicable after the Committee has made its determination with respect to the availability and amount of such benefit. If a Participant's Accounts contain more than one distribution subaccount, such benefit shall be considered to have been distributed, first, from the subaccount with respect to which the earliest distribution would be made, then, from the subaccount with respect to which the next earliest distribution would be made, and continuing in such manner until the amount of such distribution has been satisfied.

**8.4 Disability** . In the event of the Disability of the Participant, as determined in the sole discretion of the Committee, all cash payments that would otherwise be made on a later Designated Date under this Section 8 shall be accelerated by being made as soon as practicable, following the Committee's determination of such Disability, in one lump sum.

**8.5 Death** . In the event of the death of the Participant, all of the cash payments that would otherwise be made on later Designated Date under this Section 8, shall be accelerated by being made as soon as practicable following the death of the Participant. A Participant, by written instrument filed with the Committee in such manner and form as it may prescribe, may designate one or more beneficiaries to receive payment of the Participant's Deferred Compensation and interest or earnings equivalents in the event of the death of the Participant. Any such beneficiary designation may be changed from time to time prior to the death of the Participant. In the absence of a beneficiary designation on file with the Committee at the time of the Participant's death, the Deferred Compensation and interest or earnings equivalents remaining to be paid to the Participant shall be paid to the executor or administrator of the Participant's estate.

**8.6 Debiting of Plan Accounts** . Once Deferred Compensation and interest or earnings equivalents have been paid, such amounts shall be debited from the Participant's Account, and the Company shall no longer be accountable for such paid amounts.

**9. Prohibition Against Assignment or Encumbrance.**

No right, title, interest or benefit hereunder shall ever be liable for or charged with any of the torts or obligations of a Participant or any Person claiming under a Participant, or be subject to seizure by any creditor of a Participant or any Person claiming under a Participant. Except as to the selection of a “designated beneficiary” in the event of death, no Participant or any Person claiming under a Participant shall have the power to anticipate or dispose of any right, title, interest or benefit hereunder in any manner until the same shall have been actually distributed free and clear of the terms of the Plan.

**10. Amendment and Termination of the Plan.**

Subject to the terms of the Plan, the Committee may at any time and from time to time alter, amend, modify, suspend or terminate the Plan in whole or in part, except that no amendment, modification, suspension or termination that would adversely affect in any material way the rights of any Participant under any Stock Option previously granted to such Participant under the Plan shall be made without the written consent of such Participant or to the extent stockholder approval is otherwise required by applicable legal requirements. The Committee may terminate the Plan at any time with respect to periods following the date such termination is effected. No amounts may be paid to a Participant or former Participant under the Plan to the extent such a payment would be an acceleration of payment of deferred compensation prohibited by Section 409A.

**11. Nature of the Plan.**

The Plan constitutes an unfunded, unsecured liability of the Company to provide benefits in accordance with the provisions hereof. The Company, at its election, may fund the payment of benefits under the Plan by setting aside and investing, in an account on the Company’s books, such funds as the Company may, from time to time, determine. Neither the establishment of the Plan, the crediting of amounts to Accounts nor the setting aside of any funds shall be deemed to create a trust. Legal and equitable title to any funds set aside pursuant to the Plan shall remain in the Company, and neither the Participants nor any persons claiming under the Participants shall have any security or other interest in such funds. Any funds so set aside or acquired shall remain subject to the claims of the creditors of the Company, present and future. The Plan is not subject to Employee Retirement Income Security Act of 1974, as amended.

**12. Reorganization.**

The Company shall not merge or consolidate with any other entity or entities, liquidate, dissolve, reorganize, or sell substantially all of its assets and business unless and until a succeeding or continuing entity or entities agrees to assume and discharge the obligations of the Company under this Agreement. Upon the occurrence of such an event, the term “Company” as used in this Agreement shall be deemed to refer to such successor or survivor entity or entities.

### **13. Acceleration of Vesting of Stock Options .**

Notwithstanding any provision of the Plan to the contrary, in the event of an occurrence of a Change in Control, all Stock Options granted pursuant to the Plan shall become fully vested and immediately exercisable.

### **14. Miscellaneous .**

14.1 **Severability** . If any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

14.2 **Requirements of Law** . The issuance of Shares under the Plan shall be subject to all applicable laws, rules and regulations and to such approvals by any governmental agencies or national securities exchanges as may be required. The Company shall receive the consideration required by law for the issuance of Shares under the Plan.

14.3 **Securities Law Compliance** . All transactions under the Plan are intended to comply with all applicable conditions of Rule 16b-3 or its successor under the Exchange Act, unless determined otherwise by the Board. To the extent any provision of the Plan or action by the Board fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by the Board.

14.4 **Compliance With Section 409A** . Except with respect to Grandfathered Amounts, the Plan shall be operated in compliance with Section 409A and the provisions of Section 409A shall override any provisions of the Plan to the extent that they are inconsistent with Section 409A. Except with respect to Grandfathered Amounts the terms of this Agreement reflect the manner in which the Plan has been operated in good faith compliance with Section 409A since January 1, 2005.

14.5 **Governing Law** . The Plan shall be governed by the laws of the State of Texas, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of the Plan to the substantive law of another jurisdiction.

**AMENDMENT TO  
BAKER HUGHES INCORPORATED  
2002 DIRECTOR & OFFICER LONG-TERM INCENTIVE PLAN**

**THIS AGREEMENT** by Baker Hughes Incorporated,

**WITNESSETH:**

**WHEREAS** , effective as of March 6, 2002, the Board of Directors of Baker Hughes Incorporated (the “ *Board of Directors* ”) adopted the Baker Hughes Incorporated 2002 Director & Officer Long-Term Incentive Plan (the “ *Plan* ”);

**WHEREAS** , the Board of Directors reserved the right in Section 15.1 to amend the Plan; and

**WHEREAS** , the Board of Directors has determined to amend the Plan to bring the Plan into documentary compliance with section 409A of the Internal Revenue Code of 1986, as amended;

**NOW, THEREFORE** , the Board of Directors agrees that effective July 24, 2008, the Plan is amended as follows:

1. Section 2.1 of the Plan is hereby amended by adding the following new capitalized terms thereto:

“ **Assets** ” means assets of any kind owned by Baker Hughes, including but not limited to securities of Baker Hughes’ direct and indirect subsidiaries and Affiliates.

“ **Baker Hughes** ” means Baker Hughes Incorporated, a Delaware corporation, and any successor by merger or otherwise.

“ **Disability** ” shall mean (a) the inability of the Grantee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or (b) by reason of any medically determinable physical or mental impairment of the Grantee which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, the receipt by the Grantee of income replacement benefits for a period of not less than three months under an accident or health plan covering employees of

the Company or any Affiliate of the Company that is required to be treated as a single employer together with the Company under section 414 of the Code.

**“Dividend Equivalent”** means a payment equivalent in amount to dividends paid to the Company’s stockholders.

**“Entity”** means any corporation, partnership, association, joint-stock company, limited liability company, trust, unincorporated organization or other business entity.

**“Incumbent Director”** means —

(a) a member of the Board on July 24, 2008 or

(b) an individual —

(1) who becomes a member of the Board after July 24, 2008;

(2) whose appointment or election by the Board or nomination for election by Baker Hughes’ stockholders is approved or recommended by a vote of at least two-thirds of the then serving Incumbent Directors (as defined herein); and

(3) whose initial assumption of service on the Board is not in connection with an actual or threatened election contest.

**“Grantee”** means the person to whom an Award is granted.

**“Merger”** means a merger, consolidation or similar transaction.

**“Section 409A”** means section 409A of the Code and Department of Treasury rules and regulations issued thereunder.

**“Specified Owner”** means any of the following:

Baker Hughes;

(a) an Affiliate of Baker Hughes;

(b) an employee benefit plan (or related trust) sponsored or maintained by Baker Hughes or any Affiliate of Baker Hughes;

(c) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes’ then outstanding Voting Securities as a result of the acquisition of securities directly from Baker Hughes and/or its Affiliates; or

(d) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined

voting power of Baker Hughes' then outstanding Voting Securities as a result of a Merger if the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger in substantially the same proportions as their ownership of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger.

“ **Substantial Risk of Forfeiture** ” shall have the meaning ascribed to that term in Section 409A.

2. Effective for Awards granted under the Plan on or after July 24, 2008, the definition of “Change in Control” in Section 2.1 of the Plan is hereby amended by adding at the end thereof the following provisions:

Notwithstanding the foregoing, effective for Awards granted under the Plan on or after July 24, 2008, “Change in Control” means the occurrence of any of the following events:

(a) the individuals who are Incumbent Directors cease for any reason to constitute a majority of the members of the Board;

(b) the consummation of a Merger of Baker Hughes or an Affiliate with another Entity, unless the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger;

(c) any Person, other than a Specified Owner, becomes a Beneficial Owner, directly or indirectly, of securities of Baker Hughes representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities;

(d) a sale, transfer, lease or other disposition of all or substantially all of Baker Hughes' Assets is consummated (an “ *Asset Sale* ”), *unless* :

(1) the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes immediately prior to such Asset Sale own, directly or indirectly, 50 percent or more of the combined voting power of the Voting Securities of the Entity that acquires such Assets in such Asset Sale or its parent immediately after such Asset Sale in substantially the same proportions as their ownership of Baker Hughes' Voting Securities immediately prior to such Asset Sale; or

(2) the individuals who comprise the Board immediately prior to such Asset Sale constitute a majority of the board of directors or other governing body of either the Entity that acquired such Assets in such Asset Sale or its parent (or a majority plus one member where such board or other governing body is comprised of an odd number of directors); or

(e) The stockholders of Baker Hughes approve a plan of complete liquidation or dissolution of Baker Hughes.

3. The third sentence of Section 3.2 of the Plan is hereby completely amended to provide as follows:

Subject to the provisions of Section 18.14, in its discretion, the Committee may provide for the extension of the exercisability of an Award to an Employee, accelerate the vesting or exercisability of an Award to an Employee, eliminate or make less restrictive any restrictions contained in an Award to an Employee, waive any restriction or other provision of the Plan (insofar as such provision relates to Awards to Employees) or an Award to an Employee, or otherwise amend or modify an Award to an Employee in any manner that is either (i) not adverse to the Participant to whom the Award to an Employee was granted or (ii) to which the Participant consents.

4. Section 6.1 of the Plan is hereby amended by adding the following sentence at the end thereof:

An Option granted under the Plan on or after January 1, 2005 may not be granted with any Dividend Equivalents rights.

5. Section 7.1 of the Plan is hereby amended by adding the following sentence at the end thereof:

Effective for SARs granted under the Plan on or after January 1, 2005, a SAR granted under the Plan may not be granted with any Dividend Equivalents rights.

6. Section 8.6 of the Plan is hereby completely amended to provide as follows:

**8.6 Dividends and Other Distributions.** During the Period of Restriction, Participants holding Shares of Restricted Stock granted hereunder may, if the Committee (or the Board with respect to Awards granted to Directors) so determines, be credited with dividends paid with respect to the underlying Shares while they are so held in a manner determined by the Committee (or the Board with respect to Awards granted to Directors) in its sole discretion. The Committee (or the Board with respect to Awards granted to Directors) may apply any restrictions to the dividends that it deems appropriate. Effective for Restricted Stock Awards granted under the Plan on or after January 1, 2005, an Award Agreement for a Restricted Stock Unit Award may specify that the holder of the Award shall be entitled to the payment of Dividend Equivalents under the Award in a manner determined by the Committee in its sole discretion.

7. Article 8 of the Plan is hereby amended by adding the following new Section 8.8 at the end thereof:

**8.8 Time of Payment Under Restricted Stock Unit Award.** Effective for Awards granted on or after January 1, 2005, a payment under a Restricted Stock Unit Award shall be made at such time as is specified in the applicable Award Agreement. The Award Agreement shall specify that the payment will be made (a) by a date that is no later than the date that is two and one-half (2 1/2) months after the end of the Fiscal Year in which the Restricted Stock Unit Award payment is no longer subject to a Substantial Risk of Forfeiture or (b) at a time that is permissible under Section 409A.

8. Section 9.4 of the Plan is hereby completely amended to provide as follows:

**9.4 Form and Timing of Payment of Performance Units/Shares and Cash-Based Awards .** Payment of earned Performance Shares and Cash-Based Awards shall be as the Committee determines and as set forth in the Award Agreement. Payment under a Performance Unit Award or a Cash-Based Award shall be made at such time as is specified in the applicable Award Agreement. Effective for Performance Unit Awards and Cash-Based Awards granted under the Plan on or after January 1, 2005, the Award Agreement for the Award shall specify that the payment will be made (a) by a date that is no later than the date that is two and one-half (2 1/2) months after the end of the calendar year in which the Award payment is no longer subject to a Substantial Risk of Forfeiture or (b) at a time that is permissible under Section 409A.

Subject to the terms of the Plan, the Committee, in its sole discretion, may pay earned Performance Units/Shares and Cash-Based Awards in the form of cash or in Shares (or in a combination thereof) that have an aggregate Fair Market Value equal to the value of the earned Performance Units/Shares and Cash-Based Awards at the close of the applicable Performance Period. Such Shares may be granted subject to any restrictions deemed appropriate by the Committee.

An Award Agreement for a Performance Unit Award may specify that the Holder shall be entitled to the payment of Dividend Equivalents under the Award.

9. Article 12 of the Plan is hereby completely amended to provide as follows:

**Article 12 Deferrals .**

Subject to Section 18.14, the Committee (or the Board with respect to Awards granted to Directors) may permit or require a Participant to defer such Participant's receipt of the payment of cash or the delivery of Shares that would otherwise be due to such Participant by virtue of the lapse or waiver of restrictions with respect to Restricted Stock/Units or the satisfaction of any requirements or goals with respect to Performance Units/Shares, Cash-Based Awards and Stock Awards. If any such deferral election is required or permitted, the Committee (or

the Board with respect to Awards granted to Directors) shall, in its sole discretion, establish rules and procedures for such payment deferrals.

10. Article 14 of the Plan is hereby completely amended to provide as follows:

**Article 14 Acceleration.**

**14.1 Change in Control** . Notwithstanding any provision of the Plan to the contrary, in the event of an occurrence of a Change in Control all then outstanding Options, SARs, and Restricted Stock Awards granted under the Plan (other than Restricted Stock Awards that are transferred or vest contingent upon the achievement of performance goals) shall become fully vested, and exercisable and all substantial risk of forfeiture restrictions applicable thereto shall lapse. The effect, if any, of a Change in Control upon any other Award granted under the Plan shall be determined in accordance with the terms of the applicable Award Agreement and any related Terms and Conditions issued by the Committee that are applicable to the Award.

**14.2 Termination** . Notwithstanding any provision of the Plan to the contrary, if (a) an Employee's employment is terminated by the Company without Cause prior to a Change in Control (whether or not a Change in Control ever occurs) and such termination was at the request or direction of a Person who has entered into an agreement with the Company the consummation of which would constitute a Change in Control, (b) such Employee terminates his or her employment for Good Reason prior to a Change in Control (whether or not a Change in Control ever occurs) and the circumstance or event which constitutes Good Reason occurs at the request or direction of the Person described in clause (a), (c) such Employee's employment is terminated by the Company without Cause or by the Employee for Good Reason and such termination or the circumstance or event which constitutes Good Reason is otherwise in connection with or in anticipation of a Change in Control (whether or not a Change in Control ever occurs) or (d) such Employee's employment is terminated by the Company without Cause or by the Employee for Good Reason, in either case within two years following the occurrence of a Change in Control then, effective as of the effective date of the Employee's termination of employment, all outstanding Options, SARs, and Restricted Stock Awards granted under the Plan (other than Restricted Stock Awards that are transferred or will vest contingent upon the achievement of performance goals) shall become fully vested, and exercisable and all substantial risk of forfeiture restrictions applicable thereto shall lapse.

11. Article 18 of the Plan is hereby amended by adding thereto the following new Section 18.14:

**18.14 Compliance With Section 409A.** Awards shall be designed, granted and administered in such a manner that they are either exempt from the application of, or comply with, the requirements of Section 409A. If the

Committee determines that an Award, Award Agreement, payment, distribution, deferral election, transaction, or any other action or arrangement contemplated by the provisions of the Plan would, if undertaken or implemented, cause a Holder to become subject to additional taxes under Section 409A, then unless the Committee specifically provides otherwise, such Award, Award Agreement, payment, distribution, deferral election, transaction or other action or arrangement shall not be given effect to the extent it causes such result and the related provisions of the Plan and/or Award Agreement will be deemed modified, or, if necessary, suspended in order to comply with the requirements of Section 409A to the extent determined appropriate by the Committee, in each case without the consent of or notice to the Holder. The exercisability of an Option shall not be extended to the extent that such extension would subject the Holder to additional taxes under Section 409A. This Section 18.14 is effective for Awards granted under the Plan that are earned and vested on or after January 1, 2005.

**Adopted by the Board of Directors  
on July 24, 2008**

**AMENDMENT TO  
BAKER HUGHES INCORPORATED  
2002 EMPLOYEE LONG-TERM INCENTIVE PLAN**

**THIS AGREEMENT** by Baker Hughes Incorporated,

**WITNESSETH:**

**WHEREAS** , effective as of March 6, 2002, the Board of Directors of Baker Hughes Incorporated (the “ *Board of Directors* ”) adopted the Baker Hughes Incorporated 2002 Employee Long-Term Incentive Plan (the “ *Plan* ”);

**WHEREAS** , the Board of Directors reserved the right in Section 15.1 to amend the Plan; and

**WHEREAS** , the Board of Directors has determined to amend the Plan to bring the Plan into documentary compliance with section 409A of the Internal Revenue Code of 1986, as amended;

**NOW, THEREFORE** , the Board of Directors agrees that effective July 24, 2008, the Plan is amended as follows:

1. Section 2.1 of the Plan is hereby amended by adding the following new capitalized terms thereto:

“ **Assets** ” means assets of any kind owned by Baker Hughes, including but not limited to securities of Baker Hughes’ direct and indirect subsidiaries and Affiliates.

“ **Baker Hughes** ” means Baker Hughes Incorporated, a Delaware corporation, and any successor by merger or otherwise.

“ **Disability** ” shall mean (a) the inability of the Grantee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or (b) by reason of any medically determinable physical or mental impairment of the Grantee which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, the receipt by the Grantee of income replacement benefits for a period of not less than three months under an accident or health plan covering employees of

the Company or any Affiliate of the Company that is required to be treated as a single employer together with the Company under section 414 of the Code.

**“Dividend Equivalent”** means a payment equivalent in amount to dividends paid to the Company’s stockholders.

**“Entity”** means any corporation, partnership, association, joint-stock company, limited liability company, trust, unincorporated organization or other business entity.

**“Incumbent Director”** means —

(a) a member of the Board on July 24, 2008 or

(b) an individual —

(1) who becomes a member of the Board after July 24, 2008;

(2) whose appointment or election by the Board or nomination for election by Baker Hughes’ stockholders is approved or recommended by a vote of at least two-thirds of the then serving Incumbent Directors (as defined herein); and

(3) whose initial assumption of service on the Board is not in connection with an actual or threatened election contest.

**“Grantee”** means the person to whom an Award is granted.

**“Merger”** means a merger, consolidation or similar transaction.

**“Section 409A”** means section 409A of the Code and Department of Treasury rules and regulations issued thereunder.

**“Specified Owner”** means any of the following:

Baker Hughes;

(a) an Affiliate of Baker Hughes;

(b) an employee benefit plan (or related trust) sponsored or maintained by Baker Hughes or any Affiliate of Baker Hughes;

(c) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes’ then outstanding Voting Securities as a result of the acquisition of securities directly from Baker Hughes and/or its Affiliates; or

(d) a Person that becomes a Beneficial Owner of Baker Hughes’ outstanding Voting Securities representing 30 percent or more of the combined

voting power of Baker Hughes' then outstanding Voting Securities as a result of a Merger if the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger in substantially the same proportions as their ownership of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger.

“ **Substantial Risk of Forfeiture** ” shall have the meaning ascribed to that term in Section 409A.

2. Effective for Awards granted under the Plan on or after July 24, 2008, the definition of “Change in Control” in Section 2.1 of the Plan is hereby amended by adding at the end thereof the following provisions:

Notwithstanding the foregoing, effective for Awards granted under the Plan on or after July 24, 2008, “Change in Control” means the occurrence of any of the following events:

(a) the individuals who are Incumbent Directors cease for any reason to constitute a majority of the members of the Board;

(b) the consummation of a Merger of Baker Hughes or an Affiliate with another Entity, unless the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger;

(c) any Person, other than a Specified Owner, becomes a Beneficial Owner, directly or indirectly, of securities of Baker Hughes representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities;

(d) a sale, transfer, lease or other disposition of all or substantially all of Baker Hughes' Assets is consummated (an “ *Asset Sale* ”), *unless* :

(1) the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes immediately prior to such Asset Sale own, directly or indirectly, 50 percent or more of the combined voting power of the Voting Securities of the Entity that acquires such Assets in such Asset Sale or its parent immediately after such Asset Sale in substantially the same proportions as their ownership of Baker Hughes' Voting Securities immediately prior to such Asset Sale; or

(2) the individuals who comprise the Board immediately prior to such Asset Sale constitute a majority of the board of directors or other governing body of either the Entity that acquired such Assets in such Asset Sale or its parent (or a majority plus one member where such board or other governing body is comprised of an odd number of directors); or

(e) The stockholders of Baker Hughes approve a plan of complete liquidation or dissolution of Baker Hughes.

3. The third sentence of Section 3.2 of the Plan is hereby completely amended to provide as follows:

Subject to the provisions of Section 18.14, in its discretion, the Committee may provide for the extension of the exercisability of an Award, accelerate the vesting or exercisability of an Award, eliminate or make less restrictive any restrictions contained in an Award, waive any restriction or other provision of the Plan or an Award, or otherwise amend or modify an Award in any manner that is either (i) not adverse to the Participant to whom the Award was granted or (ii) to which the Participant consents.

4. Section 6.1 of the Plan is hereby amended by adding the following sentence at the end thereof:

An Option granted under the Plan on or after January 1, 2005 may not be granted with any Dividend Equivalents rights.

5. Section 7.1 of the Plan is hereby amended by adding the following sentence at the end thereof:

Effective for SARs granted under the Plan on or after January 1, 2005, a SAR granted under the Plan may not be granted with any Dividend Equivalents rights.

6. Section 8.6 of the Plan is hereby completely amended to provide as follows:

**8.6 Dividends and Other Distributions.** During the Period of Restriction, Participants holding Shares of Restricted Stock granted hereunder may, if the Committee so determines, be credited with dividends paid with respect to the underlying Shares while they are so held in a manner determined by the Committee in its sole discretion. The Committee may apply any restrictions to the dividends that it deems appropriate. Effective for Restricted Stock Awards granted under the Plan on or after January 1, 2005, an Award Agreement for a Restricted Stock Unit Award may specify that the holder of the Award shall be entitled to the payment of Dividend Equivalents under the Award in a manner determined by the Committee in its sole discretion.

7. Article 8 of the Plan is hereby amended by adding the following new Section 8.8 at the end thereof:

**8.8 Time of Payment Under Restricted Stock Unit Award.** Effective for Awards granted on or after January 1, 2005, a payment under a Restricted Stock Unit Award shall be made at such time as is specified in the applicable Award Agreement. The Award Agreement shall specify that the payment will be made (a) by a date that is no later than the date that is two and one-half (2 1/2) months after the end of the Fiscal Year in which the Restricted Stock Unit Award payment is no longer subject to a Substantial Risk of Forfeiture or (b) at a time that is permissible under Section 409A.

8. Section 9.4 of the Plan is hereby completely amended to provide as follows:

**9.4 Form and Timing of Payment of Performance Units/Shares and Cash-Based Awards .** Payment of earned Performance Shares and Cash-Based Awards shall be as the Committee determines and as set forth in the Award Agreement. Payment under a Performance Unit Award or a Cash-Based Award shall be made at such time as is specified in the applicable Award Agreement. Effective for Performance Unit Awards and Cash-Based Awards granted under the Plan on or after January 1, 2005, the Award Agreement for the Award shall specify that the payment will be made (a) by a date that is no later than the date that is two and one-half (2 1/2) months after the end of the calendar year in which the Award payment is no longer subject to a Substantial Risk of Forfeiture or (b) at a time that is permissible under Section 409A.

Subject to the terms of the Plan, the Committee, in its sole discretion, may pay earned Performance Units/Shares and Cash-Based Awards in the form of cash or in Shares (or in a combination thereof) that have an aggregate Fair Market Value equal to the value of the earned Performance Units/Shares and Cash-Based Awards at the close of the applicable Performance Period. Such Shares may be granted subject to any restrictions deemed appropriate by the Committee.

An Award Agreement for a Performance Unit Award may specify that the Holder shall be entitled to the payment of Dividend Equivalents under the Award.

9. Article 12 of the Plan is hereby completely amended to provide as follows:

**Article 12 Deferrals .**

Subject to Section 18.14, the Committee may permit or require a Participant to defer such Participant's receipt of the payment of cash or the delivery of Shares that would otherwise be due to such Participant by virtue of the lapse or waiver of restrictions with respect to Restricted Stock/Units or the satisfaction of any requirements or goals with respect to Performance Units/Shares, Cash-Based Awards and Stock Awards. If any such deferral election is required or permitted, the Committee shall, in its sole discretion, establish rules and procedures for such payment deferrals.

10. Article 14 of the Plan is hereby completely amended to provide as follows:

**Article 14 Acceleration.**

**14.1 Change in Control** . Notwithstanding any provision of the Plan to the contrary, in the event of an occurrence of a Change in Control all then outstanding Options, SARs, and Restricted Stock Awards granted under the Plan (other than Restricted Stock Awards that are transferred or vest contingent upon the achievement of performance goals) shall become fully vested, and exercisable and all substantial risk of forfeiture restrictions applicable thereto shall lapse. The effect, if any, of a Change in Control upon any other Award granted under the Plan shall be determined in accordance with the terms of the applicable Award Agreement and any related Terms and Conditions issued by the Committee that are applicable to the Award.

**14.2 Termination** . Notwithstanding any provision of the Plan to the contrary, if (a) an Employee's employment is terminated by the Company without Cause prior to a Change in Control (whether or not a Change in Control ever occurs) and such termination was at the request or direction of a Person who has entered into an agreement with the Company the consummation of which would constitute a Change in Control, (b) such Employee terminates his or her employment for Good Reason prior to a Change in Control (whether or not a Change in Control ever occurs) and the circumstance or event which constitutes Good Reason occurs at the request or direction of the Person described in clause (a), (c) such Employee's employment is terminated by the Company without Cause or by the Employee for Good Reason and such termination or the circumstance or event which constitutes Good Reason is otherwise in connection with or in anticipation of a Change in Control (whether or not a Change in Control ever occurs) or (d) such Employee's employment is terminated by the Company without Cause or by the Employee for Good Reason, in either case within two years following the occurrence of a Change in Control then, effective as of the effective date of the Employee's termination of employment, all outstanding Options, SARs, and Restricted Stock Awards granted under the Plan (other than Restricted Stock Awards that are transferred or will vest contingent upon the achievement of performance goals) shall become fully vested, and exercisable and all substantial risk of forfeiture restrictions applicable thereto shall lapse.

11. Article 18 of the Plan is hereby amended by adding thereto the following new Section 18.14:

**18.14 Compliance With Section 409A.** Awards shall be designed, granted and administered in such a manner that they are either exempt from the application of, or comply with, the requirements of Section 409A. If the Committee determines that an Award, Award Agreement, payment, distribution, deferral election, transaction, or any other action or arrangement contemplated by the provisions of the Plan would, if undertaken or implemented, cause a Holder to

become subject to additional taxes under Section 409A, then unless the Committee specifically provides otherwise, such Award, Award Agreement, payment, distribution, deferral election, transaction or other action or arrangement shall not be given effect to the extent it causes such result and the related provisions of the Plan and/or Award Agreement will be deemed modified, or, if necessary, suspended in order to comply with the requirements of Section 409A to the extent determined appropriate by the Committee, in each case without the consent of or notice to the Holder. The exercisability of an Option shall not be extended to the extent that such extension would subject the Holder to additional taxes under Section 409A. This Section 18.14 is effective for Awards granted under the Plan that are earned and vested on or after January 1, 2005.

**Adopted by the Board of Directors  
on July 24, 2008**

**CERTIFICATION**

I, Chad C. Deaton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Baker Hughes Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2008

By: /s/ Chad C. Deaton  
Chad C. Deaton  
Chairman of the Board, President  
and Chief Executive Officer

**CERTIFICATION**

I, Peter A. Ragauss, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Baker Hughes Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2008

By: /s/ Peter A. Ragauss  
Peter A. Ragauss  
Senior Vice President  
and Chief Financial Officer

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

In connection with the Quarterly Report of Baker Hughes Incorporated (the "Company") on Form 10-Q for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Chad C. Deaton, Chief Executive Officer of the Company, and Peter A. Ragauss, the Chief Financial Officer of the Company, each of the undersigned hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (i) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (ii) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

The certification is given to the knowledge of the undersigned.

/s/ Chad C. Deaton

\_\_\_\_\_  
Name: Chad C. Deaton  
Title: Chief Executive Officer  
Date: July 29, 2008

/s/ Peter A. Ragauss

\_\_\_\_\_  
Name: Peter A. Ragauss  
Title: Chief Financial Officer  
Date: July 29, 2008



## News Release

Contact:  
Gary R. Flaharty (713) 439-8039  
H. Gene Shiels (713) 439-8822

Baker Hughes Incorporated  
P.O. Box 4740  
Houston, Texas 77210-4740

***Baker Hughes Announces Dividend Increase;  
Declares Regular Quarterly Dividend; and  
Increases Share Repurchase Authorization***

HOUSTON, Texas — July 24, 2008. Baker Hughes Incorporated (BHI — NYSE) announced today that its Board of Directors has authorized a regular dividend of \$0.15 per share, an increase of approximately 15% from the previous regular quarterly dividend of \$0.13 per share.

Chad C. Deaton, Baker Hughes' chairman, president and chief executive officer announced today that the Baker Hughes Board declared the regular quarterly cash dividend of \$0.15 per share of common stock payable August 15, 2008, to holders of record August 4, 2008.

Baker Hughes also announced today that the company's Board of Directors has authorized a plan to repurchase \$1 billion of the company's common stock in addition to the existing stock repurchase plan. As of July 24, 2008, the company had authorization remaining to repurchase approximately \$1.246 billion of common stock.

Baker Hughes provides reservoir consulting, drilling, formation evaluation, completion and production products and services to the worldwide oil and gas industry.

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[www.bakerhughes.com](http://www.bakerhughes.com)

