

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

Form 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from to

Commission file number 1-7677

LSB Industries, Inc.

Exact name of Registrant as specified in its charter

Delaware

State or other jurisdiction of incorporation or organization

73-1015226
I.R.S. Employer Identification No.

16 South Pennsylvania Avenue, Oklahoma City, Oklahoma

Address of principal executive offices

73107

(Zip Code)

(405) 235-4546

Registrant's telephone number, including area code

None ;

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] 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 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 [X]

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 Act). [] Yes [X] No

The number of shares outstanding of the Registrant's voting common stock, as of October 31, 2008 was 21,299,652 shares, excluding 3,648,518 shares held as treasury stock.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at September 30, 2008 is unaudited)

	September 30, 2008	December 31, 2007
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 47,478	\$ 58,224
Restricted cash	276	203
Accounts receivable, net	106,348	70,577
Inventories:		
Finished goods	38,888	28,177
Work in process	3,526	3,569
Raw materials	32,031	25,130
Total inventories	74,445	56,876
Supplies, prepaid items and other:		
Prepaid insurance	927	3,350
Prepaid income taxes	1,535	-
Precious metals	14,400	10,935
Supplies	4,371	3,849
Other	1,619	1,464
Total supplies, prepaid items and other	22,852	19,598
Deferred income taxes	5,877	10,030
Total current assets	257,276	215,508
Property, plant and equipment, net	95,952	79,692
Other assets:		
Debt issuance and other debt-related costs, net	4,233	4,639
Investment in affiliate	3,568	3,426
Goodwill	1,724	1,724
Other, net	2,613	2,565
Total other assets	12,138	12,354
	<u>\$ 365,366</u>	<u>\$ 307,554</u>

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LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)
(Information at September 30, 2008 is unaudited)

	September 30, 2008	December 31, 2007
(In Thousands)		
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 55,190	\$ 39,060
Short-term financing and drafts payable	-	919
Accrued and other liabilities	44,193	38,942
Current portion of long-term debt	1,495	1,043
Total current liabilities	100,878	79,964
Long-term debt	122,032	121,064
Noncurrent accrued and other liabilities:		
Deferred income taxes	5,601	5,330
Other	8,343	6,913
	13,944	12,243
Contingencies (Note 10)		
Stockholders' equity:		
Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding	2,000	2,000
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued	1,000	1,000
Common stock, \$.10 par value; 75,000,000 shares authorized, 24,898,170 shares issued (24,466,506 at December 31, 2007)	2,490	2,447
Capital in excess of par value	128,056	123,336
Accumulated other comprehensive loss	(193)	(411)
Retained earnings (accumulated deficit)	16,232	(16,437)
	149,585	111,935
Less treasury stock at cost:		
Common stock, 3,648,518 shares (3,448,518 at December 31, 2007)	21,073	17,652
Total stockholders' equity	128,512	94,283
	\$ 365,366	\$ 307,554

(See accompanying notes)

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LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENT OF INCOME
(Unaudited)
Nine and Three Months Ended September 30, 2008 and 2007

	Nine Months		Three Months	
	2008	2007	2008	2007
	(In Thousands, Except Per Share Amounts)			
Net sales	\$ 569,427	\$ 451,754	\$ 210,920	\$ 147,613
Cost of sales	456,760	349,873	179,751	112,441
Gross profit	112,667	101,881	31,169	35,172
Selling, general and administrative expense	62,633	55,821	22,411	18,827
Provisions for (recovery of) losses on accounts receivable	159	874	(133)	253
Other expense	946	853	289	335
Other income	(8,417)	(3,440)	(88)	(3,340)
Operating income	57,346	47,773	8,690	19,097
Interest expense	6,363	8,062	2,643	3,482
Non-operating other income, net	(1,125)	(605)	(263)	(532)
Income from continuing operations before provisions (benefits) for income taxes and equity in earnings of affiliate	52,108	40,316	6,310	16,147
Provisions (benefits) for income taxes	19,817	(1,017)	2,388	(1,549)
Equity in earnings of affiliate	(697)	(654)	(235)	(223)
Income from continuing operations	32,988	41,987	4,157	17,919
Net loss (income) from discontinued operations	13	(348)	(4)	(377)
Net income	32,975	42,335	4,161	18,296
Dividends, dividend requirements and stock dividend on preferred stocks	306	5,608	-	203
Net income applicable to common stock	\$ 32,669	\$ 36,727	\$ 4,161	\$ 18,093
Weighted-average common shares:				
Basic	21,156	19,150	21,237	20,220
Diluted	24,884	22,990	22,654	25,072
Income per common share:				
Basic:				
Income from continuing operations	\$ 1.54	\$ 1.90	\$.20	\$.87
Net income (loss) from discontinued operations	-	.02	-	.02
Net income	\$ 1.54	\$ 1.92	\$.20	\$.89
Diluted:				
Income from continuing operations	\$ 1.40	\$ 1.65	\$.18	\$.75
Net income (loss) from discontinued operations	-	.02	-	.02
Net income	\$ 1.40	\$ 1.67	\$.18	\$.77

(See accompanying notes)

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LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
Nine Months Ended September 30, 2008

	Common Stock Shares	Non- Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Accumulated Other Comprehensive Loss	Retained Earnings (Accumulated Deficit)	Treasury Stock- Common	Total
	(In Thousands)							
Balance at December 31, 2007	24,467	\$ 3,000	\$ 2,447	\$ 123,336	\$ (411)	\$ (16,437)	\$ (17,652)	\$ 94,283
Net income						32,975		32,975
Amortization of cash flow hedge					218			218
Total comprehensive income								33,193
Dividends paid on preferred stock						(306)		(306)
Stock-based compensation				577				577
Exercise of stock options	430		43	728				771
Income tax benefit from exercise of stock options				3,412				3,412
Acquisition of 200,000 shares of common stock							(3,421)	(3,421)
Conversion of shares of redeemable preferred stock to common stock	1			3				3
Balance at September 30, 2008	24,898	\$ 3,000	\$ 2,490	\$ 128,056	\$ (193)	\$ 16,232	\$ (21,073)	\$ 128,512

(See accompanying notes)

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LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
Nine Months Ended September 30, 2008 and 2007

	2008	2007
	(In Thousands)	
Cash flows from continuing operating activities:		
Net income	\$ 32,975	\$ 42,335
Adjustments to reconcile net income to net cash provided by continuing operating activities:		
Net loss (income) from discontinued operations	13	(348)
Deferred income taxes	4,424	(3,150)
Gain on litigation judgment associated with property, plant and equipment	(3,943)	-
Loss on sales of property and equipment	130	446
Depreciation of property, plant and equipment	9,784	9,201
Amortization	914	841
Stock-based compensation	577	228
Provisions for losses on accounts receivable	159	874
Provision for (realization of) losses on inventory	400	(360)
Provisions for impairment of long-lived assets	192	250
Realization of losses on firm sales commitments	-	(328)
Equity in earnings of affiliate	(697)	(654)
Distributions received from affiliate	555	570
Changes in fair value of commodities contracts	4,931	(133)
Changes in fair value of interest rate contracts	(237)	241
Other	-	(8)
Cash provided (used) by changes in assets and liabilities:		
Accounts receivable	(36,043)	(20,656)
Inventories	(17,969)	(1,587)
Other supplies and prepaid items	(3,254)	(2,541)
Accounts payable	14,410	(3,849)
Customer deposits	(269)	(233)
Deferred rent expense	(2,909)	(2,423)
Other current and noncurrent liabilities	5,178	7,889
Net cash provided by continuing operating activities	9,321	26,605
Cash flows from continuing investing activities:		
Capital expenditures	(22,693)	(10,300)
Proceeds from litigation judgment associated with property, plant and equipment	5,948	-
Payment of legal costs relating to litigation judgment associated with property, plant and equipment	(1,884)	-
Proceeds from sales of property and equipment	63	192
Proceeds from (deposits of) restricted cash	(73)	3,651
Purchase of interest rate cap contracts	-	(621)
Other assets	(305)	(70)
Net cash used by continuing investing activities	(18,944)	(7,148)

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LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Unaudited)
Nine Months Ended September 30, 2008 and 2007

	2008	2007
	(In Thousands)	
Cash flows from continuing financing activities:		
Proceeds from revolving debt facilities	\$ 475,372	\$ 381,835
Payments on revolving debt facilities	(475,372)	(408,242)
Proceeds from 5.5% convertible debentures, net of fees	-	56,985
Proceeds from other long-term debt, net of fees	-	2,424
Payments on other long-term debt	(524)	(7,629)
Payments of debt issuance costs	-	(143)
Proceeds from short-term financing and drafts payable	-	56
Payments on short-term financing and drafts payable	(919)	(2,909)
Proceeds from exercise of stock options	771	1,112
Acquisition of common stock	(3,421)	-
Excess income tax benefit on stock options exercised	3,412	-
Dividends paid on preferred stock	(306)	(2,934)
Acquisition of non-redeemable preferred stock	-	(1,292)
Net cash provided (used) by continuing financing activities	(987)	19,263
Cash flows of discontinued operations:		
Operating cash flows	(136)	(106)
Net increase (decrease) in cash and cash equivalents	(10,746)	38,614
Cash and cash equivalents at beginning of period	58,224	2,255
Cash and cash equivalents at end of period	\$ 47,478	\$ 40,869
Supplemental cash flow information:		
Cash payments for income taxes, net of refunds	\$ 16,814	\$ 1,399
Noncash investing and financing activities:		
Accounts payable and other long-term debt associated with purchases of property, plant and equipment	\$ 4,009	\$ 2,203
Debt issuance costs	\$ -	\$ 3,026
Debt issuance costs associated with 7% convertible debentures converted to common stock	\$ -	\$ 266
7% convertible debentures converted to common stock	\$ -	\$ 4,000
Series 2 preferred stock converted to common stock of which \$12,303,000 was charged to accumulated deficit	\$ -	\$ 27,593

(See accompanying notes)

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Basis of Presentation The accompanying condensed consolidated financial statements include the accounts of LSB Industries, Inc. (the "Company", "We", "Us", or "Our") and its subsidiaries. We are a manufacturing, marketing and engineering company which is primarily engaged, through our wholly-owned subsidiary ThermaClimate, Inc. ("ThermaClimate") and its subsidiaries, in the manufacture and sale of geothermal and water source heat pumps and air handling products (the "Climate Control Business") and the manufacture and sale of chemical products (the "Chemical Business"). The Company and ThermaClimate are holding companies with no significant assets or operations other than cash and cash equivalents and our investments in our subsidiaries. Entities that are 20% to 50% owned and for which we have significant influence are accounted for on the equity method. All material intercompany accounts and transactions have been eliminated.

In the opinion of management, the unaudited condensed consolidated financial statements of the Company as of September 30, 2008 and for the nine and three-month periods ended September 30, 2008 and 2007 include all adjustments and accruals, consisting only of normal, recurring accrual adjustments which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year due, in part, to the seasonality of our sales of agricultural products and the timing of performing our major plant maintenance activities. Our selling seasons for agricultural products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles ("GAAP") have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These condensed consolidated financial statements should be read in connection with the consolidated financial statements and notes thereto included in our Form 10-K for the year ended December 31, 2007 ("2007 Form 10-K").

Note 2: Recently Issued Accounting Pronouncements In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157 - Fair Value Measurements ("SFAS 157"). SFAS 157 is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by GAAP; it does not create or modify any current GAAP requirements to apply fair value accounting. SFAS 157 provides a single definition for fair value that is to be applied consistently for all accounting applications, and also generally describes and prioritizes according to reliability the methods and input used in valuations. SFAS 157 prescribes various disclosures about financial statement categories and amounts which are measured at fair value, if such disclosures are not already specified elsewhere in GAAP. The new measurement and disclosure requirements of SFAS 157 became effective for the Company on January 1, 2008. The provisions of SFAS 157 were applied prospectively. See Note 11 - Derivatives, Hedges and Financial Instruments.

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2 ("FSP 157-2"), which delayed the effective date of SFAS 157 for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. FSP 157-2 will become effective for the Company beginning in the first quarter of 2009. We have not yet

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 2: Recently Issued Accounting Pronouncements (continued)

determined if the adoption of FSP 157-2 will significantly impact our consolidated financial statements and disclosures.

In March 2008, the FASB issued SFAS No. 161 - Disclosures about Derivative Instruments and Hedging Activities; an Amendment of SFAS 133 ("SFAS 161"). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities for the purpose of improving the transparency of financial reporting. The new disclosure requirements of SFAS 161 will become effective for the Company beginning in the first quarter of 2009. We have not yet determined if the adoption of SFAS 161 will significantly impact our consolidated financial statements and disclosures.

Note 3: Accounts Receivable

	September 30, 2008	December 31, 2007
(In Thousands)		
Trade receivables	\$ 105,646	\$ 68,234
Insurance claims	174	2,469
Other	1,099	1,182
	106,919	71,885
Allowance for doubtful accounts	(571)	(1,308)
	\$ 106,348	\$ 70,577

Note 4: Inventories Inventories are priced at the lower of cost or market, with cost being determined using the first-in, first-out ("FIFO") basis. Finished goods and work-in-process inventories include material, labor, and manufacturing overhead costs. At September 30, 2008 and December 31, 2007, inventory reserves for certain slow-moving inventory items (primarily Climate Control products) were \$544,000 and \$460,000, respectively. In addition, inventory reserves for certain nitrogen-based inventories provided by our Chemical Business were \$191,000 and \$13,000, at September 30, 2008 and December 31, 2007, respectively, because cost exceeded the net realizable value.

Changes in our inventory reserves are as follows:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Balance at beginning of period	\$ 473	\$ 1,255	\$ 583	\$ 847
Provisions for (realization of) losses	400	(360)	216	(15)
Write-offs/disposals	(138)	(327)	(64)	(264)
Balance at end of period	\$ 735	\$ 568	\$ 735	\$ 568

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 4: Inventories (continued)

The provisions for losses are included in cost of sales (realization of losses is a reduction to cost of sales) in the accompanying condensed consolidated statements of income.

Note 5: Precious Metals Precious metals are used as a catalyst in the Chemical Business manufacturing process. Precious metals are carried at cost, with cost being determined using the FIFO basis. Because some of the catalyst consumed in the production process cannot be readily recovered and the amount and timing of recoveries are not predictable, we follow the practice of expensing precious metals as they are consumed.

Occasionally, during major maintenance and/or capital projects, we may be able to perform procedures to recover precious metals (previously expensed) which have accumulated over time within our manufacturing equipment. When we accumulate precious metals in excess of our production requirements, we may sell a portion of the excess metals.

Precious metals expense, net, consists of the following:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Precious metals expense	\$ 6,209	\$ 4,779	\$ 1,855	\$ 1,665
Recoveries of precious metals	(1,343)	(1,233)	(551)	-
Gains on sales of precious metals	-	(1,876)	-	(1,387)
Precious metals expense, net	<u>\$ 4,866</u>	<u>\$ 1,670</u>	<u>\$ 1,304</u>	<u>\$ 278</u>

Precious metals expense is included in cost of sales (recoveries and gains on sales of precious metals are reductions to cost of sales) in the accompanying condensed consolidated statements of income.

Note 6: Investment in Affiliate Cepolk Holding, Inc. ("CHI"), a subsidiary of the Company, is a limited partner and has a 50% equity interest in Cepolk Limited Partnership ("Partnership") which is accounted for on the equity method. The Partnership owns an energy savings project located at the Ft. Polk Army base in Louisiana ("Project"). As of September 30, 2008, the Partnership and general partner to the Partnership is indebted to a term lender ("Term Lender") of the Project. CHI has pledged its limited partnership interest in the Partnership to the Term Lender as part of the Term Lender's collateral securing all obligations under the loan. This guarantee and pledge is limited to CHI's limited partnership interest and does not expose CHI or the Company to liability in excess of CHI's limited partnership interest. No liability has been established for this pledge since it was entered into prior to adoption of FASB Interpretation ("FIN") 45. CHI has no recourse provisions or available collateral that would enable CHI to recover its partnership interest should the Term Lender be required to perform under this pledge.

Note 7: Product Warranty Our Climate Control Business sells equipment that has an expected life, under normal circumstances and use, that extends over several years. As such, we provide warranties after equipment shipment/start-up covering defects in materials and workmanship.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 7: Product Warranty (continued)

Generally, the base warranty coverage for most of the manufactured equipment in the Climate Control Business is limited to eighteen months from the date of shipment or twelve months from the date of start-up, whichever is shorter, and to ninety days for spare parts. The warranty provides that most equipment is required to be returned to the factory or an authorized representative and the warranty is limited to the repair and replacement of the defective product, with a maximum warranty of the refund of the purchase price. Furthermore, companies within the Climate Control Business generally disclaim and exclude warranties related to merchantability or fitness for any particular purpose and disclaim and exclude any liability for consequential or incidental damages. In some cases, the customer may purchase or a specific product may be sold with an extended warranty. The above discussion is generally applicable to such extended warranties, but variations do occur depending upon specific contractual obligations, certain system components, and local laws.

Our accounting policy and methodology for warranty arrangements is to periodically measure and recognize the expense and liability for such warranty obligations using a percentage of net sales, based upon our historical warranty costs. It is possible that future warranty costs could exceed our estimates.

Changes in our product warranty obligation are as follows:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Balance at beginning of period	\$ 1,944	\$ 1,251	\$ 2,278	\$ 1,521
Add: Charged to costs and expenses	3,406	2,097	1,119	762
Deduct: Costs and expenses incurred	(3,032)	(1,838)	(1,079)	(773)
Balance at end of period	<u>\$ 2,318</u>	<u>\$ 1,510</u>	<u>\$ 2,318</u>	<u>\$ 1,510</u>

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 8: Current and Noncurrent Accrued and Other Liabilities

	September 30, 2008	December 31, 2007
	(In Thousands)	
Customer deposits	\$ 9,256	\$ 9,525
Accrued payroll and benefits	7,363	5,362
Deferred income taxes	5,601	5,330
Fair value of derivatives	5,060	172
Deferred revenue on extended warranty contracts	3,901	3,387
Accrued precious metals costs	2,669	1,359
Accrued death benefits	2,525	2,051
Accrued contractual manufacturing obligations	2,467	1,548
Accrued commissions	2,429	2,256
Accrued warranty costs	2,318	1,944
Accrued insurance	2,032	2,975
Accrued property and franchise taxes	1,944	707
Accrued interest	1,722	1,056
Accrued income taxes	1,241	4,540
Deferred rent expense	1,391	4,300
Billings in excess of costs and estimated earnings on uncompleted contracts	1,350	62
Accrued executive benefits	989	1,040
Other	3,879	3,571
	58,137	51,185
Less noncurrent portion	13,944	12,243
Current portion of accrued and other liabilities	\$ 44,193	\$ 38,942

Note 9: Long-Term Debt

	September 30, 2008	December 31, 2007
	(In Thousands)	
Working Capital Revolver Loan due 2012 (A)	\$ -	\$ -
5.5% Convertible Senior Subordinated Notes due 2012 (B)	60,000	60,000
Secured Term Loan due 2012 (C)	50,000	50,000
Other, with a current weighted-average interest rate of 6.71%, most of which is secured by machinery, equipment and real estate	13,527	12,107
	123,527	122,107
Less current portion of long-term debt	1,495	1,043
Long-term debt due after one year	\$ 122,032	\$ 121,064

(A) ThermaClime and its subsidiaries (the "Borrowers") are parties to a \$50 million revolving credit facility (the "Working Capital Revolver Loan") that provides for advances based on specified percentages of eligible accounts receivable and inventories for ThermaClime, and its subsidiaries. The Working Capital Revolver Loan, as amended, accrues interest at a base rate

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 9: Long-Term Debt (continued)

(generally equivalent to the prime rate) plus .50% or LIBOR plus 1.75%. The interest rate at September 30, 2008 was 5.50%. Interest is paid monthly. The facility provides for up to \$8.5 million of letters of credit. All letters of credit outstanding reduce availability under the facility. At September 30, 2008, amounts available for additional borrowing under the Working Capital Revolver Loan were \$49.5 million. Under the Working Capital Revolver Loan, as amended, the lender also requires the Borrowers to pay a letter of credit fee equal to 1% per annum of the undrawn amount of all outstanding letters of credit, an unused line fee equal to .375% per annum for the excess amount available under the facility not drawn and various other audit, appraisal and valuation charges.

The lender may, upon an event of default, as defined, terminate the Working Capital Revolver Loan and make the balance outstanding due and payable in full, if any. The Working Capital Revolver Loan is secured by the assets of all the ThermaClime entities other than El Dorado Nitric Company and its subsidiaries ("EDNC") but excluding the assets securing the \$50 million secured term loan discussed in (C) below and certain distribution-related assets of El Dorado Chemical Company ("EDC"). EDNC is neither a borrower nor guarantor of the Working Capital Revolver Loan. The carrying value of the pledged assets is approximately \$230 million at September 30, 2008.

The Working Capital Revolver Loan, as amended, requires ThermaClime to meet certain financial covenants measured quarterly. ThermaClime was in compliance with those covenants for the twelve-month period ended September 30, 2008. The Working Capital Revolver Loan also contains covenants that, among other things, limit the Borrowers' (which does not include the Company) ability, without consent of the lender, to:

- incur additional indebtedness,
- incur liens,
- make restricted payments or loans to affiliates who are not Borrowers,
- engage in mergers, consolidations or other forms of recapitalization, or dispose assets.

The Working Capital Revolver Loan also requires all collections on accounts receivable be made through a bank account in the name of the lender or their agent.

(B) In June 2007, we entered into a purchase agreement with each of twenty two qualified institutional buyers ("QIBs"), pursuant to which we sold \$60 million aggregate principal amount of the 5.5% Convertible Senior Subordinated Notes (the "2007 Debentures") in a private placement to the QIBs pursuant to the exemptions from the registration requirements of the Securities Act of 1933, as amended (the "Act"), afforded by Section 4(2) of the Act and Regulation D promulgated under the Act. The 2007 Debentures are eligible for resale by the investors under Rule 144A under the Act. We received net proceeds of approximately \$57 million, after discounts and commissions. In connection with the closing, we entered into an indenture (the "Indenture") with UMB Bank, as trustee (the "Trustee"), governing the 2007 Debentures. The Trustee receives customary compensation from us for such services.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 9: Long-Term Debt (continued)

The 2007 Debentures bear interest at the rate of 5.5% per year and mature on July 1, 2012. Interest is payable in arrears on January 1 and July 1 of each year, which began on January 1, 2008.

The 2007 Debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior indebtedness, including indebtedness under our revolving debt facilities. The 2007 Debentures are effectively subordinated to all present and future liabilities, including trade payables, of our subsidiaries.

The 2007 Debentures are convertible by the holders in whole or in part into shares of our common stock prior to their maturity. The conversion rate of the 2007 Debentures for the holders electing to convert all or any portion of a debenture is 36.4 shares of our common stock per \$1,000 principal amount of debentures (representing a conversion price of \$27.47 per share of common stock), subject to adjustment under certain conditions as set forth in the Indenture.

We may redeem some or all of the 2007 Debentures at any time on or after July 2, 2010, at a price equal to 100% of the principal amount of the 2007 Debentures, plus accrued and unpaid interest, all as set forth in the Indenture. The redemption price will be payable at our option in cash or, subject to certain conditions, shares of our common stock (valued at 95% of the weighted average of the closing sale prices of the common stock for the 20 consecutive trading days ending on the fifth trading day prior to the redemption date), subject to certain conditions being met on the date we mail the notice of redemption.

If a designated event (as defined in the Indenture) occurs prior to maturity, holders of the 2007 Debentures may require us to repurchase all or a portion of their 2007 Debentures for cash at a repurchase price equal to 101% of the principal amount of the 2007 Debentures plus any accrued and unpaid interest, as set forth in the Indenture. If a fundamental change (as defined in the Indenture) occurs on or prior to June 30, 2010, under certain circumstances, we will pay, in addition to the repurchase price, a make-whole premium on the 2007 Debentures converted in connection with, or tendered for repurchase upon, the fundamental change. The make-whole premium will be payable in our common stock or the same form of consideration into which our common stock has been exchanged or converted in the fundamental change. The amount of the make-whole premium, if any, will be based on our stock price on the effective date of the fundamental change. No make-whole premium will be paid if our stock price in connection with the fundamental change is less than or equal to \$23.00 per share.

At maturity, we may elect, subject to certain conditions as set forth in the Indenture, to pay up to 50% of the principal amount of the outstanding 2007 Debentures, plus all accrued and unpaid interest thereon to, but excluding, the maturity date, in shares of our common stock (valued at 95% of the weighted average of the closing sale prices of the common stock for the 20 consecutive trading days ending on the fifth trading day prior to the maturity date), if the common stock is then listed on an eligible market, the shares used to pay the 2007 Debentures and any interest thereon are freely tradable, and certain required opinions of counsel are received.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 9: Long-Term Debt (continued)

We have used a portion of the net proceeds to redeem our remaining outstanding shares of Series 2 \$3.25 convertible, exchangeable Class C preferred stock ("Series 2 Preferred"); to repay certain outstanding mortgages and equipment loans; to pay dividends in arrears on our outstanding shares of Series B 12% cumulative, convertible preferred stock ("Series B Preferred") and Series D 6% cumulative, convertible Class C preferred stock ("Series D Preferred"), all of which were owned by an affiliate; and the balance to initially reduce the outstanding borrowings under the Working Capital Revolver Loan. In addition, we have currently invested a portion of the net proceeds in U.S. Treasury obligations (cash equivalents). We intend to use the remaining portion of the net proceeds for certain discretionary capital expenditures and general working capital purposes.

In conjunction with the 2007 Debentures, we entered into a Registration Rights Agreement with the QIBs. In connection with the Registration Rights Agreement, we filed a post-effective amendment No. 1, to our previously filed registration statement, which amendment was declared effective by the SEC on April 21, 2008.

(C) ThermaClime and certain of its subsidiaries are parties to a \$50 million loan agreement (the "Secured Term Loan") with a certain lender. The Secured Term Loan matures on November 2, 2012. The Secured Term Loan accrues interest at a defined LIBOR rate plus 3%. The interest rate at September 30, 2008 was 5.79%. The Secured Term Loan requires quarterly interest payments with the final payment of interest and principal at maturity.

The Secured Term Loan is secured by the real property and equipment located at our El Dorado, Arkansas and Cherokee, Alabama chemical production facilities. The carrying value of the pledged assets is approximately \$58 million at September 30, 2008.

The Secured Term Loan borrowers are subject to numerous covenants under the agreement including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. At September 30, 2008, the carrying value of the restricted net assets of ThermaClime and its subsidiaries was approximately \$72 million. The Secured Term Loan borrowers are also subject to a minimum fixed charge coverage ratio and a maximum leverage ratio, both measured quarterly on a trailing twelve-month basis. The Secured Term Loan borrowers were in compliance with these financial covenants for the twelve-month period ended September 30, 2008.

Note 10: Contingencies We accrue for contingent losses when such losses are probable and reasonably estimable. In addition, we recognize contingent gains when such gains are realizable.

Following is a summary of certain legal matters involving the Company.

A. Environmental Matters

Our operations are subject to numerous environmental laws ("Environmental Laws") and to other federal, state and local laws regarding health and safety matters ("Health Laws"). In

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 10: Contingencies (continued)

particular, the manufacture and distribution of chemical products are activities which entail environmental risks and impose obligations under the Environmental Laws and the Health Laws, many of which provide for certain performance obligations, substantial fines and criminal sanctions for violations. There can be no assurance that material costs or liabilities will not be incurred by us in complying with such laws or in paying fines or penalties for violation of such laws. The Environmental Laws and Health Laws and enforcement policies thereunder relating to our Chemical Business have in the past resulted, and could in the future result, in compliance expenses, cleanup costs, penalties or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from our facilities or the use or disposal of certain of its chemical products. Historically, significant expenditures have been incurred by subsidiaries within our Chemical Business in order to comply with the Environmental Laws and Health Laws and are reasonably expected to be incurred in the future.

We are required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated in accordance with FIN 47. We are obligated to monitor certain discharge water outlets at our Chemical Business facilities should we discontinue the operations of a facility. We also have certain facilities in our Chemical Business that contain asbestos insulation around certain piping and heated surfaces, which we plan to maintain or replace, as needed, with non-asbestos insulation through our standard repair and maintenance activities to prevent deterioration. Since we currently have no plans to discontinue the use of these facilities and the remaining life of the facilities is indeterminable, an asset retirement liability has not been recognized. Currently, there is insufficient information to estimate the fair value of the asset retirement obligations. However, we will continue to review these obligations and record a liability when a reasonable estimate of the fair value can be made.

1. Discharge Water Matters

The chemical production facility located in El Dorado, Arkansas (the "El Dorado Facility") within our Chemical Business generates process wastewater, which includes storm water. The process water discharge and storm-water run off are governed by a state National Pollutant Discharge Elimination System ("NPDES") water discharge permit issued by the Arkansas Department of Environmental Quality ("ADEQ"), which permit is to be renewed every five years. The ADEQ issued to the El Dorado Facility a NPDES water discharge permit in 2004, and the El Dorado Facility had until June 1, 2007 to meet the compliance deadline for the more restrictive limits under the 2004 NPDES permit. In order to meet the El Dorado Facility's June 2007 limits, the El Dorado Facility has significantly reduced the contaminant levels of its wastewater.

The El Dorado Facility has demonstrated its ability to comply with the more restrictive permit limits, and the rules which support the more restrictive dissolved minerals rules have been revised to authorize a permit modification to adopt achievable dissolved minerals permit limits. The ADEQ and the El Dorado Facility have entered into a consent administration order to authorize the El Dorado Facility to continue operations without incurring permit violations pending the modification of the permit to implement the revised rule and to dispose of the El

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 10: Contingencies (continued)

Dorado Facility's wastewater into the creek adjacent to the El Dorado Facility. As of September 30, 2008, the ADEQ has not issued the revised permit.

In addition, the El Dorado Facility has entered into a consent administrative order ("CAO") that recognizes the presence of nitrate contamination in the shallow groundwater at the El Dorado Facility. A new CAO to address the shallow groundwater contamination became effective on November 16, 2006 and requires the evaluation of the current conditions and remediation based upon a risk assessment. The CAO requires the El Dorado Facility to continue semi-annual groundwater monitoring, to continue operation of a groundwater recovery system and to submit a human health and ecological risk assessment to the ADEQ. The final remedy for shallow groundwater contamination, should any remediation be required, will be selected pursuant to the new CAO and based upon the risk assessment. As an interim measure, the El Dorado Facility has installed two recovery wells to recycle groundwater and to recover nitrates. The cost of any additional remediation that may be required will be determined based on the results of the investigation and risk assessment and cannot currently be reasonably estimated. Therefore, no liability has been established at September 30, 2008.

2. Air Matters

In December 2006, the El Dorado Facility entered into a new CAO ("2006 CAO") with the ADEQ to resolve a problem with ammonia emissions from certain nitric acid units. The catalyst suppliers had represented the volume of ammonia emissions anticipated. The representation was the basis for the permitted emission limit, but the representation of the catalyst suppliers was not accurate. Under the 2006 CAO, the ADEQ allowed the El Dorado Facility to re-evaluate the catalyst performance and required the El Dorado Facility to submit a permit modification with the appropriate ammonia limits. The permit modification was submitted to ADEQ on June 11, 2007. An air permit modification was issued on August 26, 2008, which sets new limits for ammonia for the nitric acid units and requires compliance testing to be performed no later than February 21, 2009. Based on a previous study, the nitric acid units can meet these new limits. As a result of the air permit modification, continuous monitoring and monthly reporting of ammonia for these nitric acid units is no longer required.

3. Other Environmental Matters

In April 2002, Slurry Explosive Corporation ("Slurry"), later renamed Chemex I Corp., a subsidiary within our Chemical Business, entered into a Consent Administrative Order ("Slurry Consent Order") with the Kansas Department of Health and Environment ("KDHE"), regarding Slurry's Hallowell, Kansas manufacturing facility ("Hallowell Facility"). The Slurry Consent Order addressed the release of contaminants from the facility into the soils and groundwater and surface water at the Hallowell Facility. There are no known users of the groundwater in the area.

The adjacent strip pit is used for fishing. Under the terms of the Slurry Consent Order, Slurry is required to, among other things, submit an environmental assessment work plan to the KDHE for review and approval, and agree with the KDHE as to any required corrective actions to be performed at the Hallowell Facility.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 10: Contingencies (continued)

In December 2002, Slurry and Universal Tech Corporation ("UTeC"), both subsidiaries within our Chemical Business, sold substantially all of their operating assets but retained ownership of the real property. At December 31, 2002, even though we continued to own the real property, we did not assess our continuing involvement with our former Hallowell facility to be significant and therefore accounted for the sale as discontinued operations. In connection with this sale, UTeC leased the real property to the buyer under a triple net long-term lease agreement. However, Slurry retained the obligation to be responsible for, and perform the activities under, the Slurry Consent Order. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. The successor ("Chevron") of a prior owner of the Hallowell Facility has agreed, within certain limitations, to pay and has been paying one-half of the costs incurred under the Slurry Consent Order subject to reallocation.

Based on additional modeling of the site, Slurry and Chevron are pursuing a course with the KDHE of long-term surface and ground water monitoring to track the natural decline in contamination, instead of the soil excavation proposed previously. On September 12, 2007, the KDHE approved our proposal to perform two years of surface and groundwater monitoring and to implement a Mitigation Work Plan to acquire additional field data in order to more accurately characterize the nature and extent of contaminant migration off-site. The two-year monitoring program will terminate in February 2009.

At September 30, 2008, the total estimated liability (which is included in current accrued and other liabilities) in connection with this remediation matter is approximately \$132,000 and Chevron's share for these costs (which is included in accounts receivable) is approximately \$69,000. These amounts are not discounted to their present value. It is reasonably possible that a change in estimate of our liability and receivable will occur in the near term.

B. Other Pending, Threatened or Settled Litigation

1. Climate Control Business

A proposed class action was filed in the Illinois state district court in September 2007 alleging that certain evaporator coils sold by one of our subsidiaries in the Climate Control Business, Climate Master, Inc. ("Climate Master") in the state of Illinois from 1990 to approximately 2003 were defective. The complaint requests certification as a class action for the State of Illinois, which request has not yet been heard by the court. The plaintiff asserts claims based upon negligence, strict liability, breach of implied warranties, and the Illinois Consumer Fraud and Deceptive Business Practices Act. Climate Master has timely filed its pleadings to remove this action to federal court. Climate Master has also filed its answer denying the plaintiff's claims and asserting several affirmative defenses. Climate Master's insurers have been placed on notice of this matter. Several of our insurers have denied coverage and one insurer advised that it will monitor the litigation subject to a reservation of rights to decline coverage. The policies associated with insurers that have not declined coverage in this matter have deductible amounts ranging from \$100,000 to \$250,000. The Company intends to vigorously defend Climate Master in connection with this matter. Currently, the Company is unable to determine the amount of damages or the likelihood of any losses resulting from this claim. Therefore, no liability has been established at September 30, 2008.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 10: Contingencies (continued)

2. Other

Zeller Pension Plan

In February 2000, our board of directors authorized management to proceed with the sale of the automotive products business, since the automotive products business was no longer a “core business” of the Company. In May 2000, the Company sold substantially all of its assets in its automotive products business. After the authorization by the board, but prior to the sale, the automotive products business purchased the assets and assumed certain liabilities of Zeller Corporation (“Zeller”). The liabilities of Zeller assumed by the automotive products business included Zeller’s pension plan, which is not a multi-employer pension plan. In June 2003, the principal owner (“Owner”) of the buyer of the automotive products business was contacted by a representative of the Pension Benefit Guaranty Corporation (“PBGC”) regarding the plan. The Owner was informed by the PBGC of a possible under-funding of the plan and a possible takeover of the plan by the PBGC. The PBGC previously advised the Company that the PBGC may consider the Company potentially liable for the under-funding of the Zeller Plan in the event that the plan is taken over by the PBGC and alleged that the under-funding is approximately \$600,000. Our ERISA counsel has advised us that, based on certain assumptions and representations made by us to them, they believe that the possibility of an unfavorable non-appealable verdict against us in a lawsuit if the PBGC attempts to hold us liable for under-funding of the Zeller Plan is remote.

MEI Drafts

Cromus, as an assignee of Masinexportimport Foreign Trade Company (“MEI”), filed a lawsuit against us, our subsidiary, Summit Machine Tool Manufacturing Corp. (“Summit”), certain of our other subsidiaries, our chief executive officer and another officer of our Company, Bank of America, and others, alleging that it was owed \$1,533,000, plus interest from 1990, in connection with Cromus’ attempted collection of ten non-negotiable bank drafts payable to the order of MEI. The bank drafts were issued by Aerobit Ltd. (“Aerobit”), a non-U.S. company, which at the time of issuance of the bank drafts, was one of our subsidiaries. Each of the bank drafts has a face value of \$153,300, for an aggregate principal face value of \$1,533,000. The bank drafts were issued in September 1992, and had a maturity date of December 31, 2001. Each bank draft was endorsed by LSB Corp., which at the time of endorsement, was also one of our subsidiaries. The complaint also seeks \$1,000,000 from us and Summit for failure to purchase certain equipment and \$1,000,000 in punitive damages. During May 2008, the court dismissed the complaint against us and our subsidiaries and our officers (including our Chief Executive Officer). Cromus has appealed this dismissal against our subsidiaries and our officers but did not appeal the dismissal against us. Cromus must perfect its appeal not later than April 1, 2009.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 10: Contingencies (continued)

The Jayhawk Group

During July 2007, we mailed to all holders of record of our Series 2 Preferred a notice of redemption of all of the outstanding shares of Series 2 Preferred. The redemption of our Series 2 Preferred was completed on August 27, 2007, the redemption date. The terms of the Series 2 Preferred required that for each share of Series 2 Preferred so redeemed, we would pay, in cash, a redemption price equal to \$50.00 plus \$26.25 representing dividends in arrears thereon pro-rata to the date of redemption. There were 193,295 shares of Series 2 Preferred outstanding, net of treasury stock, as of the date the notice of redemption was mailed. Pursuant to the terms of the Series 2 Preferred, the holders of the Series 2 Preferred could convert each share into 4.329 shares of our common stock. If a holder of the Series 2 Preferred elected to convert his, her or its shares into our common stock pursuant to its terms, the Certificate of Designations for the Series 2 Preferred provided, and it is our position, that the holder that so converts would not be entitled to receive payment of any dividends in arrears on the shares so converted. Jayhawk Capital Management, L.L.C., and certain of its affiliates (the "Jayhawk Group"), a former affiliate of ours, converted 155,012 shares of Series 2 Preferred into 671,046 shares of common stock. The Jayhawk Group has advised us that it may bring legal action against us for all dividends in arrears (approximately \$4.0 million) on the shares of Series 2 Preferred that it converted after receipt of the notice of redemption and that it should have been able to tender all of its preferred shares under the tender offer notwithstanding an agreement between the Jayhawk Group and us that the Jayhawk Group would tender only approximately one-half of its preferred shares. The general counsel of the Jayhawk Group orally offered to settle all claims against us in return for a payment of \$100,000, representing the approximate legal fees the Jayhawk Group alleged it had incurred investigating these claims. Through counsel, we agreed to the settlement offer. After we agreed to the settlement offer verbally and by e-mail, the Jayhawk Group's general counsel purported to withdraw the settlement offer and asserted the Jayhawk Group was not bound by any settlement agreement. We believe the likelihood that the Jayhawk Group may recover the dividends in arrears is not probable, and we further believe that the settlement agreement is binding on the Jayhawk Group. As a result, a liability of \$100,000 has been established at September 30, 2008.

Securities and Exchange Commission

We have previously disclosed that the Securities and Exchange Commission ("SEC") was conducting an informal inquiry of us relating to the change in inventory accounting from LIFO to FIFO during 2004 involving approximately \$500,000 by one of our subsidiaries, which change resulted in the restatement of our financial statements for each of the three years in the period ended December 31, 2004 and our March 31, 2005 and June 30, 2005 quarterly financial statements. During April 2008, the staff of the SEC delivered a formal Wells Notice to us informing us that the staff has preliminarily decided to recommend to the SEC that it institute a civil enforcement action against us in connection with the above described matter. All assertions against us involve alleged violations of Section 13 of the 1934 Act and do not assert allegations of fraudulent conduct nor seek a monetary civil fine against us. During May 2008, we made a written submission to the senior staff of the SEC, and we have had discussions with the senior staff after such submission. The staff has indicated that it is still their intention to recommend to

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 10: Contingencies (continued)

the SEC to bring a civil injunction action against us and seek authority from the SEC to file such action. In addition, the SEC has also made assertions against our former principal accounting officer based on Section 13 of the 1934 Act, and the SEC staff has also stated its intention to recommend civil proceedings against him. The former principal accounting officer resigned as principal accounting officer, effective August 15, 2008, but remains with the Company as a senior vice president in charge of lending compliance and cash management and will be involved in our banking relationships, acquisitions and corporate planning. We are currently in discussions with the staff of the SEC regarding the settlement of this matter. There are no assurances this matter will be settled.

Other Claims and Legal Actions

We are also involved in various other claims and legal actions which in the opinion of management, after consultation with legal counsel, if determined adversely to us, would not have a material effect on our business, financial condition or results of operations.

Note 11: Derivatives, Hedges and Financial Instruments We account for derivatives in accordance with SFAS 133, which requires the recognition of derivatives in the balance sheet and the measurement of these instruments at fair value. Changes in fair value of derivatives are recorded in results of operations unless the normal purchase or sale exceptions apply or hedge accounting is elected.

In 1997, we entered into an interest rate forward agreement to effectively fix the interest rate of a long-term lease commitment (not for trading purposes). In 1999, we executed a long-term lease agreement (initial lease term of ten years) and terminated the forward agreement at a net cost of \$2.8 million. We historically accounted for this cash flow hedge under the deferral method (as an adjustment of the initial term lease rentals). Upon adoption of SFAS 133 in 2001, the remaining deferred cost amount was reclassified from other assets to accumulated other comprehensive loss and is being amortized to operations over the term of the lease arrangement. At September 30, 2008 and December 31, 2007, accumulated other comprehensive loss consisted of the remaining deferred cost of \$193,000 and \$411,000, respectively. The amount amortized to operations was \$218,000 for each of the nine months ended September 30, 2008 and 2007 and \$129,000 and \$73,000 for the three months ended September 30, 2008 and 2007, respectively. The associated income tax benefits were minimal in 2008 and there were no income tax benefits allocated to these expenses in 2007.

We have three types of contracts that are accounted for on a fair value basis, which are interest rate contracts, commodities futures/forward contracts and foreign currency contracts as discussed below. The valuation of these contracts was determined based on quoted market prices or, in instances where market quotes are not available, other valuation techniques or models used to estimate fair values.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 11: Derivatives, Hedges and Financial Instruments (continued)

Interest Rate Contracts

As part of our interest rate risk management, we periodically purchase and/or enter into various interest rate contracts. In March 2005, we purchased two interest rate cap contracts for a cost of \$590,000, which mature in March 2009. In April 2007, we purchased two interest rate cap contracts for a cost of \$621,000, which set a maximum three-month LIBOR base rate of 5.35% on \$50 million. In April 2008, we exchanged the two interest rate cap contracts purchased in 2007 for an interest rate cap contract ("2008 Interest Rate Cap Contract"), which sets a maximum three-month LIBOR base rate of 4.56% on \$25 million. The cost basis of the 2008 Interest Rate Cap Contract was \$239,000 based on the estimated fair value of the two contracts surrendered (which was also the carrying value at the time of the exchange) in accordance with Accounting Principle Board Opinion No. 29, as amended ("APB 29"). In April 2008, we also entered into an interest rate swap at no cost, which sets a fixed three-month LIBOR rate of 3.24% on \$25 million and matures in April 2012. In September 2008, we exchanged the 2008 Interest Rate Cap Contract for an interest rate swap, which sets a fixed three-month LIBOR rate of 3.595% on \$25 million and matures in April 2012. The cost basis of the new interest rate swap is \$354,000 based on the estimated fair value of the 2008 Interest Rate Cap Contract surrendered (which was also the carrying value at the time of the exchange) in accordance with APB 29.

These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS 133. At September 30, 2008 and December 31, 2007, the fair values of these contracts were \$663,000 and \$426,000, respectively, and are included in other assets in the accompanying consolidated balance sheets. For the nine months ended September 30, 2008, we recognized a gain of \$209,000 and a loss of \$64,000 for the nine months ended September 30, 2007. For the three months ended September 30, 2008 and 2007, we recognized losses of \$499,000 and \$488,000, respectively. In addition, the cash used to purchase these contracts is included in cash flows from continuing investing activities.

Commodities Futures/Forward Contracts

Raw materials for use in our manufacturing processes include copper used by our Climate Control Business and natural gas used by our Chemical Business. As part of our raw material price risk management, we periodically enter into futures/forward contracts for these materials, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS 133. At September 30, 2008 and December 31, 2007, the fair value of these contracts was \$4,931,000 and \$172,000 and is included in current and noncurrent accrued and other liabilities. Pursuant to the terms of these contracts, the fair values are classified as current or noncurrent liabilities in the accompanying condensed consolidated balance sheets. For the nine months ended September 30, 2008 and 2007, we recognized losses of \$3,766,000 and \$456,000, respectively, and for the three months ended September 30, 2008 and 2007, we recognized losses of \$8,254,000 and \$480,000, respectively, on such contracts. In addition, the cash flows relating to these contracts are included in cash flows from continuing operating activities.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 11: Derivatives, Hedges and Financial Instruments (continued)

Foreign Currency Contracts

One of our business operations purchases industrial machinery and related components from vendors outside of the United States. During 2008 as part of our foreign currency risk management, we entered into several foreign currency contracts, which set the U.S. Dollar/Euro exchange rates through December 2008. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS 133. At September 30, 2008, the fair value of these contracts (unrealized loss) was \$129,000 and is included in accrued and other liabilities in the accompanying consolidated balance sheet (none at December 31, 2007). For the nine and three-month periods ended September 30, 2008, we recognized losses of \$172,000 and \$137,000, respectively, (none in 2007) on such contracts. In addition, the cash flows relating to these contracts are included in cash flows from continuing operating activities.

The following details our assets and liabilities at September 30, 2008 that are measured at fair value on a recurring basis:

Description	September 30, 2008	Fair Value Measurements at September 30, 2008 Using	
		Quoted Prices in Active Markets for Identical Assets (Level 1) (In Thousands)	Significant Other Observable Inputs (Level 2)
Assets:			
Interest rate contracts	\$ 663	\$ -	\$ 663
Liabilities:			
Commodities futures/forward contracts	\$ 4,931	\$ 246	\$ 4,685
Foreign currency contracts	129	-	129
Total	<u>\$ 5,060</u>	<u>\$ 246</u>	<u>\$ 4,814</u>

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 11: Derivatives, Hedges and Financial Instruments (continued)

Realized and unrealized gains (losses) included in earnings and the income statement classification are as follows:

	Nine Months Ended September 30, 2008	Three Months Ended September 30, 2008
(In Thousands)		
Total gains (losses) included in earnings:		
Cost of sales	\$ (3,938)	\$ (8,391)
Interest expense	209	(499)
	<u>\$ (3,729)</u>	<u>\$ (8,890)</u>
Change in unrealized gains and losses relating to contracts still held at September 30, 2008:		
Cost of sales	\$ (5,060)	\$ (5,514)
Interest expense	275	(361)
	<u>\$ (4,785)</u>	<u>\$ (5,875)</u>

Note 12: Approval of Stock Incentive Plan During the second quarter of 2008, our board of directors adopted our 2008 Incentive Stock Plan (the "2008 Plan"), which plan was approved by our shareholders at our annual meeting of shareholders held on June 5, 2008. The number of shares of our common stock available for issuance under the 2008 Plan is 1,000,000 shares, subject to adjustment. Under the 2008 Plan, awards may be made to any employee, officer or director of the Company and its affiliated companies. An award may also be granted to any consultant, agent, advisor or independent contractor for bona fide services rendered to the Company or any affiliate (as defined in the 2008 Plan), subject to certain conditions. The 2008 Plan will be administered by the compensation and stock option committee (the "Committee") of our board of directors.

Our board of directors or the Committee may amend the 2008 Plan, except that if any applicable statute, rule or regulation requires shareholder approval with respect to any amendment of the 2008 Plan, then to the extent so required, shareholder approval will be obtained. Shareholder approval will also be obtained for any amendment that would increase the number of shares stated as available for issuance under the 2008 Plan. Unless sooner terminated by our board of directors, the 2008 Plan expires on June 5, 2018.

The following may be granted by the Committee under the 2008 Plan:

Stock Options - The Committee may grant either incentive stock options or non-qualified stock options. The Committee sets option exercise prices and terms, except that the exercise price of a stock option may be no less than 100% of the fair market value, as defined in the 2008 Plan, of the shares on the date of grant. At the time of grant, the Committee will have sole discretion in determining when stock options are exercisable and when they expire, except that the term of a stock option cannot exceed 10 years.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 12: Approval of Stock Incentive Plan (continued)

Stock Appreciation Rights ("SARs") - The Committee may grant SARs as a right in tandem with the number of shares underlying stock options granted under the 2008 Plan or on a stand-alone basis. SARs are the right to receive payment per share of the SAR exercised in stock or in cash equal to the excess of the share's fair market value, as defined in the 2008 Plan, on the date of exercise over its fair market value on the date the SAR was granted. Exercise of an SAR issued in tandem with stock options will result in the reduction of the number of shares underlying the related stock option to the extent of the SAR exercise.

Stock Awards, Restricted Stock, Restricted Stock Units, and Other Awards - The Committee may grant awards of restricted stock, restricted stock units, and other stock and cash-based awards, which may include the payment of stock in lieu of cash (including cash payable under other incentive or bonus programs) or the payment of cash (which may or may not be based on the price of our common stock).

As of September 30, 2008, no awards have been granted under the 2008 Plan; however, see discussion in Note 18-Subsequent Events.

Note 13: Income Per Common Share Net income applicable to common stock is computed by adjusting net income by the amount of preferred stock dividends, dividend requirements and the stock dividend. Basic income per common share is based upon net income applicable to common stock and the weighted-average number of common shares outstanding during each period.

Diluted income per share is based on net income applicable to common stock plus preferred stock dividends and dividend requirements on preferred stock assumed to be converted, if dilutive, and interest expense including amortization of debt issuance cost, net of income taxes, on convertible debt assumed to be converted, if dilutive, and the weighted-average number of common shares and dilutive common equivalent shares outstanding, and the assumed conversion of dilutive convertible securities outstanding.

The following is a summary of certain transactions which affected basic income per share or diluted income per share, if dilutive:

During the nine months ended September 30, 2008,

- we acquired 200,000 shares of our common stock;
- we issued 430,304 shares of our common stock as the result of the exercise of stock options; and
- we paid cash dividends on our Series B Preferred, Series D Preferred and noncumulative redeemable preferred stock ("Noncumulative Preferred") totaling approximately \$240,000, \$60,000 and \$6,000, respectively.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 13: Income Per Common Share (continued)

During the nine months ended September 30, 2007,

- we sold \$60 million of the 2007 Debentures;
- \$4,000,000 of the 7% Convertible Senior Subordinated Debentures (the "2006 Debentures") was converted into 564,789 shares of common stock;
- we issued 2,262,965 shares of common stock for 305,807 shares of our Series 2 Preferred that were tendered pursuant to a tender offer;
- we redeemed 25,820 shares of our Series 2 Preferred and issued 724,993 shares of common stock for 167,475 shares of our Series 2 Preferred;
- we received shareholders' approval in granting 450,000 shares of non-qualified stock options;
- we issued 291,100 shares of our common stock as the result of the exercise of stock options;
- we paid cash dividends of approximately \$678,000 on the shares of Series 2 Preferred we redeemed as discussed above; and
- we paid cash dividends on our Series B Preferred, Series D Preferred and Noncumulative Preferred totaling approximately \$1,890,000, \$360,000 and \$6,000, respectively.

At September 30, 2008, there were no dividends in arrears.

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LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 13: Income Per Common Share (continued)

The following table sets forth the computation of basic and diluted net income per common share:

□ 6 0 ; (Dollars In Thousands, Except Per Share Amounts)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
Numerator:				
Net income	\$ 32,975	\$ 42,335	\$ 4,161	\$ 18,296
Dividends and dividend requirements on Series B Preferred	(240)	(240)	-	(120)
Dividend requirements on shares of Series 2 Preferred which did not exchange pursuant to tender offer or redemption in 2007	-	(272)	-	-
Dividends and dividend requirements on shares of Series 2 Preferred redeemed in 2007	-	(59)	-	(17)
Stock dividend on shares of Series 2 Preferred pursuant to tender offer in 2007(1)	-	(4,971)	-	-
Dividends on Series D Preferred	(60)	(60)	-	(60)
Dividends on Noncumulative Preferred	(6)	(6)	-	(6)
Total dividends, dividend requirements and stock dividend on preferred stock	(306)	(5,608)	-	(203)
Numerator for basic net income per common share - net income applicable to common stock	32,669	36,727	4,161	18,093
Dividends and dividend requirements on preferred stock assumed to be converted, if dilutive	306	637	-	203
Interest expense including amortization of debt issuance costs, net of income taxes, on convertible debt assumed to be converted, if dilutive	1,805	1,007	-	924
Numerator for diluted net income per common share	<u>\$ 34,780</u>	<u>\$ 38,371</u>	<u>\$ 4,161</u>	<u>\$ 19,220</u>
Denominator:				
Denominator for basic net income per common share - weighted-average shares	21,155,724	19,150,030	21,237,268	20,220,419
Effect of dilutive securities:				
Convertible notes payable	2,188,000	870,725	4,000	2,188,000
Convertible preferred stock	938,999	1,657,335	939,286	1,414,784
Stock options	600,917	1,222,133	473,882	1,154,480
Warrants	-	90,241	-	94,209
Dilutive potential common shares	3,727,916	3,840,434	1,417,168	4,851,473
Denominator for diluted net income per common share - adjusted weighted-average shares and assumed conversions	<u>24,883,640</u>	<u>22,990,464</u>	<u>22,654,436</u>	<u>25,071,892</u>
Basic net income per common share	<u>\$ 1.54</u>	<u>\$ 1.92</u>	<u>\$.20</u>	<u>\$.89</u>
Diluted net income per common share	<u>\$ 1.40</u>	<u>\$ 1.67</u>	<u>\$.18</u>	<u>\$.77</u>

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 13: Income Per Common Share (continued)

(1) As discussed in our 2007 Form 10-K, in February 2007, we began a tender offer to exchange shares of our common stock for up to 309,807 of the 499,102 outstanding shares of the Series 2 Preferred. The tender offer expired on March 12, 2007 and our board of directors accepted the shares tendered on March 13, 2007. Because the exchanges under the tender offer were pursuant to terms other than the original terms, the transactions were considered extinguishments of the preferred stock. In addition, the transactions qualified as induced conversions under SFAS 84. In accordance with Emerging Issues Task Force ("EITF") Topic No. D-42, the excess of the fair value of the common stock issued over the fair value of the securities issuable pursuant to the original conversion terms was subtracted from net income in computing net income per share. Because our Series 2 Preferred are cumulative and the dividend requirements have been included in computing net income per share in previous periods and as an element of the exchange transactions, we effectively settled the dividends in arrears, the amount subtracted from net income in 2007 represents the excess of the fair value of the common stock issued over the fair value of the securities issuable pursuant to the original conversion terms less the dividends in arrears as March 13, 2007.

The following weighted-average shares of securities were not included in the computation of diluted net income per common share as their effect would have been antidilutive:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
Stock options	425,000	177,747	425,000	444,293
Convertible notes payable	-	-	2,184,000	-
Series 2 Preferred pursuant to tender offer in 2007 (2)	-	348,120	-	-
	<u>425,000</u>	<u>525,867</u>	<u>2,609,000</u>	<u>444,293</u>

(2) In accordance with EITF Topic No. D-53, the shares associated with the tender offer in 2007 were considered separately from other convertible shares of securities in computing net income per common share for the nine and three months ended September 30, 2007.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 14: Income Taxes Provisions (benefits) for income taxes are as follows:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Current:				
Federal	\$ 13,641	\$ 1,550	\$ 2,121	\$ 1,104
State	1,752	583	28	497
Total Current	<u>\$ 15,393</u>	<u>\$ 2,133</u>	<u>\$ 2,149</u>	<u>\$ 1,601</u>
Deferred:				
Federal	\$ 3,927	\$ (2,827)	\$ 388	\$ (2,827)
State	497	(323)	(149)	(323)
Total Deferred	<u>4,424</u>	<u>(3,150)</u>	<u>239</u>	<u>(3,150)</u>
Provisions (benefits) for income taxes	<u>\$ 19,817</u>	<u>\$ (1,017)</u>	<u>\$ 2,388</u>	<u>\$ (1,549)</u>

For the nine and three months ended September 30, 2008, the current provision for federal income taxes of approximately \$13.6 million and \$2.1 million, respectively, includes regular federal income tax after the consideration of permanent and temporary differences between income for GAAP and tax purposes. For the nine and three months ended September 30, 2007, the current provision for federal income taxes of approximately \$1.6 million and \$1.1 million, respectively, includes alternative minimum income tax ("AMT"). The current provision for state income taxes in 2008 includes provisions for jurisdictions not previously recognized (See discussion of FIN 48 below). The 2008 current state income tax provision also anticipates the utilization of remaining net operating loss ("NOL") carryforwards in certain states. At December 31, 2007, we had minimal federal and state NOL carryforwards and we anticipate utilizing substantially all of these NOL carryforwards during 2008 and have accrued income taxes at regular corporate tax rates. Our overall effective tax rate in 2008 is reduced by permanent tax differences.

For the nine and three months ended September 30, 2007, the benefit for deferred taxes of approximately \$3.2 million results from the reversal of valuation allowance on deferred tax assets, the benefit of AMT credits, and other temporary differences. At December 31, 2006, we had regular NOL carryforwards of approximately \$49.9 million. We account for income taxes under the provisions of SFAS 109 which requires recognition of future tax benefits (NOL carryforwards and other temporary differences) subject to a valuation allowance if it is determined that it is more-likely-than-not that such asset will not be realized. In determining whether it is more-likely-than-not that we will not realize such tax asset, SFAS 109 requires that all negative and positive evidence be considered (with more weight given to evidence that is "objective and verifiable") in making the determination. Prior to September 30, 2007, we had valuation allowances in place against the net deferred tax assets arising from the NOL carryforwards and other temporary differences. Prior to September 30, 2007, management considered certain negative evidence in determining that it was "more-likely-than-not" that the net deferred tax assets would not be utilized in the foreseeable future, thus a valuation allowance was required. The negative evidence considered primarily included our history of losses, both as to amount and trend and uncertainties surrounding our ability to generate sufficient taxable income to utilize these NOL carryforwards.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 14: Income Taxes (continued)

As the result of improving financial results during the third quarter of 2007 including some unusual transactions (settlement of pending litigation and insurance recovery of business interruption claim) and our expectation of generating taxable income in the future, we determined in the third quarter of 2007 that there was sufficient objective and verifiable evidence to conclude that it was more-likely-than-not that we would be able to realize the net deferred tax assets. As a result, we reversed the valuation allowances as a benefit for income taxes and recognized deferred tax assets and deferred tax liabilities.

When non-qualified stock options ("NSOs") are exercised, the grantor of the options is permitted to deduct the spread between the fair market value and the exercise price of the NSOs as compensation expense in determining taxable income. Under SFAS 109, income tax benefits related to stock-based compensation deductions in excess of the compensation expense recorded for financial reporting purposes are not recognized in earnings as a reduction of income tax expense for financial reporting purposes. As a result, the stock-based compensation deduction for the nine months ended September 30, 2008 to be recognized in our 2008 income tax return will exceed the related stock-based compensation expense recognized in earnings. The excess tax benefit realized (i.e., the resulting reduction in the current tax liability) related to the excess stock-based compensation tax deduction of \$3,412,000 is accounted for as an increase in capital in excess of par value for the nine months ended September 30, 2008.

We account for income taxes in accordance with FIN 48, which requires that realization of an uncertain income tax position must be "more likely than not" (i.e., greater than 50% likelihood) that the position will be sustained upon examination by taxing authorities before it can be recognized in the financial statements. Further, FIN 48 prescribes the amount to be recorded in the financial statements as the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions.

We believe that we do not have any material uncertain tax positions that meet the FIN 48 more likely than not recognition criteria other than the failure to file state income tax returns in some jurisdictions where we or some of our subsidiaries may have a filing responsibility. We had approximately \$1,241,000 and \$1,617,000 accrued for uncertain tax liabilities at September 30, 2008 and December 31, 2007, respectively, which are included in accrued and other liabilities in the accompanying condensed consolidated balance sheets.

We plan to negotiate voluntary disclosure agreements and file prior year tax returns with various taxing authorities in 2008. Therefore, we anticipate that the total amounts of unrecognized tax benefits will decrease by approximately \$911,000 by December 31, 2008 as a result of state tax payments made as part of the voluntary disclosure agreement process or other resolutions.

We and certain of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The federal tax returns for 1994 through 2004 remain subject to examination for the purpose of determining the amount of remaining tax NOL and other carryforwards. With few exceptions, the 2005-2007 years remain open for all purposes of examination by the IRS and other major tax jurisdictions.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 15: Other Expense, Other Income and Non-Operating Other Income, net

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Other expense:				
Potential litigation settlements	\$ 367	\$ -	\$ -	\$ -
Impairments of long-lived assets (1)	192	250	-	250
Income tax related penalties	176	7	175	-
Losses on sales and disposals of property and equipment	130	446	48	15
Other miscellaneous expense (2)	81	150	66	70
Total other expense	<u>\$ 946</u>	<u>\$ 853</u>	<u>\$ 289</u>	<u>\$ 335</u>
Other income:				
Litigation judgment and settlements (3)	\$ 8,235	\$ 3,272	\$ -	\$ 3,272
Other miscellaneous income (2)	182	168	88	68
Total other income	<u>\$ 8,417</u>	<u>\$ 3,440</u>	<u>\$ 88</u>	<u>\$ 3,340</u>
Non-operating other income, net:				
Interest income	\$ 1,188	\$ 607	\$ 289	\$ 549
Miscellaneous income (2)	10	73	(1)	8
Miscellaneous expense (2)	(73)	(75)	(25)	(25)
Total non-operating other income, net	<u>\$ 1,125</u>	<u>\$ 605</u>	<u>\$ 263</u>	<u>\$ 532</u>

(1) Based on estimates of the fair values obtained from external sources and estimates made internally based on inquiry and other techniques, we recognized impairments associated with certain corporate assets during the nine months ended September 30, 2008 and certain equipment associated with our Chemical Business during the nine and three months ended September 30, 2007.

(2) Amounts represent numerous unrelated transactions, none of which are individually significant requiring separate disclosure.

(3) For the nine months ended September 30, 2008, income from litigation judgment and settlements includes approximately \$7.6 million, net of attorneys' fees, relating to a previously reported litigation judgment involving a subsidiary within our Chemical Business. On June 6, 2008, we received proceeds of approximately \$11.2 million for this litigation judgment, which includes interest of approximately \$1.4 million, from which we paid attorneys' fees of approximately \$3.6 million. The payment of attorneys' fees of 31.67% of our recovery was contingent upon the cash receipt of the litigation judgment. Cash flows relating to this litigation judgment are included in cash flows from continuing operating activities, except for the portion of the judgment associated with the recovery of damages relating to property, plant and equipment and its pro-rata portion of the attorneys' fees. These cash flows are included in cash flows from continuing investing activities. In addition, a settlement was reached for \$0.4 million for the

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 15: Other Expense, Other Income and Non-Operating Other Income, net (continued)

recovery of certain environmental-related costs incurred in previous periods relating to property used by Corporate and other business operations. During the nine and three months ended September 30, 2007, our Chemical Business reached a settlement with Dynegy, Inc. and one of its subsidiaries, relating to a previously reported lawsuit. This settlement of \$3.3 million reflects the net proceeds of approximately \$2.7 million received by our Cherokee, Alabama facility (the "Cherokee Facility") and the retention by the Cherokee Facility of a disputed accounts payable amount of approximately \$0.6 million.

Note 16: Segment Information

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Net sales:				
Climate Control	\$ 230,303	\$ 221,464	\$ 83,354	\$ 75,641
Chemical	329,271	222,394	124,483	69,252
Other	9,853	7,896	3,083	2,720
	<u>\$ 569,427</u>	<u>\$ 451,754</u>	<u>\$ 210,920</u>	<u>\$ 147,613</u>
Gross profit: (1)				
Climate Control	\$ 72,346	\$ 65,061	\$ 24,892	\$ 22,433
Chemical (2) (3)	37,181	33,980	5,329	11,738
Other	3,140	2,840	948	1,001
	<u>\$ 112,667</u>	<u>\$ 101,881</u>	<u>\$ 31,169</u>	<u>\$ 35,172</u>
Operating income (loss): (4)				
Climate Control	\$ 31,017	\$ 27,875	\$ 9,835	\$ 9,750
Chemical (2) (3) (5)	34,487	27,123	1,860	11,477
General corporate expenses and other business operations, net (6)	(8,158)	(7,225)	(3,005)	(2,130)
	<u>57,346</u>	<u>47,773</u>	<u>8,690</u>	<u>19,097</u>
Interest expense	(6,363)	(8,062)	(2,643)	(3,482)
Non-operating other income (expense), net:				
Climate Control	1	2	-	-
Chemical	64	92	-	10
Corporate and other business operations	1,060	511	263	522
Benefits (provisions) for income taxes	(19,817)	1,017	(2,388)	1,549
Equity in earnings of affiliate-Climate Control	697	654	235	223
Income from continuing operations	<u>\$ 32,988</u>	<u>\$ 41,987</u>	<u>\$ 4,157</u>	<u>\$ 17,919</u>

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 16: Segment Information (continued)

- (1) Gross profit by industry segment represents net sales less cost of sales. Gross profit classified as "Other" relates to the sales of industrial machinery and related components.
- (2) As the result of the change in the fair value of our natural gas futures/forward contracts still held at September 30, 2008 and 2007, our Chemical Business recognized unrealized losses of \$4,931,000 and \$5,391,000 for the nine and three months ended September 30, 2008, respectively, and unrealized losses of \$111,000 and \$96,000 for the nine and three months ended September 30, 2007, respectively. In addition, during the nine and three months ended September 30, 2008, the Cherokee Facility incurred costs of approximately \$5,100,000 as the result of unplanned downtime during the third quarter of 2008. These costs include estimates of lost fixed overhead absorption, repair cost, and losses incurred to purchase anhydrous ammonia to replace lost production in order to meet firm sales commitments. These unrealized losses and costs contributed to a decrease in gross profit and operating income. During the three months ended September 30, 2008, our Chemical Business recognized unrealized gains of \$447,000 associated with natural gas forward contracts, which were deferred at June 30, 2008 due to uncertainties involving a sales contract with a customer. These unrealized gains contributed to an increase in gross profit and operating income.
- (3) During the nine months ended September 30, 2008 and 2007, the amounts expensed for precious metals, net of recoveries and gains, were \$4,866,000 and \$1,670,000, respectively. In addition, during the three months ended September 30, 2008 and 2007, the amounts expensed for precious metals, net of recoveries and gains, were \$1,304,000 and \$278,000, respectively. Also for the nine months ended September 30, 2008 and 2007, we incurred expenses of \$1,494,000 and \$879,000, respectively, relating to planned major maintenance activities. These net expenses contributed to a decrease in gross profit and operating income. During the nine and three months ended September 30, 2007, we realized insurance recoveries of \$1,500,000 relating to a business interruption claim associated with the Cherokee Facility. These recoveries contributed to an increase in gross profit and operating income in 2007.
- (4) Our chief operating decision makers use operating income by industry segment for purposes of making decisions, which include resource allocations and performance evaluations. Operating income by industry segment represents gross profit by industry segment less selling, general and administration expense ("SG&A") incurred by each industry segment plus other income and other expense earned/incurred by each industry segment before general corporate expenses and other business operations, net. General corporate expenses and other business operations, net, consist of unallocated portions of gross profit, SG&A, other income and other expense.
- (5) For the nine-month period ended September 30, 2008, we recognized income of \$7,560,000, net of attorneys' fees, relating to a litigation judgment. For each of the nine and three-month periods ended September 30, 2007, we recognized income of \$3,272,000 relating to a litigation settlement.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 16: Segment Information (continued)

(6) The amounts included are not allocated to our Climate Control and Chemical Businesses since these items are not included in the operating results reviewed by our chief operating decision makers for purposes of making decisions as discussed above. A detail of these amounts are as follows:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(In Thousands)			
Gross profit-Other	\$ 3,140	\$ 2,840	\$ 948	\$ 1,001
Selling, general and administrative:				
Personnel	(5,810)	(5,121)	(1,740)	(1,569)
Professional fees	(3,349)	(2,708)	(1,362)	(941)
Office overhead	(499)	(510)	(122)	(134)
Property, franchise and other taxes	(299)	(232)	(83)	(76)
Advertising	(204)	(189)	(67)	(49)
Shareholders relations	(67)	(147)	(7)	(17)
All other	(1,130)	(1,121)	(428)	(293)
Total selling, general and administrative	(11,358)	(10,028)	(3,809)	(3,079)
Other income	736	47	32	15
Other expense	(676)	(84)	(176)	(67)
Total general corporate expenses and other business operations, net	<u>\$ (8,158)</u>	<u>\$ (7,225)</u>	<u>\$ (3,005)</u>	<u>\$ (2,130)</u>

Information about our total assets by industry segment is as follows:

	September 30, 2008	December 31, 2007
		(In Thousands)
Climate Control	\$ 122,316	\$ 102,737
Chemical	173,583	121,864
Corporate assets and other	69,467	82,953
Total assets	<u>\$ 365,366</u>	<u>\$ 307,554</u>

Note 17: Related Party Transactions

Golsen Group

In connection with the completion of our March 2007 tender offer for our outstanding shares of our Series 2 Preferred, members of the Golsen Group tendered 26,467 shares of Series 2 Preferred in exchange for our issuance to them of 195,855 shares of our common stock. As a result, we effectively settled approximately \$0.63 million in dividends in arrears on the shares of Series 2 Preferred tendered by the Golsen Group. The tender by the Golsen Group was a condition to Jayhawk Group's Agreement to tender shares of Series 2 Preferred in the tender offer as discussed in Note 10-Contingencies.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 17: Related Party Transactions (continued)

After the completion of our March 2007 tender offer relating to the Series 2 Preferred, the Golsen Group held 23,083 shares of Series 2 Preferred. Pursuant to our redemption of the remaining outstanding Series 2 Preferred during August 2007, the Golsen Group redeemed 23,083 shares of Series 2 Preferred and received the cash redemption amount of approximately \$1.76 million pursuant to the terms of our redemption of all of our outstanding Series 2 Preferred. The redemption price was \$50.00 per share of Series 2 Preferred, plus \$26.25 per share in dividends in arrears pro-rata to the date of redemption.

During October 2008 and during the nine months ended September 30, 2007, the Company and certain of its subsidiaries remodeled their offices and incurred costs of \$19,000 and \$13,000, respectively, for the replacement of carpet and flooring involving a company ("Designer Rugs") owned by Linda Golsen Rappaport, the daughter of Jack E. Golsen, our Chairman and Chief Executive Officer, and sister of Barry H. Golsen, our President.

Cash Dividends

As discussed above, in August 2007, we paid cash dividends to the Golsen Group of approximately \$606,000 related to 23,083 shares of Series 2 Preferred redeemed.

In September 2007, we paid the dividends in arrears on our outstanding preferred stock utilizing a portion of the net proceeds of the sale of the 2007 Debentures and working capital, including approximately \$2,250,000 of dividends in arrears on our Series B Preferred and our Series D Preferred, all of the outstanding shares of which are owned by the Golsen Group.

In March 2008, we paid the dividends totaling approximately \$240,000 and \$60,000 on our Series B Preferred and our Series D Preferred, respectively, all of the outstanding shares of which are owned by the Golsen Group.

Quail Creek Bank

Bernard Ille, a member of our board of directors, is a director of Quail Creek Bank, N.A. (the "Bank"). The Bank was a lender to one of our subsidiaries. During the nine months ended September 30, 2007, the subsidiary made interest and principal payments on outstanding debt owed to the Bank in the respective amount of \$0.1 million and \$3.3 million. The debt accrued interest at an annual interest rate of 8.25%. The loan was secured by certain of the subsidiary's property, plant and equipment. This loan was paid in full in June 2007 utilizing a portion of the net proceeds of our sale of the 2007 Debentures.

Note 18: Subsequent Events

Bayer Agreement

On October 23, 2008, El Dorado Nitrogen, L.P. ("EDN"), and EDC, both subsidiaries of the Company, entered into a new Nitric Acid Supply Operating and Maintenance Agreement (the "Bayer Agreement") with Bayer MaterialScience, LLC ("Bayer"). The Bayer Agreement will replace the current Baytown Nitric Acid Project and Supply Agreement, dated June 27, 1997 (the "Original Bayer Agreement"), as of June 24, 2009. The Bayer Agreement is for a term of five

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 18: Subsequent Events (continued)

years commencing on June 24, 2009, following the termination of the Original Bayer Agreement. The Bayer Agreement provides up to five renewal terms of five years each, subject to either party opting against renewal prior to each new renewal period.

Under the terms of the Bayer Agreement, Bayer will purchase from EDN all of Bayer's requirements for nitric acid for use in Bayer's chemical manufacturing facility located in Baytown, Texas (the "Baytown Plant"). Bayer will also supply ammonia as required for production of nitric acid at the Baytown Plant, in addition to certain utilities, chemical additives and services that are required for such production. Any surplus nitric acid manufactured at the Baytown Plant that is not required by Bayer may be marketed to third parties by EDN. The Bayer Agreement provides that Bayer will make certain net monthly payments to EDN which will be sufficient for EDN to recover all of its costs plus a profit.

Pursuant to the terms of the Original Bayer Agreement, Bayer has provided notice of exercise of its option to purchase from a third party all of the assets comprising the Baytown Plant, except certain assets which will be owned by EDN for use in the production process (the "EDN Assets"). EDN will continue to be responsible for the maintenance and operation of the Baytown Plant in accordance with the terms of the Bayer Agreement.

If there is a change in control of EDN, Bayer will have the right to terminate the Bayer Agreement upon payment of a termination fee of approximately \$6.3 million, plus 1.1 times the then current net book value of the EDN Assets. In addition, if EDN receives a third-party offer to purchase any voting equity securities of EDN or the assets comprising the EDN Assets that EDN would like to accept, Bayer will have the option to pay the termination fee or the amount of the third party offer and to terminate the Bayer Agreement.

Grant of Stock Options

During October 2008, we granted 303,000 shares of incentive stock options under the 2008 Plan to certain employees who are not executive officers of the Company or members of our disclosure committee. The exercise price of these options was equal to the market value of our common stock at the date of grant. These options vest at the end of each one-year period at the rate of 16.5% per year for the first five years and the remaining unvested options will vest at the end of the sixth year. In addition, these options expire in October 2018.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our September 30, 2008 condensed consolidated financial statements. Certain statements contained in this MD&A may be deemed forward-looking statements. See "Special Note Regarding Forward-Looking Statements".

Overview

General

We are a manufacturing, marketing and engineering company, operating through our subsidiaries. Our wholly-owned subsidiary, ThermaClime, through its subsidiaries, owns substantially all of our core businesses consisting of the:

- Climate Control Business engages in the manufacturing and selling of a broad range of air conditioning and heating products in the niche markets we serve consisting of geothermal and water source heat pumps, hydronic fan coils, large custom air handlers and other related products used in controlling the environment in commercial and residential new building construction, renovation of existing buildings and replacement of existing systems. For the first nine months of 2008, approximately 40% of our consolidated net sales relates to the Climate Control Business.

For the first nine months of 2008, approximately 84% of the sales of the Climate Control Business relates to the commercial construction market, both new and renovation, and approximately 16% relates to the single-family residential geothermal market, both new and renovation.

- Chemical Business engages in the manufacturing and selling of chemical products produced from three plants located in Arkansas, Alabama and Texas for the industrial, mining and agricultural markets. For the first nine months of 2008, approximately 58% of our consolidated net sales relates to the Chemical Business.

For the first nine months of 2008, approximately 65% of the sales of the Chemical Business relates to the industrial and mining sector. Most of these sales were made pursuant to contracts and/or pricing arrangements that include raw material feedstock cost of natural gas, anhydrous ammonia and sulfur, as a pass-through component in the sales price. The balance of approximately 35% of sales, relates to the agricultural sector. These sales were primarily made at the market price in effect, which prices do not necessarily move in tandem with the cost of our raw material feedstocks.

We believe the current global financial conditions will affect customer demand for our products in both the Climate Control and Chemical Businesses. However, we are unable to predict the potential effect on the future demand from our customers.

In our Climate Control's commercial markets, the orders received in the third quarter of 2008 were \$74.1 million compared to \$61.9 million average for the first two quarters of 2008. We believe there will be contraction in both non-residential, commercial construction and residential

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construction in general. To date, our sales of geothermal products to the single family residential sector have increased in spite of the downturn in residential construction. However at this point, we are unable to assess the potential impact on the sales of our products.

To date in our Chemical Business' industrial sector, the order level has remained relatively steady. However, due to concerns by most industrial companies regarding the outlook for consumer and industrial spending and the effect it will have on sales, our larger industrial chemical customers are reducing inventories. As a result, we expect orders for our industrial products to decline. In our agricultural sector, it is currently difficult to determine the effect of global market conditions that could affect fertilizer demand. Currently, pricing for urea ammonium nitrate "UAN" and ammonium nitrate "AN" fertilizers are higher than our average selling prices during the first and second quarters of 2008, but have recently dropped from levels experienced during the third quarter of 2008.

Third Quarter of 2008

Our sales for the third quarter of 2008 were \$210.9 million compared to \$147.6 million for the third quarter of 2007, our operating income was \$8.7 million compared to \$19.1 million in 2007, and our net income was \$4.2 million, after an income tax provision of \$2.4 million, compared to net income of \$18.3 million, after a benefit for income taxes of \$1.5 million, for the third quarter of 2007.

The sales increase of \$63.3 million includes an increase of \$7.7 million in our Climate Control Business and an increase of \$55.2 million in our Chemical Business. Approximately \$51.0 million of our Chemical Business' increase relates to significantly higher selling prices due to higher market prices and to the pass through of the higher costs of raw material feedstocks. As a result of our ability to pass through most raw material cost increases through sales price increases on a significant portion of the sales of our Chemical Business, our Chemical Business was able to maintain a consistent level of gross profit. However, since the increase in sales was primarily a result of increases in raw material costs instead of volume increases, the gross profit as a percent of sales declined significantly. In addition, our Chemical Business recognized other significant unusual loss items in the third quarter of 2008 that negatively affected gross profit as discussed in the table below.

With respect to operating income and net income, there are a number of factors that affect the comparability of the third quarter of 2008 to the third quarter of 2007. Our Chemical Business' operating income includes the following significant unusual income (loss) items:

	Third Quarter of 2008	Third Quarter of 2007	Effect
		(In Millions)	
Unrealized non-cash losses on natural gas contracts (1)	\$ (4.9)	\$ -	\$ (4.9)
Unplanned downtime of Cherokee Facility (2)	(5.1)	-	(5.1)
Other income from litigation settlement	-	3.3	(3.3)
Insurance recoveries of business interruption claims	-	1.5	(1.5)
Total	<u>\$ (10.0)</u>	<u>\$ 4.8</u>	<u>\$ (14.8)</u>

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- (1) The amount relates to the unrealized losses on our outstanding natural gas contracts at September 30, 2008. These natural gas contracts secure a large portion of the profit margin on significant orders with firm sales prices to be shipped subsequent to September 30, 2008.
- (2) These costs relate to repeated unplanned downtime of the anhydrous ammonia plant at the Cherokee Facility, which reduced production and sales. Costs include estimates of lost fixed overhead absorption, repair costs, and losses incurred to purchase anhydrous ammonia to replace lost production in order to meet firm sales commitments.

In addition, approximately \$4.0 million of UAN shipments scheduled for September 2008 were delayed into October due to out-bound transportation problems caused by Hurricanes Ike and Gustav.

Also, income taxes have a significant effect on the comparability of the third quarter of 2008 compared to the same quarter in 2007. For the third quarter of 2008, we recognized a provision for income taxes of \$2.4 million compared to a benefit of \$1.5 million for the same period in 2007. During the third quarter of 2008, we recognized current and deferred federal and state income taxes due, in part, to increased taxable income and higher effective tax rates. Prior to September 30, 2007, we had valuation allowances in place against the deferred tax assets arising from net operating loss ("NOL") carry forwards and other temporary differences. As the result of improving financial results during the third quarter of 2007 including the unusual 2007 transactions shown above and our expectation of generating taxable income in the future, we reversed the valuation allowances and recognized a deferred tax benefit of approximately \$3.1 million, partially offset by a provision for current federal and state income taxes of \$1.6 million, which resulted in a net benefit of \$1.5 million.

Climate Control Business

Our Climate Control Business has consistently generated annual profits and positive cash flows and continues to do so.

Climate Control's net sales were approximately \$83.4 million compared to \$75.6 million for the third quarter of 2007, an increase of \$7.7 million or 10.2%. The improvement in net sales relates to a 20.9% increase in geothermal and water source heat pump products, partially offset by an overall 5.0% decline in sales of our fan coil and other HVAC products.

For the third quarter of 2008, the order level was \$101.0 million as compared to \$66.0 million in the same period of 2007, an increase of \$35.0 million or 53%. Consistent with net sales, the increase in orders was primarily for geothermal and water source heat pump products. We saw some softening in the order level for hydronic fan coil products that was offset by orders for other HVAC products.

Due to the increase in net sales, Climate Control's gross profit in the third quarter of 2008 increased to \$24.9 million, or 29.9% of net sales, as compared to \$22.4 million, or 29.7% of net sales, in the same period of 2007. For each of the third quarters of 2008 and 2007, Climate Control's operating income before allocation of corporate overhead was \$9.8 million. For the third quarter of 2008, operating income, as a percentage of net sales, was negatively impacted by an increase in operating expenses primarily related to variable selling expenses, warranty

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expenses, professional fees, group insurance expenses and increased sales and marketing personnel.

We continue to closely follow the contraction and volatility in the credit markets and have attempted to assess the impact on the commercial construction sectors that we serve including but not limited to new construction and/or renovation of facilities in the following sectors:

- Lodging
- Manufacturing
- Healthcare
- Offices
- Education
- Multi-Family

Due to the economic climate that exists, we believe there will be some contraction in new projects in certain sectors, but at this point, we are unable to assess the potential impact. However, as indicated above, our order level for the third quarter of 2008 was at record levels, primarily for our geothermal and water source heat pump products. As indicated below, our backlog of orders for Climate Control products was \$85.8 million at September 30, 2008.

We expect continued volatility in material costs, especially for copper, steel and aluminum and components that include those metals. Although we continue to monitor and take measures to mitigate and control material cost fluctuations through hedging transactions, contract purchases and volume agreements, there can be no assurance that our selling prices will track raw material and component cost changes. Most recently, commodity prices have dropped considerably. For example, during the month of October 2008, copper has traded at less than half the price reached in July of 2008 and aluminum has dropped by over a third since March of 2008.

Our Climate Control Business manufactures most of its products to customer orders that are placed well in advance of required delivery dates. As a result, our Climate Control Business maintains a significant backlog that eliminates the necessity to carry substantial inventories other than for firm customer orders. At September 30, 2008, the backlog of confirmed orders was approximately \$85.8 million compared to \$63.3 million and \$54.5 million at June 30, 2008 and December 31, 2007, respectively. We expect to ship substantially all the orders in the backlog within the next twelve months and have the production capacity in place to do so.

The majority of our Climate Control business is subject to the competitive bid process and the opportunity to pass through cost increases for materials depends on market conditions at the time we are bidding for a job. Once an order is accepted and entered into our backlog, the price usually cannot be adjusted to pass through any subsequent changes in our costs.

Our Climate Control Business will continue to launch new products and product upgrades in an effort to maintain our current market position and to establish presence in new markets. Our Climate Control Business' profitability over the last few years has been affected by operating losses of certain product lines being developed during that time. Our emphasis has been to increase the sales levels of these operations above the breakeven point. During 2007 and into 2008, the results for these products reflected modest improvement. Although these products have not yet achieved profitability, we continue to believe that these products have good long-term

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prospects. However, our ability to continue to produce one new potentially profitable product of our large air handling business, the Fan Matrix, depends on the successful outcome of the currently pending patent infringement litigation matter which is discussed under Legal Proceedings of Part II of this report.

Management focuses on the following objectives for Climate Control:

- monitoring and managing the current economic environment,
- increasing the sales and operating margins of all products,
- developing and introducing new and energy efficient products,
- improving production and product delivery performance, and
- expanding the markets we serve, both domestic and foreign.

Chemical Business

Our Chemical Business has production facilities in Baytown, Texas (the "Baytown Facility"), El Dorado, Arkansas (the "El Dorado Facility") and Cherokee, Alabama (the "Cherokee Facility"). The Baytown and El Dorado Facilities produce nitrogen products from anhydrous ammonia that is delivered by pipeline and the El Dorado Facility also produces sulfuric acid from recovered elemental sulfur delivered by truck and rail. The Cherokee Facility produces anhydrous ammonia and nitrogen products from natural gas that is delivered by pipeline. In addition, we own idle ammonia and downstream derivative chemical process units in Pryor, Oklahoma (the "Pryor Facility"), which we are in the process of activating, subject to obtaining a sales or distribution agreement and necessary permits, as discussed below under "Liquidity and Capital Resources-Pryor Facility." When activated, this facility will produce anhydrous ammonia, urea ammonium nitrate ("UAN") and certain other industrial products from natural gas.

Our Chemical Business reported net sales for the third quarter of 2008 of \$124.5 million compared to \$69.3 million for the third quarter of 2007, an increase of \$55.2 million. Operating income before allocation of corporate overhead was \$1.9 million compared to \$11.5 million in the same period of 2007.

The increase in sales of \$55.2 million includes overall sales price increases of approximately \$51.0 million attributable to significantly higher selling prices for our products produced at our facilities.

As shown in the table above and discussed below, our Chemical Business' operating income for the third quarter of 2008 decreased by \$10.0 million for unrealized losses on outstanding natural gas contracts and costs relating to unplanned downtime of the Cherokee Facility. For the third quarter of 2007, unusual items increased operating income by \$4.8 million. Excluding these unusual items for both periods, results for the third quarter of 2008 are comparable to the third quarter of 2007.

Our primary raw material feedstocks, anhydrous ammonia, natural gas and sulfur, are commodities subject to significant price fluctuations, and are generally purchased at prices in effect at the time of purchase. During the third quarter of 2008, natural gas ranged in price from \$6.98 to \$13.16 per MMBtu and averaged approximately \$10.80 per MMBtu compared to an average cost in the third quarter of 2007 of \$6.55 MMBtu. At November 3, 2008, the price for

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natural gas was \$6.15 per MMBtu. During the third quarter of 2008, anhydrous ammonia ranged in price based on the low Tampa metric price per ton from \$585 to \$931 per metric ton and averaged approximately \$818, compared to an average cost in the third quarter of 2007 of \$299 per metric ton. At November 3, 2008, the Tampa price for anhydrous ammonia was \$575 per metric ton. During the third quarter of 2008, the cost for sulfur based on the Tampa price averaged approximately \$617 per long ton compared to an average cost in the third quarter of 2007 of \$84 per long ton. At November 3, 2008, the Tampa price for sulfur has dropped to \$150 per long ton. Due to the uncertainty of these commodity markets, we continue to generate sales pursuant to agreements and/or pricing formulas that provide for the pass through of raw material and other variable costs and certain fixed costs.

We have entered into futures contracts to hedge the cost of natural gas for the purpose of securing a significant portion of the profit margin on certain orders for products that our Chemical Business produces. Recent extreme volatility in natural gas futures prices has created wide swings in the market value of our natural gas hedges. Due to a steep decline in natural gas futures prices, the unrealized non-cash losses on our outstanding natural gas hedges were \$4.9 million at September 30, 2008, of which approximately \$2.6 million relate to contracts that will settle during the fourth quarter of 2008. For the fourth quarter of 2008, the unrealized gain or loss to be recognized on natural gas hedges still outstanding at December 31, 2008 will depend on the futures price of natural gas as of December 31, 2008, as compared to the futures price as of September 30, 2008. Therefore, we are unable to predict the impact these hedges will have on the fourth quarter and future quarters. However, these hedges contractually secure a large portion of the profit margin on significant orders for our Chemical Business at the time the customer orders are accepted and is indeed realized at the time the physical transactions occur. The interim mark-to-market accounting adjustments produce volatility in our financial statements; however, the unrealized gains or losses are non-cash items.

Currently and during most of 2008, ammonium nitrate produced from purchased anhydrous ammonia at current market prices is at a competitive disadvantage to ammonium nitrate produced from natural gas. However, this differential changes from time to time, due to volatility of natural gas and anhydrous ammonia costs. We estimate that during the third quarter of 2008, the cost differential was approximately \$120 per ton of ammonium nitrate.

During the third quarter of 2008, the Cherokee Facility experienced repeated downtime, which downtime reduced production and sales by our Chemical Business. As a result, interim repairs were made at the Cherokee Facility during this period. Due to this repeated downtime, the Cherokee Facility lost approximately 20 days of operation reducing our Chemical Business' operating income by approximately \$5.1 million during the third quarter of 2008. Beginning in early October 2008, more extensive repairs were made at this facility during a planned major maintenance activity ("Turnaround") and work continues at this time.

Our Chemical Business expenses the costs relating to Turnarounds as they are incurred. During the third quarter of 2008, expenses for Turnarounds were approximately \$0.9 million compared to \$0.5 million during the same period in 2007. Based on our current plan for Turnarounds to be performed during the fourth quarter of 2008, we currently estimate that we will incur approximately \$4.1 million of Turnaround costs. However, it is possible that the actual costs could be significantly different than our estimates.

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Our Chemical Business uses precious metals as a catalyst in the manufacturing process of nitric acid, which costs for these precious metals have been volatile. In addition, during major maintenance and capital projects performed during the third quarter of 2008, we performed procedures to recover precious metals (previously expensed) which had accumulated over time within our manufacturing equipment. Also during the third quarter of 2007, we sold a portion of our precious metals that exceeded our production requirements. As the result, precious metals expense, net of recoveries and gains, increased \$1.0 million as compared to the third quarter of 2007. Current prices for precious metals are less than half the prices were a year ago and significantly lower than the peak levels reached in June 2008.

Our Chemical Business continues to focus on growing our non-seasonal industrial customer base with an emphasis on customers accepting the risk inherent with raw material costs, while at the same time, maintaining a strong presence in the seasonal agricultural sector, when the potential for favorable gross profit margins is available. A significant percentage of the costs to operate process plants, other than costs for raw materials and utilities, are fixed costs. Our long-term strategy includes optimizing production efficiency of our facilities, thereby lowering the fixed cost of each ton produced.

Liquidity and Capital Resources

The following is our cash and cash equivalents, total interest bearing debt and stockholders' equity:

	September 30, 2008	December 31, 2007
	(In Millions)	
Cash and cash equivalents	\$ 47.5	\$ 58.2
Long-term debt:		
2007 Debentures due 2012	\$ 60.0	\$ 60.0
Secured Term Loan due 2012	50.0	50.0
Other	13.5	12.1
Total long-term debt	\$ 123.5	\$ 122.1
Total stockholders' equity	\$ 128.5	\$ 94.3

As indicated above, we believe our capital structure and liquidity at September 30, 2008 reflect a reasonably sound financial position. In addition to our outstanding debt, our \$50 million Working Capital Revolver Loan is undrawn and available to fund operations, if needed. At September 30, 2008, the ratio between long-term debt, before the use of cash on hand to pay down debt, and stockholders' equity was approximately 0.96 to 1 as compared to 1.3 to 1 at December 31, 2007.

The 2007 Debentures bear interest at the annual rate of 5.5% and mature on July 1, 2012. Interest is payable in arrears on January 1 and July 1 of each year. Our board of directors has granted management the authority to repurchase all or a portion of the 2007 Debentures on favorable terms if an opportunity is presented on terms satisfactory to management.

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The Secured Term Loan matures on November 2, 2012 and accrues interest at a defined LIBOR rate plus 3%. The interest rate at September 30, 2008 was 5.79%. The Secured Term Loan requires quarterly interest payments with the final payment of interest and principal at maturity. The Secured Term Loan is secured by the real property and equipment located at the El Dorado and Cherokee Facilities.

ThermaClime and certain of its subsidiaries are subject to numerous covenants under the Secured Term Loan including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions.

At September 30, 2008, we had approximately \$49.5 million of borrowing availability under the Working Capital Revolver Loan based on eligible collateral. Historically, ThermaClime and its subsidiaries' (the "Borrowers") primary cash needs have been for working capital and capital expenditures. The Borrowers depend upon their Working Capital Revolver Loan, internally generated cash flows, and secured property and equipment financing in order to fund operations and pay obligations.

The Working Capital Revolver Loan and the Secured Term Loan have financial covenants that are discussed below under "Loan Agreements - Terms and Conditions". The Borrowers' ability to maintain borrowing availability under the Working Capital Revolver Loan depends on their ability to comply with the terms and conditions of the loan agreements and their ability to generate cash flow from operations. The Borrowers are restricted under their credit agreements as to the funds they may transfer to the Company and their non-ThermaClime affiliates and certain ThermaClime subsidiaries. This limitation does not prohibit payment to the Company of amounts due under a Services Agreement, Management Agreement and a Tax Sharing Agreement.

Income Taxes

As previously discussed, in 2007 and certain prior years, our effective tax rate had been minimal due to the valuation allowances on NOL carryforwards and other deferred tax assets. In the third quarter of 2007, due to our improved operating results, it was determined that the valuation allowances were no longer necessary. At December 31, 2007, we had minimal NOL carryforwards remaining. We anticipate utilizing substantially all of the NOL carryforwards in 2008 and we have been recognizing and paying federal income taxes at regular corporate tax rates.

Capital Expenditures

General

Cash used for capital expenditures during the nine months ended September 30, 2008 was \$22.7 million, including \$6.3 million primarily for property, production equipment, and other upgrades for additional capacity in our Climate Control Business and \$16.3 million for our Chemical Business, primarily for process and reliability improvements of existing facilities. As discussed below, our current commitment for the fourth quarter of 2008 is approximately \$7.9 million.

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Other capital expenditures for the fourth quarter of 2008 are believed to be discretionary. In addition, although not approved or committed, we are considering numerous capital expenditures related to our Chemical Business that would utilize a significant amount of our existing cash on hand, if not separately financed.

Current Commitments

As of the date of this report, we have committed capital expenditures of approximately \$7.9 million for the fourth quarter of 2008. The expenditures include \$5.5 million for process and reliability improvement in our Chemical Business, including \$0.9 million relating to the Pryor Facility. In addition, our current commitments include \$2.4 million for property and production equipment in our Climate Control Business. We plan to fund these expenditures from working capital, which may include utilizing our Working Capital Revolver Loan, and financing arrangements.

Certain events relating to our Chemical Business

Pryor Facility - As previously reported, we are considering activating a portion of our idle Pryor Facility subject to securing a sales agreement with a strategic customer to purchase and distribute the majority of the UAN production. Based on our discussions with several large strategic industry customers, we believe that we will be able to reach an agreement to sell or distribute the UAN production at the Pryor Facility.

Based on the current status of those discussions and our expectation that we will receive the necessary permits, we have hired key personnel to operate the facility and have positioned the additional necessary personnel to be hired at appropriate intervals during the start-up phases.

We were originally advised by the permitting authorities, that we would receive our permits in October 2008. However, due to delays relating to administrative procedures, the final permits could be delayed 90 to 120 days. Currently, we do not believe that there are any impediments to the issuance of permits to operate the facility. Therefore, we are proceeding with the preparations to start the facility. Barring unforeseen delays and subject to securing a sales or distribution agreement as discussed above and obtaining the required permits, we expect the anhydrous ammonia plant and nitric acid plant to start up during the second quarter of 2009 and the urea plant and the production of UAN to start during the third quarter of 2009. When all of these plants become operational, we believe they will add approximately \$120 million in annual sales at current prices. The preliminary estimated total cost to activate the Pryor Facility is approximately \$15 to \$20 million with a portion of these costs to be expensed as incurred. This project will probably be funded from our available cash on hand and working capital. However, the actual timeframe on when we could begin production, the related amount of sales and the total cost to activate the facility could be significantly different than our current estimates.

Bayer Agreement - On October 23, 2008, El Dorado Nitrogen, L.P. ("EDN") and EDC, both subsidiaries of Company, entered into a new Nitric Acid Supply Operating and Maintenance Agreement (the "Bayer Agreement") with Bayer MaterialScience, LLC ("Bayer"). The Bayer Agreement will replace the current Baytown Nitric Acid Project and Supply Agreement, dated June 27, 1997 (the "Original Bayer Agreement"), as of June 24, 2009. The Bayer Agreement is for a term of five years commencing on June 24, 2009, following the termination of the Original

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Bayer Agreement. The Bayer Agreement provides up to five renewal terms of five years each, subject to either party opting against renewal prior to each new renewal period.

Under the terms of the Bayer Agreement, Bayer will purchase from EDN all of Bayer's requirements for nitric acid for use in Bayer's chemical manufacturing facility located in Baytown, Texas (the "Baytown Plant"). Bayer will also supply ammonia as required for production of nitric acid at the Baytown Plant, in addition to certain utilities, chemical additives and services that are required for such production. Any surplus nitric acid manufactured at the Baytown Plant that is not required by Bayer may be marketed to third parties by EDN. The Bayer Agreement provides that Bayer will make certain net monthly payments to EDN which will be sufficient for EDN to recover all of its costs plus a profit.

Pursuant to the terms of the Original Bayer Agreement, Bayer has provided notice of exercise of its option to purchase from a third party all of the assets comprising the Baytown Plant, except certain assets which will be owned by EDN for use in the production process (the "EDN Assets"). EDN will continue to be responsible for the maintenance and operation of the Baytown Plant in accordance with the terms of the Bayer Agreement.

If there is a change in control of EDN, Bayer will have the right to terminate the Bayer Agreement upon payment of a termination fee of approximately \$6.3 million, plus 1.1 times the then current net book value of the EDN Assets. In addition, if EDN receives a third-party offer to purchase any voting equity securities of EDN or the assets comprising the EDN Assets that EDN would like to accept, Bayer will have the option to pay the termination fee or the amount of the third party offer and to terminate the Bayer Agreement. For the year ended December 31, 2007, EDN, a subsidiary of EDNC, had sales to Bayer of approximately 15% and 7% of the Chemical Business' and the Company's consolidated sales, respectively.

Potential Increase of Imported Ammonium Nitrate - In 1999, in response to an influx of very low-priced imports of ammonium nitrate from Russia, EDC joined with other United States producers of fertilizer-grade ammonium nitrate to file an antidumping petition seeking relief from unfairly traded ammonium nitrate from Russia. The petition was successful, and in May 2000, the United States and Russia entered into a "suspension agreement" limiting the quantity and setting minimum export prices of Russian ammonium nitrate that may be imported into the United States market. The suspension agreement was concluded under a statutory provision applicable to non-market economy ("NME") countries.

In 2002, the United States government "graduated" Russia to market economy status. Russian ammonium nitrate producers and the Russian government recently requested that the suspension agreement be converted to the type of agreement normally available in market economy cases. Unlike NME agreements, suspension agreements with market economy countries may only require that the prices of those imports reflect full production costs (plus profit) of the foreign producer. This change in the suspension agreement may result in a substantial increase in the volume of Russian ammonium nitrate imported into the United States. Russia is the world's largest producer and exporter of fertilizer-grade ammonium nitrate and Russia has substantial excess ammonium nitrate production capacity. Russian producers benefit from natural gas supplied at state-set prices that are below market-determined values, which reduces their production costs. Other factors, however, such as transportation costs may partially offset natural gas and production cost advantages.

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Stock Repurchase Authorization

As previously reported, our board of directors enacted a stock repurchase authorization for an unstipulated number of shares for an indefinite period of time commencing March 12, 2008. The stock repurchase authorization will remain in effect until such time as of our board of directors decides to end it. During the first nine months of 2008, we repurchased 200,000 shares of our common stock (none during the third quarter of 2008).

Dividends

We are a holding company and, accordingly, our ability to pay cash dividends on our preferred stock and our common stock depends in large part on our ability to obtain funds from our subsidiaries. The ability of ThermaClime (which owns substantially all of the companies comprising the Climate Control Business and Chemical Business) and its wholly-owned subsidiaries to pay dividends and to make distributions to us is restricted by certain covenants contained in the \$50 million Working Capital Revolver Loan and the \$50 million Secured Term Loan. Under the terms of these agreements, ThermaClime cannot transfer funds to us in the form of cash dividends or other distributions or advances, except for:

- the amount of income taxes that ThermaClime would be required to pay if they were not consolidated with us;
- an amount not to exceed fifty percent (50%) of ThermaClime's consolidated net income during each fiscal year determined in accordance with generally accepted accounting principles plus amounts paid to us within the first bullet above, provided that certain other conditions are met;
- the amount of direct and indirect costs and expenses incurred by us on behalf of ThermaClime pursuant to a certain services agreement;
- amounts under a certain management agreement between us and ThermaClime, provided certain conditions are met, and
- outstanding loans not to exceed \$2.0 million at any time.

We have not paid cash dividends on our outstanding common stock in many years and we do not currently anticipate paying cash dividends on our outstanding common stock in the foreseeable future. However, our board of directors has not made a definitive decision whether or not to pay such dividends in 2008.

During the first nine months of 2008, the 2008 dividend requirements were declared and paid on our preferred stock. Therefore, there were no unpaid dividends in arrears at September 30, 2008.

Each share of preferred stock is entitled to receive an annual dividend, only when declared by our board of directors, payable as follows:

- Series B Preferred at the rate of \$12.00 a share payable January 1, which dividend is cumulative;
- Series D Preferred at the rate of \$.06 a share payable on October 9, which dividend is cumulative; and
- Non-Cumulative Preferred at the rate of \$10.00 a share payable April 1, which are non-cumulative.

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Compliance with Long-Term Debt Covenants

As discussed below under “Loan Agreements - Terms and Conditions”, the Secured Term Loan and Working Capital Revolver Loan, as amended, of ThermaClime and its subsidiaries require, among other things, that ThermaClime meet certain financial covenants. ThermaClime's forecasts for the remainder of 2008 indicate that ThermaClime will be able to meet all required financial covenant tests for the remainder of 2008.

Loan Agreements - Terms and Conditions

5.5% Convertible Senior Subordinated Debentures - As previously reported, on June 28, 2007, we completed a private placement to twenty-two qualified institutional buyers, pursuant to which we sold \$60.0 million aggregate principal amount of the 2007 Debentures. We received net proceeds of approximately \$57.0 million, after discounts and commissions. The 2007 Debentures bear interest at the rate of 5.5% per year and mature on July 1, 2012. Interest is payable in arrears on January 1 and July 1 of each year, which began on January 1, 2008. In addition, the 2007 Debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior indebtedness, including indebtedness under our revolving debt facilities. The 2007 Debentures are effectively subordinated to all present and future liabilities, including trade payables, of our subsidiaries.

The 2007 Debentures are convertible by the holders in whole or in part into shares of our common stock prior to their maturity. The conversion rate of the 2007 Debentures for the holders electing to convert all or any portion of a debenture is 36.4 shares of our common stock per \$1,000 principal amount of debentures (representing a conversion price of \$27.47 per share of common stock), subject to adjustment under certain conditions as set forth in the Indenture.

Working Capital Revolver Loan - - ThermaClime's Working Capital Revolver Loan is available to fund its working capital requirements, if necessary, through April 13, 2012. Under the Working Capital Revolver Loan, ThermaClime and its subsidiaries may borrow on a revolving basis up to \$50.0 million based on specific percentages of eligible accounts receivable and inventories. As a result of using a portion of the proceeds from the 2007 Debentures to pay down the Working Capital Revolver Loan, at September 30, 2008, there were no outstanding borrowings. In addition, the net credit available for additional borrowings under our Working Capital Revolver Loan was approximately \$49.5 million. The Working Capital Revolver Loan requires that ThermaClime meet certain financial covenants measured quarterly. ThermaClime was in compliance with those covenants for the twelve-month period ended September 30, 2008.

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Secured Term Loan - As previously reported, in November 2007, ThermaClime and certain of its subsidiaries entered into the \$50.0 million Secured Term Loan with a certain lender. Proceeds from the Secured Term Loan were used to repay the previous senior secured loan. The Secured Term Loan matures on November 2, 2012. The Secured Term Loan accrues interest at a defined LIBOR rate plus 3%. The interest rate at September 30, 2008 was 5.79%. The Secured Term Loan requires only quarterly interest payments with the final payment of interest and principal at maturity. The Secured Term Loan is secured by the real property and equipment located at the El Dorado and Cherokee Facilities. The carrying value of the pledged assets is approximately \$58 million at September 30, 2008.

The Secured Term Loan borrowers are subject to numerous covenants under the agreement including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. At September 30, 2008, the carrying value of the restricted net assets of ThermaClime and its subsidiaries was approximately \$72 million. The Secured Term Loan borrowers are also subject to a minimum fixed charge coverage ratio and a maximum leverage ratio, both measured quarterly on a trailing twelve-month basis. The Secured Term Loan borrowers were in compliance with these financial covenants for the twelve-month period ended September 30, 2008. The maturity date of the Secured Term Loan can be accelerated by the lender upon the occurrence of a continuing event of default, as defined.

Cross - Default Provisions - The Working Capital Revolver Loan agreement and the Secured Term Loan contain cross-default provisions. If ThermaClime fails to meet the financial covenants of the Secured Term Loan, the lender may declare an event of default, making the debt due on demand. If this should occur, there are no assurances that we would have funds available to pay such amount or that alternative borrowing arrangements would be available. Accordingly, ThermaClime could be required to curtail operations and/or sell key assets. These actions could result in the recognition of losses that may be material.

Seasonality

We believe that our only seasonal products are fertilizer and related chemical products sold by our Chemical Business to the agricultural industry. The selling seasons for those products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November in the geographical markets in which the majority of our agricultural products are distributed. As a result, our Chemical Business increases its inventory of agricultural products prior to the beginning of each planting season. In addition, the amount and timing of sales to the agricultural markets depend upon weather conditions and other circumstances beyond our control.

Related Party Transaction

During October 2008, the Company remodeled their offices and incurred costs of \$19,000 for the replacement of carpet and flooring involving a company ("Designer Rugs") owned by Linda Golsen Rappaport, the daughter of Jack E. Golsen, our Chairman and Chief Executive Officer, and sister of Barry H. Golsen, our President.

Critical Accounting Policies and Estimates

See our discussion on critical accounting policies in Item 7 of our Form 10-K for the year ended December 31, 2007. In addition, the preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses, and disclosures of contingencies.

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Results of Operations

Nine months ended September 30, 2008 compared to Nine months ended September 30, 2007

Net Sales

The following table contains certain information about our net sales in different industry segments for the nine months ended September 30,

	<u>2008</u>	<u>2007</u>	<u>Change</u>	<u>Percentage Change</u>
(Dollars In Thousands)				
Net sales:				
Climate Control:				
Geothermal and water source heat pumps	\$ 136,161	\$ 127,292	\$ 8,869	7.0 %
Hydronic fan coils	65,701	65,414	287	0.4 %
Other HVAC products	28,441	28,758	(317)	(1.1)%
Total Climate Control	<u>\$ 230,303</u>	<u>\$ 221,464</u>	<u>\$ 8,839</u>	4.0 %
Chemical:				
Industrial acids and other chemical products	\$ 126,690	\$ 72,784	\$ 53,906	74.1 %
Agricultural products	120,661	92,002	28,659	31.2 %
Mining products	81,920	57,608	24,312	42.2 %
Total Chemical	<u>\$ 329,271</u>	<u>\$ 222,394</u>	<u>\$ 106,877</u>	48.1 %
Other	<u>\$ 9,853</u>	<u>\$ 7,896</u>	<u>\$ 1,957</u>	24.8 %
Total net sales	<u>\$ 569,427</u>	<u>\$ 451,754</u>	<u>\$ 117,673</u>	26.0 %

Climate Control Business

- Net sales of our geothermal and water source heat pump products increased primarily as a result of a 15% increase in our average selling price per unit due to a change in product mix, primarily more residential products that have higher selling prices partially offset by an 8% decrease in the number of units sold. The number of units sold in 2007 was especially strong due to the concerted effort to reduce the substantial backlog of customer orders on hand at the end of 2006. During the first nine months of 2008, we continued to maintain a market share leadership position of approximately 40%, based on data supplied by the Air-Conditioning, Heating and Refrigeration Institute ("AHRI");
- Net sales of our hydronic fan coils increased slightly primarily due to a 3% increase in our average selling price partially offset by a decrease in the number of units sold. During the first nine months of 2008, we continued to maintain a market share leadership position, of approximately 39%, based on data supplied by the AHRI;
- Net sales of our other HVAC products decreased slightly primarily as the result of a decrease in the number of modular chillers products sold as the result of lower order levels.

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Chemical Business

The El Dorado and Cherokee Facilities produce all the chemical products described in the table above and Baytown produces only industrial acids products. For the first nine months of 2008, overall sales prices for the Chemical Business increased 55% while the volume of tons sold decreased 3%, compared with the same period of 2007.

- Sales prices at the El Dorado Facility increased 49% related, in part, to the high cost of raw materials, anhydrous ammonia and sulfur, which we were able to pass through to our customers and also to strong global agricultural market demand relative to supply volumes during this period. Volume at the El Dorado Facility decreased 15% or 78,000 tons. The decrease in tons sold was primarily attributable to (i) 34,000 fewer tons of agricultural ammonium nitrate sold primarily in the first half of 2008 compared to the same period of 2007 due to poor weather conditions and lower demand for ammonium nitrate in favor of urea, a competing product in El Dorado's market area, as well as reduced forage application due to poor conditions in the cattle market and (ii) 20,000 fewer tons of industrial grade ammonium nitrate sold to the mining industry in the first quarter of 2008. Industrial grade ammonium nitrate is sold under a multi-year supply agreement that includes minimum monthly and annual volume requirements, as well as the pass through of raw material costs. For 2008, we expect the customer will either meet the volume requirements or pay liquidated damages, pursuant to the terms of the supply agreement. Although volumes of industrial grade ammonium nitrate were down, sales prices increased under this supply agreement due to higher average selling prices but had a minimum impact to gross profit and operating income;
- Sales prices and volumes at the Cherokee Facility increased 57% and 10%, respectively, primarily related to the market-driven demand for UAN and mining products. Sales prices also increased with the pass through of our higher natural gas costs in the first nine months of 2008 compared to same period of 2007, recoverable under pricing arrangements with certain of our industrial customers. The increase in volume was partially offset by the unplanned downtime experienced during the third quarter of 2008 as discussed above under "Overview-Third Quarter of 2008 and Chemical Business";
- Sales prices increased approximately 84% at the Baytown Facility due to higher global ammonia pricing, which is recoverable under the Original Bayer Agreement but had a minimum impact to gross profit and operating income. Overall volumes increased 3% as the result of an increase in customer demand.

Other - Net sales classified as "Other" consists of sales of industrial machinery and related components. The increase in net sales relates primarily to increased customer demand for our machine tool products.

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Gross Profit

Gross profit by industry segment represents net sales less cost of sales. The following table contains certain information about our gross profit in different industry segments for the nine months ended September 30,

	<u>2008</u>	<u>2007</u>	<u>Change</u>	<u>Percentage Change</u>
	(Dollars In Thousands)			
Gross profit:				
Climate Control	\$ 72,346	\$ 65,061	\$ 7,285	11.2%
Chemical	37,181	33,980	3,201	9.4%
Other	3,140	2,840	300	10.6%
	<u>\$ 112,667</u>	<u>\$ 101,881</u>	<u>\$ 10,786</u>	10.6%
Gross profit percentage (1):				
Climate Control	31.4%	29.4%	2.0%	
Chemical	11.3%	15.3%	(4.0) %	
Other	31.9%	36.0%	(4.1) %	
Total	19.8%	22.6%	(2.8) %	

(1) As a percentage of net sales

The increase in gross profit in our Climate Control Business was primarily the result of the increase in our average selling prices as discussed above and the increase of \$1.7 million in gains recognized on our futures contracts for copper partially offset by the reduction in sales volumes discussed above. In addition, the above changes were also the primary reasons for the increase in our gross profit percentage.

The increase in gross profit of our Chemical Business relates primarily to the increase in sales prices of products sold by the El Dorado and Cherokee Facilities, as discussed above, in relation to raw material costs. However, this increase in gross profit in our Chemical Business was partially offset by unrealized losses of \$4.9 million on our natural gas futures/forward contracts outstanding at September 30, 2008. In addition, the Cherokee Facility incurred costs of approximately \$5.1 million as the result of unplanned downtime during the third quarter of 2008 as discussed above under "Overview - Chemical Business." Also during the first nine months of 2008, the amount expensed for precious metals, net of recoveries and gains, was \$4.9 million compared to \$1.7 million during the same period in 2007. In general, other non-raw material manufacturing expenses, including steam (produced from natural gas), maintenance and Turnarounds, electricity and labor, increased during the first nine months of 2008 compared to the same period of 2007. Our Chemical Business incurred expenses for Turnarounds of \$1.5 million for the first nine months of 2008 compared to \$0.9 million for the same period in 2007. These losses and expenses contributed to a decrease in gross profit. During the first nine months of 2007, we realized non-recurring insurance recoveries of \$1.5 million relating to a business interruption claim. These recoveries contributed to an increase in gross profit in 2007. As a result of these changes discussed above, our overall gross profit percentage declined for the first nine months of 2008 as compared to the same period of 2007.

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The increase in gross profit classified as "Other" (see discussion above) is due primarily to the increase in sales as discussed above. The decline in our gross profit percentage was primarily due to additional costs incurred relating to a large customized industrial machine tool and the recognition of unrealized losses of \$129,000 on our foreign currency contracts.

Operating Income

Our chief operating decision makers use operating income by industry segment for purposes of making decisions which include resource allocations and performance evaluations. Operating income by industry segment represents gross profit by industry segment less selling, general and administrative expense ("SG&A") incurred by each industry segment plus other income and other expense earned/incurred by each industry segment before general corporate expenses and other business operations, net. General corporate expenses and other business operations, net consist of unallocated portions of gross profit, SG&A, other income and other expense. The following table contains certain information about our operating income for the nine months ended September 30,

	<u>2008</u>	<u>2007</u>	<u>Change</u>
		(In Thousands)	
Operating income:			
Climate Control	\$ 31,017	\$ 27,875	\$ 3,142
Chemical	34,487	27,123	7,364
General corporate expense and other business operations, net	(8,158)	(7,225)	(933)
	<u>\$ 57,346</u>	<u>\$ 47,773</u>	<u>\$ 9,573</u>

Operating Income - Climate Control: The net increase in operating income of our Climate Control Business resulted primarily from the net increase of gross profit of \$7.3 million as discussed above. This increase in operating income was partially offset by an increase in warranty expenses of \$1.3 million due to the increase in sales volume and costs incurred, an increase in personnel costs of \$2.0 million as the result of an increase in the number of personnel and costs associated with group insurance and other employee benefits, and an increase in professional fees of \$0.9 million primarily relating to legal expenses associated with patent defense costs relating to potential new product development in the large air-handler product line.

Operating Income - Chemical: The net increase of our Chemical Business' operating income includes the net increase in gross profit of \$3.2 million as discussed above. In addition, as previously reported, during the nine months ended September 30, 2008, our Chemical Business recognized income of \$7.6 million from a litigation judgment. During the same period of 2007, we recognized income of \$3.3 million relating to a litigation settlement.

General Corporate Expense and Other Business Operations, Net: The net increase in our general corporate expense and other business operations, net relates primarily to increased personnel costs of \$0.7 million resulting from increased compensation and other employee benefits, professional fees of \$0.6 million due, in part, for assistance in our evaluation of our internal controls and procedures and related documentation for Sarbanes-Oxley requirements and to legal fees on various litigation matters and other expense of \$0.6 million relating primarily to potential litigation settlements, an impairment of long-lived assets and income tax related

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penalties, partially offset by an increase in other income of \$0.7 million due, in part, to litigation settlements.

Interest Expense

Interest expense was \$6.4 million for the first nine months of 2008 compared to \$8.1 million for the same period of 2007, a decrease of \$1.7 million. This net decrease primarily relates to a decrease of \$2.0 million as the result of obtaining a lower interest rate associated with the Secured Term Loan compared to the interest rate associated with the previous senior secured loan, a decrease of \$1.0 million due to the continuous pay off of the Working Capital Revolver Loan during 2008, partially offset by the increase of \$1.9 million relating to the 2007 Debentures.

Non-Operating Other Income, Net

Our non-operating other income, net was \$1.1 million for the first nine months of 2008 compared to \$0.6 million for the same period in 2007. The increase of \$0.5 million relates primarily to interest income earned from investing a portion of the net proceeds from the 2007 Debentures in money market funds.

Provision and Benefit For Income Taxes

The provision for income taxes for the nine months ended September 30, 2008 was \$19.8 million compared to a benefit for income taxes of \$1.0 million for the same period in 2007. During the first nine months of 2008, we incurred current and deferred federal and state income taxes due, in part, to increased taxable income and higher effective tax rates. During the same period of 2007, we recognized a benefit for income taxes as the result of the reversal of valuation allowances against net deferred assets of approximately \$3.2 million. The benefit derived from the reversal of the valuation allowances was partially offset by an increase in the federal AMT and state income taxes resulting from increased taxable income and higher effective tax rates.

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Three months ended September 30, 2008 compared to Three months ended September 30, 2007

Net Sales

The following table contains certain information about our net sales in different industry segments for the three months ended September 30,

	2008	2007	Change	Percentage Change
	(Dollars In Thousands)			
Net sales:				
Climate Control:				
Geothermal and water source heat pumps	\$ 53,692	\$ 44,417	\$ 9,275	20.9 %
Hydronic fan coils	21,475	22,493	(1,018)	(4.5) %
Other HVAC products	8,187	8,731	(544)	(6.2) %
Total Climate Control	<u>\$ 83,354</u>	<u>\$ 75,641</u>	<u>\$ 7,713</u>	10.2 %
Chemical:				
Industrial acids and other chemical products	\$ 47,686	\$ 27,050	\$ 20,636	76.3 %
Agricultural products	42,918	23,918	19,000	79.4 %
Mining products	33,879	18,284	15,595	85.3 %
Total Chemical	<u>\$ 124,483</u>	<u>\$ 69,252</u>	<u>\$ 55,231</u>	79.8 %
Other	<u>\$ 3,083</u>	<u>\$ 2,720</u>	<u>\$ 363</u>	13.3 %
Total net sales	<u>\$ 210,920</u>	<u>\$ 147,613</u>	<u>\$ 63,307</u>	42.9 %

Climate Control Business

- Net sales of our geothermal and water source heat pump products increased primarily as a result of a 28% increase in our average selling price per unit due to changes in product mix, primarily more residential products that have higher selling prices partially offset by a 5% decrease in the number of units sold. During the third quarter of 2008, we continued to maintain a market share leadership position of approximately 40%, based on data supplied by the AHRI;
- Net sales of our hydronic fan coils decreased primarily due to a 9% decrease in the number of units sold partially offset by a 5% increase in our average selling price. During the third quarter of 2008, we continued to maintain a market share leadership position, of approximately 37%, based on data supplied by the AHRI;
- Net sales of our other HVAC products decreased as the result of a reduction in engineering and construction services completed on our construction contracts.

Chemical Business

The El Dorado and Cherokee Facilities produce all the chemical products described in the table above and Baytown produces only industrial acids products. For the third quarter of 2008, overall sales prices for the Chemical Business increased 84% while the volume of tons sold decreased 3%, compared with the same quarter of 2007.

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- Sales prices at the El Dorado Facility increased 84% related, in part, to the high cost of raw materials, anhydrous ammonia and sulfur, which we were able to pass through to our customers and also to strong global agricultural market demand relative to supply volumes during this period. Volume at the El Dorado Facility decreased 4% or 6,000 tons. The decrease in tons sold was primarily attributable to (i) fewer tons of sulfuric acid sold due to a scheduled Turnaround of the sulfuric acid plant during the third quarter of 2008 and (ii) lower spot market sales of blended nitric acids, partially offset by increased sales of agricultural ammonium nitrate. As previously discussed, industrial grade ammonium nitrate is sold under a multi-year supply agreement that includes the pass through of raw material costs. As a result, sales prices increased under this supply agreement due to higher average selling prices but had a minimal impact to gross profit and operating income;
- Sales prices and volumes at the Cherokee Facility increased 65% and 7%, respectively, primarily related to the market-driven demand for UAN fertilizer. Sales prices also increased due to the pass through of higher natural gas costs in the third quarter of 2008 compared to the third quarter of 2007, recoverable under pricing arrangements with certain of our industrial customers. The increase in volume was partially offset by the unplanned downtime experienced during the third quarter of 2008 as discussed above under "Overview-Third Quarter of 2008 and Chemical Business";
- Sales prices increased approximately 108% at the Baytown Facility due to the pass through of higher ammonia costs but had a minimal impact to gross profit and operating income. Overall volumes decreased 10% as the result of lower customer demand during the third quarter of 2008 for our industrial acids products due to the downtime associated with Hurricane Ike.

Other - Net sales classified as "Other" consists of sales of industrial machinery and related components. The increase in net sales relates primarily to increased customer demand for our machine tool products.

Gross Profit

Gross profit by industry segment represents net sales less cost of sales. The following table contains certain information about our gross profit in different industry segments for the three months ended September 30,

	2008	2007	Change	Percentage Change
	(Dollars In Thousands)			
Gross profit:				
Climate Control	\$ 24,892	\$ 22,433	\$ 2,459	11.0%
Chemical	5,329	11,738	(6,409)	(54.6)%
Other	948	1,001	(53)	(5.3)%
	<u>\$ 31,169</u>	<u>\$ 35,172</u>	<u>\$ (4,003)</u>	<u>(11.4)%</u>
Gross profit percentage (1):				
Climate Control	29.9%	29.7%	0.2%	
Chemical	4.3%	16.9%	(12.6)	%
Other	30.7%	36.8%	(6.1)	%
Total	<u>14.8%</u>	<u>23.8%</u>	<u>(9.0)</u>	<u>%</u>

(1) As a percentage of net sales

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The increase in gross profit in our Climate Control Business was primarily the result of the increase in our average selling prices and changes in our product mix partially offset by a reduction in sales volumes as discussed above. As a result, our gross profit percentage slightly increased.

The decrease in gross profit of our Chemical Business relates partly to unrealized losses of \$4.9 million on our natural gas futures/forward contracts outstanding at September 30, 2008. In addition, the Cherokee Facility incurred costs of approximately \$5.1 million as the result of unplanned downtime during the third quarter of 2008 as discussed above under "Overview-Chemical Business." Also during the third quarter of 2008, the amount expensed for precious metals, net of recoveries, was \$1.3 million compared to \$0.3 million, during the same period in 2007. In general, other non-raw material manufacturing expenses, including steam (produced from natural gas), maintenance and Turnarounds, electricity and labor, increased during the third quarter of 2008 compared to the same period of 2007. These losses and expenses contributed to a decrease in gross profit. During the third quarter of 2007, we realized non-recurring insurance recoveries of \$1.5 million relating to a business interruption claim. These recoveries contributed to an increase in gross profit in 2007. The decrease in gross profit of our Chemical Business was partially offset by the increase in sales prices (in relation to our raw material costs) of products sold by the El Dorado and Cherokee Facilities as discussed above and the recognition of unrealized gains of \$0.4 million associated with natural gas contracts, which were deferred at June 30, 2008 due to uncertainties involving a sales contract with a customer. As the result of these changes discussed above, our overall our gross profit percentage declined for the third quarter of 2008 as compared to the same period of 2007.

The decrease in gross profit classified as "Other" (see discussion above) is due primarily to the recognition of unrealized losses of \$123,000 on our foreign currency contracts, which also decreased our gross profit percentage.

Operating Income

Our chief operating decision makers use operating income by industry segment for purposes of making decisions which include resource allocations and performance evaluations. Operating income by industry segment represents gross profit by industry segment less selling, general and administrative expense ("SG&A") incurred by each industry segment plus other income and other expense earned/incurred by each industry segment before general corporate expenses and other business operations, net. General corporate expenses and other business operations, net consist of unallocated portions of gross profit, SG&A, other income and other expense. The following table contains certain information about our operating income for the three months ended September 30,

	<u>2008</u>	<u>2007</u>	<u>Change</u>
		(In Thousands)	
Operating income:			
Climate Control	\$ 9,835	\$ 9,750	\$ 85
Chemical	1,860	11,477	(9,617)
General corporate expense and other business operations, net	(3,005)	(2,130)	(875)
	<u>\$ 8,690</u>	<u>\$ 19,097</u>	<u>\$ (10,407)</u>

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Operating Income - Climate Control: The net increase in operating income of our Climate Control Business resulted primarily from the net increase in gross profit of \$2.5 million partially offset by an increase in personnel costs of \$1.2 million due to an increase in the number of personnel and costs associated with group insurance and other employee benefits, and an increase in professional fees of \$0.5 million primarily as the result of legal expenses associated with patent defense costs relating to potential new product development in the large air-handler product line.

Operating Income - Chemical: The net decrease of our Chemical Business' operating income relates, in part, to the net decrease in gross profit of \$6.4 million as discussed above. In addition, during the third quarter of 2007, our Chemical Business recognized income of \$3.3 million relating to a litigation settlement, which did not occur during the same period of 2008.

General Corporate Expense and Other Business Operations, Net: The increase in our general corporate expense and other business operations, net relates primarily to increased professional fees of \$0.4 million due, in part, for assistance in our evaluation of our internal controls and procedures and related documentation for Sarbanes-Oxley requirements and to legal fees on various litigation matters.

Interest Expense

Interest expense was \$2.6 million for the third quarter of 2008 compared to \$3.5 million for the same period of 2007, a decrease of \$0.9 million. This net decrease primarily relates to a decrease of \$0.7 million as the result of obtaining a lower interest rate associated with the Secured Term Loan compared to the interest rate associated with the previous senior secured loan.

Provision and Benefit For Income Taxes

The provision for income taxes for the three months ended September 30, 2008 was \$2.4 million compared to a benefit of \$1.5 million for the same period in 2007. During the third quarter of 2008, we incurred current and deferred federal and state income taxes due, in part, to increased taxable income and higher effective tax rates. During the same period of 2007, we recognized a benefit for income taxes as the result of the reversal of valuation allowances against net deferred assets of approximately \$3.2 million. The benefit derived from the reversal of the valuation allowances was partially offset by an increase in the federal AMT and state income taxes resulting from increased taxable income and higher effective tax rates.

Cash Flow From Continuing Operating Activities

Historically, our primary cash needs have been for operating expenses, working capital and capital expenditures. We have financed our cash requirements primarily through internally generated cash flow, borrowings under our revolving credit facilities, secured asset financing and the sale of assets. See additional discussions concerning cash flow relating to our Climate Control and Chemical Businesses under "Overview" and "Liquidity and Capital Resources" of this MD&A.

For the first nine months of 2008, net cash provided by continuing operating activities was \$9.3 million, including net income plus depreciation and amortization, deferred income taxes, gain on litigation judgment associated with property, plant and equipment, changes in fair value of

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commodities contracts and other adjustments partially offset by cash used by changes in assets and liabilities.

Accounts receivable increased \$36.0 million including:

- an increase of \$24.5 million relating to the Chemical Business as the result of increased sales at our facilities primarily as the result of higher sales prices primarily related directly to higher costs of raw material feedstocks as well as seasonal higher sales volumes and
- an increase of \$12.8 million relating to the Climate Control Business due primarily to increased sales volume and prices of our Climate Control products preceding September 2008 compared to those preceding December 2007.

Inventories increased \$18.0 million relates primarily to an increase of \$16.4 million relating to the Chemical Business primarily relating to higher raw material costs and volume on hand of agricultural ammonium nitrate.

Other supplies and prepaid items increased \$3.3 million including:

- an increase of \$3.5 million relating to higher volume on hand and costs of precious metals used in the manufacturing process of the Chemical Business and
- an increase of \$1.5 million relating to estimated income tax payments in excess of our estimated current income tax obligations partially offset by
- a decrease of \$2.4 million in prepaid insurance as the result of recognizing the related insurance expense for the first nine months of 2008.

Accounts payable increased \$14.4 million including:

- an increase of \$12.1 million in the Chemical Business primarily as the result of obtaining more favorable payment terms on our natural gas purchases, costs incurred associated with a Turnaround being performed at the Cherokee Facility, and increased cost and tons of anhydrous ammonia purchased due, in part, to cover firm sales commitments associated with the Cherokee Facility and
- an increase of \$2.7 million in the Climate Control Business due, in part, to the increased level of raw material inventory purchases.

Customer deposits decreased \$0.3 million including:

- a decrease of \$1.6 million in the Chemical Business as the result of the shipment of product associated with these deposits partially offset by
- an increase of \$0.9 million in the Climate Control Business primarily as the result of deposits received on our geothermal and water source heat pump products.

The change in deferred rent expense of \$2.9 million is due to the scheduled lease payments during the first nine months of 2008 exceeding the rent expense recognized on a straight-line-basis.

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The increase in other current and noncurrent liabilities of \$5.2 million includes:

- an increase in accrued payroll and benefits of \$2.0 million primarily as the result of an increase in the number of days accrued due to the timing of our payroll-related payments,
- an increase in accrued precious metals costs of \$1.3 million relating to the required replacement of precious metals utilized in the manufacturing process at the Baytown Facility,
- an increase in billings in excess of costs and estimated earnings on uncompleted contracts of \$1.3 million due to invoices issued to customers pursuant to the terms of construction contracts,
- an increase in accrued property and franchise taxes of \$1.2 million primarily as the result of the recognition of property and franchise taxes for the first nine months of 2008 partially offset by
- a decrease in accrued income taxes of \$3.3 million due primarily to payments made to the taxing authorities partially offset by the recognition of income taxes for the first nine months of 2008.

Cash Flow from Continuing Investing Activities

Net cash used by continuing investing activities was \$18.9 million for the first nine months of 2008, which included \$22.7 million for capital expenditures of which \$6.3 million and \$16.3 million are for the benefit of our Climate Control and Chemical Businesses, respectively. As previously reported, we received proceeds from a litigation judgment, of which \$4.1 million (net of attorneys' fees of \$1.9 million) was associated with property, plant and equipment.

Cash Flow from Continuing Financing Activities

Net cash used by continuing financing activities was \$1.0 million, which primarily consisted of \$3.4 million used for the acquisition of 200,000 shares of our common stock as previously reported and payments on short-term financing and other long-term debt of \$1.4 million partially offset by \$3.4 million related to the excess income tax benefit on stock options exercised and proceeds of \$0.8 million from the exercise of stock options.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K under the Securities Exchange Act of 1934, as amended, except for the following:

Cepolk Holding, Inc. ("CHI"), a subsidiary of the Company, is a limited partner and has a 50% equity interest in Cepolk Limited Partnership ("Partnership") which is accounted for on the equity method. The Partnership owns an energy savings project located at the Ft. Polk Army base in Louisiana ("Project"). At September 30, 2008, our investment was \$3.6 million. For the first nine months of 2008, distributions received from this Partnership were \$0.6 million and our equity in earnings was \$0.7 million. As of September 30, 2008, the Partnership and general partner to the Partnership is indebted to a term lender ("Lender") of the Project with a term extending to December 2010 ("Loan"). CHI has pledged its limited partnership interest in the

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Partnership to the Lender as part of the Lender's collateral securing all obligations under the Loan. This guarantee and pledge is limited to CHI's limited partnership interest and does not expose CHI or the Company to liability in excess of CHI's limited partnership interest. No liability has been established for this pledge since it was entered into prior to adoption of FIN 45. CHI has no recourse provisions or available collateral that would enable CHI to recover its partnership interest should the Lender be required to perform under this pledge.

Aggregate Contractual Obligations

In the operation of our businesses, we enter into contracts, leases and borrowing arrangements. In connection with the Original Bayer Agreement with Bayer, under which we are to supply nitric acid with a provision for pass through of production costs subject to certain performance obligations on our part, EDN entered into a 10 year lease in June 1999 that requires minimum future net lease rentals of approximately \$6.9 million at September 30, 2008. The lease payments are includable costs in these agreements. These lease rentals are made monthly over the term of the agreements, typically with one annual payment representing a majority of the amount due for the year. Lease payments totaling \$2.0 million due during the remainder of 2008 have been considered in evaluating our liquidity. See discussion concerning the new Bayer Agreement that will replace the Original Bayer Agreement as of June 24, 2009 under "Liquidity and Capital Resources-Bayer Agreement".

As discussed in our Form 10-K for the year ended December 31, 2007 and in our Form 10-Qs for the quarterly periods ended March 31, 2008 and June 30, 2008, we have certain contractual obligations, with various maturity dates, related to the following:

- long-term debt,
- interest payments on long-term debt,
- capital expenditures,
- operating leases,
- commodities futures contracts,
- contractual manufacturing obligations,
- purchase obligations and
- other contractual obligations.

Under "Liquidity and Capital Resources" of Item 2 and "Commodity Price Risk" of Item 3 of this Part I, we discussed the following which occurred during the three months ended September 30, 2008:

- our contractual obligations relating to commodities futures/forward contracts were approximately \$13.5 million as of September 30, 2008 and
- our committed capital expenditures were approximately \$7.9 million for the fourth quarter of 2008.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

General

Our results of operations and operating cash flows are impacted by changes in market prices of copper, steel, anhydrous ammonia and natural gas, changes in market currency exchange rates, and changes in market interest rates.

Forward Sales Commitments Risk

Periodically, we enter into forward firm sales commitments for products to be delivered in future periods. As a result, we could be exposed to embedded losses should our product costs exceed the firm sales prices. At September 30, 2008, there were no embedded losses associated with sales commitments with firm sales prices.

Commodity Price Risk

Our Climate Control Business buys substantial quantities of copper and steel for use in manufacturing processes and our Chemical Business buys substantial quantities of anhydrous ammonia and natural gas as feedstocks generally at market prices. Periodically, our Climate Control Business enters into futures contracts for copper and our Chemical Business enters into futures/forward contracts for natural gas, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS 133. At September 30, 2008, our Chemical Business had purchase commitments under these contracts for approximately 1.1 million MMBtu of natural gas through December 2009 at a weighted-average cost of \$12.32 per MMBtu (\$13.5 million) and a weighted-average market value of \$7.83 per MMBtu (\$8.6 million).

Foreign Currency Risk

One of our business operations purchases industrial machinery and related components from vendors outside of the United States. As part of our foreign currency risk management, we entered into several foreign currency contracts, which set the U.S. Dollar/Euro exchange rates through December 2008. At September 30, 2008, our commitments under these contracts were for approximately 0.9 million Euros at a weighted-average contract exchange rate of 1.55 and a weighted-average market exchange rate of 1.41.

Interest Rate Risk

Our interest rate risk exposure results from our debt portfolio which is impacted by short-term rates, primarily variable-rate borrowings from commercial banks, and long-term rates, primarily fixed-rate notes, some of which prohibit prepayment or require a substantial premium payment with the prepayment.

Reference is made to our Form 10-K for the year ended December 31, 2007, for an expanded analysis of expected maturities of long-term debt and its weighted-average interest rates.

As part of our interest rate risk management, we periodically purchase and/or enter into various interest rate contracts. At September 30, 2008, we have two interest rate cap contracts, which set a maximum three-month LIBOR rate of 4.59% on a total of \$30 million and mature in March

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2009. In addition, we have an interest rate swap, which sets a fixed three-month LIBOR rate of 3.24% on \$25 million and matures in April 2012. Also, we have an interest rate swap, which sets a fixed three-month LIBOR rate of 3.595% on \$25 million and matures in April 2012. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS 133. At September 30, 2008, the fair values of these contracts were \$0.7 million.

At September 30, 2008, the carrying value of our long-term debt exceeded the estimated fair value by approximately \$8.6 million. At December 31, 2007, the estimated fair value of our long-term debt exceeded the carrying value by approximately \$2.0 million.

Item 4. Controls and Procedures

As previously reported in our Form 10-K for the year ended December 31, 2007 and in our Form 10-Qs for the quarterly periods ended March 31, 2008 and June 30, 2008, we have identified one significant deficiency in our disclosure controls and procedures relating to controls over electronic spreadsheets. To mitigate this lack of controls over spreadsheets, we implemented additional review and approval procedures over these spreadsheets. In evaluating the effectiveness of our disclosure controls and procedures at September 30, 2008 as discussed below, management considered these mitigating controls and controls involving financial review procedures.

As of the end of the period covered by this report, we carried out an evaluation, with the participation of our Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934). Based upon that evaluation, we have concluded, with the participation of our Principal Executive Officer and our Principal Financial Officer, that our disclosure controls and procedures were effective. There were no changes to our internal control over financial reporting during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**SPECIAL NOTE REGARDING
FORWARD-LOOKING STATEMENTS**

Certain statements contained within this report may be deemed "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. All statements in this report other than statements of historical fact are Forward-Looking Statements that are subject to known and unknown risks, uncertainties and other factors which could cause actual results and performance of the Company to differ materially from such statements. The words "believe", "expect", "anticipate", "intend", "will", and similar expressions identify Forward-Looking Statements. Forward-Looking Statements contained herein relate to, among other things:

- management's objectives for Climate Control include monitoring and managing the current economic environment, increasing the sales and operating margins of all products, developing and introducing new and energy efficient products, improving production and product delivery performance, and expanding the markets we serve, both domestic and foreign;
- the current global financial conditions will affect customer demand for our products in both the Climate Control and Chemical Businesses;
- there will be contraction in both non-residential, commercial construction and residential construction in the Climate Control Business;
- it is currently difficult to determine the effect of global market conditions that could affect fertilizer demand in the Chemical Business;
- orders for our industrial products to decline in our Chemical Business;
- there will be some contraction in new projects in certain sectors of the Climate Control Business;
- continued volatility in material costs, especially for copper, steel and aluminum and components that include those metals;
- we will ship substantially all the orders in the backlog within the next twelve months and have the production capacity in place to do so in our Climate Control Business;
- when activated, the Pryor Facility will produce anhydrous ammonia, urea ammonium nitrate and certain other industrial products from natural gas;
- reaching an agreement to sell or distribute the UAN production at the Pryor Facility;
- due to the uncertainty of these commodity markets, we continue to generate sales pursuant to agreements and/or pricing formulas that provide for the pass through of raw material and other variable costs and certain fixed costs in the Chemical Business;
- we are unable to predict the impact these hedges will have on the fourth quarter and future quarters;
- the amount our Chemical Business will incur for Turnaround costs in the fourth quarter of 2008;
- our long-term strategy in the Chemical Business includes optimizing production efficiency of our facilities, thereby lowering the fixed cost of each ton produced;
- our capital structure and liquidity at September 30, 2008 reflect a reasonably sound financial position;
- utilizing substantially all of the NOL carryforwards in 2008;
- the amount of time the permits could be delayed relating to the Pryor Facility and that there are no impediments to the issuance of permits to operate the facility;
- the timing when the plants at the Pryor Facility will begin production, the type of products the facility will produce, and the amount of annual sales this facility will add;

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- the stock repurchase authorization will remain in effect until such time as of our board of directors decides to end it;
- the customer will either meet the volume requirements or pay liquidated damages, pursuant to the terms of the agreement;
- the amount to activate the Pryor Facility and the source of its funding;
- the Climate Control Business will continue to launch new products and product upgrades in an effort to maintain our current market position and to establish presence in new markets;
- our Chemical Business continues to focus on growing our non-seasonal industrial customer base with an emphasis on customers accepting the risk inherent with raw material costs, while maintaining a strong presence in the seasonal agricultural sector;
- the new product lines in the Climate Control Business have good long-term prospects;
- our Working Capital Revolver Loan is available to fund operations;
- not paying cash dividends on our outstanding common stock in the foreseeable future;
- ability to meet all required financial covenant tests for the remainder of 2008 under our loan agreements;
- having adequate cash to satisfy our cash requirements as they become due in 2008;
- the change in the suspension agreement may result in a substantial increase in the volume of Russian ammonium nitrate imported into the United States;
- our seasonal products in our Chemical Business; and
- the amount of capital expenditures during the fourth quarter of 2008.

While we believe the expectations reflected in such Forward-Looking Statements are reasonable, we can give no assurance such expectations will prove to have been correct. There are a variety of factors which could cause future outcomes to differ materially from those described in this report, including, but not limited to,

- decline in general economic conditions, both domestic and foreign,
- material reduction in revenues,
- material increase in interest rates,
- ability to collect in a timely manner a material amount of receivables,
- increased competitive pressures,
- changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, pending,
- additional releases (particularly air emissions) into the environment,
- material increases in equipment, maintenance, operating or labor costs not presently anticipated by us,
- the requirement to use internally generated funds for purposes not presently anticipated,
- the inability to secure additional financing for planned capital expenditures,
- material changes in the cost of certain precious metals, anhydrous ammonia, natural gas, copper and steel,
- changes in competition,
- the loss of any significant customer,
- changes in operating strategy or development plans,
- inability to fund the working capital and expansion of our businesses,
- changes in the production efficiency of our facilities,
- adverse results in any of our pending litigation,

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- modifications to or termination of the suspension agreement between the United States and Russia,
- activating operations at the Pryor Facility is subject to obtaining a customer to purchase and distribute a majority of its production and obtaining necessary permits;
- inability to obtain necessary raw materials and
- other factors described in "Management's Discussion and Analysis of Financial Condition and Results of Operation" contained in this report.

Given these uncertainties, all parties are cautioned not to place undue reliance on such Forward-Looking Statements. We disclaim any obligation to update any such factors or to publicly announce the results of any revisions to any of the Forward-Looking Statements contained herein to reflect future events or developments.

**PART II
OTHER INFORMATION**

Item 1. Legal Proceedings

There are no material legal proceedings or material developments in any such legal proceedings pending against us and/or our subsidiaries not reported in Item 3 of our Form 10-K for year ended December 31, 2007 and in Item I of Part II of our Form 10-Qs for the quarters ended March 31, 2008 and June 30, 2008, except for the following material developments to such proceedings that occurred during the third quarter of 2008:

Patent Litigation Matter

On December 7, 2007, Huntair Inc. ("Huntair") filed a lawsuit against our subsidiary, ClimateCraft, Inc. ("ClimateCraft"), alleging patent infringement, which is pending in the U.S. District Court for the Northern District of Illinois, Eastern Division. Huntair accuses ClimateCraft of infringing two patents, each directed to an air handler section having fans arranged in a fan array. ClimateCraft answered the Complaint and has asserted counterclaims of patent non-infringement, invalidity and unenforceability. ClimateCraft will defend this litigation vigorously.

The University of Kansas Matter

During the first quarter of 2008, the University of Kansas Endowment Charitable Gift Fund ("KU") filed a lawsuit against us in the U.S. District Court, for the District of Kansas at Kansas City, styled The KU Endowment Charitable Gift Fund vs. LSB Industries, Inc., Case No. 08-CV-2066. During the third quarter of 2008, we settled this claim with KU for \$200,000 and the plaintiff has dismissed its lawsuit.

Securities and Exchange Commission

We have previously disclosed that the SEC was conducting an informal inquiry of us relating to the change in inventory accounting from LIFO to FIFO during 2004 involving approximately \$500,000 by one of our subsidiaries, which change resulted in the restatement of our financial statements for each of the three years in the period ended December 31, 2004 and our March 31, 2005 and June 30, 2005 quarterly financial statements.

During April 2008, the staff of the SEC delivered a formal Wells Notice to us informing us that the staff has preliminarily decided to recommend to the SEC that it institute a civil enforcement action against us in connection with the above described matter. All assertions against us involve alleged violations of Section 13 of the 1934 Act and do not assert allegations of fraudulent conduct nor seek a monetary civil fine against us. We submitted a written response to the SEC in connection with the Wells Notice, and we have had discussions with the senior staff after such submission. The staff has indicated that it is still their intention to recommend to the SEC to bring a civil injunction action against us and seek authority from the SEC to file such action. In addition, the SEC has also made assertions against our former principal accounting officer based on Section 13 of the 1934 Act and the SEC staff has also stated its intention to recommend civil and/or administrative proceedings against him. Our former principal accounting officer has also

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submitted to the SEC and senior staff a written response to the Wells Notice. Effective August 15, 2008, the former principal accounting officer resigned as principal accounting officer but remains with the Company as a senior vice president. We are currently in discussions with the staff of the SEC regarding the settlement of this issue. There are no assurances that this matter will be settled.

MEI Drafts

Cromus, as an assignee of Masinexportimport Foreign Trade Company ("MEI"), filed a lawsuit against us, our subsidiary, Summit Machine Tool Manufacturing Corp. ("Summit"), certain of our other subsidiaries, our chief executive officer and another officer of our Company, Bank of America, and others, alleging that it was owed \$1,533,000, plus interest from 1990, in connection with Cromus' attempted collection of ten non-negotiable bank drafts payable to the order of MEI. The bank drafts were issued by Aerobit Ltd. ("Aerobit"), a non-U.S. company, which at the time of issuance of the bank drafts, was one of our subsidiaries. Each of the bank drafts has a face value of \$153,300, for an aggregate principal face value of \$1,533,000. The bank drafts were issued in September 1992, and had a maturity date of December 31, 2001. Each bank draft was endorsed by LSB Corp., which at the time of endorsement, was also one of our subsidiaries. The complaint was styled as Cromus, as assignee of Masinexportimport Industrial Group, S.A. v. Summit, et al., Index No. 114890107 (NY Sup.Ct, NY Co.). The complaint also seeks \$1,000,000 from us and Summit for failure to purchase certain equipment and \$1,000,000 in punitive damages. During May, 2008, the court dismissed the complaint against us, our subsidiaries and our officers (including our chief executive officer). Cromus has appealed the dismissal against our subsidiaries and our officers and did not appeal the dismissal against us. The plaintiff must perfect its appeal no later than April 1, 2009.

Environmental Matter

The El Dorado Facility has completed the implementation of air emission controls required under the consent administrative order, effective February 2004, between the El Dorado Facility and the ADEQ.

Item 1A. Risk Factors

Reference is made to Item 1A of our Form 10-K for the year ended December 31, 2007 and in Item I of Part II of our Form 10-Q for the quarter ended March 31, 2008, for our discussion concerning risk factors. There are no material changes from the risk factors disclosed in these reports.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sale of Unregistered Securities

During the three months ended September 30, 2008, we issued the following unregistered equity securities:

On August 6, 2008, we issued 1,160 shares of common stock to Knight Equity Markets, L.P. upon the conversion of 29 shares of our convertible noncumulative preferred stock, par value \$100 per share (the "Noncumulative Preferred"). Pursuant to the terms of the

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Noncumulative Preferred, the conversion rate was 40 shares of common stock for each share of Noncumulative Preferred. The common stock was issued pursuant to the exemption from the registration of securities afforded by Section 3(a)(9) of the Securities Act. No commissions or other remuneration was paid for this issuance. We did not receive any proceeds upon the conversion of the Noncumulative Preferred.

Item 3. Defaults upon Senior Securities

Not applicable

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

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

(a) Exhibits The Company has included the following exhibits in this report:

- 10.1 Nitric Acid Supply, Operating and Maintenance Agreement, dated October 23, 2008, between El Dorado Nitrogen L.P., El Dorado Chemical Company, and Bayer MaterialScience LLC. **Certain Information Within This Exhibit Has Been Omitted As It Is The Subject Of A Request By The Company For Confidentiality Treatment By The Securities And Exchange Commission Under The Freedom Of Information Act. The Omitted Information Has Been Filed Separately With The Secretary Of The Securities And Exchange Commission For Purposes Of This Report.**
- 31.1 Certification of Jack E. Golsen, Chief Executive Officer, pursuant to Sarbanes-Oxley Act of 2002, Section 302.
- 31.2 Certification of Tony M. Shelby, Chief Financial Officer, pursuant to Sarbanes-Oxley Act of 2002, Section 302.
- 32.1 Certification of Jack E. Golsen, Chief Executive Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906.
- 32.2 Certification of Tony M. Shelby, Chief Financial Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Company has caused the undersigned, duly authorized, to sign this report on its behalf on this 6th day of November 2008.

LSB INDUSTRIES, INC.

By: /s/ Tony M. Shelby

Tony M. Shelby
Executive Vice President of Finance and Chief Financial Officer
(Principal Financial Officer)

By: /s/ Harold L. Rieker Jr.

Harold L. Rieker Jr.
Vice President and Principal Accounting Officer

**NITRIC ACID SUPPLY, OPERATING AND MAINTENANCE
AGREEMENT**

By and Among

EL DORADO NITROGEN, L.P., EL DORADO CHEMICAL COMPANY,

and

BAYER MATERIALSCIENCE LLC

INFORMATION IN THIS DOCUMENT HAS BEEN OMITTED FROM THIS PUBLIC FILING PURSUANT TO A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

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NITRIC ACID SUPPLY, OPERATING AND MAINTENANCE AGREEMENT

THIS NITRIC ACID SUPPLY, OPERATING AND MAINTENANCE AGREEMENT (this "Agreement") is made and entered into this 23rd day of October in 2008 (the "Effective Date"), by and among EL DORADO NITROGEN, L.P., a Texas limited partnership ("EDNLP"), EL DORADO CHEMICAL COMPANY, an Oklahoma corporation ("El Dorado") and BAYER MATERIALSCIENCE LLC, a Delaware limited liability company ("BMS").

WITNESSETH:

WHEREAS, BMS owns and operates a chemical manufacturing facility located in Baytown, Chambers County, Texas (the "Bayer Baytown Plant");

WHEREAS, BMS engages in a manufacturing process at the Bayer Baytown Plant that requires Nitric Acid meeting certain agreed-upon specifications described in Section 2 hereof ("Nitric Acid");

WHEREAS, BMS desires to obtain Nitric Acid for use in connection with the Bayer Baytown Plant;

WHEREAS, the parties entered into a Baytown Nitric Acid Project and Supply Agreement on June 27, 1997, which provided that EDNLP build, operate and maintain a manufacturing facility capable of producing Nitric Acid (the "Nitric Acid Facility") on real property leased to EDNLP by BMS and located at the Bayer Baytown Plant;

WHEREAS, the Baytown Nitric Acid Project and Supply Agreement is expected to terminate on June 23, 2009, after the payment of the Fixed Price Purchase Option by BMS, upon which title to all assets comprising the Nitric Acid Facility, with the exception of any assets comprising the EDNLP Net Book Value as defined herein shall reside with BMS and where title to the assets comprising the EDNLP Net Book Value shall reside with EDNLP;

WHEREAS, this Agreement shall succeed the Baytown Nitric Acid Project and Supply Agreement and the terms of this Agreement shall become effective as of the Commencement Date;

WHEREAS, BMS agrees to supply ammonia that is required for the production of Nitric Acid and that is requested by EDNLP in connection with the operation of the Nitric Acid Facility and to accept, at no charge to BMS, excess steam produced therefrom;

WHEREAS, BMS agrees, in accordance with the terms and conditions of this Agreement, to supply to EDNLP certain utilities, chemical additives and services that are required for the production of Nitric Acid at the Nitric Acid Facility and to share certain facilities and services with EDNLP;

WHEREAS, EDNLP agrees to supply Nitric Acid to BMS, subject to and in accordance with the terms and conditions of this Agreement;

WHEREAS, beginning on the Commencement Date, as hereinafter defined, BMS desires to purchase from EDNLP all of

BMS's requirements for Nitric Acid for use at the Bayer Baytown Plant; and

WHEREAS, beginning on the Commencement Date, EDNLP will use reasonable efforts to market and distribute to third parties Surplus Nitric Acid manufactured at the Nitric Acid Facility that is not required by BMS;

WHEREAS, BMS and EDNLP agree that all calculations for the period of June 24, 2009 through June 30, 2009 shall be performed in accordance with the terms and conditions of the Baytown Nitric Acid Project and Supply Agreement as amended and all calculations for the purchase of Nitric Acid and related services performed after this period, with the exception of any reconciliation related to activities performed prior to that date, shall be in accordance with the terms and conditions herein; and

WHEREAS, EDNLP agrees to provide to BMS at no charge, its co-product aqueous ammonia through facilities and pipelines designed and installed by BMS, and according to the agreed upon specifications described in Section 1.6 ("Aqua Ammonia Specifications").

NOW, THEREFORE, in consideration of the premises, and other good and valuable consideration, the receipt and sufficiency of all of which is hereby acknowledged, and intending to be legally bound, the parties hereby agree as follows:

AGREEMENT

The preamble and recitals above are incorporated in this Agreement as though each had been fully repeated herein.

SECTION 1: DEFINITIONS

Unless otherwise defined herein, the following terms have the respective meanings assigned to them for purposes of this Agreement:

1.1 Additives – Shall mean chlorine, 32 percent caustic and 98 percent sulfuric acid as described more fully in Schedule 1.

1.2 Affiliate - Shall mean any person, partnership, corporation, or other entity that controls, is controlled by or is under common control with a specified person, partnership, corporation or other entity. For purposes of this definition, "control" shall mean the power, whether direct or indirect, and whether by exercise of voting power or contract or otherwise, to direct the management policies and decisions of another entity.

1.3 Ammonia - All ammonia necessary for the manufacture of Nitric Acid by EDNLP at the Nitric Acid Facility at the operating rates necessary to meet BMS's requirements of Nitric Acid and EDNLP's sales requirements of Surplus Nitric Acid, which ammonia shall be supplied to EDNLP by BMS for its use and as required by EDNLP at the Nitric Acid Facility pursuant to the terms of this Agreement.

1.4 Ammonia Specifications - Shall mean the specifications for Ammonia set forth on Schedule 2 to this Agreement.

1.5 Aqua Ammonia – shall mean a co-product of the production process supplied to BMS by EDNLP as more fully described in Section 10.4.

1.6 Aqua Ammonia Specification — Shall mean the appearance, component concentrations, delivery pressures and delivery temperature as described in Section 10.4 Aqua Ammonia Supply.

1.7 Back-up Supply Plan – Shall mean that certain Back-up Supply Plan set forth in the attached Exhibit B.

1.8 Battery Limits – Shall mean the boundary lines of the Nitric Acid Facility and described more fully in Exhibit A.

1.9 Bayer Baytown Plant - Shall have the meaning set forth in the recitals.

1.10 Baytown Nitric Acid Project and Supply Agreement – Shall mean that agreement entered into by and among the parties to this Agreement on June 27, 1997 which provides the terms and conditions upon which EDNLP leased land from BMS to build the Nitric Acid Facility, as well as the terms and conditions of supplying Nitric Acid and operating and maintaining the Nitric Acid Facility, as amended.

1.11 BMS - Shall have the meaning set forth in the preamble.

1.12 BMS Capital Additions - Shall mean all capital investments after the Commencement Date made by or on behalf of BMS at the Nitric Acid Facility as determined in accordance with GAAP, including without limitation capitalized maintenance expenditures.

1.13 BMS Capital Component - Shall mean the sum of *** divided by 120 plus the monthly amortization of the BMS Capital Additions amortized evenly over a 10 year period.

1.14 BMS Catalyst Balance - Shall mean BMS's initial balance of catalyst paid for to use in the production process of the Nitric Acid Facility, plus additions, minus reductions, that result expressed in troy ounces, and further described in Section 7 of this Agreement.

1.15 Boiler Blowdown - Shall mean water discharged from the Nitric Acid Facility to maintain optimum boiler operations at the Nitric Acid Facility.

1.16 Business Day - Shall mean any day other than a (i) Saturday, (ii) Sunday or (iii) holiday on which national banks in New York City, New York are not open for business.

1.17 Capital Costs Monthly Charge - Shall mean the sum of the EDNLP *** and ***.

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1.18 Catalyst – Shall mean the Precious Metals formed into a gauze for use in the conversion of Ammonia within the production process of the Nitric Acid Facility.

1.19 Change of Control Event - Shall mean any of the following events:

(A) EDNLP, El Dorado or LSB Industries, Inc. (a Delaware corporation and the parent company of El Dorado, hereinafter "LSB") is merged or consolidated into or with another corporation or other legal person not affiliated with EDNLP, El Dorado or LSB and, as a result, (i) EDNLP, El Dorado or LSB, whichever is applicable, is not the surviving entity and (ii) shareholders of the acquiring party have directly or indirectly acquired more than a majority of the combined voting power of the then-outstanding voting securities of such corporation or person immediately after such transaction;

(B) EDNLP, El Dorado or LSB sells or otherwise transfers all or substantially all of its assets (other than pursuant to a sale-leaseback transaction) to any other corporation or other legal person not affiliated with EDNLP, El Dorado or LSB, or LSB sells or otherwise transfers a majority of all of the voting equity securities of EDNLP or El Dorado to any other corporation or other legal person not affiliated with LSB and, as a result of such sale or transfer, less than a majority of the combined voting power of the then-outstanding voting securities of such corporation or person immediately

after such sale or transfer is held in the aggregate by the holders of Voting Stock (as defined below) of EDNLP, El Dorado or LSB, whichever is applicable, immediately prior to such sale or transfer;

(C) There is a report filed on Schedule 13D or Schedule 14D-1 (or any successor schedule, form or report), each as promulgated pursuant to the Securities Exchange Act of 1934, as amended, disclosing that any person (as the term "person" is used in Section 13(d)(3) or Section 14(d)(2) of the Securities Exchange Act of 1934) has become the beneficial owner (as the term "beneficial owner" is defined under Rule 13d-3 or any successor rule or regulation promulgated under the Securities Exchange Act of 1934) of securities representing ten percent (10%) or more of the combined voting power of the then-outstanding securities entitled to vote generally in the election of directors of EDNLP, El Dorado or LSB (the "Voting Stock"), and such person has publicly disclosed or otherwise manifested an intention to cause the occurrence of an event described in subparagraphs (A), (B), (D) or (E) of this Section 1.18 in respect of EDNLP, El Dorado or LSB, and such person is ultimately successful in affecting the occurrence of an event described in subparagraphs (A), (B), (D) or (E) of this Section 1.18;

(D) EDNLP, El Dorado or LSB files a report or proxy statement with the Securities and Exchange Commission,

pursuant to the Securities Exchange Act of 1934, disclosing in response to Form 8-K or Schedule 14A (or any successor schedule, form or report or item therein) that a change of control of EDNLP, El Dorado or LSB has occurred or will occur in the future pursuant to any then-existing contract or transaction (provided, however, that the pledge of the capital stock of LSB, EDNLP or El Dorado to a third party lender in connection with a bona fide financing transaction will not, absent a default under such financing transaction, be considered in determining whether a Change of Control Event has occurred under this Section 1.18(D)); or

(E) If during any period of two (2) consecutive years, individuals who at the beginning of any such period constitute the directors of EDNLP, El Dorado or LSB cease for any reason to constitute at least a majority thereof, unless the election, or the nomination for election by the relevant company's stockholders, of each director of the relevant company first elected during such period was approved by a vote of at least a majority of the directors of the relevant company then still in office.

1.20 Commencement Date - Shall mean June 24, 2009, upon default free termination of the Baytown Nitric Acid Project and Supply Agreement.

1.21 Compliance Program - Shall have the meaning set forth in Section 9.1(F) hereof.

1.22 Condensate – Shall mean Excess Steam or condensate that meets the requirements of Schedule 1 hereof.

1.23 Delivered Unit Cost - Shall mean:

Where:

1.24 Delivery Systems - All pipelines, powerlines and other fixtures and improvements to the Bayer Baytown Plant (including, without limitation, pipe racks and other related fixtures) that comprise the systems that are necessary to transport to or from the Battery Limits: (i) Ammonia to be used

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in the Nitric Acid Facility; (ii) Utilities and Additives to be supplied to the Nitric Acid Facility, including water treatment sewers and pipelines; (iii) Nitric Acid produced at the Nitric Acid Facility; (iv) Excess Steam (as defined herein) and Condensate; and (v) Aqua Ammonia produced at the Nitric Acid Facility.

1.25 Demonstrated Capacity - - Shall mean the sum of the highest level of production of Nitric Acid at the Nitric Acid Facility during each month of any Operating Period, adjusted for normal outages and turnarounds and adjusted by Seasonal Effects.

1.26 EDNLP - Shall have the meaning set forth in the preamble.

1.27 EDNLP Catalyst Balance - Shall mean EDNLP's initial balance of Catalyst purchased for use in the production process at the Nitric Acid Facility through the Initial Term of the Baytown Nitric Acid Project and Supply Agreement and not reimbursed by BMS, minus reductions, that result expressed in troy ounces, and further described in Section 7 of this Agreement.

1.28 EDNLP Default Termination Fee - Shall mean the EDNLP Net Book Value.

1.29 EDNLP Net Book Value - - The then current Net Book Value (NBV) of assets contained within the Nitric Acid Facility purchased by EDNLP which are not included within the Initial

Capital Investment and for which BMS did not elect to pay for directly (as per Schedule 3).

1.30 Effective Date - Shall have the meaning set forth in the preamble.

1.31 Egress Fee - The throughput charge of *** per ton of Surplus Nitric Acid (one hundred percent assay basis) shipped from the Nitric Acid Facility pursuant to Section 5.2 hereof.

1.32 El Dorado – Shall have the meaning set forth in the Preamble.

1.33 El Dorado Catalyst Balance – Shall be equal to zero, as related to El Dorado as Guarantor of the Agreement.

1.34 Environmental Assessments – Shall mean: (i) the Geotechnical Study and Environmental Baseline Assessment, report number LA1387.001, dated December 9, 1996, prepared by Geraghty & Miller, Inc. and relating to the Nitric Acid Facility; and (ii) the subsequent Geotechnical Study and Environmental Baseline Assessment prepared by Geraghty & Miller, Inc. performed July 18, 1997, prior to the date of the groundbreaking for construction of the Nitric Acid Facility. The parties acknowledge that at the termination of this Agreement, BMS shall promptly cause a qualified environmental engineering firm to conduct an exit assessment and provide copies thereof to EDNLP and BMS.

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1.35 Environmental, Health and Safety Laws - Any and all federal, state and local laws, statutes, ordinances, rules, regulations, orders, codes and notices relating to pollution or protection of human health or the environment (including, without limitation, those relating to releases or threatened releases of pollutants, contaminants, toxic or hazardous substances or wastes into the environment) including, without limitation, the following statutes, as amended from time to time: (a) the Resource Conservation and Recovery Act , 42 U.S.C. § 6901 et seq.; (ii) Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. § 9601 et seq.; (iii) Superfund Amendments and Reauthorization Act of 1986; (iv) Clean Air Act, 42 U.S.C. § 7401 et seq.; (v) The Clean Water Act, 33 U.S.C. § 1251 et seq.; (vi) Safe Drinking Water Act, 42 U.S.C. § 300f et seq.; and (vii) Toxic Substances Control Act, 15 U.S.C. § 2601 et seq. and (viii) the Occupational Safety and Health Act, 29 U.S.C. § 651 et seq.

1.36 Event of Default - Shall have the meaning set forth in Section 18 hereof.

1.37 Excess Steam - Shall mean all excess steam or Condensate that meets the requirements of Schedule 1 hereof, and results from the production of Nitric Acid at the Nitric Acid Facility and is not required for the operation of the Nitric Acid Facility. Excess Steam shall be saturated, have a minimum pressure of seven hundred (700) P.S.I.G. at the inlet

control/letdown valve at the Battery Limits and shall have a minimum of five hundred eight degrees Fahrenheit(508° F) superheat.

1.38 Excluded Fixed Costs - Shall mean any tax other than those based upon revenue or income, insurance premiums, BMS's net distributed unit costs or allocation rates for services and utilities, contract maintenance and expenses, and EDNLP hourly or salaried wage rates and benefits.

1.39 Expiration Termination Fee - Shall mean (i) \$6,318,857 (ii) plus 1.1 times the EDNLP Net Book Value.

1.40 Facility – Shall have the meaning set forth in Section 11.

1.41 First Operating Period - Shall mean the period from June 24, 2009 through December 31, 2009.

1.42 Fixed Costs - Shall collectively mean the total amount of all fixed costs incurred by EDNLP for spending categories, as defined and as set forth on Schedule 4 hereto, in the operation, maintenance, repair and improvement of the Nitric Acid Facility other than BMS Capital Additions or Variable Costs. Fixed Costs include without limitation: ***; provided, however, that (i) all such Fixed Costs shall be directly related to the manufacture of Nitric Acid at the Nitric Acid Facility

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and (ii) such Fixed Costs shall not include expenditures incurred in connection with:

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1.43 Fixed Costs Monthly Charge - Shall mean the mutually agreed upon level of Fixed Costs spending as determined pursuant to Sections 4.1(B) and 4.1(E), hereof, in each case divided by the number of full calendar months in the relevant Operating Period.

1.44 Fixed Price Purchase Option - Shall mean *** which shall be paid by BMS in conjunction with the expiration or termination of the Baytown Nitric Acid Project and Supply Agreement in exchange for title to all assets comprising the Nitric Acid Facility except for those assets comprising the EDNLP Net Book Value.

1.45 Force Majeure Event - Shall mean any circumstance materially interfering with the performance of this Agreement that is reasonably beyond the control of the party hereto that is affected by such circumstances, such as but not limited to fire; storm; flood; act of God; war; terrorist act or response to threat of terrorist act; explosion; sabotage; strike or other labor trouble; shortage of labor, utilities, fuel or energy; embargo; car shortage; accident; any new occurrence of a material environmental hazard or catastrophe; expropriation of plant, product, raw materials, utilities, fuel or energy in whole or in part by federal or state authority; inability to secure machinery or other equipment for the manufacture of the product; acts of the federal, state or local government or any

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agency thereof, including, without limitation, any material change in Environmental, Health and Safety Laws.

1.46 Fugitive Emissions - Shall mean any gaseous or particulate contaminant entering the atmosphere without first passing through a vent designed to direct or control its flow.

1.47 GAAP - Shall mean generally accepted United States accounting principles consistently applied.

1.48 Guarantor - Shall mean El Dorado Chemical Company.

1.49 Industrial District Payments – Shall mean those taxes levied on the Nitric Acid Facility by the City of Baytown, Texas pursuant to the Industrial District Agreements between Bayer and the City of Baytown and EDNLP and the City of Baytown, which may be amended from time to time.

1.50 Initial Capital Investment – Shall have the meaning set forth in the Baytown Nitric Acid Project and Supply Agreement.

1.51 Initial Term - Shall mean the initial term of this Agreement commencing on the Effective Date and ending on June 30th of the fifth (5th) year following the Commencement Date; unless (a) sooner terminated as provided hereunder, (b) extended in accordance with Section 22 of this Agreement or (c) extended for a period equal to the duration of a Force Majeure Event as agreed by the parties.

1.52 Laws - Shall have the meaning set forth in Section 9.1(F) hereof.

1.53 Maximum Use – Shall mean the monthly quantities of Utilities and Additives as outlined in Schedule 1.

1.54 Moving Average Actual Cost - Shall mean the inventory cost valuation method employed by BMS from time to time for the valuation of all raw materials utilized at the Bayer Baytown Plant.

1.55 NBV – Shall have the meaning set forth in Schedule 3 hereof.

1.56 NBV Payback – Shall have the meaning set forth in Schedule 3 hereof.

1.57 Net Distributed Cost - - Shall mean *** consistent with the terms and provisions of this Agreement. Such *** shall be determined and allocated in a manner consistent with the methods used by BMS from time to time ***.

1.58 Net Sales Price - Shall mean the gross invoice price of Surplus Nitric Acid (as defined in Section 1.79 hereof)

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sold by EDNLP, net of ***.

1.59 Nitric Acid - Shall mean all product produced at the Nitric Acid Facility in accordance with the terms of the Agreement and conforming to the Nitric Acid Specifications.

1.60 Nitric Acid Facility - - Shall have the meaning set forth in the recitals.

1.61 Nitric Acid Specifications - Shall mean the specifications for Nitric Acid set forth in Section 2.2 hereof.

1.62 Operating Fee Monthly Charge- Shall mean a fixed fee of *** per year divided by 12. The Operating Fee Monthly Charge is subject to adjustment upon mutual written agreement after the Initial Term and upon the expiration of each subsequent Renewal Term.

1.63 Operating Period - Shall mean the First Operating Period and any subsequent calendar year beginning on the first (1st) day of January immediately after the conclusion of the First Operating Period and ending on the last day of each December until the end of the Term; provided, however, that the

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final Operating Period shall terminate on the date of termination or expiration of this Agreement.

1.64 Permits - All necessary federal, state and local governmental permits, approvals, licenses, authorizations and consents required in connection with the design, construction and operation of the Nitric Acid Facility, including, without limitation, all construction and environmental permits.

1.65 Precious Metals - Shall mean metals, such as palladium, platinum, and rhodium, which make up the Catalyst used in the production process in the Nitric Acid Facility.

1.66 Production Shortfall - - Shall mean any failure by EDNLP to provide Nitric Acid requested by BMS subject to the conditions as set forth in the Section 4.5(E) herein, up to the higher of the nameplate or Demonstrated Capacity of the Nitric Acid Facility if (and to the extent) such failure is not caused by (a) a Force Majeure Event, (b) BMS's failure to provide Ammonia, Utilities or Services (as defined herein), (c) the misalignment of a planned outage that has been properly noticed and agreed upon pursuant to Section 4.5(E) hereof, or (d) the Seasonal Effects upon the production capabilities of the Nitric Acid Facility.

1.67 Project Agreements - Shall collectively mean this Agreement and the Confidentiality Agreements dated June 24, 2002 and August 21, 2002 and any respective amendments thereto.

- 1.68 Rebate Reconciliation Statement – Shall have the meaning as set forth in Section 5 hereof.
- 1.69 Recovery – Shall mean the extraction of Precious Metals from the production process of the Nitric Acid Facility, either through sludge or gauze refining, which results in Precious Metals that will not be reintroduced into the production process, and which will be sold or held on account for one of the parties.
- 1.70 Renewal Term - The renewal term of this Agreement subsequent to the Initial Term shall be five (5) years in duration unless sooner terminated as provided hereunder.
- 1.71 Return on NBV – Shall have the meaning set forth in Schedule 3 hereof.
- 1.72 Right of First Refusal - Shall have the meaning set forth in Section 23 hereof.
- 1.73 Safety Improvement Program - Shall have the meaning set forth in Section 9.1(E)(2)(b) hereof.
- 1.74 Seasonal Effects - Shall mean the varying ambient conditions that may limit the Nitric Acid Facility's maximum operating rates, including but not limited to ambient temperature and humidity.
- 1.75 Services – Shall mean any services provided by BMS to EDNLP.
- 1.76 Spill - Shall mean any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting,

escaping, leaching, pumping or dispersing of gaseous, solid or liquid substances into the environment, excluding discharges allowed or permitted under Environmental, Health and Safety Laws.

1.77 Start-up Nitric Acid - - Shall have the meaning set forth in Section 2.2 hereof.

1.78 Substitute Blended Nitric Acid - Shall have the meaning set forth in Section 2.2 hereof.

1.79 Surplus Nitric Acid - Shall mean any Nitric Acid produced by EDNLP at the Nitric Acid Facility that is sold to any party other than BMS and its Affiliates.

1.80 Technology Agreement - - That certain Technology Sublicense and Non-Disclosure Agreement, by and between Bayer Corporation, El Dorado Nitrogen Company, ICF Kaiser Engineers, Inc. and La Grande Paroisse S.A., executed on July 28,1997.

1.81 Term - The Initial Term and all Renewal Terms of this Agreement, as determined in accordance with Section 22 hereof.

1.82 Termination Date - The date of termination of the Agreement pursuant to Section 19 or Section 23 hereof.

1.83 Total Estimates - Shall have the meaning specified in Section 4.5(C) hereof.

1.84 Utilities - Shall have the meaning set forth in Section 11 hereof. BMS shall invoice EDNLP monthly for utilities and Additives provided.

- -

- 1.85 Variable Costs Adjustments - Shall have the meaning specified in Section 4.2 hereof.
- 1.86 Variable Costs Component - Shall mean EDNLP's variable costs in manufacturing Nitric Acid as set forth on Schedule 6 hereto and as adjusted in accordance with Section 4.2 hereof.
- 1.87 Voting Stock - Shall mean securities representing ten percent (10%) or more of the combined voting power of the then-outstanding securities entitled to vote generally in the election of directors of an entity.
- 1.88 Washdown Water - Shall mean waste water periodically generated from essential maintenance activities within the Nitric Acid Facility's Battery Limits and meeting the specifications in Schedule 5.
- 1.89 Waste - The water-borne liquid, gaseous or solid substances resulting from the Nitric Acid manufacturing process at the Nitric Acid Facility and falling within at least one of the following categories:
- (A) Sanitary Sewage - Non-Waste effluent generated in kitchens, change rooms and bathrooms at the Nitric Acid Facility as a result of activities necessary to preserve and maintain human health and hygiene.
- (B) Cooling Tower Blowdown - Shall mean waste water discharged from the Nitric Acid Facility meeting the specifications in Schedule 5.

(C) Routine Process Waste - - waste of the general types listed below, with the characteristics set forth in the attached Schedule 5:

- (a) Washdown Water;
- (b) Lab Samples;
- (c) Process Purges;
- (d) Leaks;

(e) Boiler Blowdown; and

- (f) Ammonia Vaporizer Blowdown.

Subject to any contrary provisions of this Agreement, the Nitric Acid Facility may discharge into the overhead waste water piping to the Waste Treatment Facilities, via existing lines or those to be constructed, Routine Process Waste that meets the quality and quantity specifications set forth in Schedule 5:

(D) Stormwater - Shall mean the following three types of precipitation falling within the Battery Limits and meeting the specifications in Schedule 5:

(1) Initial Stormwater - Shall mean the first inch of precipitation falling on the padded areas within a twenty-four (24) hour period;

(2) Additional Stormwater - - Shall mean any precipitation falling on the padded areas in excess of the Initial Stormwater; and

(3) Uncollected Stormwater - Shall mean any precipitation falling on unpadded areas within the Battery Limits.

(E) Other Wastes - Shall mean any waste other than the wastes defined in this section generated at the Nitric Acid Facility (including, without limitation, oily sludge generated in the blowdown process, waste lubricating oils, construction debris and production/maintenance generated wastes).

1.90 Waste Treatment Facilities – The portion of the Nitric Acid Facility that accepts the Waste for necessary treatment and all pipelines, equipment, fixtures, and improvements appurtenant thereto.

1.91 Waste Treatment Services – The services for the treatment and disposal of Waste to be provided to the Nitric Acid Facility by BMS pursuant to the requirements of this Agreement.

SECTION 2: NITRIC ACID

2.1 Supply - From the Commencement Date until the Termination Date, BMS and EDNLP agree that BMS shall acquire, and EDNLP shall supply, BMS's monthly requirements of Nitric Acid meeting the requirements set forth in Section 2.2(A) hereof, to the extent of BMS's needs for facilities located at the Bayer Baytown Plant, from the Nitric Acid Facility, up to the maximum monthly production of the Nitric Acid Facility. BMS may obtain any nitric acid requirements at the Bayer Baytown Plant in excess of the available production of the Nitric Acid

Facility from El Dorado or from any other source whatsoever. In the event of any planned or unplanned outage, BMS, EDNLP and El Dorado agree that the Back-up Supply Plan, attached hereto as Exhibit B, shall become operative, if required.

2.2 (A) Nitric Acid Specifications - EDNLP covenants that it will operate the Nitric Acid Facility to provide Nitric Acid of:

- (i) an assay of at least sixty-five percent (65%);
- (ii) an iron content of not more than one and three-tenths parts per million (1.3 ppm) on a thirty (30) day rolling average, and in no event to exceed ten parts per million (10 ppm);
- (iii) total oxides of nitrogen, as N_2O_3 , of not more than one hundred parts per million (100 ppm);
- (iv) color of less than one hundred (100) APHA units; and
- (v) a chloride content of not more than ten parts per million (10 ppm).

During the first five hours following any start-up of the Nitric Acid Facility, EDNLP may provide Nitric Acid meeting the minimum criteria set forth in Section 2.2(B) hereof ("Start-up Nitric Acid"). During any planned or unplanned outage, EDNLP shall be permitted to provide nitric acid meeting the minimum criteria set forth in Section 2.2(B) hereof ("Substitute Blended

Nitric Acid") pursuant to the Back-up Supply Plan set forth in Exhibit B hereto.

2.2 (B) Start-up Nitric Acid and Substitute Blended Nitric Acid: Specifications - EDNLP covenants that Start-up Nitric Acid and Substitute Blended Nitric Acid shall meet the following minimum specifications:

- (i) an assay of at least sixty-four percent (64%);
- (ii) an iron content of not more than ten parts per million (10 ppm);
- (iii) total oxides of nitrogen, as N_2O_3 , content of not more than one hundred fifty parts per million (150 ppm);
- (iv) a color of not more than one hundred fifty (150) APHA units; and
- (v) a chloride content of not more than ten parts per million (10 ppm).

BMS may from time to time, in its sole discretion and in the interest of improved operating efficiency or other factors, waive or relax EDNLP's compliance with any specification set forth in Section 2.2(A) or Section 2.2(B) hereof. Any such waiver or relaxation set forth in a letter executed by BMS making reference to this Section 2.2 shall operate as an effective amendment hereto; provided, however, that no such waiver or relaxation shall preclude BMS from later

restoring the previous specification by written notice to EDNLP if necessary in BMS's sole discretion.

2.3 Place of Delivery - Unless otherwise provided herein, BMS shall accept physical delivery of Nitric Acid that is purchased hereunder at the product output flange at the Battery Limits.

2.4 Most Favored Customer - -

(A) If EDNLP sells or otherwise provides Surplus Nitric Acid out of the Nitric Acid Facility, directly or indirectly through any affiliated party, to a third party for an end use similar to BMS's end use at a total delivered price that is lower than the Delivered Unit Cost, EDNLP will immediately reduce the Variable Costs Component and/or the Operating Fee Monthly Charge for an equivalent volume of Nitric Acid by an amount sufficient to make the Delivered Unit Cost to BMS hereunder at least *** per short ton lower than the total delivered price on the Surplus Nitric Acid sold or provided to such end user.

All in-kind transfers ("swap" arrangements) otherwise permitted by Section 2.6 hereof are excluded from the operation of this paragraph.

(B) If at any time subsequent to the Commencement Date, the Nitric Acid Facility is operating at a projected production rate (after proportional adjustments for planned outages) of less than (a) 25,842 short tons of Nitric

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Acid per month and (b) 310,100 short tons of Nitric Acid per Operating Period, EDNLP may request BMS's consent to sell Surplus Nitric Acid to another customer at a total delivered price that is less than the Delivered Unit Cost (after proportional adjustment for planned outages) to BMS without reducing the Variable Costs Component and/or the Operating Fee Monthly Charge as provided by Section 2.4(A) hereof. BMS may grant or withhold such consent in its sole discretion.

(C) If, in any calendar month subsequent to the Commencement Date, the Nitric Acid Facility has produced less than 25,842 short tons of Nitric Acid as a consequence of materially insufficient demand by BMS attributable to unplanned outages at downstream production units and, as a result, the Delivered Unit Cost for that calendar month exceeds the Net Sales Price divided by the number of tons of Surplus Nitric Acid sold to any third party under a pre-existing written contract between EDNLP and such third party, EDNLP shall be excused from the provisions of Section 2.4(A) in respect of third party sales under such pre-existing written contract until such time as the unit(s) causing the unplanned outage are placed back in service.

2.5 Sales Optimization - EDNLP hereby covenants that it will exercise reasonable efforts to maximize sales to third parties of Nitric Acid produced at the Nitric Acid Facility to the extent such Nitric Acid is not purchased by BMS.

2.6 Swaps - All in-kind transfers, or swap arrangements, entered into by EDNLP shall provide for the return of inventory to, or replacement of inventory by, the Nitric Acid Facility.

SECTION 3: MAINTENANCE AND OPERATING SERVICES

The Baytown Nitric Acid Project and Supply Agreement is expected to terminate on June 23, 2009, with the exception of certain calculations outlined herein, if no defaults occur, and after the payment of the Fixed Price Purchase Option by BMS who will obtain title to all assets comprising the Nitric Acid Facility, with the exception of those assets comprising the EDNLP Net Book Value. After the Commencement Date, BMS agrees to allow EDNLP to keep those assets comprising the EDNLP Net Book Value at the Nitric Acid Facility for use in the production process. EDNLP shall be responsible for the maintenance and operation of all assets that comprise the Nitric Acid Facility.

EDNLP shall use reasonable efforts to operate the Nitric Acid Facility in accordance with applicable industry engineering standards, past operating practices developed by EDNLP, and within the parameters prescribed in the operating and maintenance manuals. EDNLP shall monitor and document the operation and maintenance of the Nitric Acid Facility in accordance with manufacturer's recommendations unless otherwise agreed upon by the parties during periodic review meetings.

EDNLP shall comply with all applicable Laws, and shall provide BMS upon its reasonable request access to all documentation related to the operation and maintenance of the Nitric Acid Facility.

EDNLP shall be obliged to use reasonable efforts to maintain the Nitric Acid Facility in good repair and operating condition and shall maintain the Nitric Acid Facility in regular intervals as prescribed and provided for in the maintenance manuals (if available) and shall apply at least the same standard of care it has observed in the past with the objective to maintain the Nitric Acid Facility in continuous and safe operation consistent with good engineering practices. EDNLP shall furthermore use reasonable efforts to repair the Nitric Acid Facility, whenever needed, in a proper and workman like manner using original replacement parts or replacement parts which correspond to the originals in all relevant respects including technical standards and applicable warranties. EDNLP shall periodically inform BMS of the actual maintenance and repair condition of the Nitric Acid Facility and shall also inform BMS in advance of any major maintenance work that exceeds \$100,000, if reasonably possible, and as soon as reasonably possible prior to any work that requires a shutdown of the Nitric Acid Facility.

EDNLP shall not make capital investments in the Nitric Acid Facility without the prior written approval of BMS. BMS

shall be free to grant or deny such approval, as the cost for such capital investments shall be borne by BMS.

If productivity advances are possible only as a result of investments or other additional costs, EDNLP shall describe to BMS in writing the reasons therefore and propose that BMS make such investments and BMS shall incur such additional costs without mark up or additions from EDNLP upon BMS approval.

If BMS determines on its own to improve the operation capacity and/or efficiency of the Nitric Acid Facility, EDNLP shall not unreasonably withhold its cooperation or participation in such projects.

EDNLP shall not perform or implement changes which may have a significant influence on the process, operation, construction, yields and safety of the Nitric Acid Facility, including any sub-soil work without BMS's prior written approval, which shall, where applicable, be subject to the provisions in this Agreement.

SECTION 4: PRICE

4.1 Operating Period Costs - For all Nitric Acid that EDNLP supplies to BMS during Operating Periods, BMS shall pay to EDNLP the following:

(A) Variable Costs Component - For each short ton of Nitric Acid provided hereunder, BMS shall pay to EDNLP, on a monthly basis, an amount equal to the Variable Costs

Component as defined in Schedule 6 (as adjusted pursuant to Section 4.2 hereof).

(B) Fixed Costs Monthly Charge - Within fifteen (15) days of the conclusion of each calendar month, BMS shall also pay to EDNLP the Fixed Costs Monthly Charge. The Fixed Costs Monthly Charge in each Operating Period shall be 1/12 of the annually agreed upon fixed cost budget. The annually agreed upon fixed cost budget will be determined in the quarter prior to the start of the Operating Period but not less than thirty (30) days before the start of the new Operating Period subject to any possible adjustments as provided in Section 4.1(E) hereof.

(C) Monthly Capital Charge - Within fifteen (15) days of the conclusion of each calendar month, BMS shall also pay to EDNLP the Capital Costs Monthly Charge.

(D) Operating Fee Monthly Charge - Within fifteen (15) days of the conclusion of each calendar month during each Operating Period, BMS shall also pay to EDNLP the Operating Fee Monthly Charge in respect of the preceding calendar month.

(E) Reconciliation of Fixed Costs; Adjustments to Fixed Costs Monthly Charge - (i) At the end of each Operating Period, EDNLP shall provide BMS with a detailed statement of Fixed Costs actually incurred during such period and in the form set forth in Schedule 4 hereto. BMS shall reimburse EDNLP for

*** of all Fixed Costs incurred in such Operating Period in excess of the aggregate of all Fixed Costs Monthly Charges paid by BMS during the Operating Period, or EDNLP shall reimburse BMS *** of the aggregate of all Fixed Costs Monthly Charges paid by BMS during the Operating Period, in excess of the Fixed Costs actually incurred; provided, however, that the reimbursements described above shall be adjusted to reflect the elimination of changes in Excluded Fixed Costs from such reimbursement. Increases or decreases attributable to an expansion or contraction of the hourly or salaried work force shall in all cases be subject to the Fixed Costs sharing arrangement described in the second sentence of this Section 4.1(E).

(ii) At the end of each Operating Period, EDNLP shall reimburse BMS for *** of the excess of those Fixed Costs constituting estimated Excluded Fixed Costs paid by BMS in any Operating Period over the level of actual Excluded Fixed Costs incurred by EDNLP in the subject Operating Period, and BMS shall reimburse EDNLP for *** of the excess of actual Excluded Fixed Costs incurred by EDNLP over those Fixed Costs constituting estimated Excluded Fixed Costs paid by BMS in any Operating Period.

(iii) Reimbursement amounts due under this Section 4.1(E) shall be issued through either a debit or credit,

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as appropriate, by EDNLP within forty-five (45) days of the end of the relevant Operating Period.

(iv) In the event that the annual reconciliations hereunder result in consistent changes in the level of end of Operating Period Fixed Costs, the parties agree to negotiate in good faith appropriate adjustments to the Fixed Costs Monthly Charges to minimize the cash flow impact of such consistent changes.

4.2 Adjustments to Variable Costs Component (All Operating Periods) - During each Operating Period, the Variable Costs Component shall be adjusted in accordance with the following:

(A) Ammonia - BMS shall pay to EDNLP the actual cost of Ammonia each month and at the actual consumption rate per ton Nitric Acid.

(B) Precious Metals - BMS shall pay to EDNLP the Precious Metals charges at the agreed-to unit cost for Precious Metals and the agreed-to consumption levels in troy ounces per ton Nitric Acid produced at the Nitric Acid Facility set forth in Section 4.2(B)(1) herein. Within fifteen (15) days after completion of fabrication of the replacement gauze, EDNLP will issue a debit or credit to BMS for: (i) the difference of the actual unit cost versus the agreed to unit cost for replacement metals; (ii) for the actual consumption quantities of Precious Metals; and (iii) for the Precious

Metals cost and consumption quantities applicable to the sale of Surplus Nitric Acid as as described more fully in Section 5.1(A) herein.

(1) Catalyst Composition Adjustments. For each production campaign, the parties will evaluate and agree to in writing, the composition of catalyst gauze used in the Nitric Acid Facility in an effort to improve ammonia conversion efficiency and/or reduce associated operating costs.

(C) Electricity -EDNLP shall bill BMS the actual cost of electricity each month at a consumption rate not to exceed 65,000 KWH per day.

(D) All Other Variable Costs – BMS shall pay EDNLP (using actual tons Nitric Acid delivered to BMS) for all other variable costs.

The adjustments described in this Section 4.2 are hereinafter collectively referred to as the "Variable Costs Adjustments."

(E) Monthly Payments – All variable costs and fees described in this Section 4.2 shall be netted such that one payment shall occur per month.

4.3 Fixed Costs Reimbursements by EDNLP

(A) Reimbursement of Fixed Costs for Production Shortfalls - During each Operating Period, EDNLP shall reimburse BMS for those Fixed Costs absorbed by Production Shortfalls. Reimbursement payments due under this Section 4.3 shall be made

by EDNLP, on an estimated basis, within thirty (30) days of the end of each calendar quarter and, on a final reconciliation basis, within forty-five (45) days of the end of the relevant Operating Period, as provided below:

(B) Calculation of Reimbursement Payments

(i) Quarterly - Quarterly Fixed Costs reimbursement payments shall be calculated in accordance with the following formula:

Where:

If seasonal fluctuations in Nitric Acid Facility throughput make the quarterly reimbursement payments hereunder impracticable, the parties hereto may agree to an annual reimbursement by EDNLP to BMS of Fixed Costs absorbed by Production Shortfalls.

(ii) End of Operating Period Reconciliation - At the end of each Operating Period, the parties shall calculate

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the actual Fixed Costs reimbursement payments due BMS in respect of such Operating Period in accordance with the following formula:

Where:

The end-of-Operating-Period reimbursement payment due BMS shall be reduced by the amount of any estimated payments made by EDNLP under Section 4.3(B)(i) hereof. In the event the amount due BMS under this Section 4.3(B)(ii) is less than the aggregate amount of the estimated payments under Section 4.3(B)(i), BMS shall promptly reimburse the overpayment.

4.4 Operating Fee Reimbursements by EDNLP

(A) Reimbursement of Operating Fee Monthly Charge for Production Shortfalls - During each Operating Period, EDNLP shall reimburse BMS for the portion of the Operating Fee Monthly Charge absorbed by Production Shortfalls. Reimbursement

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payments due under this Section 4.4 shall be made by EDNLP, on an estimated basis, within thirty (30) days of the end of each calendar quarter and, on a final reconciliation basis, within forty-five (45) days of the end of the relevant Operating Period, as provided below:

(B) Calculation of Reimbursement Payments, Production Shortfalls -

(i) Quarterly - Quarterly operating fee reimbursement payments shall be calculated in accordance with the following formula:

Where:

If seasonal fluctuations in Nitric Acid Facility throughput make the quarterly reimbursement of the Operating Fee Monthly Charge hereunder impracticable, the parties hereto may agree to an annual reimbursement by EDNLP to BMS of the Operating Fee Monthly Charge absorbed by Production Shortfall.

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(ii) End of Operating Period Reconciliation - At the end of each Operating Period, the parties shall calculate the actual Operating Fee reimbursement payments due BMS in respect of such Operating Period in accordance with the following formula:

Where:

The reimbursement payment due BMS shall be reduced by the amount of any estimated payments made by EDNLP under Section 4.4(B)(i) hereof. In the event the amount due BMS under this Section 4.4(B)(ii) is less than the aggregate amount of the estimated payments under Section 4.4(B)(i), BMS shall promptly reimburse the overpayment.

4.5 Miscellaneous (Invoices, Forecasts and Planned Outages) Provisions –

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(A) Forecasts by BMS - Not less than ninety (90) days before the end of each Operating Period, BMS shall provide to EDNLP an eighteen (18) month written forecast as to the anticipated quantity of Nitric Acid to be purchased by BMS during each month of the following Operating Period and as to the schedule on which Nitric Acid is to be purchased. Such forecasts shall include anticipated daily use rates of Nitric Acid by BMS.

(B) Forecasts by EDNLP - Prior to the Commencement Date and not less than ninety (90) days before the end of each Operating Period, EDNLP shall provide to BMS (a) an eighteen (18) month written sales forecast as to the quantity of Nitric Acid produced at the Nitric Acid Facility anticipated to be sold to third parties by EDNLP during the subsequent eighteen (18) month period and the schedule on which Nitric Acid is to be sold.

(C) Effect of Forecasts - The parties shall add five percent (5%) to the monthly and total estimates provided by BMS under Section 4.5(A), the sum of each of which shall be hereinafter referred to as the "Total Estimates." For Nitric Acid in excess of the Total Estimates, EDNLP may sell to third parties at any time Nitric Acid produced at the Nitric Acid Facility on a daily, monthly or annual basis, and BMS shall have no claim to such Nitric Acid in excess of the Total Estimates. Except as provided in the foregoing sentence, all forecasts and

estimates provided under this Section 4.5 shall be for information and planning purposes only and shall not be construed as firm orders or firm commitments on either party's part.

(D) Monthly Requirement Plans - Not less than five (5) days prior to the end of each month, BMS shall provide a 90 day requirements plan for Nitric Acid. Such requirement plans shall be subject to reasonable revision, modification or cancellation, and to unplanned outages at the Bayer Baytown Plant or the Nitric Acid Facility. Not less than five (5) days prior to the end of each month, EDNLP shall provide BMS with a monthly total requirements plan for Nitric Acid. Such EDNLP total requirements plan shall be subject to reasonable revisions, modification or cancellation and to unplanned outages at the Bayer Baytown Plant, the Nitric Acid Facility or plants of third party customers, or El Dorado's Arkansas plant.

(E) Planned Outages - EDNLP shall provide to BMS at least sixty (60) days' notice of any planned outage of the Nitric Acid Facility, and shall schedule any such outage only with the prior written consent of BMS (which shall not be unreasonably withheld). BMS shall provide to EDNLP at least sixty (60) days' notice of any planned outage of any relevant production unit located at Baytown. Initial scheduling of planned outages of the Nitric Acid Facility shall be completed prior to December 15th of the previous year for the subsequent

year. However, circumstances may arise which require a change to the initial schedule. When BMS or EDNLP discover that a change to the planned outage schedule is necessary, the request shall be communicated to the other party as soon as reasonably possible. EDNLP agrees to work with BMS and use reasonable efforts to accommodate all requested changes to the planned outage schedule.

The parties shall make reasonable efforts to work together to coordinate outages to prevent any adverse impact that may be caused by a planned outage of the Nitric Acid Facility or any other relevant production unit in Baytown.

(F) Contract Maintenance Expenditures - EDNLP shall consult with BMS on all major contract maintenance activities to manage contract maintenance costs as referenced in Schedule 4 hereof.

4.6 Taxes -

(A) During the Term, EDNLP shall be responsible for and pay all Industrial District Payments and ad valorem taxes and assessments, both general and special, levied on the Nitric Acid Facility or the assets comprising the EDNLP Net Book Value in accordance with this Section 4.6. Such payments shall be reimbursed by BMS as part of the Fixed Costs described in Section 4 and Schedule 4.

(B) EDNLP has executed an agreement with the City of Baytown, Texas (the "City") regarding additional payment to the City as a result of the construction and operation of the Nitric Acid Facility. As soon as practical, BMS and EDNLP shall make reasonable efforts to enter into new or modified agreements with the City of Baytown in accordance with this section to separate the ownership of the Nitric Acid Facility and EDNLP Net Book Value for future taxing purposes.

(C) Other Taxes: In addition to the above taxes, EDNLP shall also pay all federal, state or local sales, excise or use taxes levied against the activities at the Nitric Acid Facility, or against the assets comprising the EDNLP Net Book Value. EDNLP shall also submit a list of the personal property leased by EDNLP and maintained at the Nitric Acid Facility to the appropriate official of Chambers County and shall pay all taxes applicable thereto. At the request of BMS, EDNLP shall provide BMS with evidence of such payments. Such

payments shall be reimbursed by BMS as part of the Fixed Costs described in Section 4 and Schedule 4.

(D) Information: Any appropriate taxing authority shall have reasonable access to the Nitric Acid Facility upon reasonable notice to EDNLP and subject to compliance with BMS and EDNLP health, safety and welfare policies. EDNLP shall also furnish such documentary information as reasonably required by such authority.

(E) All new taxes, excises and other governmental charges, including, without limitation, all charges for Waste, sewer, solid waste disposal and similar services, and all increases in existing taxes, excises and charges, except taxes on or measured by revenues or income or similar taxes imposed after the Commencement Date of this Agreement, or after the date any price is determined or modified, on or as a result of the production, sale or transportation of the goods sold hereunder that EDNLP may be required to pay, may be added to the Fixed Costs.

SECTION 5: BMS REIMBURSEMENT, REBATE AND EGRESS FEE

5.1 Reimbursement and Rebate

(A) In addition to the various reimbursement payments due to BMS, in any Operating Period, EDNLP shall reimburse BMS for a portion of the Precious Metals charges attributable to Surplus Nitric Acid sales paid to EDNLP by BMS under section 4.2(B). Reimbursement payments due under this section 5.1(A) shall be made by EDNLP, on an estimated basis within 30 days of the end of each calendar quarter and on an actual basis through a final reconciliation within forty-five (45) days of the end of the relevant Operating Period as provided below:

(i) Quarterly – The quarterly reimbursement payment shall be calculated in accordance with the following formula:

Where:

(ii) End of Operating Period Reconciliation – At the end of each Operating Period EDNLP shall calculate the actual reimbursement payment due BMS in respect of such Operating Period in accordance with the following formula:

Where:

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The reimbursement payment due BMS shall be adjusted by the amount of any estimated payments made by EDNLP under Section 5.1(A)(i) hereof. In the event the amount due BMS under this Section 5.1(A)(ii) is less than the aggregate amount of the estimated payments made under Section 5.1(A)(i), BMS shall promptly reimburse the overpayment.

(B) In addition to the various reimbursement payments due to BMS, in any Operating Period EDNLP shall pay to BMS a rebate for a portion of the aggregate Net Sales Price of all Surplus Nitric Acid sold by EDNLP.

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Reimbursement payment due under this section 5.1(B) shall be made by EDNLP, on an estimated basis within 30 days of the end of each calendar quarter and on a final reconciliation basis within forty-five (45) days of the end of the relevant Operating Period as provided below:

(i) Quarterly – Quarterly rebate payment shall be calculated in accordance with the following formula:

Where:

(ii) End of Operating Period Reconciliation – At the end of each Operating Period, EDNLP shall calculate the actual rebate payment due BMS in respect of such Operating Period in accordance with the following formula:

Where:

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The rebate payment due BMS shall be adjusted by the amount of any estimated payments made by EDNLP under Section 5.1(B)(i) hereof. In the event the amount due BMS under this Section 5.1(B)(ii) is less than the aggregate amount of the estimated payments made under Section 5.1(B)(i), BMS shall promptly reimburse the overpayment.

Notwithstanding the foregoing, the rebate payments due BMS under this Section 5.1(B) shall not result in EDNLP's retention of less than *** per short ton (***) from such Surplus Nitric Acid sales; provided, however, that in the event that the Net Sales Price less the reimbursement made under Section 5.1(A), that amount divided by the total tons of Surplus Nitric Acid sold to third parties, is less than *** per short ton of Surplus Nitric Acid, EDNLP will not retain more than the Net Sales Price less the reimbursement made under Section 5.1(A).

(C) Within forty-five (45) days of the end of each Operating Period, EDNLP shall deliver to BMS a statement containing the detailed calculation of such rebate (each, a

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"Rebate Reconciliation Statement"). The Rebate Reconciliation Statement shall be supported by a summary sales report prepared by EDNLP which shall reflect the total quantity and sales of Surplus Nitric Acid sold from the Nitric Acid Facility during the relevant Operating Period.

5.2 Egress Fees - EDNLP shall pay to BMS an Egress Fee for all Surplus Nitric Acid sold by EDNLP.

SECTION 6: TITLE AND RISK OF LOSS

6.1 Ammonia - EDNLP shall have title to and risk of loss of Ammonia when such Ammonia enters the input flange to the Nitric Acid Facility.

6.2 Nitric Acid Produced by EDNLP at the Nitric Acid Facility for BMS - When BMS receives the Nitric Acid at the Nitric Acid output flange, title to and risk of loss of the Nitric Acid shall pass to BMS.

6.3 Nitric Acid From El Dorado and Third Party Suppliers Under the Back-up Supply Plan - When nitric acid is shipped from El Dorado or a third party to BMS at the Bayer Baytown Plant pursuant to the Back-up Supply Plan, title to and risk of loss of the nitric acid shall pass to BMS at the battery limits of the El Dorado plant or the third party plant, F.O.B. such producing plant.

6.4 Surplus Nitric Acid - When Surplus Nitric Acid is shipped from the Nitric Acid Facility to a third party customer,

EDNLP's standard terms and conditions of sale shall be F.O.B. Nitric Acid Facility and shall provide that title to and risk of loss of the Nitric Acid pass to the third party customer at the Battery Limits of the Nitric Acid Facility.

6.5 Aqua Ammonia— BMS shall have title to and risk of loss of Aqua Ammonia at the EDNLP output flange at the Battery Limits of the Nitric Acid Facility.

SECTION 7: CATALYST PAYMENT AND RECOVERY

7.1 Term - This Section shall remain in full force and effect for a period of twenty years from the Commencement Date of this Agreement, notwithstanding the termination of this Agreement, in part or in whole.

7.2 Initial Balance - Both EDNLP and BMS have previously invested in Catalyst, comprised of Precious Metals, which have been or continue to be used in the production process of the Nitric Acid Facility, represented by an initial balance which represents each party's total unrecovered investment in the Catalyst to date. The BMS initial Catalyst balance contains: (i) the amount of Catalyst purchased as part of the Initial Capital Investment; (ii) plus the quantity of Precious Metals paid for by BMS to replenish or repair Catalyst subsequent to the start up of the Nitric Acid Facility up to the Commencement Date of this Agreement; (iii) less any sludge or other Precious Metals recoveries from the process credited to BMS subsequent to the start up of the Nitric Acid Facility up to

the Commencement Date of this Agreement; (iv) less any metals sold by EDNLP on behalf of BMS prior to the Commencement Date.

The EDNLP initial Catalyst balance contains: (i) that amount of Catalyst paid for by EDNLP, for which EDNLP has not been reimbursed, subsequent to the start up of the Nitric Acid Facility up to the Commencement Date of this Agreement; (ii) less any sludge or other Precious Metals recoveries from the process credited to EDNLP subsequent to the start up of the Nitric Acid Facility up to the Commencement Date of this Agreement; (iv) less any metals allocated to EDNLP and sold by EDNLP prior to the Commencement Date.

Initial balances shall be adjusted for any Catalyst credits or debits resulting from the reconciliation of the refining and Recovery of the Catalyst in use as of the Commencement Date.

7.3 Additions – All Catalyst or Precious Metals purchased under this Agreement shall be added to the Catalyst balance of BMS.

7.4 Recoveries - During the effective period of this Agreement, EDNLP's third party provider shall conduct, at EDNLP's request, attempted Recoveries by (i) removing sludge or Precious Metals found within the Nitric Acid Facility, if any, and (ii) having the sludge or Precious Metals processed and refined to recover any Precious Metals. Upon termination or expiration of this Agreement and continuing for the twenty (20)

year term of this Section 7, the attempted Recovery shall be conducted by (i) removing sludge or Precious Metals found within the Nitric Acid Facility, if any, and (ii) having the sludge or Precious Metals processed and refined to recover any Precious Metals.

Any Precious Metals Recovery from the production process at the Nitric Acid Facility shall be allocated among the parties based on the then-current EDNLP Catalyst Balance and BMS Catalyst Balance. For example, if 100 troy ounces of Precious Metals are recovered and the EDNLP Catalyst Balance is 1,000 troy ounces and the BMS Catalyst Balance is 9,000 troy ounces, then 90 troy ounces would be allocated to the BMS Catalyst Balance, because the BMS Catalyst Balance represents 90% of the sum of the BMS Catalyst Balance and the EDNLP Catalyst Balance. The remaining 10 troy ounces would be allocated to the EDNLP Catalyst Balance.

During the term of this Agreement, upon receiving the Precious Metals from the Recovery, EDNLP shall, based on the allocation method described above and at BMS's option, either (i) transfer to BMS its allocation of the actual metals; or (ii) sell the BMS allocation of Precious Metals at the then current market price and provide BMS with the proceeds from such sale, as directed by BMS. After the expiration or termination of this Agreement, upon receiving the Precious Metals from the Recovery, BMS shall, based on the allocation method described above and at

EDNLP's option, either (i) transfer to EDNLP its allocation of the actual metals; or (ii) sell the EDNLP allocation of Precious Metals at the then current market price and provide EDNLP with the proceeds from such sale, as directed by EDNLP. During the effective term of this Agreement and upon termination or expiration of this Agreement, EDNLP shall bear the appropriate proportion of Recovery charges based on the allocation method described above.

7.5 Reductions – Each party's Catalyst balance shall be decreased by the troy ounces of Precious Metals recovered under the previous section, if any.

7.6 Catalyst Balance - BMS shall maintain, or instruct EDNLP to maintain, balances of each Precious Metal used in the Catalyst in troy ounces. The BMS Catalyst Balance shall be calculated by increasing the initial catalyst balance by the additions referred to above, minus the reductions referred to above. The EDNLP Catalyst Balance shall be calculated by reducing the initial Catalyst balance by the reductions referred to above.

7.7 Schedule – Any attempt to recover Catalyst or to remove sludge at the Nitric Acid Facility shall require the prior written consent of BMS. EDNLP shall further have the right, and BMS shall provide reasonable notice to EDNLP of its occurrence, to direct a mutually agreed upon third party

observer to witness any Catalyst sludge or Precious Metals recoveries performed by BMS in accordance with this Section 7 of this Agreement. The parties shall be required to employ industry standards to reach a settlement for each sludge or Precious Metals recovery.

7.8 Settlement - Upon the expiration of this Section 7 which has a term of twenty years, the parties agree to negotiate in good faith to reach a settlement as to the remaining EDNLP Catalyst Balance. The parties recognize that the value of this settlement shall be dependent on the timing of the recoveries, the then-current market value of the Precious Metals, the expected recovery rates, and the recoveries previously credited to EDNLP during the term of this Section 7 of this Agreement.

Upon termination of this Agreement, any amounts paid by BMS under Section 4.2 as a prepayment for Catalyst or Precious Metals and not used for refining or refabricating of Catalyst, and that has not been reimbursed by EDNLP to BMS under Section 5.1, shall be returned to BMS within thirty (30) days of the termination date.

SECTION 8: NITRIC ACID WARRANTY AND TECHNOLOGY

8.1 Title - EDNLP warrants that the Nitric Acid delivered by it shall conform to the Nitric Acid Specifications and shall be free of all liens and encumbrances. Upon delivery to BMS, BMS shall obtain good and marketable title to the Nitric Acid. EDNLP shall be released from this warranty if and to the

extent that the failure to meet the Nitric Acid Specifications was attributable to BMS's failure to meet the specifications for, or quantities of, Ammonia or Utilities. The parties hereby agree to take reasonable efforts to mitigate the application of this Section by promptly notifying the other party of any detected deficiency in the Ammonia and Utilities provided.

8.2 Technology Approval - - The Technology Agreement became effective on July 28, 1997 provides that Bayer Corporation or its assignees, designees or affiliates have and shall continue to have the right to continue to use the technology necessary to operate the Nitric Acid Facility from and after the Termination Date.

SECTION 9: REPRESENTATIONS, WARRANTIES AND COVENANTS

9.1 Representations, Warranties and Covenants of EDNLP - EDNLP hereby represents and warrants to BMS as follows:

(A) Corporate Standing - EDNLP is a Limited Partnership duly organized, validly existing and in good standing under the laws of the State of Texas, and is duly qualified to transact business and is in good standing in each jurisdiction in which the conduct of its business requires such qualification. EDNLP has the full corporate power and authority to enter into and perform this Agreement and to consummate the transactions therein. The execution, delivery and performance

of this Agreement is authorized by all necessary corporate action of EDNLP.

(B) Binding Effect of Project Agreements - This Agreement constitutes legal, valid and binding obligations of EDNLP, enforceable against EDNLP in accordance with their terms. The execution, delivery and performance of this Agreement does not violate or conflict with any provision of the Certificate of Limited Partnership or Agreement of Limited Partnership of EDNLP.

(C) Consents - Except for the Permits, no consent, approval or authorization from, notice to, or filing or registration with, any governmental authority or agency, or from, to or with any other person or entity under any contract, license or agreement to which EDNLP is a party, is necessary or

required to be obtained or made by EDNLP in connection with the execution, delivery or performance of this Agreement by EDNLP or the consummation by EDNLP of the transactions contemplated by this Agreement.

(D) Conflicts - There is no:

(1) litigation or governmental proceeding pending or, so far as is known to any officer of EDNLP, threatened, which in any such case, would prohibit or materially delay the ability of EDNLP to execute, deliver and perform this Agreement in accordance with its terms;

(2) asserted claim or basis for any claim of default, breach of liability under or violation of any law, rule or regulation applicable to EDNLP, which in any such case, would prohibit or materially delay the ability of EDNLP to execute, deliver and perform this Agreement in accordance with its terms; nor

(3) any agreement or order to which EDNLP is a party or by which EDNLP is bound, which in any such case, would prohibit or materially delay the ability of EDNLP to execute, deliver and perform this Agreement in accordance with its terms.

(E) Health and Safety Covenants -

(1) EDNLP represents and warrants that EDNLP is a member in good standing of the American Chemistry Council.

(2)(a) EDNLP hereby agrees to exercise reasonable efforts to operate the Nitric Acid Facility with the objective of achieving an Occupational Health and Safety Administration total Recordable Occupational Injury or Illness rate (as defined in 29 C.F.R. § 1904.12 (1996); hereinafter "Recordable Incidence Rate") goal consistent with BMS's Recordable Incidence Rate goal for the Bayer Baytown Plant.

(b) In the event that injuries at the Nitric Acid Facility indicate to BMS in its reasonable discretion that there exists (i) a pattern of improper safety

practice by EDNLP at the Nitric Acid Facility, (ii) a failure of EDNLP to maintain a safe working environment at the Nitric Acid Facility, then EDNLP shall meet with representatives of BMS to develop and implement a safety improvement program ("Safety Improvement Program") for the Nitric Acid Facility to bring its operations into compliance or to cure the shortcomings BMS has identified to EDNLP and EDNLP shall take all reasonable steps to implement such Safety Improvement Program.

(F) Compliance with Laws & Permits - (1) EDNLP shall exercise reasonable efforts to operate the Nitric Acid Facility in full compliance with all applicable federal, state and local laws, statutes, ordinances, rules, regulations, orders, codes, judgments, decrees and other governmental requirements applicable to EDNLP and/or the Nitric Acid Facility (including, without limitation, Environmental, Health and Safety Laws) (collectively, "Laws") and in compliance with the terms of all applicable operating, environmental, occupancy and other permits and similar requirements. EDNLP shall promptly notify BMS of the occurrence of any violation of any such Law and/or the occurrence of any reportable Spill or reportable environmental release at the Nitric Acid Facility.

(2) In the event that any occurrences at the Nitric Acid Facility indicate to BMS in its reasonable discretion that there exists a pattern of conduct resulting in frequent or material violations of Laws, EDNLP shall meet with

representatives of BMS promptly and upon request of BMS to develop and implement a remedial program ("Compliance Program") for the Nitric Acid Facility to bring its operations into compliance with Laws or to cure the shortcomings identified to EDNLP by BMS, and EDNLP shall take all reasonable steps to implement such Compliance Program.

(G) Nitric Acid Facility Capacity - EDNLP shall use reasonable efforts to operate and maintain the Nitric Acid Facility to have a production capacity of 476,000 short tons of Nitric Acid per year.

(H) Hazards Analyses - EDNLP shall perform periodic revalidation process hazards analyses (PHAs) of the Nitric Acid Facility (including nitric acid provided under the Back-up Supply Plan). Representatives of BMS may participate in such safety hazards analyses.

(I) Common Carriers - EDNLP shall select common carriers for the transportation of Surplus Nitric Acid in accordance with the principles of the Responsible Care initiative of the American Chemistry Council.

(J) Corporate Purpose - - EDNLP covenants that the corporate purpose of EDNLP, as set forth in its Agreement of Limited Partnership, is (a) to engage in all activities reasonably related to (i) the production of Nitric Acid at the Nitric Acid Facility, (ii) the provision of Nitric Acid to BMS pursuant to this Agreement and (iii) the sale of Surplus Nitric

Acid produced at the Nitric Acid Facility to third parties and (b) to engage in all activities reasonably related to maintenance and operation of the Nitric Acid Facility.

(K) Quality Standards - EDNLP will cooperate with BMS to achieve such quality standards and certifications (for example, ISO 9000 standards) as either party may reasonably request.

(L) Environmental Covenants – EDNLP covenants and warrants (i) that no underground tanks have been installed under the real property upon which the Nitric Acid Facility is located during the term of the Baytown Nitric Acid Project and Supply Agreement and EDNLP covenants and warrants that it shall not install any such tanks without the prior written approval of BMS; (ii) EDNLP agrees to indemnify and hold harmless BMS from and against any and all losses, damages, claims, costs, liabilities and expenses (including reasonable attorney’s fees and court costs) arising from any treatment, storage or disposal of any unauthorized waste or reporting a Spill or release of any unauthorized waste into the environment resulting from EDNLP’s operation of the Nitric Acid Facility, and (iii) that EDNLP shall remediate any environmental Spill or release of any unauthorized waste identified during the environmental assessment which shall be conducted upon termination or expiration of this Agreement that was not identified in the Environmental Assessments conducted previously unless EDNLP can

reasonably demonstrate that such environmental Spill or unauthorized waste was not caused, or would not have been caused, by the operation of the Nitric Acid Facility and by the negligence or acts of EDNLP.

9.2 Representations, Warranties and Covenants of El Dorado - El Dorado hereby represents and warrants to BMS as follows:

(A) Corporate Standing - El Dorado is a corporation duly organized, validly existing and in good standing under the laws of the state of Oklahoma, and is duly qualified to transact business and is in good standing in each jurisdiction in which the conduct of its business requires such qualification. El Dorado has the full corporate power and authority to enter into and perform this Agreement and to consummate the transactions therein. The execution, delivery and performance of this Agreement is authorized by all necessary corporate action of El Dorado.

(B) Binding Effect of Project Agreements - This Agreement constitutes legal, valid and binding obligations of El Dorado, enforceable against El Dorado in accordance with their terms. The execution, delivery and performance of this Agreement does not violate or conflict with any provision of the Articles of Incorporation or Bylaws of El Dorado.

(C) Consents - Except for the Permits, no consent, approval or authorization from, notice to, or filing or

registration with any governmental authority or agency, or from, to or with any other person or entity under any contract, license or agreement to which El Dorado is a party is necessary or required to be obtained or made by El Dorado in connection with the execution, delivery or performance of this Agreement by El Dorado or the consummation by El Dorado of the transactions contemplated by this Agreement.

(D) Conflicts - There is no:

(1) litigation or governmental proceeding pending or, so far as is known to any officer of El Dorado, threatened, which, in any such case, would prohibit or materially delay the ability of El Dorado to execute, deliver and perform this Agreement in accordance with its terms;

(2) asserted claim or basis for any claim of default, breach of liability under or violation of any law, rule or regulation applicable to El Dorado, which, in any such case, would prohibit or materially delay the ability of El Dorado to execute, deliver and perform this Agreement in accordance with its terms; nor

(3) any agreement or order to which El Dorado is a party or by which El Dorado is bound, which, in any such case, would prohibit or materially delay the ability of El Dorado to execute, deliver and perform this Agreement in accordance with its terms.

(E) Back-up Supply - El Dorado will supply nitric acid to BMS in accordance with the Back-up Supply Plan set forth in Exhibit B hereof.

9.3 Representations, Warranties and Covenants of BMS - BMS hereby represents and warrants to EDNLP as follows:

(A) Corporate Standing - BMS is a Delaware limited liability company, validly existing and in good standing under the laws of the State of Delaware. BMS is duly qualified to transact business and is in good standing in each jurisdiction in which the conduct of its business requires such qualification. BMS has the full power and authority to enter into and perform this Agreement to which BMS is a party and to consummate the transactions therein. The execution, delivery and performance of this Agreement is authorized by all necessary action of BMS.

(B) Binding Effect of Project Agreements - This Agreement constitutes legal, valid and binding obligations of BMS, enforceable against BMS in accordance with its terms. The execution, delivery and performance of this Agreement does not violate or conflict with any provision of the certificate of formation of BMS.

(C) Consents - Except for the Permits, no consent, approval or authorization from, or notice to, or filing or registration with any governmental authority or agency, or

from, to or with any other person or entity under any contract, license or agreement to which BMS is a party is necessary or required to be obtained or made by BMS in connection with the execution, delivery or performance of this Agreement by BMS or the consummation by BMS of the transactions contemplated by this Agreement.

(D) Conflicts - There is no:

(1) litigation or governmental proceeding pending or, so far as is known to any officer of BMS, threatened, which, in any such case, would prohibit or materially delay the ability of BMS to execute, deliver and perform this Agreement in accordance with its terms;

(2) asserted claim or basis for any claim of default, breach of liability under or violation of any law, rule or regulation applicable to BMS, which, in any such case, would prohibit or materially delay the ability of BMS to execute, deliver and perform this Agreement in accordance with its terms; nor

(3) any agreement or order to which BMS is a party or by which BMS is bound; which, in any such case, would prohibit or materially delay the ability of BMS to execute, deliver and perform this Agreement in accordance with its terms.

(E) Quality Standards - BMS will cooperate with EDNLP to achieve such quality standards and certifications (for

example, ISO 9000 standards) as either party may reasonably request.

(F) No Material Interference – Subject to the performance obligations by EDNLP under this Agreement, BMS agrees that, in the exercise of its rights under this Agreement, BMS shall not act in a manner which would materially interfere with the operations of the Nitric Acid Facility by EDNLP.

(G) Environmental Covenants – (i) Other than may be indicated in the Environmental Assessments, BMS covenants and warrants it has not filed and has not been required to file any notice under any Environmental, Health and Safety Law indicating past or present treatment, storage or disposal of any unauthorized waste or reporting a Spill or release of any unauthorized waste into the environment onto the Nitric Acid Facility from areas within the Bayer Baytown Plant other than the Nitric Acid Facility; and (ii) in addition to the other indemnifications contained herein, BMS agrees to indemnify and hold harmless EDNLP from and against any and all losses, damages, claims, costs, liabilities and expenses (including reasonable attorney’s fees) arising from the soil or ground water contamination if the source of such contamination of the Nitric Acid Facility is found to be from a location within the Bayer Baytown Plant other than the Nitric Acid Facility.

(H) Compliance with Laws: BMS shall use reasonable efforts to operate the Bayer Baytown Plant in full

compliance with all Laws and in compliance with the terms of all applicable operating, environmental, occupancy and other permits and similar requirements. BMS will promptly notify EDNLP of the occurrence of any violation of any such Law which would materially impact EDNLP's operation of the Nitric Acid Facility.

SECTION 10: AMMONIA

10.1 Supply by BMS - BMS shall supply to EDNLP at the Battery Limits of the Nitric Acid Facility the Ammonia required for EDNLP's use in manufacturing Nitric Acid and supplying Aqua Ammonia to BMS; provided, however, that BMS shall not be obligated to supply EDNLP with more than one hundred twenty percent (120%) of the monthly nameplate requirements of the Nitric Acid Facility. BMS shall charge EDNLP for the Ammonia at BMS's Net Distributed Cost on a Moving Average Actual Cost basis. BMS warrants that the Ammonia supplied hereunder shall meet the applicable Ammonia Specifications set forth on the attached Schedule 2. BMS covenants that such Ammonia shall be free of all liens and encumbrances. The Ammonia shall be delivered by or on behalf of BMS to EDNLP at the Battery Limits of the Nitric Acid Facility via the Delivery System or other agreed-upon mechanism. BMS shall invoice EDNLP monthly for Ammonia provided by BMS.

10.2 Procurement of Ammonia by EDNLP - Subject to the terms of any ammonia procurement contracts between BMS and its

ammonia supplier(s) and subject to the satisfactory resolution of any logistical issues between BMS and EDNLP regarding the segregation and maintenance of ammonia inventory, the parties hereby agree that upon EDNLP's request, the parties will negotiate in good faith the possibility of the sourcing of ammonia for Surplus Nitric Acid sales by EDNLP on its own behalf (provided, however, that this clause shall not be interpreted to require BMS to pay any premium, increased cost or penalty for Ammonia under its procurement contracts as a result of such direct sourcing by EDNLP).

10.3 Measurement of Ammonia Supplied

(A) Metering – The certified pipeline delivery meter, or if necessary the back-up meter, shall be the basis upon which any charges will be assessed against EDNLP for the consumption of Ammonia. EDNLP shall operate and maintain metering equipment to measure EDNLP's consumption of the Ammonia supplied by pipeline. EDNLP shall also operate and maintain metering equipment that measures the transfer of Aqua Ammonia to BMS supplied by pipeline.

(B) Calibration - EDNLP shall calibrate all meters in accordance with manufacturer's recommendations. EDNLP shall calibrate the meters relative to each other. EDNLP shall designate one meter as the primary meter from which all readings shall be taken. The second meter's readings shall be used during failure, testing or recalibration of the first meter and

to periodically verify the reading of the first meter. EDNLP shall also permit BMS, at BMS's expense, to inspect the meters at any time, provided such inspection does not unreasonably interfere with EDNLP's operations at the Nitric Acid Facility.

10.4 Aqua Ammonia Supply: EDNLP shall supply to BMS at the Battery Limits of the Nitric Acid Facility, Aqua Ammonia that has been produced in the manufacture of Nitric Acid. The intent is that the supply will normally meet BMS's needs although availability will depend upon the Nitric Acid unit being on-stream. BMS will have a back-up supply of ammonium hydroxide available as a contingency. The estimated properties for Aqua Ammonia are described as follows:

- Appearance- Clear, colorless liquid.
- Concentration- Ammonium hydroxide concentration 15-35% expressed as percent ammonia.
- Oil- Maximum 0.7%
- Iron- Maximum 0.1%
- Delivery Pressure- minimum- 60 psig, typical- 90 psig, maximum- 275 psig
- Delivery Temperature (F)- Typical- Ambient
- Delivery Flow (#/hr as NH3)- Typical- 30 #/hr, Maximum- 75 #/hr

BMS expressly acknowledges that EDNLP makes no guarantee but shall put forth reasonable efforts that Aqua Ammonia will conform to all the properties described herein [although all

Aqua Ammonia delivered hereunder shall contain at least ten percent (10%) ammonium hydroxide concentration expressed as a percentage ammonia, suspended in an inert aqueous solution]. BMS agrees to accept all Aqua Ammonia from EDNLP as it is delivered via pipeline to BMS. BMS shall not require EDNLP to perform any chemical analyses of Aqua Ammonia prior to its delivery to BMS.

SECTION 11: UTILITIES

11.1 Provision of Utilities - BMS shall supply certain utilities and additives in specified quantities (each, a "Utility" and "Additive") based on certain assumptions set forth in Schedule 1, to the Nitric Acid Facility for use in the manufacture of Nitric Acid and operation and maintenance of the Nitric Acid Facility, such supply to be in the amounts and manner provided in this Section 11. EDNLP warrants that the quantities provided in Schedule 1 are a good faith estimate of the quantities of Utilities it will consume at an annual production rate of 476,000 short tons of Nitric Acid per year. It is expressly understood that BMS shall not be obligated to supply any Utilities or Additives other than those specifically listed in this Agreement and that BMS shall not be obligated to supply such Utilities or Additives in excess of the quantities provided for in Schedule 1. BMS's obligations hereunder shall at all times remain subject to any competing priorities BMS may have at the BMS Baytown Plant for such Utilities or Additives.

BMS shall provide all such Utilities and Additives to the Nitric Acid Facility at the Battery Limits in accordance with the specifications set forth on Schedule 1 hereto and at BMS's Net Distributed Cost.

(A) Water - The Bayer Baytown Plant is served by public utility-supplied and plant-supplied water that is piped through and from the Bayer Baytown Plant. BMS agrees to supply to the Nitric Acid Facility at the Battery Limits: (i) boiler feed water; (ii) fire water; (iii) potable water; (iv) plant (non-potable) water; and (v) demineralized water in the amounts and at the specifications set forth in Schedule 1. BMS shall supply all water at BMS's Net Distributed Cost.

(B) Nitrogen - BMS agrees to supply to the Nitric Acid Facility at the Battery Limits, at BMS's Net Distributed Cost, nitrogen gas through pipelines located at or on the Bayer Baytown Plant in the amounts and in the specifications set forth in Schedule 1.

(C) Air - BMS agrees to supply to the Nitric Acid Facility at the Battery Limits, at BMS's Net Distributed Cost: (i) plant air and (ii) instrument air through pipelines located at or on the Bayer Baytown Plant in the amounts and in the specifications set forth in Schedule 1.

(D) Steam - BMS agrees to supply to the Nitric Acid Facility at the Battery Limits, at BMS's Net Distributed Cost, six hundred thirty pounds per square inch gauged steam

through pipelines located at or on the Bayer Baytown Plant in the amounts and in the specifications set forth in Schedule 1.

(E) Natural Gas - BMS agrees to supply to the Nitric Acid Facility at the Battery Limits, at BMS's Net Distributed Cost, natural gas through pipelines located at or on the Bayer Baytown Plant in the amounts and at the specifications set forth in Schedule 1.

(F) Chlorine - BMS agrees to supply to the Nitric Acid Facility at the Battery Limits at BMS's Net Distributed Cost, chlorine through pipelines located at or on the Bayer Baytown Plant in the amounts and in the specifications set forth in Schedule 1.

(G) Caustic - BMS agrees to supply to the Nitric Acid Facility at the Battery Limits at BMS's Net Distributed Cost, 32 percent caustic through pipelines located at or on the Bayer Baytown Plant in the amounts and in the specifications set forth in Schedule 1.

(H) Electrical Power - (1) A cogeneration facility ("Facility") exists at the Bayer Baytown Plant. The Nitric Acid Facility shall obtain its electric requirements from the Facility at such time as the Facility supplies electric energy to the Bayer Baytown Plant. All references to electricity for the conduct of operations at the Nitric Acid Facility shall mean and refer to the supply of electric requirements for the Nitric Acid Facility.

(2) BMS agrees to supply electrical power to the Nitric Acid Facility at the Battery Limits. The electrical power shall be supplied at the same cost as electric energy is supplied to BMS under the Energy Services Agreement between Bayer Corporation and Calpine Construction Finance Company, L.P. and subsequently assigned to BMS plus applicable BMS distribution fees.

(3) In the event that the supply of electric requirements to the Nitric Acid Facility as contemplated by this Section 11.1(H) does or is likely to result in a regulatory consequence that imposes burdens upon BMS, then EDNLP will without the expenditures of funds cooperate with BMS and engage in commercially reasonable measures to mitigate the effects of such regulatory consequences and burdens.

(4) The obligations of the parties hereunder will not be affected in the event that the Facility is unable to produce electric energy in sufficient quantities to meet EDNLP's electric requirements (e.g., back-up power), so long as electric energy is available from other sources, including the grid, to supply EDNLP's electric requirements in the same manner and by the same means as BMS's electric energy requirements at the Bayer Baytown Plant are supplied. In those instances when EDNLP's electric requirements are supplied by other sources as contemplated by the preceding sentence, then the price to EDNLP

for the supply of EDNLP's electric requirements shall be the cost to BMS for electric energy from such other sources, plus EDNLP's pro rata share of the infrastructure and distribution costs.

(5) Notwithstanding anything to the contrary herein contained, the parties desire to confirm that EDNLP shall be relieved of its obligation to supply Nitric Acid to BMS to the same extent as: (i) provided in Section 14.1 of this Agreement; (ii) as provided under the Force Majeure Event provisions of this Agreement;(iii) and/or as otherwise provided under this Agreement, in the event there is a failure to deliver electricity to the Nitric Acid Facility.

(I) Sulfuric Acid: BMS provides 98% sulfuric acid deliveries to EDNLP for the cooling tower via tank trucks. Trucks are typically scheduled on Wednesday of each week. The supplier monitors the sulfuric acid tank level. Based on this information 98% sulfuric acid deliveries are scheduled by BMS as needed. EDNLP may also contact the BMS Environmental Control Department and Utilities (ECDU) to be put on the schedule for the next delivery, at least one day in advance. Approval of the certificate of analysis is done by the polyurethane quality area prior to delivery to EDNLP. At the end of the month, BMS informs EDNLP of the amount of 98% sulfuric acid delivered during the month. EDNLP then reports this number to BMS

accounting, which is then included in the monthly Variable Costs Component

11.2 Utility Quality

(A) BMS makes no warranty with regard to the quality or quantity of the Utilities or Additives made available to the Nitric Acid Facility under this Agreement.

(B) EDNLP shall be released from the warranty contained in Section 8 of this Agreement as to Nitric Acid produced at the Nitric Acid Facility if and to the extent EDNLP can establish that the failure to meet the Nitric Acid Specifications was attributable to BMS's failure to meet the relevant specifications for, or quantities of, Ammonia or Utilities provided to the Nitric Acid Facility. EDNLP shall exercise reasonable efforts to mitigate the application of this section by promptly notifying BMS of any detected deficiency in the Utilities provided.

11.3 Utility Cross Connections

EDNLP agrees to maintain and operate the utility cross connection systems as originally designed to prevent possible cross contamination between the Nitric Acid Facility's processes and a given Utility or possible cross contamination between two Utility streams.

11.4 Utility Meters

(A) EDNLP shall operate and maintain existing demand metering equipment to measure the Nitric Acid Facility's demand

and consumption of the Utilities and Additives. The readings will be the basis upon which any charges will be assessed against EDNLP for the consumption of Utilities and Additives, unless any reading is proven to be in error in accordance with Section 11.4(B).

(B) EDNLP shall calibrate all meters in accordance with manufacturer's recommendations. EDNLP shall give BMS three (3) days notice of, and BMS has the right to observe the calibration of any meters installed by EDNLP. EDNLP shall recalibrate each meter as recommended by the manufacturer. If during any such periodic recalibration any meter is found to be inaccurate by more than the manufacturer's tolerances, then EDNLP shall repair or recalibrate such meter to the manufacturer's tolerances. If a meter is inaccurate by more than the manufacturer's tolerances, the party that has benefited from the inaccuracy shall refund to the other party one hundred percent (100%) of the discrepancy, back to the date of the last calibration or, if identifiable, back to the date of the failure that triggered the inaccuracy. EDNLP agrees to exercise reasonable efforts to conduct all meter readings, inspections, recalibrations and repairs in such a manner that it will not unreasonably interfere with BMS's operations at the Bayer Baytown Plant. BMS may, at BMS's expense, inspect the meters at any time, provided such inspection does not

unreasonably interfere with the operation of the Nitric Acid Facility.

(C) If any inspection by BMS reveals an inaccurate meter (as determined under the preceding paragraph), then the parties shall negotiate an appropriate adjustment to be made to the cost of the affected Utility.

(D) EDNLP shall provide the electricity, 32% caustic, and chlorine usage to BMS each month to be used for monthly billing.

(E) BMS shall use the data collection system (currently PI) to determine the monthly Utility usages from the EDNLP meters.

(F) EDNLP shall provide BMS a summary of each Utility usage each month. This summary will serve as a reference to the values obtained in 11.4(E) and shall be included in the monthly Fixed Costs Monthly Charge and Variable Costs Component. EDNLP and BMS shall exercise commercially reasonable efforts to resolve any significant discrepancies in a timely manner.

11.5 Resale of Utilities

EDNLP covenants that it shall not sell, transfer or distribute to any other party (including Affiliates of EDNLP) those Utilities or Additives provided to the Nitric Acid Facility by BMS pursuant to this Agreement.

SECTION 12: WASTE

Wastes from the Nitric Acid Facility may be described by the following categories:

1. Sanitary Sewage;
2. Cooling Tower Blowdown;
3. Routine Process Wastes;
4. Stormwater; and
5. Other Wastes.

BMS reserves the right to test the Waste streams and, in the event BMS notifies EDNLP that the Waste streams do not comply with Schedule 5, EDNLP shall promptly take all appropriate action to bring the Waste streams into compliance with Schedule 5. In addition, BMS may assess EDNLP a surcharge to cover the actual costs of all special handling and extra treatment incurred by BMS for Waste that fails to meet established specifications. In no case shall BMS be required to accept Waste that will cause BMS to exceed limits imposed by permits. With BMS's prior approval, which shall not unreasonably be withheld, EDNLP may construct and locate additional lines for transportation of the Waste, provided that all such Waste, other than Sanitary Sewage, is processed and directed above ground. BMS shall invoice EDNLP for such use of the Waste Treatment Facilities on a Net Distributed Cost basis and such costs shall be included in the Variable Cost Component.

12.1 Use of Sanitary Sewers

EDNLP shall discharge all Sanitary Sewage or Waste into the existing sanitary sewer system or Waste Treatment Facilities in such a manner as to ensure that such discharges

comply with Laws and do not unreasonably interfere with BMS operations at the Bayer Baytown Plant. EDNLP shall promptly correct any nonconforming discharges. EDNLP shall not allow any third party or any other site source to cause any substance, including Waste, to be discharged into the sanitary sewer system on the Nitric Acid Facility or the Bayer Baytown Plant. EDNLP shall use reasonable efforts to make no discharges that violate any: (i) Laws; (ii) insurance or underwriting rules or regulations disclosed to or known by EDNLP on or prior to the Commencement Date; or (iii) revised insurance or underwriting rules or regulations reasonably imposed by BMS's loss prevention consultants and insurance carriers following the Commencement Date. EDNLP shall grant BMS access to all records and files that relate in any manner to any discharge by EDNLP into the sanitary sewer system during the term of this Agreement. BMS reserves the right to analyze, at its sole cost and expense, Sanitary Sewage at the tie-in points.

12.2 Cooling Tower Blowdown

EDNLP may discharge into BMS's Cooling Tower Blowdown header, via existing lines or lines to be constructed, Cooling Tower Blowdown that meets the quality and quantity specifications set forth in Schedule 5. To ensure that the Cooling Tower Blowdown is acceptable for treatment in the Waste Treatment Facilities, any chemicals used in the cooling tower must be approved by BMS.

12.3 Routine Process Waste

(1) In connection with the production of Nitric Acid by EDNLP at the Nitric Acid Facility, EDNLP anticipates producing Routine Process Waste of the general types listed below, with the characteristics set forth in the attached Schedule 5:

- (a) Washdown Water;
- (b) Lab Samples;
- (c) Process Purges;
- (d) Leaks;

(e) Boiler Blowdown; and

- (f) Ammonia Vaporizer Blowdown.

(2) Subject to any contrary provisions of this Section 12, EDNLP may discharge into the overhead waste water piping to the Waste Treatment Facilities, via existing lines or those to be constructed, Routine Process Waste from the Nitric Acid Facility that meets the quality and quantity specifications set forth in Schedule 5. With BMS's prior approval, which shall not unreasonably be withheld, EDNLP may construct and locate additional lines for transportation of

Routine Process Waste, provided that all such Routine Process Waste is processed and directed above ground.

12.4 Initial Stormwater and Additional Stormwater

EDNLP shall install, operate and maintain facilities to capture all Initial Stormwater and Additional Stormwater that falls on padded areas. EDNLP shall construct such facilities so that the Initial Stormwater is segregated from the Additional

Stormwater. EDNLP shall discharge (pump) the Initial Stormwater along with the Routine Process Wastes, via existing pipelines or those to be constructed, into the Waste Treatment Facilities. EDNLP shall sample the Additional Stormwater and analyze the pH and general appearance of the Additional Stormwater to ensure that it does not exceed the permissible contamination levels for Additional Stormwater described in Schedule 5. If the Additional Stormwater does not exceed the permissible contamination levels set forth in Schedule 5, then EDNLP shall discharge the Additional Stormwater, via existing pipelines or those to be constructed, into the Bayer Baytown Plant's stormwater system. If the Additional Stormwater exceeds the permissible contamination levels set forth in Schedule 5, then EDNLP shall hold the Additional Stormwater until it can be discharged, via existing pipelines or those to be constructed, into the Waste Treatment Facilities, provided that BMS has analyzed the Additional Stormwater and determined that based on level of contamination and volume, the Waste Treatment Facilities can accept such Additional Stormwater.

12.5 Uncollected Stormwater

Uncollected Stormwater will be directed, via pipelines, existing or to be built, or by ground elevation, to BMS's underground stormwater piping. EDNLP will not allow contamination of Uncollected Stormwater.

12.6 EDNLP's Disposal of Other Wastes

EDNLP shall be solely responsible for the proper segregation, storage and disposal of any other Waste (including, without limitation, oily sludge from the ammonia separation system, waste lubricating oils, construction debris and production/maintenance generated wastes) generated at the Nitric Acid Facility, the storage, conveyance, treatment and disposal of which shall be performed in accordance with all applicable Environmental, Health and Safety Laws and all BMS guidelines and procedures. EDNLP shall use waste management services mutually agreed upon by the parties for the segregation and disposal of such other wastes. BMS shall not reimburse EDNLP for any costs associated with the storage, conveyance, treatment and disposal process of other waste except as otherwise provided in this Agreement.

12.7 General

(A) BMS shall maintain the Waste Treatment Facilities in good condition and repair and in such a manner as to allow the Waste to be treated and discharged in compliance with all applicable Laws, including, without limitation, Environmental, Health and Safety Laws. EDNLP shall maintain any pipelines, sumps, sump pumps or other facilities located on the Nitric Acid Facility in compliance with all applicable Laws, including without limitation, Environmental, Health and Safety Laws.

(B) Upon reasonable notice, EDNLP and BMS shall each grant to the other access to all properties, records and files relating to the deliveries and discharge of Waste. BMS and EDNLP shall submit written reports to each other containing such matters and information as are reasonably requested by the other party.

(C) EDNLP shall be responsible for ensuring that the Nitric Acid Facility maintains compliance with all leak detection and repair programs related to Fugitive Emissions as mandated by all applicable Environmental, Health and Safety Laws.

(D) EDNLP shall be responsible, at its expense, for all costs associated with the proper containment, clean-up, treatment and disposal of all Spills and materials contaminated by such Spills arising from EDNLP's operation of the Nitric Acid Facility. EDNLP shall employ the Spill remediation services and disposal outlets mutually agreed upon by the parties.

(E) EDNLP shall operate and maintain, metering equipment to measure EDNLP's discharge of Routine Process Waste and Cooling Tower Blowdown into the Waste Treatment System.

SECTION 13: FIRE PROTECTION, SAFETY AND SECURITY

13.1 Fire Protection

(A) With the prior written approval of BMS, which will not be unreasonably withheld, EDNLP may make such

additions to the fire protection system at the Nitric Acid Facility as EDNLP requires for the protection of the Nitric Acid Facility. BMS shall maintain in good condition and repair and shall make available for the benefit of the Nitric Acid Facility in case of an emergency the portion of the fire protection system located at or on the Bayer Baytown Plant. EDNLP, at its cost and expense, shall maintain in good condition and repair and shall make available for the benefit of the Bayer Baytown Plant in case of an emergency the portion of the fire protection system located at the Nitric Acid Facility. EDNLP shall be responsible for notifying the designated authority of emergencies occurring at the Nitric Acid Facility. EDNLP shall only use water from the fire protection system for emergency purposes and shall immediately report any such use to the designated authority at the Bayer Baytown Plant.

(B) BMS agrees to furnish the fire-fighting services for the Nitric Acid Facility that BMS has available for the protection of its own property and personnel. EDNLP agrees to cooperate with BMS in furnishing such services, including participating in any fire drill procedures at the Nitric Acid Facility, as reasonably requested by BMS. Subject to the prior execution of confidentiality agreements in form and substance satisfactory to BMS and its counsel, BMS agrees to grant EDNLP and its insurance carriers access to the Bayer Baytown Plant and the improvements located thereon as required by EDNLP's

insurance carriers for inspections related to fire protection or other safety measures.

13.2 Safety

(A) EDNLP will use reasonable efforts to operate the Nitric Acid Facility according to sound engineering practice and all applicable Laws and regulations. In the interest of promoting a safe manufacturing environment, EDNLP and BMS agree to meet quarterly to discuss and review safety items of mutual interest.

(B) EDNLP shall maintain and use the public address system that is integrated with the Bayer Baytown Plant public address system so as to permit centralized emergency notification and other central announcements to personnel at the Nitric Acid Facility. BMS shall maintain connections for the public address system at the Battery Limits.

(C) BMS will provide EDNLP with a list of VHF radio frequencies for routine use at the Nitric Acid Facility and for emergency communication with the BMS disaster response office. EDNLP shall utilize radio equipment capable of transmitting and receiving information on the assigned frequencies.

(D) BMS will provide EDNLP with phosgene monitoring badges for use by EDNLP personnel at the Nitric Acid Facility. EDNLP shall require the use of such badges by all personnel at the Nitric Acid Facility, and shall cause such

badges to be handled and examined in accordance with BMS safety rules applicable to the use and examination of such badges.

(E) Emergency Response – BMS shall provide an Emergency Response Team for incidents including but not limited to firefighting and rescue. BMS shall provide equipment (fire truck, rescue truck, ambulance) and personnel for emergency response. BMS shall provide air monitoring on the Bayer Baytown Plant perimeter and in the community, as necessary. BMS will put any EDNLP emergency message on the CAER (Community Awareness Emergency Response) Line. EDNLP is responsible for making all required notifications. BMS shall assist with communications with outside emergency response teams, as necessary. EDNLP shall provide one representative to guide BMS if emergency response is needed at EDNLP. BMS schedules off-site training classes for fire brigade (Fire School) and rescue team (Rescue School) training. EDNLP may participate along with BMS employees for this training, provided the EDNLP pays for their employees.

Bayer shall perform annual drills and shall allow EDNLP to participate in such drills.

(F) Hurricane Response – During potential hurricane events BMS coordinates Bayer Baytown Plant activities as outlined in the BMS safety procedure. Status meetings shall occur as needed and as outlined in the BMS safety procedure. EDNLP is expected to provide a representative to these meetings. In the event of an evacuation, EDNLP will provide one hurricane

“ride-out” team member to stay in the plantsite, along with BMS ride-out personnel, during the evacuation period.

13.3 Security

For purposes of security planning, EDNLP is included in the BMS security requirements as regulated by the U.S. Coast Guard. EDNLP shall be responsible for providing internal security for the Nitric Acid Facility. BMS shall have no responsibility for the internal security of the Nitric Acid Facility. BMS will provide perimeter security and trucking services at the Bayer Baytown Plant perimeter.

Where allowed by law, BMS will provide security for EDNLP within the fenceline. EDNLP will follow BMS security procedures for EDNLP employees, visitors, and contractors and shall participate in BMS security training and drills. BMS is responsible for tank truck access into and out of the Bayer Baytown Plant. Truck drivers are required to provide a valid drivers license with photo identification and HazMat certification. EDNLP is responsible for the truck drivers from the time they arrive at the Nitric Acid Facility until they depart back the truck gate to exit the Bayer Baytown Plant. EDNLP shall provide and maintain a security camera on its absorber which can be controlled by BMS security staff.

13.4 Parking and Access

EDNLP officers, directors, employees, agents, contractors and invitees may park in the parking lots located on the Bayer Baytown Plant, and such parties shall use access routes designated by BMS to reach the Nitric Acid Facility, in each case. EDNLP officers, directors, employees, agents, contractors and invitees shall observe all conditions imposed by BMS for parking and security at the Bayer Baytown Plant. EDNLP officers, directors, employees, agents, contractors and invitees shall have access to the Nitric Acid Facility at all times during the Term of this Agreement; provided, however, that EDNLP officers, directors, employees, agents, contractors and invitees must observe Bayer Baytown Plant security procedures at all times. BMS may restrict the access of EDNLP officers, directors, employees, agents, contractors and invitees in the event of an emergency.

(A) EDNLP shall maintain a four (4) spot truck loading and unloading rack for nitric acid and the three (3) spot truck unloading rack for Ammonia.

SECTION 14: INTERRUPTION OF AMMONIA, UTILITIES OR NITRIC ACID

14.1 Interruption of EDNLP Feedstock - If BMS is unable to or fails to deliver Ammonia, Utilities, or Additives to the Nitric Acid Facility as required, then EDNLP may procure such Ammonia, Utilities, or Additives elsewhere through any

commercially reasonable source. Notwithstanding the foregoing, EDNLP may supply such Ammonia, Utilities, and Additives through the infrastructure of the Bayer Baytown Plant only with the prior approval of BMS, which shall not be unreasonably withheld. Any procurement by EDNLP of Ammonia, Utilities, or Additives from parties other than BMS shall be at EDNLP's risk, and shall have no effect on the warranty made to BMS by EDNLP pursuant to Section 8 hereof. Nitric acid produced using such Ammonia shall first be supplied to BMS. If BMS is unable to or fails to deliver Ammonia, Utilities, or Additives, EDNLP's sole exclusive remedy for such failure is set forth in Section 18 hereof.

14.2 Interruption of Nitric Acid - If EDNLP is unable to or fails to provide BMS's monthly Nitric Acid requirements for the Bayer Baytown Plant and EDNLP is unable to provide back-up supply to BMS, then BMS may procure such nitric acid elsewhere through any commercially reasonable source. EDNLP shall permit BMS to use EDNLP's four (4) spot truck loading and unloading rack if BMS requires use of the same for the receipt of nitric acid from third party suppliers. EDNLP shall perform the unloading activities.

SECTION 15: PIPELINE AND DELIVERY SYSTEM OPERATION AND MAINTENANCE

15.1 Plant Systems - EDNLP shall operate and maintain the systems necessary to transport Ammonia, Utilities,

Additives, Waste or other material provided or handled by the Delivery Systems to or from tie-in points at the Battery Limits to the Nitric Acid Facility.

15.2 Connection Points - BMS shall be responsible for operating and maintaining the Delivery Systems outside of the Battery Limits of the Nitric Acid Facility. EDNLP shall be responsible for operating and maintaining the Delivery Systems inside the Nitric Acid Facility.

SECTION 16: PERMITS

EDNLP shall be responsible for the preparation, filing and cost of obtaining and maintaining all Permits related to the operation of the Nitric Acid Facility. BMS reserves the right to approve, or to disapprove, all Permit applications prepared by EDNLP and EDNLP shall give BMS at least ten (10) days to review permit applications. BMS shall provide EDNLP reasonable assistance as necessary to obtain the Permits as EDNLP may request. EDNLP shall provide BMS reasonable assistance to transfer the Permits upon the expiration or termination of this Agreement.

SECTION 17: INSURANCE

17.1 EDNLP's Insurance - EDNLP shall maintain, or cause to be maintained, the following insurance:

(A) Insurance Against Public Liability - EDNLP shall procure and maintain in effect at all times from the

Commencement Date until the expiration or termination of this Agreement: automobile liability, comprehensive general and excess liability insurance policies applying to bodily injury (including death) and third party property damage arising from the activities of EDNLP under the Project Agreements. Such coverage shall have a minimum combined single limit of liability of at least Five Million Dollars (\$5,000,000) and a general aggregate limit of at least Five Million Dollars (\$5,000,000). All such policies shall be written to apply to all bodily injury, property damage, personal injury and other losses occurring during the policy term. Such coverage shall also contain endorsements: (A) deleting any employee exclusion on personal injury coverage; (B) including employees as additional insureds; (C) deleting any liquor liability exclusion; (D) providing for coverage of employer's automobile non-ownership liability; (E) providing for fire legal liability coverage; (F) providing for explosion, collapse and underground liability coverage; and (G) providing for contractual liability.

(B) Workers' Compensation and Other Insurance - EDNLP shall also carry workers' compensation insurance and such other forms of insurance that EDNLP is required by law to provide, covering loss resulting from injury, sickness, disability or death of the employees of EDNLP arising out of and in the course of their employment to the extent required by law,

together with employer's liability coverage with a limit of at least One Million Dollars (\$1,000,000).

(C) Business Interruption – Business interruption insurance shall be carried at the discretion and cost of EDNLP. BMS shall not be responsible for payment or reimbursement of any premiums or deductibles related to such business interruption insurance. BMS shall have no rights to make a claim under any business interruption insurance that may be carried by EDNLP.

(D) Pollution Liability Insurance – EDNLP shall carry sudden and accidental pollution liability insurance. Such coverage shall have a limit of at least Five Million Dollars (\$5,000,000) per occurrence and annual aggregate.

(E) Insurance Certificates – EDNLP shall provide a copy of all applicable insurance certificates to BMS within ten (10) days following the Commencement Date, and on an annual basis thereafter.

(F) Deductibles: In all cases, BMS shall be responsible for the payment of the deductibles for insurance as mentioned above, including without limitation, the deductible under pollution insurance purchased by EDNLP for the Nitric Acid Facility, but excluding business interruption insurance.

17.2 BMS's Insurance - BMS shall maintain, or cause to be maintained, the following insurance:

(A) Insurance Against Loss or Damage - BMS shall maintain or cause to be maintained in effect at all

times during the Term, property insurance to the extent BMS reasonably deems adequate for the Nitric Acid Facility and the assets comprising the EDNLP Net Book Value and keep it, and all of the Catalyst, and equipment and machinery comprising the Nitric Acid Facility insured on a replacement value basis and on an all-risk basis, which shall include coverage for the following without limitation: perils of earthquake, windstorm, flood, fire or other casualty; vandalism and malicious mischief; coverage for replacement costs and cost of demolition endorsements; and comprehensive boiler and machinery coverage.

(B) Insurance Against Public Liability. - BMS shall procure and maintain in effect at all times from the Commencement Date until the expiration or termination of this Agreement, automobile liability, comprehensive general and excess liability insurance policies applying to bodily injury (including death) and third party property damage arising from the activities of BMS under the Project Agreements. Such coverage shall have a minimum combined single limit of liability of at least Five Million Dollars (\$5,000,000) and a general aggregate limit of at least Five Million Dollars (\$5,000,000). All such policies shall be written to apply to all bodily injury, property damage, personal injury and other covered losses occurring during the policy term. Such coverage shall also contain endorsements: (A) deleting any employee exclusion on personal injury coverage; (B) including employees as

additional insureds; (C) deleting any liquor liability exclusion; (D) providing for coverage of employer's automobile non-ownership liability; (E) providing for fire legal liability coverage; (F) providing for explosion, collapse and underground liability coverage; and (G) providing for contractual liability.

(C) Workers' Compensation and Other Insurance - BMS shall also carry workers' compensation insurance and such other forms of insurance that BMS is required by law to provide covering loss resulting from injury, sickness, disability or death of the employees of BMS arising out of and in the course of their employment to the extent required by law, together with employer's liability coverage with a limit of at least One Million Dollars (\$1,000,000).

17.3 Waiver of Subrogation Rights - Notwithstanding anything to the contrary herein, EDNLP and BMS each waive all of its insurer's rights of recovery, claim, action or cause of action against the other, its agents, officers, directors, shareholders or employees for any loss or damage that may occur to the Nitric Acid Facility, or any personal property of either party hereto, by reason of any cause or origin, that is insured against under insurance coverages hereunder, excluding the sole negligence of the other party hereto, its agents, officers or employees. The insurance policies required hereunder shall be endorsed if necessary to waive the insured's rights of subrogation against EDNLP or BMS as applicable. Each party's

fulfillment of the obligations of this Section 17 shall not, of itself, in whole or in part satisfy or fulfill its indemnity, liability or other obligations owing under the Agreement or applicable law.

17.4 Miscellaneous Insurance Provisions - Each party shall provide the other party with thirty (30) days notice of cancellation or material change in terms of any of the coverage described in this Section 17 required to be maintained by the party. If at any time during the Term, the amount or type of insurance coverage that each party is required to carry under this Section 17 is, in the reasonable judgment of the other party, materially deficient under Sections 17.1 or 17.2 hereof, the party not in default of this Section 17 may, at its option: (A) notify the defaulting party in writing that it has thirty (30) days in which to cure such deficiency or the defaulting party shall be in default hereunder, or (B) pay any premiums or take any other steps necessary to cure the deficiency, in which case the defaulting party shall be liable to the non-defaulting party for all premiums and other costs associated with such cure.

17.5 Form of Policies - All insurance policies required to be carried under this Agreement shall be obtained from insurance companies of good national or international reputation. In any event, deductible amounts shall not exceed ten percent (10%) of the limit of liability in dollars for each

required insurance. However, the above conditions of approval and limitations of amounts of deductible shall not apply when the conditions of self-insurance set forth in Section 17.6 below are satisfied. Upon request by BMS, EDNLP shall provide to BMS two insurance quotes which cover the cost of incremental additional or new insurance mentioned herein. BMS shall determine which insurance policy, including premium and deductible amounts, is most advantageous and may determine that EDNLP be covered under BMS insurance policies if BMS deems this action appropriate.

17.6 Self-Insurance - Any insurance required to be maintained by either party under this Agreement (other than workers' compensation insurance) may be maintained under a plan of self-insurance. However, either party shall be entitled to use such self-insurance only (A) during periods when such party's net worth exceeds Two Hundred Fifty Million Dollars (\$250,000,000), and (B) if such party maintains adequate reserves or liquid assets for payment of claims of liability against the other party, including the replacement value of the EDNLP Net Book Value in the case of EDNLP and the Nitric Acid Facility in the case of BMS.

17.7 Blanket Coverage - Any policy required to be maintained by either party under this Agreement may be maintained under a "blanket policy" that insures other parties or locations. However, the amount of insurance and the type of

coverage required to be provided hereunder may not be thereby diminished, changed or adversely affected.

17.8 Failure of EDNLP to Insure - If EDNLP fails to procure or maintain the insurance that EDNLP is required to maintain pursuant to Section 17.1 hereof, BMS may procure, on behalf of EDNLP, the minimum amount of insurance coverage required under Section 17.1 hereof, and EDNLP shall promptly reimburse BMS for the same. Insurance charges for such required insurance are included in Fixed Costs.

SECTION 18: DEFAULT AND REMEDIES

18.1 EDNLP Events of Default - An EDNLP Event of Default shall occur upon the occurrence of any one or more of the following events, unless the event is caused by BMS or any of BMS's agents or contractors:

(A) If EDNLP is unable to provide, for any reason substantially related to EDNLP's negligence or any material breach of EDNLP's obligations hereunder, a minimum of the lesser of (i) BMS's monthly Nitric Acid requirements for the Bayer Baytown Plant or (ii) 18,458 short tons per month of Nitric Acid, in each case under any combination of this Agreement and the Back-up Supply Plan, provided, however, that if EDNLP is unable to provide such amounts of Nitric Acid, EDNLP

shall have no obligation to purchase substitute ammonia or utilities;

(B) If EDNLP fails to meet, for thirty (30) days during any one hundred eighty (180) day period or forty-five (45) days during any three hundred sixty-five (365) day period, its obligations to provide to BMS Nitric Acid meeting the Nitric Acid Specifications in Section 2.2 hereof, provided such failure to provide Nitric Acid meeting the Nitric Acid Specifications has a material adverse effect on the DNT/SAC or MNB/Aniline plants, located within the Bayer Baytown Plant;

(C) If EDNLP fails to pay to BMS any amount due BMS pursuant to Sections 4.3 ("Fixed Costs Reimbursements"), 4.5 ("Operating Fee Reimbursements by EDNLP"), 5 ("BMS Reimbursement, Rebate and Egress Fee") or 17.8 ("Failure of EDNLP to Insure") hereof, when and as due, and such payments are not being contested in good faith by appropriate proceedings;

(D) If EDNLP breaches any of its covenants set forth in Section 9.1(E) hereof ("Health and Safety Covenants") or in Section 9.1(L) hereof ("Environmental Covenants");

(E) If EDNLP breaches its covenants set forth in Section 9.1(F) ("Compliance with Laws & Permits") hereof; or

(F) If EDNLP materially defaults in the due performance or observance of any other term, covenant or agreement on its part to be performed or observed pursuant to

any of the provisions of this Agreement or any of the other Project Agreements.

18.2 EDNLP Cure Periods - In the event any EDNLP Event of Default occurs, EDNLP shall have the following cure periods following written notice by BMS to EDNLP:

(A) Sixty (60) days in the case of a default under Section 18.1(A) hereof;

(B) Zero (0) days, in the case of a default under Section 18.1(B) hereof;

(C) Ten (10) Business Days, in the case of a default under Section 18.1(C) hereof;

(D) Ten (10) days, in the case of a default under Section 18.1(D) hereof (provided, however, that in the event of a default under Section 18.1(D) that is caused by a breach by EDNLP of its covenant under Section 9.1(E)(2), EDNLP shall have a reasonable period of time, which in no event shall exceed one hundred eighty (180) days, to implement the Safety Improvement Program described in Section 9.1(E)(2)(b) hereof);

(E) In the case of a default under Section 18.1(E) hereof, a reasonable period of time which in no event shall exceed one hundred eighty (180) days, to implement the Compliance Program described in Section 9.1(F)(2) hereof and to obtain results which indicate to BMS in its reasonable discretion that EDNLP has substantially addressed and corrected the issues identified pursuant to Section 9.1(F)(2) hereof; and

(F) Forty-five (45) days, in all other cases, unless such EDNLP Event of Default cannot reasonably be cured in forty-five (45) days and EDNLP has, during such forty-five (45) day period, undertaken reasonably effective curative measures, in which case the cure period for such EDNLP Event of Default shall be the number of days reasonably required to effectuate such cure.

If any EDNLP Event of Default is remedied within the aforementioned cure periods, such EDNLP Event of Default shall not constitute a continuing EDNLP Event of Default and this Agreement shall continue in full force and effect as if said EDNLP Event of Default had not occurred. The waiver of any EDNLP Event of Default under this Agreement shall not constitute a waiver of any subsequent EDNLP Event of Default.

18.3 BMS Events of Default - - A BMS Event of Default shall occur upon the occurrence of any one or more of the following events, unless the event is caused by Force Majeure, by EDNLP or any of EDNLP agents or contractors:

(A) If BMS is unable to provide, for any reason substantially related to BMS's negligence or any material breach of BMS's obligations hereunder, a minimum of the lesser of the Ammonia necessary to produce (i) BMS's monthly Nitric Acid requirements for the Bayer Baytown Plant or (ii) 18,458 short tons per month of Nitric Acid (less any amounts supplied to BMS under the Back-up Supply Plan);

(B) If BMS fails to meet, for thirty (30) days during any one hundred eighty (180) day period or forty-five (45) days during any three hundred sixty-five (365) day period, its obligations to supply to EDNLP certain Ammonia, Utilities or Services to be supplied by BMS and such failure to provide Ammonia, Utilities or Services has a material adverse effect on the Nitric Acid Facility;

(C) If BMS fails to pay to EDNLP any amount due EDNLP pursuant to Section 4 hereof when and as due; or

(D) If BMS materially defaults in the due performance or observance of any other term, covenant or agreement on its part to be performed or observed pursuant to any of the provisions of this Agreement or any of the other Project Agreements.

18.4 BMS Cure Periods - In the event of any BMS Event of Default occurs, BMS shall have the following cure periods following written notice by EDNLP to BMS:

(A) Sixty (60) days, in the case of a default under Section 18.3(A); or

(B) Zero (0) days, in the case of a default under Section 18.3(B) hereof;

(C) Ten (10) Business Days, in the case of a default under Section 18.3(C) hereof; and

(D) Forty-five (45) days, in all other cases, unless such BMS Event of Default cannot reasonably be cured in

forty-five (45) days and, during such forty-five (45) day period, BMS has undertaken reasonably effective curative measures, in which case the cure period for such BMS Event of Default shall be the number of days reasonably required to effectuate such cure.

If any BMS Event of Default is remedied within the aforementioned cure periods, such BMS Event of Default shall not constitute a continuing BMS Event of Default and this Agreement shall continue in full force and effect as if said BMS Event of Default had not occurred. The waiver of any BMS Event of Default under this Agreement shall not constitute a waiver of any subsequent BMS Event of Default.

18.5 BMS Remedies for EDNLP Events of Default - The parties agree that upon the occurrence of an EDNLP Event of Default (and subject to the continuation of such Event of Default beyond any applicable cure periods), BMS shall have the following rights and remedies (in addition to the indemnification rights provided for in Section 20.1 hereof):

(A) If an EDNLP Event of Default occurs pursuant to Section 18.1(A) hereof, BMS shall have the termination rights specified in Section 19.1 hereof and EDNLP shall pay to BMS the difference between the reasonable cost of any purchase of substitute nitric acid (including cost of transportation, storage, handling and any other direct costs associated with procuring substitute nitric acid) and the Variable Costs

Component in respect of all Nitric Acid ordered by BMS and not delivered by EDNLP during the existence of and continuation of the EDNLP Event of Default;

- (B) If an EDNLP Event of Default occurs pursuant to Section 18.1(B) hereof, BMS shall have the termination rights specified in Section 19.1 hereof and EDNLP shall pay to BMS its actual damages incurred in connection with the provision of nitric acid failing to meet the Nitric Acid Specifications during the existence and continuation of the EDNLP Event of Default;
- (C) If an EDNLP Event of Default occurs pursuant to Section 18.1(C) hereof, BMS shall have the termination rights specified in Section 19.1 hereof; provided, however, that if EDNLP contests the amounts due BMS, EDNLP and BMS shall first resolve such payment dispute in accordance with Section 24 hereof;
- (D) If an EDNLP Event of Default occurs pursuant to Section 18.1(D) hereof, BMS shall have the termination rights specified in Section 19.1 hereof and EDNLP shall pay to BMS its damages incurred; and
- (E) In all other EDNLP Events of Default, BMS shall have the termination rights specified in Section 19.1 hereof and EDNLP shall pay to BMS its damages incurred and BMS shall have any and all other rights and remedies available, whether at law or at equity.

In addition to any and all other remedies available to BMS as specified above, BMS shall have the right to offset its damages incurred pursuant to any Event of Default against any payments due EDNLP under the Project Agreements or otherwise.

18.6 EDNLP Remedies for BMS Events of Default - The parties agree that upon the occurrence of a BMS Event of Default (and subject to the continuation of such Event of Default beyond any applicable cure periods), EDNLP shall have the following rights and remedies (in addition to the indemnification rights provided for in Section 20.2 hereof):

(A) If a BMS Event of Default occurs due to BMS's failure to provide sufficient quantities of Ammonia pursuant to Section 18.3(A) hereof or BMS's failure to provide sufficient quantities of Utilities, Additives or Services pursuant to Section 18.3(B) hereof, EDNLP shall have the termination rights specified in Section 19.2 hereof and BMS shall pay to EDNLP the difference between the cost of any reasonable purchase of ammonia, utilities or services, as the case may be (including cost of transportation, storage, handling and any other direct costs associated with procuring substitute ammonia, utilities, additives or services) and the price of Ammonia, Utilities, Additives or Services, as the case may be, under the Project Agreements in respect of all Ammonia, Utilities, Additives and/or Services ordered by EDNLP from BMS

during the existence and continuation of the BMS Event of Default;

(B) If a BMS Event of Default occurs due to BMS's failure to provide Ammonia, Utilities, Additives or Services that meet specifications pursuant to Section 18.3(B) hereof, EDNLP shall have the termination rights specified in Section 19.2 hereof and BMS shall pay to EDNLP its actual damages incurred in connection with the provision of Ammonia, Services or Utilities failing to meet the specifications for Ammonia, Services, Additives and Utilities during the existence and the continuation of the BMS Event of Default;

(C) If a BMS Event of Default occurs pursuant to Section 18.3(C) hereof, EDNLP shall have the termination rights specified in Section 19.2 hereof; provided, however, that if BMS contests the amounts due EDNLP, BMS and EDNLP shall first resolve such payment dispute in accordance with Section 24 hereof. Following such resolution in EDNLP's favor, EDNLP shall have the termination rights specified in Section 19.2 hereof provided that BMS does not pay to EDNLP its damages incurred within a period of thirty days after the decision agreed to among the parties; and

(D) In all other BMS Events of Default, EDNLP shall have the termination rights specified in Section 19.2 hereof and BMS shall pay to EDNLP its damages, and EDNLP shall

have any and all other rights and remedies available, whether at law or at equity.

In addition to any and all other remedies available to EDNLP as specified above, EDNLP shall have the right to offset its damages incurred pursuant to an Event of Default against any payments due BMS under the Project Agreements or otherwise.

SECTION 19: TERMINATION

19.1 BMS's Optional Termination Rights - BMS shall have an option to terminate this Agreement by written notice to EDNLP upon an occurrence of an EDNLP Event of Default that is not cured within any applicable cure period;

19.2 EDNLP's Optional Termination Rights - EDNLP shall have an option to terminate this Agreement by written notice to BMS upon an occurrence of a BMS Event of Default that is not cured within any applicable cure period.

19.3 Automatic Termination - - This Agreement shall be automatically terminated:

(A) at the expiration of the Term, if the Term of this Agreement is not extended beyond either the Initial Term or any current Renewal Term;

(B) in the event that either BMS, on the one hand, or EDNLP or El Dorado on the other hand (collectively, EDNLP Parties) (i) makes an assignment for the benefit of creditors, becomes insolvent or admits in writing its inability

to pay its debts as they become due, files a voluntary petition in bankruptcy or a petition seeking reorganization, liquidation, dissolution or similar relief under any law or regulation; (ii) either BMS or one of the EDNLP Parties applies for, consents to or acquiesces in the appointment of a trustee, receiver or liquidator for itself or any of its property; or (iii) an involuntary bankruptcy or involuntary insolvency proceeding is commenced by either BMS or either of the EDNLP Parties and such involuntary bankruptcy or involuntary insolvency proceeding is not dismissed within ninety (90) days of its commencement.

19.4 Effects of Termination

(A) In the event that (i) the Term of this Agreement is not extended beyond either the Initial Term or any current Renewal Term, (ii) is terminated as a result of an EDNLP Event of Default, (iii) is terminated as a result of a BMS Event of Default or (iv) is automatically terminated pursuant to Section 19.3 hereof, BMS shall pay to EDNLP the appropriate termination fee (as hereinafter provided); the Project Agreements shall terminate (except as otherwise provided in Section 7 and in Section 19.4(B) hereof). In the case of a termination due to (a) the expiration of the Initial Term or any Renewal Term, any automatic termination under Section 19.3 hereof, or a BMS Event of Default, BMS shall pay to EDNLP the Expiration Termination Fee; and (b) an EDNLP Event of Default, BMS shall pay to EDNLP the EDNLP Default Termination Fee.

EDNLP's interest in and title to the assets comprising the EDNLP Net Book Value shall be transferred to BMS upon payment to EDNLP of the Expiration Termination Fee or the EDNLP Default Termination Fee, whichever is applicable.

(B) The termination contemplated by this Section 19 shall be conditioned upon and subject to the receipt of any necessary regulatory approvals, including without limitation the expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (if applicable), and any necessary approvals under the Exon-Florio Act, as amended (if applicable). At the termination, subject to payment of the Expiration Termination Fee to EDNLP by BMS, EDNLP shall take all action necessary (in the sole discretion of BMS and its counsel) to transfer its interest in the assets comprising the EDNLP Net Book Value to BMS free and clear of any and all liens, encumbrances and liabilities (direct, contingent and otherwise). The rights and obligations set forth in Section 7, rights set forth in Section 18, the obligations set forth in this Section 19, and the indemnification obligations contained in Section 20 and elsewhere in the Project Agreements shall survive any termination or expiration of the Project Agreements, and the payment of the Expiration Termination Fee or the EDNLP Default Termination Fee shall be subject to offset by either party for damages otherwise recoverable by the respective party hereunder as applicable.

(C) Upon termination of this Agreement pursuant to this Section 19 or exercise of the Right of First Refusal pursuant to Section 23 hereof, the nondefaulting party or parties shall be entitled to recover from the defaulting party or parties, in addition to all other sums due and payable by the defaulting party or parties hereunder, all expenses incurred in enforcing this Agreement, including without limitation, all reasonable attorneys' fees and out-of-pocket litigation expenses. Termination of this Agreement for any cause whatsoever shall not interfere with, affect or prevent the collection by the nondefaulting party or parties of any and all sums of money accrued hereunder or otherwise due to the nondefaulting party or parties prior to the date such termination becomes effective. Termination of this Agreement for any reason shall not relieve the defaulting party or parties of any of its or their unfulfilled obligations under this Agreement, including, without limitation, its or their indemnification obligations hereunder.

(D) Upon notification of termination or upon impending expiration of the Agreement, EDNLP shall provide BMS employees with all necessary information and knowledge required to operate the Nitric Acid Facility prior to the effective date of the termination or expiration of the Agreement.

(E) Notwithstanding anything seemingly to the contrary herein, Section 7 of this Agreement and provisions

relating thereto shall not be terminated and shall survive until twenty (20) years after the Commencement Date of this Agreement.

SECTION 20: INDEMNIFICATION

20.1 EDNLP Indemnification

(A) EDNLP shall indemnify, defend and save BMS and its Affiliates harmless from and against any and all claims, actions, obligations, suits, damages (whether direct, actual, special, consequential or otherwise, but excluding lost profits), fines, penalties, losses, costs, liabilities and expenses, including, without limitation, reasonable attorneys' fees, out-of-pocket litigation expenses and other costs incurred by, asserted against or awarded against BMS or its Affiliates to the extent such claims or damages arise, directly or indirectly, from, or are related in any way to, EDNLP's or its subcontractors' performance of the obligations contained herein, including claims made in connection with (i) any negligence or misconduct on the part of EDNLP or its officers, employees, agents, invitees or contractors, (ii) any bodily injury, loss of life, personal injury or death to persons or damage to property occurring in or on the Nitric Acid Facility not attributable, in whole or in part, to the negligence or intentional misconduct of the party seeking to be indemnified, (iii) any breach by EDNLP of any Environmental, Health and Safety Law, any Spill or the remediation, abatement, containment, clean-up, disposal or

response costs associated with environmental conditions at the Bayer Baytown Plant or the Nitric Acid Facility caused by EDNLP, (iv) any failure by EDNLP to observe or comply with any applicable Laws , or (v) a breach of any other EDNLP covenant or agreement hereunder or under any of the Project Agreements, provided, however, that until the occurrence of an EDNLP Event of Default: (a) BMS's remedy for EDNLP's failure to supply Nitric Acid is expressly limited to the difference between all costs associated with the procurement of substitute nitric acid and the Variable Costs Component and (b) BMS's remedy for off-specification nitric acid is expressly limited to actual damages.

(B) If EDNLP's indemnification obligations under Section 20.1(A) hereof arise or result from EDNLP's sole negligence, EDNLP shall (subject to any limitations set forth in Section 20.1(A) hereof) remain entirely responsible for the results and consequences of its sole negligence, and if EDNLP's indemnification obligations under Section 20.1(A) hereof arise or result from joint or concurrent negligence of more than one party, EDNLP shall be responsible (subject to any limitations set forth in Section 20.1(A) hereof) for only that portion of the claim, loss, damage, cost or expense caused by the negligence of EDNLP, EDNLP's agents or employees, subcontractors retained by EDNLP or agents or employees of such subcontractors.

In all other cases, all remedies under Section 18 hereof and at law and equity are available to BMS.

20.2 BMS Indemnification

(A) BMS shall indemnify, defend and save EDNLP and its Affiliates harmless from and against any and all claims, actions, obligations, suits, damages (whether direct, actual, special, consequential or otherwise, but excluding lost profits), fines, penalties, losses, costs, liabilities and expenses, including, without limitation, reasonable attorneys' fees, out-of-pocket litigation expenses and other costs incurred by, asserted against or awarded against EDNLP or its Affiliates to the extent such claims or damages arise, directly or indirectly, from, or are related in any way to, BMS's performance of the obligations contained herein, including claims made in connection with (i) any negligence or misconduct on the part of BMS or its officers, employees, agents, invitees or contractors, (ii) any bodily injury, loss of life, personal injury or death to persons or damage to property occurring in or on the Bayer Baytown Plant (other than the Nitric Acid Facility) not attributable, in whole or in part, to the negligence or intentional misconduct of the party seeking to be indemnified, (iii) any breach by BMS of any Environmental, Health and Safety Law or any Spill or the remediation, abatement, containment, clean-up, disposal or response costs associated with environmental conditions at the Bayer Baytown Plant or the

Nitric Acid Facility caused by BMS, (iv) any failure by BMS to observe or comply with any applicable laws or government rules or regulations or (v) a breach of any other BMS covenant or agreement hereunder or any of the Project Agreements, provided, however, that until the occurrence of a BMS Event of Default, EDNLP's remedy for BMS's failure to provide Ammonia, Utilities or Services is expressly limited to the difference between all costs associated with the purchase of substitute ammonia, utilities or services, as the case may be, and the price of Ammonia, Utilities or Services, as the case may be, under the Project Agreements.

(B) If BMS's indemnification obligations under Section 20.2(A) hereof arise or result from BMS's sole negligence, BMS shall (subject to any limitations set forth in Section 20.2(A) hereof) remain entirely responsible for the results and consequences of its sole negligence, and if BMS's indemnification obligations under Section 20.2(A) hereof arise or result from joint or concurrent negligence of more than one party, BMS shall be responsible (subject to any limitations set forth in Section 20.2(A) hereof) for that portion of the claim, loss, damage, cost or expense caused by the negligence of BMS, BMS's agents or employees, subcontractors retained by BMS or agents or employees of such subcontractors. In all other cases, all remedies under Section 18 hereof and at law and equity are available to EDNLP.

20.3 Indemnification Details - The indemnity, defense, and hold harmless protections provided under this Section 20 are expressly intended to include, but are not limited to:

(A) Any and all claims and damages for, on account of, or arising from, personal injuries, sickness, disease or death actually or allegedly sustained by any party, its subcontractor, Affiliate, or any third party. The parties hereby expressly waive, for purposes of the indemnity, defense and hold harmless protections provided under this Section 20, any workers' compensation immunity that it would otherwise have under any applicable law from liability for such personal injury, sickness, disease or death claims related to any claim brought by the indemnified party or its Affiliates under this indemnity, defense and hold harmless agreement. Such waiver of immunity does not extend to direct claims or damages brought by, or on behalf of, or awarded to, the indemnifying party's employees against the indemnified party, but such waiver is intended to include claims and damages brought by, or on behalf of, or awarded to, the indemnifying party's or its subcontractor's employees against the indemnified party or its Affiliates.

(B) Any and all claims and damages relating in any way to any infringement by any services or materials provided to either party pursuant to this Agreement of any patent,

copyright, trade secret or other intellectual property right of any person or entity.

(C) Any and all claims and damages for, on account of, or arising from, property damage actually or allegedly sustained by any third party or party, its subcontractors, or their Affiliates.

The indemnifying party agrees to attempt in good faith to timely, amicably and fully settle all claims or damages asserted or awarded against the indemnified party and that may be covered by this Section 20 such that the indemnified party and its Affiliates are fully protected from and against any subsequent claims and damages asserted by the same claimant.

The indemnifying party's indemnity obligations as set forth herein shall not be limited by any limitation on the amount or type of damages, benefits or compensation payable by or for the indemnifying party under Worker's Compensation Acts, Disability Benefit Acts or other employee benefit acts on account of claims against the indemnified party or its Affiliates by an employee of the indemnifying party or anyone employed directly or indirectly by the indemnifying party or anyone for whose acts the indemnifying party may be liable. In no event shall the indemnifying party's obligations hereunder be limited to the extent of any insurance available to or provided by the indemnifying party.

The indemnifying party's duty to indemnify, defend and hold harmless the indemnified party and its Affiliates under this Section 20 shall survive the termination of the Agreement for a period of two years. The indemnified party rights to indemnity, defense and hold harmless protections under this Section 20 are cumulative of, and are provided by the indemnifying party without prejudice to, any other rights or remedies available to the indemnified party or its Affiliates.

20.4 Notice of Proceedings - - The indemnitee shall give the indemnitor notice of any suit, proceeding or action (whether pending or threatened) commenced by any party which could give rise to damages under this Section 20. Such notice shall be given within thirty (30) days of indemnitee's discovery or receipt of such matter (but the failure to notify within such time period shall not rescind the indemnitor's duty to indemnify but shall only reduce the amount of the indemnification amount to the extent that the indemnifying party is damaged by such delay). The indemnitor shall then have the option, at its own cost and expense, to participate in or assume control of such proceedings by retaining counsel reasonably acceptable to the indemnitee. If the indemnitor does not make its election within thirty (30) days of its receipt of the indemnitee's notice, the indemnitee may proceed with the defense of the matter and indemnitor shall be bound by the result.

20.5 Insurance - Notwithstanding anything contained in this Section 20 to the contrary, it is the intention of the parties to avail themselves, to the maximum extent possible, of the proceeds of the insurance policies required to be maintained pursuant to this Agreement and to the extent the damages or expenses referenced by this Section 20 are paid by such insurance policies (including deductibles), this indemnity shall be inapplicable. To the extent that a party's indemnity or liability is greater than the proceeds of the insurance policies, that party shall be solely responsible for the indemnity or liability not covered by such insurance policies.

SECTION 21: INJUNCTIVE RELIEF

The parties acknowledge that irreparable damage may occur in the event that any of the material provisions of this Agreement are not performed in accordance with their specific terms or are otherwise breached and such performance does not occur or such breach is not cured within the period set forth above. Each of the parties therefore agrees that the other parties shall be entitled to an injunction or injunctions to prevent nonperformance or breach of material provisions of this Agreement and to enforce specifically the terms and provisions hereof, this being in addition to any other remedy to which they are entitled at law or in equity.

SECTION 22: TERM AND RENEWALS

22.2 Renewals - The Term of this Agreement shall be automatically renewed for five (5) successive Renewal Terms each consisting of five (5) years unless either BMS or EDNLP has given the other party written notice of its intention not to renew the Term of this Agreement not less than twelve (12) and no more than eighteen (18) months before the expiration of the Initial Term or the current Renewal Term, as the case may be. If either party gives such notice, then not more than ninety (90) days nor less than sixty (60) days before the end of the Term, BMS shall pay to EDNLP the Expiration Termination Fee and shall terminate this Agreement pursuant to Section 19 hereof.

SECTION 23: RIGHT OF FIRST REFUSAL

23.1(A) Change of Control Event - Upon the occurrence of a Change of Control Event, EDNLP shall notify BMS of BMS's option and right to pay the Expiration Termination Fee and to terminate this Agreement pursuant to Section 19 hereof. BMS shall have a reasonable amount of time, not to exceed sixty (60) days, from its receipt of notice of a Change of Control Event to exercise an option to pay to EDNLP the EDNLP Expiration Termination Fee and to terminate this Agreement in accordance with Section 19 hereof.

23.1(B) Third Party Offer - If EDNLP desires to sell and receives a bona fide third-party offer to purchase any voting equity securities of EDNLP or the assets comprising the EDNLP Net Book Value (other than purchases of product in the ordinary course of business) that EDNLP would like to accept, EDNLP shall notify BMS of BMS's option and right to pay either the Expiration Termination Fee or the amount of the third party offer, whichever is lower, and to terminate this Agreement pursuant to Section 19 hereof (the Right of First Refusal). BMS shall have a reasonable amount of time, not to exceed sixty (60) days, from its receipt of the notice of a bona-fide third party offer to exercise an option to pay to EDNLP the EDNLP Expiration Termination Fee or the amount of the third party offer and to terminate this Agreement in accordance with Section 19 hereof.

23.2 Injunctive Relief and Specific Performance - The parties acknowledge that irreparable damage may occur in the event that any of the material provisions of this Section 23 are not performed in accordance with their specific terms or are otherwise breached and such performance does not occur or such breach is not cured within the period set forth above. Each of the parties therefore agrees that the other party will be entitled to an injunction or injunctions to prevent nonperformance or breach of material provisions of this Section 23 and to enforce specifically the terms and provisions

hereof, this being in addition to any other remedy to which they are entitled at law or in equity.

SECTION 24: DISPUTE RESOLUTION

24.1 General - Unless otherwise provided herein or in the Project Agreements, any dispute arising hereunder or under the Project Agreements shall be resolved in the manner specified in this Section 24.

24.2 Dispute Resolution - The parties agree to exercise reasonable efforts to resolve any dispute promptly and within a reasonable period of time. If any such dispute cannot be resolved within fifteen (15) Business Days, either party shall have the right to notify the other party that it wishes to convene a personal meeting between the senior management of BMS and the senior management of EDNLP. Such meeting shall take place within fifteen (15) Business Days of the delivery of such notice. The representatives of the parties shall then meet and attempt in good faith to resolve the subject dispute. If such attempt is unsuccessful, either party may proceed to litigate the matter at issue. Any such negotiation or series of negotiations shall be maintained as confidential by the parties and the parties covenant that they shall not disclose (other than to their respective Affiliates) either the existence of such proceedings or the content thereof to any other party without the express written consent of the opposite party. Any

participation in or initiation of such discussions shall not be deemed to be an admission of liability and no statement made or provided in or related to such negotiations shall be construed as a statement against interest or otherwise disclosed or used in any proceeding involving the parties.

24.3 Commencement of Legal Actions - In the absence of irreparable harm or material damages, the parties agree that no party shall be entitled to commence any legal action to resolve any dispute hereunder prior to the completion of the procedures specified in Section 24.2 hereof. If a party declines or fails to participate in the meeting contemplated by Section 24.2 hereof, the other party shall be entitled to request any court of competent jurisdiction to grant a stay of litigation while the parties attempt to settle the litigation through this negotiation method. The party declining to participate agrees not to oppose such a stay.

24.4 Governing Law - The construction and interpretation of this Agreement shall be governed by the internal laws of the State of Texas, without regard to conflicts-of-laws provisions.

24.5 Submission to Jurisdiction - The parties hereto hereby irrevocably submit to the jurisdiction of the United States District Court located in Harris County, Texas over any dispute arising out of or relating to this Agreement or any of the transactions contemplated hereby. Each party hereby

irrevocably agrees that all claims in respect of such dispute or proceeding shall be heard and determined in such court. The parties hereby irrevocably waive, to the fullest extent permitted by applicable law, any objection that they may now or hereafter have to the venue of any such dispute brought in such court, and any defense of inconvenient forum of any dispute under the Project Agreements.

24.6 Consent to Service of Process - Each of the parties hereto hereby consents to process being served by either party to this Agreement in any suit, action or proceeding by mailing of a copy thereof in accordance with the provisions of Section 30 hereof.

SECTION 25: ENTIRE AGREEMENT

This Agreement, the Technology Agreement, and the Confidentiality Agreements together with all the amendments thereto and the schedules attached hereto and thereto, contain the entire understanding of the parties and supersede any prior understanding and agreements among them respecting the subject matter hereof and thereof. There are no agreements, arrangements or understandings, oral or written, between and among the parties hereto relating to the subject matter of this Agreement and the other Project Agreements that are not set forth or expressly referred to herein or therein.

SECTION 26: MODIFICATION

This Agreement shall not be modified or amended, except by written instrument executed by the duly authorized officers of the parties hereto.

SECTION 27: PAYMENTS

All amounts payable hereunder shall be paid in lawful money of the United States on a net fifteen (15) day basis, with interest to accrue thereafter at a rate equal to the prime rate charged by Citibank, N.A. The acceptance by either party of bank drafts, checks or other media of payment will be subject to immediate collection of the full face amount thereof and the payment shall not be deemed to have been paid until actually received in cash by the respective party, except that no interest shall be charged after receipt of any bank drafts, checks or other media of payment that is collected in cash in the ordinary course of business and without unusual delay.

SECTION 28: DEMURRAGE

BMS or EDNLP shall unload and release all transportation equipment promptly to minimize demurrage or other out-of-pocket expense resulting from delivery. The amount of any demurrage or out-of-pocket expense resulting to either party from the other party's delay in unloading or releasing transportation equipment will be paid by the responsible party.

SECTION 29: COOPERATION

The parties hereto shall cooperate and take all such reasonable and necessary actions required to achieve the stated purposes of the Project Agreements during the Term hereof. EDNLP shall use reasonable efforts to optimize the total cost for operation of the Nitric Acid Facility, taking into account various operating parameters, including without limitation the value of steam, the required production rates, and ambient conditions. EDNLP shall consult with BMS on its operating plans at least quarterly to manage total Nitric Acid costs to BMS. The parties acknowledge that operating the Nitric Acid Facility at higher production rates may result in lower yields. If this were to occur, the parties shall meet to resolve any concerns.

SECTION 30: NOTICES

Any notice, communication or statement required or permitted to be given hereunder shall be in writing and deemed to be sufficiently given when delivered in person, or on the second Business Day following the date of transmission by U.S. certified or registered mail, return receipt requested, or on the Business Day following the date of transmission by overnight courier to the address of the respective party below:

Bayer MaterialScience LLC
100 Bayer Road
Pittsburgh, Pennsylvania 15205-9741
Attn: Vice President, Procurement

Bayer MaterialScience LLC
8500 West Bay Road
Baytown, Texas 77520
Attn: Head of Basic Chemicals Production

El Dorado Nitrogen, L.P.

16 South Pennsylvania Avenue
Oklahoma City, Oklahoma 73107
Attn: President

El Dorado Chemical Company
16 South Pennsylvania Avenue
Oklahoma City, Oklahoma 73107
Attn: President

and: LSB Industries, Inc.

16 South Pennsylvania Avenue
Oklahoma City, Oklahoma 73107
Attn: General Counsel

Either party may, by notice given as aforesaid, change its address or its party that receives notices for all subsequent notices.

SECTION 31: BINDING AGREEMENT

This Agreement shall be binding upon and shall inure to the benefit of the respective successors and assigns of the parties hereto, as the case may be, and may not be terminated, modified, changed or amended, except by a written instrument signed by the party to be charged.

SECTION 32: WAIVER

No waiver by BMS or EDNLP of any default or breach of any covenant, condition or stipulation herein shall be treated as a waiver of any subsequent default, or breach of the same or any other covenant, condition or stipulation hereof.

SECTION 33: CONSTRUCTION

The singular form of any word used herein shall include the plural, and vice versa. The use herein of a word of any gender shall include each of the masculine, feminine and neuter genders. The headings or titles of the several sections and paragraphs of this Agreement are for convenience only. They shall not affect the meaning, construction or effect of the provisions hereof and do not constitute a part of this Agreement.

Nothing contained in or done pursuant to this Agreement or any of the other Project Agreements shall be deemed or construed by the parties hereto, or by any third party, to create the relationship of principal and agent, partnership, joint venture or any association whatsoever between BMS and EDNLP. It is expressly understood and agreed that no provisions contained in this Agreement, nor any act or acts of the parties hereto, shall be deemed to create any agency, partnership or joint venture relationship between BMS and EDNLP.

SECTION 34: COUNTERPARTS

This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which taken together constitute one instrument.

SECTION 35: ASSIGNMENT

EDNLP may not assign its respective rights and obligations under the Project Agreements to any other party without first obtaining the express written consent of BMS, which consent may be granted or withheld by BMS in its sole discretion; provided, however that upon the termination or expiration of this Agreement, EDNLP may assign its rights and obligations under Section 7 of this Agreement without restriction.

SECTION 36: AUDIT RIGHTS

Each calculation, adjustment, payment or estimate made pursuant to the Project Agreements shall be supported by appropriate work papers and background data and shall be made in conformity with GAAP. Each party shall have the right, at its own expense, to employ a firm of independent certified public accountants to conduct an audit of any adjustment or calculation made pursuant to the Project Agreements. Such auditors shall execute agreements of confidentiality reasonably acceptable to both parties, approval of the form of which shall not be unreasonably withheld. The parties agree that they shall exercise reasonable, good faith efforts from time to time throughout the Term in an effort to minimize the administrative and accounting burdens on one another that may be occasioned by the application of this Section 36.

SECTION 37: GUARANTY

The Guarantor hereby unconditionally guarantees the full and faithful performance by EDNLP of all of the terms, provisions, representations, warranties and obligations of EDNLP pursuant to the Project Agreements, including without limitation the indemnification and remedial provisions of the Project Agreements. The Guarantor further agrees that BMS may, without notice to or further assent of the Guarantor, and without in any way releasing or impairing the obligations of the Guarantor hereunder (i) waive compliance with, or any default under, the Project Agreements; (ii) modify or amend any provisions of the Project Agreements with the written consent of EDNLP only; (iii) grant extensions or renewals of any of the obligations of EDNLP; and (iv) in all respects deal with EDNLP as if this guaranty were not in effect. The obligations of the Guarantor under this guaranty shall remain in force notwithstanding any event that would, in the absence of this clause, result in the release or discharge by operation of law of the Guarantor from the performance of its obligations hereunder. The liability of the Guarantor under this guaranty to BMS shall be a guaranty of performance and of payment, not merely a guaranty of collection, and the liability of the Guarantor under this guaranty shall not be contingent upon the exercise by BMS of any right it may have in respect of the Guarantor. This guaranty obligation is not intended to and shall not release or extinguish any obligations of EDNLP to BMS. The provisions of this Section 37 are not

intended to create and shall not create or impose any obligations on the Guarantor in favor of any third party, the provisions of this Section 37 being only for the benefit of BMS.

SECTION 38: FORCE MAJEURE

Upon the occurrence of a Force Majeure Event, the obligations of the parties shall be suspended pending removal, termination or cure of the Force Majeure Event, except the obligation to make payments due under this Agreement. This Section 38 shall apply to all provisions, terms and conditions of this Agreement, notwithstanding anything seemingly to the contrary herein.

SECTION 39: CONTROLLING AGREEMENT

To the extent any of the Project Agreements contain conflicting provisions, the terms of this Agreement shall control.
IN WITNESS WHEREOF, the undersigned have executed this Nitric Acid Supply, Operating and Maintenance Agreement effective as of the date first above written.

BAYER MATERIALSCIENCE LLC

By: /s/ Gregory S. Babe

Name:
Gregory S. Babe
Title: President and CEO

EL DORADO NITROGEN, L.P.

By: /s/ Anne O. Rendon

Name: Anne O. Rendon

Title: President of the General Partner of El Dorado Nitrogen, LP,
El Dorado Acid LLC

El Dorado Chemical Company executes this Nitric Acid Supply, Operating and Maintenance Agreement solely for purposes of the representations, warranties and covenants set forth in Section 9.2 hereof, the provisions of Section 18.4 hereof, the guaranty set forth in Section 37 hereof and the Back-up Supply Plan attached hereto as Exhibit B.

EL DORADO CHEMICAL COMPANY

By: /s/ Tony M. Shelby

Name: Tony M. Shelby

Title: Vice President

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EXHIBIT A
SITE DATA

1.1 Location and Site Data

Plant Location: Baytown, Texas, on portion of Block 12C

Typical Climatological Data:

Height above sea level	23 feet
Minimum Winter temperature	17° F
Maximum summer temperature	102° F
Design air temperature for aircooled exchangers	105° F
Direction of Prevailing Winds	S/SE
Design max. wind strength	125 mph for the absorber column; others per 1995 Code
Design max. rainfall intensity	2.5 inches/hour

1.2 Product Storage

BMS requires storage tanks to have secondary containment for product storage. Tanks provide 4900 tons (100 percent acid basis) days storage at plant capacity. EDNLP shall include product pumps and necessary piping to users. EDNLP shall also provide acid piping to battery limits with a separate metering station for nitration and mononitrobenzene (MNB).

1.3 Civil Engineering Information

Refer to Fugro-McClelland (Southwest), Inc. report of August 29, 1996. The piling on all absorbers is no lower than thirty-two feet (32') below mean sea level assuming a grade of at least 23' above mean sea level. IF EDNLP requires any additional soil investigation, EDNLP shall arrange for the performance of such investigations and shall bear the cost of the same. BMS requests one copy of any soil investigation done by EDNLP.

1.4 Metes And Bounds Description

Tract I

Field notes of a 2.755 acre tract of land situated in the Christian Smith League, Abstract No. 22, Chambers County, Texas, and being out of and a part of the following tracts of land:

1. A called 45.837 acre tract of land conveyed to Mobay Chemical Company by Sidney S. McClendon III, Trustee by

deed dated March 10, 1970 and recorded in Volume 313 at page 345 of the Deed Records of Chambers Country, Texas.

2. A called 286.359 acre tract of land conveyed to Mobay Chemical Company by Sidney S. McClendon III, Trustee by deed dated March 10, 1970 and recorded in Volume 313 at page 340 of the Deed Records of Chambers Country, Texas.

This 2.755 acre tract of land is more particularly described by metes and bounds as follows, to-wit:

Note: All bearings are Lambert Grid Bearings and all coordinates refer to the State Plane Coordinate System, South Central Zone, as defined by Article 5300A of the revised civil statutes of the State of Texas. Scale factor equal 0.9998961. Lambert Grid bearings to plant bearings -12 Deg 31 Min 34 Sec in the northwest and southeast quadrant, +12 Deg 31 Min 34 Sec in the Northeast and Southwest Quadrant. Reference is made to plat of even date accompanying this description.

Commencing at the Northeast corner of said 45.837 acres, the Northwest corner of said 286.359 acres, and in the South line of a 166.443 acre tract of land conveyed to Mobay Chemical Company by Sidney S. McClendon III, Trustee by deed dated January 4, 1974, and recorded in Volume 352 at Page 148 of the Deed Records of Chambers County, Texas, having a State Plan Coordinate System value of X equal 3,297,676.49 and Y equal 725,015.83.

Thence South 34 Deg 28 Min 15 Sec West across said 45.837 acres a distance of 706.72 feet to a ½ inch iron rod set for the Northwest corner of this tract of land, and in the centerline of a 50 foot road right of way, said corner being the Place of Beginning. This corner has a State Plane Coordinate System Value of X equal 3,297,276.54 and Y equal 724,433.26, and a Plant Coordinate Value of N equal 7630 and E equal 7215.

Thence North 77 Deg 28 Min 26 Sec East with the North line of this tract of land, and across said 45.837 acres a distance of 300.00 feet to a ½ inch iron rod set for the Northeast corner of this tract of land in the centerline of a 50 foot right of way.

Thence South 12 Deg 31 Min 34 Sec East with the East line of this tract of land, the centerline of said 50 food road, across said 45.837 acres, and across said 286.359 acres a distance of 400.000 feet to a ½ inch iron rod set for the Southeast corner of this tract of land.

Thence South 77 Deg 28 Min 26 Sec West with the South line of this tract of land, and across said 286.359 acres a distance of 300 feet to a ½ inch iron rod set for the Southwest corner of this tract of land, and in the centerline of said 50 foot road.

Thence North 12 Deg 31 Min 34 Sec West with the West line of this tract of land, the centerline of said 50 foot road, across said 45.837 acres, and across said 286.359 acres a distance of

400.000 feet to the Place of Beginning, containing within said boundaries 2.755 acres of land.

1.5 Nameplate Capacity

The Nitric Acid Facility has a nameplate capacity of 443,000 short tons (100% basis) per year.

EXHIBIT B

BACK-UP SUPPLY PLAN

SUPPLY FOR OUTAGES, Start-Ups, or Shortfalls up to the Total Estimates

ASSUMPTIONS:

- In the event of a planned outage, beginning storage at minimum level of 95% capacity, 4750 tons (100% basis)
- Storage capacity of 5000 tons (100% basis)
- During an outage, BMS usage rate does not exceed BMS nameplate consumption (approximately 1,200 tons per day)

Note 1:

EDNLP shall invoice BMS for all costs incurred in the delivery of Nitric Acid hereunder. If the outage is caused by BMS, the price for Nitric Acid shipped from the El Dorado, Arkansas plant shall be the actual delivered cost of El Dorado ammonia in the nitric acid for the month in which the nitric acid was shipped, plus the average conversion fee paid by El Dorado's other nitric acid customers, plus the actual freight charges incurred by El Dorado or EDNLP, as applicable. If the outage is caused by EDNLP, the price for Nitric Acid shipped from the El Dorado, Arkansas plant shall be the then-current price for Nitric Acid shipped to BMS under the Nitric Acid Supply, Operating and Maintenance Agreement (adjusted for different ammonia costs) plus the applicable transportation charges. If the cause of the outage cannot be determined, the parties will negotiate in good faith a reasonable price for the nitric acid shipped from El Dorado.

When feasible, nitric acid shall be supplied on a swap basis, whether from El Dorado or a third party.

All Nitric Acid delivered to BMS shall meet the specifications set forth in Section 2.2 of the Nitric Acid Supply, Operating and Maintenance

Agreement. The price for nitric acid shipped from third parties shall be in all cases the price billed to EDNLP plus the applicable transportation charges.

EDNLP will use reasonable efforts to supply Nitric Acid hereunder at the lowest cost to BMS. Reasonable efforts include supplying BMS with shipments from its El Dorado, Arkansas facility when product is available, unless the total delivered cost to BMS of a third party shipment is lower than the total delivered cost from El Dorado's facility. Shipments from third parties must have BMS's prior approval.

- Note 2:** El Dorado will not hold capacity idle to cover outages; however, any allocation of nitric acid to downstream products, including any internal production, or proportionate sales of nitric acid from El Dorado is subject to EDNLP first providing to BMS a minimum of fifty percent (50%) of BMS's requirements for Nitric Acid (50% of BMS's monthly requirements are currently estimated to be approximately 18,500 tons) from El Dorado or a combination of nitric acid from El Dorado and other sources.
- Note 3:** The supply plan for an outage is subject to availability of drivers and transportation equipment suitable for nitric acid services, which EDNLP currently believes will be available. EDNLP will use its best commercial efforts to obtain suitable drivers and transportation equipment. Nitric acid that cannot be delivered due to unavailability of transportation equipment shall not be included as Production Shortfall.
- Note 4:** Subject to the provisions of Note 3 herein and allowing for a phase-in period (as shown by example below) whereby it may take several days to reach such delivery requirements, regardless of (1) the cause of an outage; (2) whether an outage is planned or unplanned; or (3) whether the assumptions stated above occur in fact, EDNLP is required in the event of an outage to provide BMS a minimum of fifty percent (50%) of BMS's monthly requirements of Nitric Acid, estimated to be approximately 18,500 tons, equivalent to an average of approximately forty tank trucks per

day. For further clarification, the parties agree that subject to the phase-in period (as shown by example below), EDNLP shall provide to BMS a minimum of one-fourth (¼) of fifty percent (50%) of BMS's monthly requirements of Nitric Acid per week for the duration of the outage.

Example:

<u>Day #</u>	<u>Est. Trucks/ Tons</u>	<u>Daily Use</u>	<u>Ending Inventory</u>
0	0		4300
1	15/ 230	600	3930
2	20/ 305	600	3635
3	30/ 460	600	3495
4	40/ 610	600	3505
5	40/ 610	600	3515

SCHEDULE 1
Utilities and Chemical Additives Supplied by BMS

(A) - - Water

Plant water:

The Coastal Water Authority supplies raw water to the Bayer Baytown Plant through the canal which runs to the east of the site. This water flows either directly to the south plant water system or to one of two 7.5 million gallon reservoirs at the east plant water system. The reservoirs provide both reserve capacity for the fire water system and storage of raw water to be processed in the east plant water system. At both plant water systems, the raw water is chemically treated prior to being introduced into the systems' clarifiers. The clarified water is then sent through a set of sand filters. The sand filter effluent is stored in either a 1 million gallon tank at the south system or a 1.5 million gallon storage tank at the east system. Under normal operations, plant water is distributed to the site at approximately 135 PSIG.

Typical EDNLP monthly volume is estimated to be 20 million gallons at an average rate of approximately 450 gallons per minute. The EDNLP water consumption shall not exceed a maximum rate of 870 gallons per minute. The maximum plant water system pressure (system design pressure) is 145 PSIG.

Demineralized water:

Plant water is initially run across one of four carbon beds to reduce organics and improve turbidity. The filtered water then travels through one of four demineralized water trains. With each train, the filtered water is first sent across the cation exchanger where the positive ions are removed. The decationized water then flows across the anion exchanger where the negative ions are removed. Train 4 utilizes a decarbonator (removes CO₂) prior to a series of weak and strong anion beds. The effluent from the anion bed then travels through the mix bed exchanger containing both types of resin which produces a virtually ion free water. This water is then sent to the 300,000 gallon storage tank. Under normal operations, demineralized water is distributed to the site at approximately 120 PSIG from BMS Environmental Control Department and Utilities (ECDU). The Chlor Alkali unit also exports on average approximately 350 to 400 gallons per minute of demineralized water into the plant supply system.

The normal maximum EDNLP consumption rate is 40 gallons per minute. Demineralized water can also back up the boiler feed water supply. The maximum demineralized water pressure (system design pressure) is 140 psig.

In the event BMS cannot provide boiler feed water meeting the specifications and quantities specified, EDNLP shall be entitled to use demineralized water for makeup up to a maximum quantity of 275 gallons per minute, subject, however, to reasonable allocation among

BMS and its guest facilities in the event of a shortage of such demineralized water.

Fire water:

The Bayer Baytown Plant's fire water system is supplied from two locations at the site (east or west). At the east system, raw water from the site's reservoirs is supplied to a combination of diesel and electric motor driven pumps. These pumps supply the main system header, which encompasses the entire site. Pressure is maintained in this header at approximately 125 PSIG by the electric "jockey" pump. A decrease in the header pressure will automatically start the diesel fire water pumps. An emergency fire water reserve of approximately 2.4 million gallons is maintained at the east system. The west system has a dedicated 2.0 million gallon capacity when at normal operating level. This system is equipped with an electric motor driven "jockey" pump to maintain header pressure. The west system also has two diesel driven fire water pumps to maintain system pressures in the event of a loss of power to the area.

BMS will supply fire water to the Battery Limits of the Nitric Acid Facility at a sufficient pressure and flow rate to meet EDNLP design and insurance requirements of the Nitric Acid Facility.

Potable water:

The Bayer Baytown Plant receives potable water through of a 12-inch diameter header from the City of Baytown. Under normal operations, the potable water is distributed at approximately 100 PSIG using one of the two booster pumps equipped with variable speed drives. During freeze precautions the larger of the two potable water booster pumps is used to meet demand at approximately 135 PSIG. In the event of an electrical failure, the emergency potable water diesel pump will automatically start to maintain system pressures. Potable water is to be used exclusively to supply safety showers, eye wash stations, and routine potable water needs in the plant.

Typical monthly volume is estimated to be approximately 5,000 gallons. Potable water consumption shall not exceed a maximum monthly rate of 20,000 gallons. Potable water shall meet the minimum municipal guidelines. The maximum pressure (system design pressure) is 150 PSIG.

Boiler feed water:

The condensate returned from the steam users at the site is collected in one of two drums where flash steam is recovered. The condensate is then sent to a deaerator where the recovered flash steam is used to strip the non-condensable gases and heat the water to its saturation point. Chemicals are added at this point to remove the remaining oxygen and limit system piping corrosion. Under normal operations boiler feed water supply to EDNLP operates in the range from 150 to 230 PSIG. The boiler feed water system design pressure is 230 PSIG.

(B) Nitrogen:

The Bayer Baytown Plant is supplied from a single supplier through both of the sites two metering stations (south and east). The nitrogen from the east metering station is supplied at approximately 140 PSIG to the site. Nitrogen from the south metering station is supplied at both 140 PSIG and approximately 400 PSIG. The 400 PSIG nitrogen system is to be used solely for the site's emergency shutdown systems.

The continuous usage is estimated to be minor. Monthly volume on an intermittent basis is approximately 15,000 - 25,000 SCF. The maximum pressure (system design pressure) is 150 PSIG for the 140 PSIG system.

C) Instrument/plant air:

Plant and instrument air is supplied to the Bayer Baytown Plant via five air compressors operated in parallel at one of two locations (west and north systems). At the west air system, the compressed air from any of the three compressors in service enters the adjacent air receivers that act as pulsation dampeners. The compressed air is then sent through a set of air dryers prior to being distributed to the plant air or instrument air distribution systems. The discharge piping is arranged so that any compressor can feed either air header. At the north air system, the compressed air exits one of the two compressors, then enters the adjacent air dryers. It is then sent to the adjacent air receiver prior to being sent to either the plant or instrument air headers. Both instrument and plant air are distributed above 90 PSIG and at a -40 F dew point. In the event of pressure loss in the instrument air system, there are two emergency nitrogen connections to supply nitrogen to the instrument air header and maintain system pressure.

Typical volume during truck unloading is estimated to be 300 SCFM. Typical monthly volume is expected to be 1.5 - 2.5 million SCF at an average rate of approximately 50 SCFM. The maximum plant/instrument air pressure (system design pressure) is 120 PSIG.

During the plant start-up, plant air must be used to seal the compressor train until minimum governor speed is reached. Plant air consumption shall not exceed a maximum rate of 700 SCFM during process start-up.

(D) Steam:

Steam at the Bayer Baytown Plant is supplied at three pressures (720 PSIG, 630 PSIG, and 150 PSIG). The majority of 720 PSIG steam is supplied to the site by the Calpine Cogeneration Unit located on the north side of the site. Typically, the steam supplied by this unit is letdown through the site's letdown stations for use by the production units. The 630 PSIG steam is supplied either through one of the two 720 PSIG to 630 PSIG steam letdown stations or produced by one of the site's waste heat boilers. The letdown stations operate on pressure control and supply 630 PSIG steam as needed to satisfy production demands. The site's 150 PSIG steam is supplied through one of the two

630 PSIG to 150 PSIG steam letdown stations or one of the site's waste heat boilers.

Except for each start-up and shutdown of the Nitric Acid Facility, during normal operation EDNLP will not consume steam from BMS. EDNLP shall export approximately 30,000 to 60,000 pounds of steam per hour to BMS. The EDNLP export steam pressure will be adequate to supply the site 630 PSIG steam system. All steam treatment must be compatible with the BMS steam treatment system.

(E) Natural gas:

Natural gas to Bayer Baytown Plant is supplied by a primary and secondary supplier at each of the site's two metering stations. Natural gas from the primary supplier is distributed to the site from both the east and south metering stations at approximately 90 PSIG. The secondary supplier is used solely as a back-up at the south metering station and will automatically begin supplying gas if the system's pressures fall below 80 PSIG.

No natural gas is consumed in the nitric acid manufacturing process. Natural gas may be used in the laboratory or in the offices and buildings for heat and air conditioning. Natural gas consumption is estimated to average less than 1 SCFM.

(F) Chlorine

Chlorine is used for water treatment at the cooling tower. Based on the anticipated blowdown rate, chlorine consumption will average 100 pounds per day, with a peak consumption of 170 pounds per day. The chlorine will be standard commercial grade with a minimum of 99.5% chlorine by weight. The maximum chlorine supply pressure (system design pressure) is 150 PSIG.

(G) 32% caustic (32% NaOH, 32% sodium hydroxide)

32% caustic will be used primarily for neutralization. Caustic consumption will average 25-30 pounds per day on a 100% basis with peak consumption of 1,500 pounds per day. BMS supplies 32% membrane grade caustic solution to EDNLP. The maximum supply pressure (system design pressure) is 175 PSIGS.

(H) 98% sulfuric acid

BMS provides 98% sulfuric acid deliveries to EDNLP for the cooling tower via tank trucks. Trucks are typically scheduled on Wednesday of each week. The supplier monitors the sulfuric acid tank level. Based on this information 98% sulfuric acid deliveries are scheduled by BMS as needed. EDNLP may also contact the BMS Environmental Control Department and Utilities to be put on the schedule for the next delivery, at least one day in advance. Approval of the Certificate of Analysis is done by the polyurethane quality area prior to delivery to EDNLP. At the end of the month, BMS informs EDNLP of the amount of 98% sulfuric acid delivered during the month. EDNLP reports this number to the appropriate accounting department, which is then included in the monthly Variable Cost Component.

SCHEDULE 2

AMMONIA

Purchased Anhydrous Ammonia Specification

Ammonia, Anhydrous - Commercial Grade

Properties:

Appearance	Clear, colorless Liquid
Oil, PPM	5.0 ppm
Water, weight %	0.5% maximum
Iron (Fe), PPM	1 maximum
Nonvolatile	0.5% maximum
Delivery Pressure	200 P.S.I.G.
Delivery Temperature, expected	Ambient

SCHEDULE 4 – Fixed Costs

El
 Dorado 12 Period
 Cost Sharing
 Summary Period+
 1 13
 December 2007

Account Number	Description	Year to Date					Adj	Net Balance	(Penalty) Benefit to EDNC
		Actual	Baseline Budget	Variance	Sharing	YTD Accrual			
Fixed Utilities									
7230.101	Electricity	***	***	***	***	***	***	***	***
7230.106	Natural Gas	***	***	***	***	***	***	***	***
7230.107	Water - Drinking (Potable)	***	***	***	***	***	***	***	***
7230.108	Nitrogen	***	***	***	***	***	***	***	***
7320.109	Instrument Air	***	***	***	***	***	***	***	***
7320.110	Plant Air	***	***	***	***	***	***	***	***
Allocated and Services									
7590.011	Bayer Lab Fee	***	***	***	***	***	***	***	***
7590.012	Bayer F.I.E.	***	***	***	***	***	***	***	***
6900.004	Medical	***	***	***	***	***	***	***	***
8610.000	Management Fees	***	***	***	***	***	***	***	***
Salaries									
5110.002	Salaries	***	***	***	***	***	***	***	***
Hourly Labor									
4325.001	Wages	***	***	***	***	***	***	***	***
5130.001	Clerical – Hourly	***	***	***	***	***	***	***	***
4325.002	Shift Premium Hourly	***	***	***	***	***	***	***	***
Overtime									
5410.000	Hourly Overtime Base and Premium	***	***	***	***	***	***	***	***
Travel Expenses									
7269.001	ACC Responsible Care	***	***	***	***	***	***	***	***
7260.000	Travel	***	***	***	***	***	***	***	***
7261.000	Airline	***	***	***	***	***	***	***	***
7269.000	Other Travel	***	***	***	***	***	***	***	***
7272.000	Meeting & Conferences	***	***	***	***	***	***	***	***
7280.001	Other Auto Expense, Car Rental	***	***	***	***	***	***	***	***
7262.000	Hotel Expense	***	***	***	***	***	***	***	***
7264.000	Taxi, Bus, Train, Limo	***	***	***	***	***	***	***	***
7271.000	Meals	***	***	***	***	***	***	***	***
Insurance & Benefits									
6220.000	Employee Benefits - Health Benefits	***	***	***	***	***	***	***	***
6900.000	Employee Benefits – Other	***	***	***	***	***	***	***	***
7510.002	Employment Agencies	***	***	***	***	***	***	***	***
7911.000	Recruiting Expense	***	***	***	***	***	***	***	***
7912.000	Relocation Expense	***	***	***	***	***	***	***	***
6900.001	Tuition Reimbursement	***	***	***	***	***	***	***	***
6620.000	Employee Relations	***	***	***	***	***	***	***	***
6900.002	Attendance Awards	***	***	***	***	***	***	***	***
6900.003	Uniforms	***	***	***	***	***	***	***	***
6420.000	Overtime Meals	***	***	***	***	***	***	***	***
7930.001	Professional Dues & Memberships	***	***	***	***	***	***	***	***
Training Expense									
6510.000	Training Time (wages)	***	***	***	***	***	***	***	***
6510.001	Safety Programs & Training	***	***	***	***	***	***	***	***
6510.002	Training Program	***	***	***	***	***	***	***	***
Workman's Compensation									
6210.000	Workers' Compensation Insurance	***	***	***	***	***	***	***	***
8410.000	General Liability Insurance	***	***	***	***	***	***	***	***
Payroll Taxes									
6100.000	Employee Benefits - Payroll Taxes	***	***	***	***	***	***	***	***

- (1) Property insurance premiums, including deductibles and retention amounts, shall be paid directly by BMS. Insurance coverage referenced herein.
- (2) The headcount is capped at 5 salaried positions, 9 Process Technicians, 1 Hourly E&I Specialist, and 1 Hourly Administrative person. Overtime is capped at 21.5 percent of wages.

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Account Number	Description	Year to Date					YTD Accrual	Adj	Net Balance	(Penalty) Benefit to EDNC
		Actual	Baseline Budget	Variance	Sharing					
Property Insurance										
8430.003	Automobile Insurance	***	***	***	***	***		***	***	***
Property Taxes										
8510.000	Real Estate & Personal Property Tax	***	***	***	***	***		***	***	***
8520.000	Franchise Tax	***	***	***	***	***		***	***	***
Direct Environmental Expense										
7590.100	Non Hazardous/Trash Waste Disposal	***	***	***	***	***		***	***	***
7590.101	Permits/Certification - EC	***	***	***	***	***		***	***	***
7590.102	Environmental Consultants	***	***	***	***	***		***	***	***
7950.002	Trade Relations	***	***	***	***	***		***	***	***
7350.101	Instrument Supplies	***	***	***	***	***		***	***	***
7590.103	Misc. (Unexpected Cost)	***	***	***	***	***	***	***	***	***
Contract Maintenance										
7350.000	Repair & Maintenance Work	***	***	***	***	***		***	***	***
7350.100	Temporary Personnel	***	***	***	***	***		***	***	***
7392.001	Data Processing - Computer/Technical Support	***	***	***	***	***		***	***	***
7350.102	Bottled Gases	***	***	***	***	***		***	***	***
7350.103	Process Filter Replacements	***	***	***	***	***		***	***	***
7350.104	Contract Labor	***	***	***	***	***		***	***	***
7350.105	Maint. Contract Labor Supervisory & Occup. Health	***	***	***	***	***		***	***	***
7350.106	Contract Drafting	***	***	***	***	***		***	***	***
7350.107	Purchased Operating/Maintenance Equipment	***	***	***	***	***		***	***	***
7350.108	Repairs & Maintenance - Outside Services	***	***	***	***	***		***	***	***
7140.000	Repairs & Maintenance - Materials	***	***	***	***	***		***	***	***
7140.100	Gaskets	***	***	***	***	***		***	***	***
7140.200	Instrument/Electrical	***	***	***	***	***		***	***	***
7140.300	Pipe,Fittings,Etc.	***	***	***	***	***		***	***	***
7140.400	Mechanical	***	***	***	***	***		***	***	***
7140.500	Tools	***	***	***	***	***		***	***	***
7350.109	Repairs & Maintenance - Lab/Office Equip	***	***	***	***	***		***	***	***
7350.110	Signs & Line Labeling Maintenance	***	***	***	***	***		***	***	***
7350.111	Vehicle Maintenance - Outside Services	***	***	***	***	***		***	***	***
7350.112	Operating Maint. - Computer Equip. & Software	***	***	***	***	***		***	***	***
7350.113	Administration Maint - Computer Equip & Software	***	***	***	***	***		***	***	***
7350.114	Contract Telecommunication Service	***	***	***	***	***		***	***	***
7350.115	Maintenance Trailer	***	***	***	***	***		***	***	***
7520.001	Outside Janitorial Service	***	***	***	***	***		***	***	***
7590.000	Miscellaneous Outside Service	***	***	***	***	***		***	***	***
7229.000	Freight - Miscellaneous	***	***	***	***	***		***	***	***
7290.100	Catalyst Warehouse Storage & Handling	***	***	***	***	***		***	***	***
7350.116	Turnaround Expense	***	***	***	***	***		***	***	***
7350.117	Engineering Support Services	***	***	***	***	***		***	***	***
	Experimental Projects / Tests	***	***	***	***	***		***	***	***
7290.101	Rotating Equipment Spare Storage	***	***	***	***	***		***	***	***
In-Plant Lab Supplies & Equipment										
7150.100	Laboratory Supplies	***	***	***	***	***		***	***	***
Safety Equipment Upkeep										
6430.100	Safety Medical Supplies	***	***	***	***	***		***	***	***
6430.101	Safety Shoes	***	***	***	***	***		***	***	***
6430.102	Safety Supplies	***	***	***	***	***		***	***	***
Office Expenses, Phones, Etc.										
7180.001	Stationery & Printing	***	***	***	***	***		***	***	***
7180.000	General Office Supplies	***	***	***	***	***		***	***	***
7180.100	Blueprinting & Drafting	***	***	***	***	***		***	***	***
7181.000	Computer Supplies - Other	***	***	***	***	***		***	***	***
7140.002	Janitorial & Housekeeping Supplies	***	***	***	***	***		***	***	***
7190.000	Other Supplies & Materials	***	***	***	***	***		***	***	***
7181.100	Purchased PC Hardware	***	***	***	***	***		***	***	***
7181.101	Purchased PC Software	***	***	***	***	***		***	***	***
7180.101	Purchased Office Equipment	***	***	***	***	***		***	***	***
7180.102	Purchased Other Hardware	***	***	***	***	***		***	***	***
7240.000	Telephone	***	***	***	***	***		***	***	***
7241.000	Long Distance	***	***	***	***	***		***	***	***
7242.000	Cellular Telephone	***	***	***	***	***		***	***	***
7250.000	Postage	***	***	***	***	***		***	***	***

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Account Number	Description	Year to Date					Adj	Net Balance	(Penalty) Benefit to EDNC
		Actual	Baseline Budget	Variance	Sharing	YTD Accrual			
Rental Requirement									
8310.000	Automobile Insurance	***	***	***	***	***		***	***
8311.000	Leased Office Equipment	***	***	***	***	***		***	***

Plant Vehicle Expense									
7280.000	Gas & Oil for Vehicles/Supply Fuel	***	***	***	***	***		***	***
7281.000	Auto Mileage	***	***	***	***	***		***	***
		***	***	***		***	***	***	***

- (1) The final total in the Net Balance column is the resulting debit or credit to BMS
(2) These pages are intended to be a non-binding example.

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Fixed Utility	Budgeted QPUs/mo	Units	Actual QPU-Jan	Actual QPU-Apr	Actual QPU-Jun	Actual QPU-Jul	Actual QPU-Oct	Totals	
Total Budgeted Billing to Bayer included in FCC									
Natural Gas		***\$/kscf	***	***	***	***	***	***	
Potable Water		***\$/k gal	***	***	***	***	***	***	
Nitrogen		***\$/k lbs	***	***	***	***	***	***	
Instrument Air		***\$/kscf	***	***	***	***	***	***	
Plant Air		***\$/kscf	***	***	***	***	***	***	
								\$	***
Bayer Actual \$/QPU (variable portion only)									
Natural Gas		kscf	***	***	***	***	***	***	
Potable Water		k gal	***	***	***	***	***	***	
Nitrogen		kscf	***	***	***	***	***	***	
Instrument Air		kscf	***	***	***	***	***	***	
Plant Air		kscf	***	***	***	***	***	***	
Actual QPU Volumes									
Natural Gas		***kscf	***	***	***	***	***	***	
Potable Water		***k gal	***	***	***	***	***	***	
Nitrogen		***kscf	***	***	***	***	***	***	
Instrument Air		***kscf	***	***	***	***	***	***	
Plant Air		***kscf	***	***	***	***	***	***	
QPU Volume Variance									
					2007				
Natural Gas			***	***	***	***	***	***	
Potable Water			***	***	***	***	***	***	
Nitrogen			***	***	***	***	***	***	
Instrument Air			***	***	***	***	***	***	
Plant Air			***	***	***	***	***	***	
QPU \$\$ Volume Variance									
					2007				
Natural Gas			***	***	***	***	***	***	
Potable Water			***	***	***	***	***	***	
Nitrogen			***	***	***	***	***	***	
Instrument Air			***	***	***	***	***	***	
Plant Air			***	***	***	***	***	***	
								\$	***
***% Sharing on Volume Variance									
					2007				
Natural Gas			***	***	***	***	***	***	
Potable Water			***	***	***	***	***	***	
Nitrogen			***	***	***	***	***	***	
Instrument Air			***	***	***	***	***	***	
Plant Air			***	***	***	***	***	***	
								\$	***
Price Variance (***% Pass-through)									
					2007				
Natural Gas			***	***	***	***	***	***	
Potable Water			***	***	***	***	***	***	
Nitrogen			***	***	***	***	***	***	
Instrument Air			***	***	***	***	***	***	
Plant Air			***	***	***	***	***	***	
Price Variance (***% Pass-through)									
					2007				
Natural Gas			***	***	***	***	***	***	
Potable Water			***	***	***	***	***	***	
Nitrogen			***	***	***	***	***	***	
Instrument Air			***	***	***	***	***	***	
Plant Air			***	***	***	***	***	***	
Fixed Charge on Instrument and Plant Air, all taken to plant air									
Budget	\$	***\$	***	***	***	***	***	***	
Actual			***	***	***	***	***	***	
Difference		***	***	***	***	***	***	***	
								\$	***
Sharing Reimbursement Due to (from) Bayer									
					2007				
Natural Gas			***	***	***	***	***	***	
Potable Water			***	***	***	***	***	***	
Nitrogen			***	***	***	***	***	***	
Instrument Air			***	***	***	***	***	***	
Plant Air			***	***	***	***	***	***	
								\$	***

***INDICATES CERTAIN INFORMATION IN THIS DOCUMENT WHICH HAS BEEN OMITTED FROM THIS PUBLIC FILING PURSUANT TO A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

SCHEDULE 5

WASTE

BASIS:

1. For pH control of Routine Process Waste, Initial Stormwater and Additional Stormwater, EDNLP will neutralize with caustic soda.
2. EDNLP will discharge Cooling Tower Blowdown into the Bayer Baytown Plant's cooling tower blowdown header.
3. The overhead waste water header backpressure is up to 50 P.S.I.G. during rains.
4. Normal flow rates below are based on Nitric Acid Facility production of 443,000 short tons of nitric acid (100% basis) a year.
5. EDNLP will continuously monitor pH and flow to waste water header as well as pH of Additional Stormwater to BMS's storm sewer.
6. EDNLP must keep Uncollected Stormwater free of contaminants.

Waste Stream	Quality	Peak Flow	Normal Flow
Flow to Cooling Tower Blowdown header, gpm	pH range 7.5 - 8.0 Anticipated metal levels: ¹ Cr 0.013 lb/day Cu 0.045 lb/day Ni 0.014 lb/day Pb 0.007 lb/day Zn 0.767 lb/day	138	85
Flow to Waste Water header Routine Process Waste, gpm Washdown Water Lab Samples Process Purges Leaks Boiler Blowdown	warranted pH range of 5.0 to 8.0	150	15

* Intermittent flow from Waste Water Sump to header when pumping rate is about 100 gpm.

Total Flow to Waste Water header, gpm

¹ Metal levels of this water shall be no more than twice the anticipated metal levels.

SCHEDULE 7

AFE Number	EDNLP Net Book Value	Date	Description
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To be completed as of July 1, 2009

CERTIFICATION

I, Jack E. Golsen, Chairman of the Board and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of LSB Industries, Inc. (the "registrant");
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(s) 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)) 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 annual 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 this case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) 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 function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls 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 controls over financial reporting.

Date: November 6, 2008
Jack E. Golsen
Chairman of the Board and
Chief Executive Officer

/s/ Jack E. Golsen



CERTIFICATION

I, Tony M. Shelby, Executive Vice President of Finance and Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of LSB Industries, Inc. (the "registrant");
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(s) 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)) 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 annual 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 this case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) 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 function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls 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 controls over financial reporting.

Date: November 6, 2008
Tony M. Shelby
Executive Vice President of Finance
and Chief Financial Officer

/s/ Tony M. Shelby

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 LSB Industries, Inc. ("LSB") on Form 10-Q for the period ended September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"). I, Jack E. Golsen, Chairman of the Board and Chief Executive Officer of LSB, certify pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of LSB.

/s/ Jack E. Golsen
Jack E. Golsen
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

November 6, 2008

This certification is furnished to the Securities and Exchange Commission solely for purpose of 18 U.S.C. §1350 subject to the knowledge standard contained therein, and not for any other purpose.

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 LSB Industries, Inc. ("LSB"), on Form 10-Q for the period ended September 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"). I, Tony M. Shelby, Executive Vice President of Finance and Chief Financial Officer of LSB, certify pursuant to 18 U.S.C. §1350, to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of section 13 (a) or 15 (d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Tony M. Shelby _____
Tony M. Shelby
Executive Vice President of Finance and
Chief Financial Officer
(Principal Financial Officer)

November 6, 2008

This certification is furnished to the Securities and Exchange Commission solely for purpose of 18 U.S.C. §1350 subject to the knowledge standard contained therein and not for any other purpose.