Contingently Convertible Securities

Included in debt at December 31, 2004 and 2003 were $2.1 billion principal amount at maturity of zero-coupon convertible senior debentures with a 20-year term. This debt accretes to face value at maturity at a rate of 3.75% per annum. Beginning on June 20, 2004, and every June 20th and December 20th until maturity, the debentures are subject to an increased accretion rate if the closing sales price of the Company's common stock is equal to or less than 60% of the then current conversion price of the notes for any 20 trading days out of the last 30 consecutive trading days ending three business days prior to June 20, 2004, or later semiannual date. The conversion price of the notes as of December 31, 2004 was $56.96, and the bonds were not subject to an increased accretion rate for the semiannual period beginning December 20, 2004.

These debentures may be converted into shares of the Company's common stock at a conversion ratio of 9.5111 shares per $1,000 principal amount at maturity of debentures, which was equal to an initial conversion price of $50.01 per share of the Company's common stock. The debenture holders may convert their debentures into the Company's common stock prior to maturity under any of the following circumstances: (1) the closing sales price of the Company's common stock for at least 20 trading days in the 30 consecutive trading days ending on the day prior to the surrender date is more than 120% (declining by .256% at the end of each semi-annual period over the life of the debentures to 110%) of the then-current conversion price; (2) International Paper's credit rating is downgraded by each of Moody's and S&P to below Baa3 and BBB-, respectively; (3) the Company has called the notes for redemption; (4) the Company distributes to all holders of the Company's common stock certain rights entitling them to purchase, for a period expiring within 60 days, common stock at less than the closing sales price of the Company's common stock at the time; or (5) the Company distributes to all holders of our common stock, the assets, debt securities or certain rights to purchase the Company's debt securities, which distribution has a per share value exceeding 12.5% of the closing sales price of the Company's common stock on the day preceding the declaration for such distribution.

Beginning in the fourth quarter of 2004, as required by a recent FASB consensus, the dilutive effect of the convertible notes has been reflected in diluted earnings per share in periods when dilutive (see the caption "Information About Capital Structure – Contingently Convertible Securities" in Note 4), with prior periods restated.

Security holders have the right to require repurchase of these securities on June 20th in each of the years 2006, 2011 and 2016, at a repurchase price equal to the accreted principal amount to the repurchase date. The repurchase may be for International Paper common stock or cash, or a combination of both, at the Company's option.

International Paper also has the option to redeem the securities for cash after June 19, 2006. On or after June 20, 2006 and prior to June 20, 2008, the redemption may only occur if the closing sales price of the Company's common stock exceeds 120% of the then-current conversion price for at least 20 trading days in the 30 consecutive trading days ending on the date redemption notice is given. On or after June 20, 2008, the redemption price will be equal to the then-accreted principal amount plus any accrued and unpaid cash interest to the redemption date.

NOTE 13 DERIVATIVES AND HEDGING ACTIVITIES

International Paper periodically uses derivatives and other financial instruments to hedge exposures to interest rate, commodity and currency risks. For hedges that meet the criteria under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," International Paper, at inception, formally designates and documents the instrument as a hedge of a specific underlying exposure, as well as the risk management objective and strategy for undertaking each hedge transaction. Because of the high degree of effectiveness between the hedging instrument and the underlying exposure being hedged, fluctuations in the value of the derivative instruments are generally offset by changes in the value or cash flows of the underlying exposures being hedged. Derivatives are recorded in the consolidated balance sheet at fair value, determined using available market information or other appropriate valuation methodologies, in other current or noncurrent assets or liabilities. The earnings impact resulting from the change in fair value of the derivative instruments is recorded in the same line item in the consolidated statement of operations as the underlying exposure being hedged. The financial instruments that are used in hedging transactions are assessed both at inception and quarterly thereafter to ensure they are effective in offsetting changes in either the fair value or cash flows of the related underlying exposures. The ineffective portion of a financial instrument's change in fair value, if any, would be recognized currently in earnings together with the changes in fair value of any derivatives not designated as hedges.

Interest Rate Risk

Interest rate swaps may be used to manage interest rate risks associated with International Paper's debt. Some of these instruments qualify for hedge accounting in accordance with SFAS No. 133 and others do not. Interest rate swap agreements with a total notional amount at December 31,