

Edgar Filing: UNOCAL CORP - Form 10-Q

UNOCAL CORP
Form 10-Q
November 14, 2001

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2001

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 1-8483

UNOCAL CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 95-3825062 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

2141 ROSECRANS AVENUE, SUITE 4000, EL SEGUNDO, CALIFORNIA 90245
(Address of principal executive offices)
(Zip Code)

(310) 726-7600
(Registrant's Telephone Number, Including Area Code)

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

Number of shares of Common Stock, \$1 par value, outstanding as of
October 31, 2001: 243,991,498

TABLE OF CONTENTS

Edgar Filing: UNOCAL CORP - Form 10-Q

| PART I | PAGE |
|---|------|
| Item 1. Financial Statements | |
| Consolidated Earnings..... | 1 |
| Consolidated Balance Sheet..... | 2 |
| Consolidated Cash Flows..... | 3 |
| Notes to Financial Statements..... | 4 |
| Operating Highlights | 24 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations..... | 25 |
| Item 3 Quantative and Qualitative Disclosures About Market Risk..... | 38 |
| PART II | |
| Item 1 Legal Proceedings..... | 40 |
| Item 5 Other Information..... | 40 |
| Item 6 Exhibits and Reports on Form 8-K..... | 41 |
| SIGNATURES..... | 42 |
| EXHIBIT INDEX..... | 43 |

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED EARNINGS
(UNAUDITED)

| | For the Three Months Ended September 30, | |
|--|---|----------|
| | 2001 | 2000 |
| Millions of dollars except per share amounts | | |
| ----- | | |
| Revenues | | |
| Sales and operating revenues | \$ 1,573 | \$ 2,338 |
| Interest, dividends and miscellaneous income | 8 | |
| Gain (loss) on sales of assets | (2) | |
| ----- | | |
| Total revenues | 1,579 | 2,340 |
| Costs and other deductions | | |
| Crude oil, natural gas and product purchases | 617 | 1,378 |
| Operating expense | 352 | 322 |
| Selling, administrative and general expense | 25 | 23 |
| Depreciation, depletion and amortization | 270 | 234 |
| Dry hole costs | 53 | 41 |
| Exploration expense | 37 | 41 |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | |
|--|---------|--------|
| Interest expense | 48 | 5 |
| Property and other operating taxes | 19 | 2 |
| Distributions on convertible preferred securities of subsidiary trust | 8 | |
| <hr/> | | |
| Total costs and other deductions | 1,429 | 2,13 |
| Earnings from equity investments | 37 | 4 |
| <hr/> | | |
| Earnings from continuing operations before income taxes and minority interests | 187 | 25 |
| <hr/> | | |
| Income taxes | 77 | 6 |
| Minority interests | 8 | 1 |
| <hr/> | | |
| Earnings from continuing operations | 102 | 17 |
| Discontinued operations | | |
| Gain on disposal (net of tax) | - | 1 |
| <hr/> | | |
| Earnings from discontinued operations | - | 1 |
| Cumulative effect of accounting change (net of tax) | - | |
| <hr/> | | |
| Net earnings | \$ 102 | \$ 19 |
| <hr/> | | |
| Basic earnings per share of common stock (a) | | |
| Continuing operations | \$ 0.42 | \$ 0.7 |
| Discontinued operations | - | 0.0 |
| <hr/> | | |
| Net earnings | \$ 0.42 | \$ 0.7 |
| <hr/> | | |
| Diluted earnings per share of common stock (b) | | |
| Continuing operations | \$ 0.42 | \$ 0.7 |
| Discontinued operations | - | 0.0 |
| <hr/> | | |
| Net earnings | \$ 0.42 | \$ 0.7 |
| <hr/> | | |
| Cash dividends declared per share of common stock | \$ 0.20 | \$ 0.2 |
| <hr/> | | |

-1-

CONSOLIDATED BALANCE SHEET

| | September |
|---------------------------------------|-----------|
| Millions of dollars | 2001 |
| <hr/> | |
| Assets | |
| Current assets | |
| Cash and cash equivalents | \$ 371 |
| Accounts and notes receivable | 953 |
| Inventories | 92 |
| Deferred income taxes | 154 |
| Other current assets | 32 |
| <hr/> | |
| Total current assets | 1,602 |
| Investments and long-term receivables | 1,446 |
| Properties - net (b) | 7,344 |
| Deferred income taxes | 133 |
| Other assets | 171 |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | |
|---|-----------|
| Total assets | \$ 10,696 |
| ===== | |
| Liabilities and Stockholders' Equity | |
| Current liabilities | |
| Accounts payable | \$ 894 |
| Taxes payable | 258 |
| Dividends payable | 49 |
| Interest payable | 48 |
| Current portion of environmental liabilities | 117 |
| Current portion of long-term debt and capital leases | 9 |
| Other current liabilities | 154 |
| ----- | |
| Total current liabilities | 1,529 |
| Long-term debt and capital leases | 2,850 |
| Deferred income taxes | 663 |
| Accrued abandonment, restoration and environmental liabilities | 595 |
| Other deferred credits and liabilities | 893 |
| Minority interests | 443 |
| Company-obligated mandatorily redeemable convertible preferred securities of a subsidiary trust holding solely parent debentures | 522 |
| Common stock (\$1 par value, shares authorized: 750,000,000 (c)) | 254 |
| Capital in excess of par value | 539 |
| Unearned portion of restricted stock issued | (20) |
| Retained earnings | 2,966 |
| Accumulated other comprehensive income | (86) |
| Notes receivable - key employees | (41) |
| Treasury stock - at cost (d) | (411) |
| ----- | |
| Total stockholders' equity | 3,201 |
| ----- | |
| Total liabilities and stockholders' equity | \$ 10,696 |
| ===== | |

-2-

CONSOLIDATED CASH FLOWS
(UNAUDITED)

UNOCAL CORP

| | For the Nine Months Ended September 30, 2001 |
|---|---|
| Millions of dollars | 2001 |
| ----- | |
| Cash Flows from Operating Activities | |
| Net earnings | \$ 644 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | |
| Depreciation, depletion and amortization | 783 |
| Dry hole costs | 140 |
| Deferred income taxes | 113 |
| (Gain) loss on sales of assets (pre-tax) | 1 |
| Gain on disposal of discontinued operations (pre-tax) | (25) |
| Earnings applicable to minority interests | 38 |
| Other | 115 |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | |
|---|---------|
| Working capital and other changes related to operations | |
| Accounts and notes receivable | 360 |
| Inventories | (4) |
| Accounts payable | (194) |
| Taxes payable | (24) |
| Other | (167) |
| <hr style="border-top: 1px dashed black;"/> | |
| Net cash provided by operating activities | 1,780 |
| <hr style="border-top: 1px dashed black;"/> | |
| Cash Flows from Investing Activities | |
| Capital expenditures (includes dry hole costs) | (1,257) |
| Major acquisitions | (536) |
| Proceeds from sales of assets | 26 |
| Proceeds from sale of discontinued operations | 25 |
| <hr style="border-top: 1px dashed black;"/> | |
| Net cash used in investing activities | (1,742) |
| <hr style="border-top: 1px dashed black;"/> | |
| Cash Flows from Financing Activities | |
| Long-term borrowings | 467 |
| Reduction of long-term debt and capital lease obligations | (221) |
| Minority interests | (17) |
| Proceeds from issuance of common stock | 14 |
| Dividends paid on common stock | (146) |
| Loans to key employees | - |
| Other | 1 |
| <hr style="border-top: 1px dashed black;"/> | |
| Net cash provided by (used in) financing activities | 98 |
| <hr style="border-top: 1px dashed black;"/> | |
| Increase in cash and cash equivalents | 136 |
| <hr style="border-top: 1px dashed black;"/> | |
| Cash and cash equivalents at beginning of year | 235 |
| <hr style="border-top: 1px dashed black;"/> | |
| Cash and cash equivalents at end of period | \$ 371 |
| <hr style="border-top: 3px double black;"/> | |
| Supplemental disclosure of cash flow information: | |
| Cash paid during the period for: | |
| Interest (net of amount capitalized) | \$ 150 |
| Income taxes (net of refunds) | \$ 354 |

See Notes to the Consolidated Financial Statements.

-3-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(1) General

The consolidated financial statements included in this report are unaudited and, in the opinion of management, include all adjustments necessary for a fair presentation of financial position and results of operations. All adjustments are of a normal recurring nature. Such financial statements are presented in accordance with the Securities and Exchange Commission's disclosure requirements for Form 10-Q.

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes filed with the Commission in Unocal Corporation's 2000 Annual Report on Form 10-K.

For the purpose of this report, Unocal Corporation (Unocal) and its consolidated

Edgar Filing: UNOCAL CORP - Form 10-Q

subsidiaries, including Union Oil Company of California (Union Oil), are referred to as the "Company".

The consolidated financial statements of the Company include the accounts of subsidiaries in which a controlling interest is held. Investments in entities without a controlling interest are accounted for by the equity method. Under the equity method, the investments are stated at cost plus the Company's equity in undistributed earnings and losses after acquisition. Income taxes estimated to be payable when earnings are distributed are included in deferred income taxes.

Results for the nine months ended September 30, 2001, are not necessarily indicative of future financial results.

Segment data and certain other items in the prior year financial statements have been reclassified to conform to the 2001 presentation:

- |X| The Pipelines business has been combined with certain activities of the Company's gas storage businesses in Canada, which were previously reported in the Exploration and Production segment, into a new segment called Midstream.
- |X| The Carbon and Minerals businesses are no longer disclosed as a separate segment and are now reported in the Corporate and Other heading.

-4-

(2) Accounting Changes

ADOPTION OF NEW ACCOUNTING STANDARDS - Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) and Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (SFAS 138). These standards require that all derivative instruments be recorded on the balance sheet at their fair values. Changes in the fair values of derivative instruments are reported in current-period earnings unless they are designated and qualify as effective hedges.

In accordance with the transition provisions of SFAS 133, the Company recorded a one-time after-tax charge of approximately \$1 million during the first quarter of 2001 in its consolidated earnings statement, representing the cumulative effect of the accounting change, and an after-tax unrealized loss of approximately \$59 million to accumulated other comprehensive income in its consolidated balance sheet, of which \$28 million is expected to be reclassified to the consolidated earnings statement during 2001. The transition amounts represented accumulated changes in the fair values of derivative instruments that were previously off balance sheet and used to hedge certain future commodity sales (e.g., commodity swaps, options). Accumulated losses in fair value of these derivative instruments will be substantially offset by corresponding gains on the hedged commodity sales when those sales occur. Amounts pertaining to the derivative contracts of acquired companies that were previously capitalized under purchase accounting rules were not impacted.

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES - The objectives of the Company's risk management policies include reducing the overall volatility of the Company's cash flows, preserving revenues and pursuing outright pricing positions in hydrocarbon derivative financial instruments. As part of its overall risk management strategy, the Company enters into various derivative instrument contracts to offset portions of its exposures to changes in interest rates, changes in foreign currency exchange rates, and fluctuations in crude oil

Edgar Filing: UNOCAL CORP - Form 10-Q

and natural gas prices.

At the inception of a derivative contract, the Company may choose to designate and document a derivative as a hedge of a certain exposure. In general, the Company enters into derivative instruments to hedge two types of exposures: cash flow exposures and fair value exposures. Hedges of cash flow exposures are generally undertaken to reduce cash flow volatility associated with forecasted transactions. They may also be used to reduce volatility associated with cash flows to be paid related to recognized liabilities. Hedges of fair value exposures are undertaken to hedge recognized assets or liabilities or unrecognized firm commitments against changes in fair value.

On the date that a hedge is established, the Company designates and documents the derivative as either a cash flow hedge or a fair value hedge. Changes in the values of derivatives not designated and documented as hedges are recorded in current-period earnings. Changes in the values of derivatives that qualify for, and are designated and effective as, cash flow hedges are deferred and recorded as components of accumulated other comprehensive income until the hedged transactions occur and are then recognized in earnings. The ineffective portions of cash flow hedge derivatives' changes in values are recognized immediately in earnings as components of sales revenues. During the second quarter of 2001, the Company changed its methodology for calculating the effectiveness of options purchased as cash flow hedges to conform with the April 2001 interpretation of SFAS 133 by the Financial Accounting Standards Board's "Derivatives Implementation Group". Most gains and losses associated with the time value of cash flow hedging options will be included in the effectiveness calculations and, generally, deferred as components of other comprehensive income until the hedged transactions are recognized in earnings. Previously, these gains and losses had been excluded from the measurement of hedge effectiveness and recognized in sales revenues. Changes in the values of derivatives that qualify for, and are designated and effective as, fair value hedges are recognized in current-period earnings as components of the line items reflecting the underlying hedged transactions. Changes in the fair values of the underlying hedged items (e.g., recognized assets, liabilities or unrecognized firm commitments) are also recognized in current-period earnings and offset the changes in the values of the corresponding hedging derivatives. Any resulting fair value hedge ineffectiveness is recognized

-5-

in current-period earnings as the difference between the offsetting changes in values of the derivative and the underlying hedged item.

The Company documents its risk management objectives, its strategies for undertaking various hedge transactions and the relationships between hedging instruments and hedged items. Derivatives designated as cash flow hedges are linked to forecasted transactions. Derivatives identified as fair value hedges are linked to specific assets, liabilities or firm commitments. At hedge inception and on an on-going basis, the Company assesses whether changes in the values of derivatives used in hedging activities are highly effective in offsetting changes in the values of the hedged items. The Company discontinues hedge accounting prospectively when either (1) it determines that a derivative is not highly effective as a hedge, (2) the derivative is sold, exercised or otherwise terminated, (3) management elects to remove the derivative's hedge designation, (4) the hedged transaction is no longer expected to occur, or (5) a hedged item no longer meets the definition of a firm commitment. When a hedged forecasted transaction is no longer expected to occur, the derivative continues to be carried on the balance sheet at its fair value and all gains and losses that were previously deferred in accumulated other comprehensive income are recognized immediately in earnings. When a hedged item no longer meets the definition of a firm commitment, the derivative continues to be carried on the

Edgar Filing: UNOCAL CORP - Form 10-Q

balance sheet at its fair value and any asset or liability that was recorded on the balance sheet for the change in value of the hedged firm commitment are removed from the balance sheet and recognized immediately in current-period earnings. In all other situations where hedge accounting is discontinued, the derivatives continue to be carried on the balance sheet at their fair values and any prospective changes in their fair values are recognized in current-period earnings. Deferred gains and losses already recorded in accumulated other comprehensive income remain until the forecasted transactions occur, at which time those gains and losses are recognized in earnings.

Effective July 1, 2001, the Company adopted SFAS No. 141, "Business Combinations," which eliminated the pooling method of accounting for a business combination, except for qualifying business combinations that were initiated prior to July 1, 2001, and requires that all combinations be accounted for using the purchase method. Any Goodwill acquired in a business combination under the provisions of SFAS No. 141 shall be accounted for in accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," which allows for the nonamortization of any purchased goodwill prior to the effective adoption date of SFAS No. 142. The Company will adopt all the other provisions of SFAS No. 142 effective January 1, 2002.

(3) Major Acquisitions

In July 2001, the Company's Northrock Resources Ltd. (Northrock) Canadian subsidiary completed its cash acquisition of all the outstanding shares of common stock of Tethys for \$2.76 (C\$4.25) per share. The asset base of Tethys was complementary to Northrock's operations in Western Canada, providing significant operational synergies with existing activity in Northrock's West-Central Alberta and Southeast Saskatchewan core areas. The results of Tethys' operations have been included in the consolidated financial statements since the acquisition date of July 17, 2001. The cash value of the transaction was approximately \$93 million, which included acquired identifiable assets of \$121 million, goodwill of \$30 million, assumed debt of \$20 million, net negative working capital and other obligations of \$4 million and a liability for deferred income taxes of \$34 million. The assumed debt was repaid at the end of July subsequent to the acquisition. The acquisition was accounted for as a purchase and was funded using cash on hand. None of the goodwill amount recorded is expected to be deductible for income tax purposes.

In May 2001, the Company's Pure Resources, Inc. (Pure), subsidiary completed its cash acquisition of all the outstanding shares of common stock of Hallwood Energy Corporation (Hallwood) for \$12.50 per share and all the outstanding shares of Series A Cumulative Preferred Stock of Hallwood at a price of \$10.84 per share. The total transaction was valued at approximately \$271 million, including assumed debt of \$87 million, which was subsequently refinanced in May 2001 (see note 10), and other obligations. The acquisition was accounted for as a purchase and was funded through the combination of a new Pure line of credit and borrowings under Pure's existing revolving credit facilities, none of which are guaranteed by the Company. This acquisition added to Pure's positions in its business areas of the San Juan and Permian Basins and the Gulf Coast region.

-6-

In January 2001, Pure acquired oil and gas properties, certain general and limited oil and gas partnership interests and fee mineral and royalty interests from International Paper Company. The total cost of the acquisition was approximately \$271 million in cash. Included in the transaction were total proved reserves of approximately 25 million barrels of oil equivalent and ownership in 6 million gross fee mineral acres (3.2 million net) along with participation in several offshore exploration programs. The transaction was funded from Pure's credit facilities (see note 10). This acquisition expanded

Edgar Filing: UNOCAL CORP - Form 10-Q

Pure's business areas into the Gulf Coast region and offshore in the Gulf of Mexico.

(4) Other Financial Information

During the third quarters of 2001 and 2000, approximately 32 percent and 55 percent, respectively, of total sales and operating revenues were attributable to the resale of crude oil, natural gas and natural gas liquids purchased from others in connection with the Company's trading and marketing activities. For the nine months ended September 30, 2001 and 2000, these percentages were approximately 32 percent and 54 percent, respectively. Related purchase costs were classified as expenses in the crude oil, natural gas and product purchases category on the consolidated earnings statement. The lower resale activity in both the third quarter and nine months periods of 2001, compared to the same periods a year ago, reflected decreases primarily related to the marketing and trading of crude oil and condensate.

Capitalized interest totaled \$8 million and \$4 million for the third quarters of 2001 and 2000, respectively, and \$19 million and \$9 million for the nine months ended 2001 and 2000, respectively. The increases were primarily due to the capitalized interest related to the West Seno oil and gas development project in the deepwater Kutei Basin, offshore East Kalimantan, Indonesia.

(5) Income Taxes

Income taxes on earnings from continuing operations for the third quarter and nine months periods of 2001 were \$77 million and \$447 million, respectively, compared with \$67 million and \$309 million for the comparable periods of 2000. The effective income tax rates for the third quarter and nine months periods of 2001 were 43 percent and 42 percent, respectively, compared with 28 percent and 36 percent for the comparable periods of 2000.

The higher effective income tax rate for the third quarter of 2001, compared to the same period a year ago, reflected the effects of changes in the mix of foreign versus domestic earnings, currency-related adjustments in Thailand, and adjustments made in the third quarter of 2000 related to prior year U.S. and Canadian tax matters. The higher effective income tax rate for the nine months period of 2001, compared to the same period a year ago, reflected the effects of currency-related adjustments in Thailand and an adjustment made in 2000 related to prior year Canadian tax matters.

(6) Discontinued Operations

In 2001, the Company recorded its initial pre-tax gain of \$25 million (\$16 million after-tax) related to a participation agreement tied to its former West Coast refining, marketing and transportation assets, which were sold in 1997. The participation agreement covers price differences between California Air Resources Board Phase 2 gasoline and conventional gasoline. The maximum potential payments under this participation agreement are capped at \$100 million and extend to 2003.

The 2000 results reflected the Company's former agricultural products business, which was sold later in that year.

-7-

(7) Earnings Per Share

The following are reconciliations of the numerators and denominators of the

Edgar Filing: UNOCAL CORP - Form 10-Q

basic and diluted earnings per share (EPS) computations for earnings from continuing operations for the third quarters and the nine months ended September 30, 2001 and 2000:

| Millions except per share amounts | Earnings (Numerator) | S (Denominator) |
|--|-------------------------|--------------------|
| <hr style="border-top: 1px dashed black;"/> | | |
| Three months ended September 30, 2001 | | |
| Earnings from continuing operations | \$ 102 | |
| Basic EPS | | |
| Effect of dilutive securities | | |
| Options and common stock equivalents | | |
| Diluted EPS | 102 | |
| Distributions on subsidiary trust preferred securities (after-tax) | 7 | |
| Antidilutive | \$ 109 | |
| <hr style="border-top: 1px dashed black;"/> | | |
| Three months ended September 30, 2000 | | |
| Earnings from continuing operations | \$ 176 | |
| Basic EPS | | |
| Effect of dilutive securities | | |
| Options and common stock equivalents | | |
| Diluted EPS | 176 | |
| Distributions on subsidiary trust preferred securities (after-tax) | 7 | |
| Diluted EPS | \$ 183 | |
| <hr style="border-top: 1px dashed black;"/> | | |
| Nine months ended September 30, 2001 | | |
| Earnings from continuing operations | \$ 629 | |
| Basic EPS | | |
| Effect of dilutive securities | | |
| Options and common stock equivalents | | |
| Diluted EPS | 629 | |
| Distributions on subsidiary trust preferred securities (after-tax) | 20 | |
| Diluted EPS | \$ 649 | |
| <hr style="border-top: 1px dashed black;"/> | | |
| Nine months ended September 30, 2000 | | |
| Earnings from continuing operations | \$ 550 | |
| Basic EPS | | |
| Effect of dilutive securities | | |
| Options and common stock equivalents | | |
| Diluted EPS | 550 | |
| Distributions on subsidiary trust preferred securities (after-tax) | 20 | |
| Diluted EPS | \$ 570 | |

Edgar Filing: UNOCAL CORP - Form 10-Q

Not included in the computation of diluted EPS for the period ended September 30, 2001 and 2000, were options outstanding to purchase approximately 5.2 million and 7.4 million shares, respectively, of common stock. These options were not included in the computation as the exercise prices were greater than the year-to-date average market price of the common shares. The diluted EPS computation for the three months ended September 30, 2001 and 2000, did not include options outstanding to purchase approximately 6.3 million and 6.9 million shares, respectively, of common stock because their exercise prices were greater than the average market prices of the common shares during the respective quarters.

-8-

(8) Comprehensive Income

The Company's comprehensive income was:

| Millions of dollars | For the Three Months Ended September 30, | |
|---|---|--------|
| | 2001 | 2000 |
| Net earnings | \$ 102 | \$ 190 |
| Cumulative effect of change in accounting principle | | |
| SFAS 133 adoption (a) | - | - |
| Change in unrealized loss on hedging instruments (b) | 17 | - |
| Reclassification adjustment for settled hedging contracts (c) | (3) | - |
| Change in foreign currency translation adjustments | (24) | (8) |
| Comprehensive income | \$ 92 | \$ 182 |

(9) Restricted Cash

Of the total amounts of cash and cash equivalents reported at September 30, 2001, cash in the amount of \$29 million was restricted as to usage or withdrawal, compared to \$33 million that was restricted as of December 31, 2000. Under the terms of the Company's limited-recourse project financing for its share of the Azerbaijan International Operating Company Early Oil Project, the Company's share of principal and interest payments to the lenders are payable only out of the proceeds from the Company's sale of crude oil from the project. In keeping with the terms of the financing agreements, \$5 million at September 30, 2001, of the Company's oil sales proceeds (cash) were reserved for debt principal and interest obligations falling due within the next 180 days. In addition, at September 30, 2001, the Company had reserved \$24 million in cash, which was placed in December 2000 with a trustee to ultimately be used in settlement of claims arising out of the valuation of the royalty owners' portions of crude oil produced from certain federal and Indian land leases. Per the terms of the trust agreement the trustee invests the cash in acceptable investments and will deliver to the Company any cash balances remaining in the trust after final settlement of the claims. The Company anticipates final settlement and disbursement of all funds by the end of 2001.

(10) Long Term Debt and Credit Agreements

During the nine months period of 2001, the Company's consolidated debt,

Edgar Filing: UNOCAL CORP - Form 10-Q

including the current portion, increased by \$353 million. This was substantially due to an increase of \$467 million in long term debt incurred by the Company's Pure subsidiary to fund two of its acquisitions (see note 3). In June 2001, Pure issued, in a private placement, \$350 million in unsecured senior notes, which bear interest at 7.125 percent and mature in 10 years. The notes were issued at a discount to their face value. Pursuant to a registration rights agreement, Pure registered the notes in the fourth quarter of 2001. Pure used the proceeds to repay a portion of its senior credit facilities and to repay interim financing associated with the Hallwood acquisition (see note 3). At September 30, 2001, Pure had \$188 million outstanding under a 364-day revolving credit facility due September 29, 2002, and had nothing outstanding under its five-year revolving credit facility due September 29, 2005. Each of these unsecured credit agreements provides a \$250 million line of credit. None of the Pure debt is guaranteed by the Company.

During the third quarter of 2001, the Company retired \$61 million of medium-term notes, \$39 million of 8.75 percent notes, which matured as scheduled during the quarter, and \$20 million of long-term debt assumed in the Tethys acquisition (see note 3).

-9-

(11) Accrued Abandonment, Restoration and Environmental Liabilities

At September 30, 2001, the Company had accrued \$476 million for the estimated future costs to abandon and remove wells and production facilities. The total costs for these abandonments are predominantly accrued for on a unit-of-production basis and are estimated to be approximately \$640 million. This estimate was derived in large part from abandonment cost studies performed by independent third party firms and is used to calculate the amount to be amortized. The Company's reserve for environmental remediation obligations at September 30, 2001 totaled \$236 million, of which \$117 million was included in current liabilities.

(12) Commitments and Contingencies

The Company has certain contingent liabilities with respect to material existing or potential claims, lawsuits and other proceedings, including those involving environmental, tax and other matters, certain of which are discussed more specifically below. The Company accrues liabilities when it is probable that future costs will be incurred and such costs can be reasonably estimated. Such accruals are based on developments to date, the Company's estimates of the outcomes of these matters and its experience in contesting, litigating and settling other matters. As the scope of the liabilities becomes better defined, there will be changes in the estimates of future costs, which could have a material effect on the Company's future results of operations and financial condition or liquidity.

Environmental matters - The Company is subject to loss contingencies pursuant to federal, state and local environmental laws and regulations. These include existing and possible future obligations to investigate the effects of the release or disposal of certain petroleum, chemical and mineral substances at various sites; to remediate or restore these sites; to compensate others for damage to property and natural resources, for remediation and restoration costs and for personal injuries; and to pay civil penalties and, in some cases, criminal penalties and punitive damages. These obligations relate to sites owned by the Company or others and are associated with past and present operations, including sites at which the Company has been identified as a potentially responsible party (PRP) under the federal Superfund laws and comparable state laws.

Edgar Filing: UNOCAL CORP - Form 10-Q

Liabilities are accrued when it is probable that future costs will be incurred and such costs can be reasonably estimated. However, in many cases, investigations are not yet at a stage where the Company is able to determine whether it is liable or, even if liability is determined to be probable, to quantify the liability or estimate a range of possible exposure. In such cases, the amounts of the Company's liabilities are indeterminate due to the potentially large number of claimants for any given site or exposure, the unknown magnitude of possible contamination, the imprecise and conflicting engineering evaluations and estimates of proper clean-up methods and costs, the unknown timing and extent of the corrective actions that may be required, the uncertainty attendant to the possible award of punitive damages, the recent judicial recognition of new causes of action, the present state of the law, which often imposes joint and several and retroactive liabilities on PRPs, the fact that the Company is usually just one of a number of companies identified as a PRP, or other reasons.

As disclosed in note 11, at September 30, 2001, the Company had accrued \$236 million for estimated future environmental assessment and remediation costs at various sites where liabilities for such costs are probable. At those sites where investigations or feasibility studies have advanced to the stage of analyzing feasible alternative remedies and/or ranges of costs, the Company estimates that it could incur possible additional remediation costs aggregating approximately \$250 million.

-10-

Tax matters - The Company believes it has adequately provided in its accounts for tax items and issues not yet resolved. Several prior material tax issues are unresolved. Resolution of these tax issues impact not only the year in which the items arose, but also the company's tax situation in other tax years. With respect to 1979-1984 taxable years, all issues raised for these years have now been settled, with the exception of the effect of the carryback of a 1993 net operating loss (NOL) to tax year 1984 and resultant credit adjustments. The 1985-1990 taxable years are before the Appeals Division of the Internal Revenue Service (IRS). All issues raised with respect to those years have now been settled, with the exception of the effect of the 1993 NOL carryback and resultant adjustments. The settlements were subject to review by the Joint Committee on Taxation of the U.S. Congress. The Joint Committee has reviewed the settled issues with respect to 1979-1990 taxable years and no additional issues have been raised. While all tax issues for the 1979-1990 taxable years have been agreed and reviewed by the Joint Committee, these taxable years will remain open due to the 1993 NOL carryback. The 1993 NOL results from certain specified liability losses which occurred during 1993 and which resulted in a tax refund of \$73 million. Consequently, these tax years will remain open until the specified liability loss, which gave rise to the 1993 NOL, is finally determined by the IRS and is either agreed to with the IRS or otherwise concluded in the Tax Court proceeding. In 1999, the United States Tax Court granted Unocal's motion to amend the pleadings in its Tax Court cases to place the 1993 NOL carryback in issue. The 1991-1992 taxable years are now before the Appeals Division of the IRS. The 1993-1997 taxable years are under examination by the IRS.

Pure Resources, Inc. Employment and Severance Agreements - Under circumstances specified in the employment and/or severance agreements entered into between the Company's Pure subsidiary and its officers, each covered officer will have the right to require Pure to purchase its common shares currently held or subsequently obtained by the exercise of any option held by the officer at a calculated "net asset value" per share. The circumstances under which certain officers may exercise this right include the termination of the officer without

Edgar Filing: UNOCAL CORP - Form 10-Q

cause prior to May 25, 2003, termination for any reason after May 24, 2003, a change in control of either Pure or Unocal and other events specified in the agreements. The net asset value per share is calculated by reference to each common share's pro rata amount of the present value of Pure's proved reserves discounted at 10 percent, as defined, times 110 percent, less funded debt, as defined. At September 30, 2001, Pure estimated that the amount which it would have to repurchase under these agreements was approximately \$114 million, which is reflected in other deferred credits and liabilities on the consolidated balance sheet. The repurchase amount will fluctuate with the market value of Pure's common stock and/or changes in the net asset value per share.

-11-

Other matters - The Company has a five-year lease agreement relating to its Discoverer Spirit deepwater drillship, with a remaining term of approximately four years at September 30, 2001. The drillship has a minimum daily rate of approximately \$210,000. In August 2001, the Company signed a sublease agreement with a third party for a minimum period of 200 days. Under the provisions of the agreement, the third party will assume the lease payments to the lessor during the sublease period. The sublease period is expected to begin in early 2002 after the Company completes its current drilling of a well in the Gulf of Mexico deep water. The future remaining minimum lease payment obligation excluding the minimum sublease 200-day period was approximately \$260 million at September 30, 2001.

The Company's Molycorp subsidiary, working cooperatively and collaboratively with the New Mexico Environmental Department and other state agencies, has secured permits covering discharges from its Questa, New Mexico, molybdenum mine. This process involved the posting by Molycorp of two performance bonds totaling \$152 million that are intended to provide financial assurance of completion of preliminary closure plans (only required upon cessation of operations) and other obligations required under the terms of the permits. The amounts of the performance bonds were based on estimations provided by the state of New Mexico agencies. Unocal has indemnified the insurance company that issued the bonds with respect to all amounts that may be drawn against them.

The Company also has certain other contingent liabilities with respect to litigation, claims, and contractual agreements arising in the ordinary course of business. Although these contingencies could result in expenses or judgments that could be material to the Company's results of operations for a given reporting period, on the basis of management's best assessment of the ultimate amount and timing of these events, such expenses or judgments are not expected to have a material adverse effect on the Company's consolidated financial condition or liquidity.

(13) Financial Instruments and Commodity Hedging

Fair values of debt and other long-term instruments - The estimated fair value of the Company's long-term debt at September 30, 2001, including the current portion, was approximately \$3.065 billion. Fair values were based on the discounted amounts of future cash outflows using the rates offered to the Company for debt with similar remaining maturities.

The estimated fair value of the mandatorily redeemable convertible preferred securities of the Company's subsidiary trust was \$499 million at September 30, 2001. The fair value was based on the trading prices of the preferred securities on September 28, 2001, as reported to the Company.

Commodity hedging activities - During the third quarter of 2001, the Company recognized \$2 million in after-tax gains for the ineffectiveness of both cash

Edgar Filing: UNOCAL CORP - Form 10-Q

flow and fair value hedges. During the nine months period of 2001, the Company recognized \$3 million in after-tax losses for the ineffectiveness of both cash flow and fair value hedges. At September 30, 2001, the Company had approximately \$3 million of after-tax deferred losses in accumulated other comprehensive income on the consolidated balance sheet related to cash flow hedges for future commodity sales for the period beginning October 2001 through October 2004. Of this amount, approximately \$10 million in after-tax gains are expected to be reclassified to the consolidated earnings statement during the next twelve months.

-12-

(14) Supplemental Condensed Consolidating Financial Information

Unocal guarantees all the publicly held securities issued by its 100 percent-owned subsidiaries Unocal Capital Trust and Union Oil. Such guarantees are full and unconditional and no other subsidiaries of Unocal or Union Oil guarantee these securities.

The following tables present condensed consolidating financial information for (a) Unocal (Parent), (b) the Trust, (c) Union Oil (Parent) and (d) on a combined basis, the subsidiaries of Union Oil. Virtually all of the Company's operations are conducted by Union Oil and its subsidiaries.

CONDENSED CONSOLIDATED EARNINGS STATEMENT For the three months ended September 30, 2001

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|---|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| <hr/> | | | | | |
| Revenues | | | | | |
| Sales and operating revenues | \$ - | \$ - | \$ 360 | \$ 1,479 | |
| Interest, dividends and miscellaneous income | 1 | 8 | - | 8 | |
| Gain (loss) on sales of assets | - | - | (3) | 1 | |
| <hr/> | | | | | |
| Total revenues | 1 | 8 | 357 | 1,488 | |
| Costs and other deductions | | | | | |
| Purchases, operating and other expenses | 1 | - | 253 | 1,068 | |
| Depreciation, depletion and amortization | - | - | 102 | 168 | |
| Dry hole costs | - | - | 15 | 38 | |
| Interest expense | 8 | - | 39 | 10 | |
| Distributions on convertible preferred securities | - | 8 | - | - | |
| <hr/> | | | | | |
| Total costs and other deductions | 9 | 8 | 409 | 1,284 | |
| <hr/> | | | | | |
| Equity in earnings of subsidiaries | 107 | - | 147 | - | |
| Earnings from equity investments | - | - | 2 | 35 | |
| <hr/> | | | | | |
| Earnings from continuing operations before income taxes and minority interests | 99 | - | 97 | 239 | |
| <hr/> | | | | | |
| Income taxes | (3) | - | (10) | 90 | |
| Minority interests | - | - | - | 2 | |
| <hr/> | | | | | |
| Earnings from continuing operations | 102 | - | 107 | 147 | |
| Earnings from discontinued operations | - | - | - | - | |
| Cumulative effect of accounting change | - | - | - | - | |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | |
|--------------|--------|------|--------|--------|
| Net earnings | \$ 102 | \$ - | \$ 107 | \$ 147 |
|--------------|--------|------|--------|--------|

-13-

CONDENSED CONSOLIDATED EARNINGS STATEMENT
For the three months ended September 30, 2000

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|---|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| Revenues | | | | | |
| Sales and operating revenues | \$ - | \$ - | \$ 486 | \$ 2,227 | |
| Interest, dividends and miscellaneous income | - | 8 | 5 | 5 | |
| Gain on sales of assets | - | - | 1 | 4 | |
| Total revenues | - | 8 | 492 | 2,236 | |
| Costs and other deductions | | | | | |
| Purchases, operating and other expenses | 1 | - | 299 | 1,877 | |
| Depreciation, depletion and amortization | - | - | 94 | 145 | |
| Dry hole costs | - | - | 26 | 21 | |
| Interest expense | 8 | - | 50 | 4 | |
| Distributions on convertible preferred securities | - | 8 | - | - | |
| Total costs and other deductions | 9 | 8 | 469 | 2,047 | |
| Equity in earnings of subsidiaries | 197 | - | 215 | - | |
| Earnings from equity investments | - | - | 11 | 33 | |
| Earnings from continuing operations before income taxes and minority interests | 188 | - | 249 | 222 | |
| Income taxes | (3) | - | 54 | 16 | |
| Minority interests | - | - | (2) | 5 | |
| Earnings from continuing operations | 191 | - | 197 | 201 | |
| Earnings from discontinued operations | - | - | - | 14 | |
| Net earnings | \$ 191 | \$ - | \$ 197 | \$ 215 | |

-14-

CONDENSED CONSOLIDATED EARNINGS STATEMENT
For the nine months ended September 30, 2001

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|---------------------|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| Revenues | | | | | |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | |
|---|--------|------|----------|----------|
| Sales and operating revenues | \$ - | \$ - | \$ 1,540 | \$ 5,165 |
| Interest, dividends and miscellaneous income | 6 | 25 | 3 | 21 |
| Gain (loss) on sales of assets | - | - | (2) | 1 |
| <hr/> | | | | |
| Total revenues | 6 | 25 | 1,541 | 5,187 |
| Costs and other deductions | | | | |
| Purchases, operating and other expenses | 3 | - | 898 | 3,779 |
| Depreciation, depletion and amortization | - | - | 301 | 482 |
| Dry hole costs | - | - | 49 | 91 |
| Interest expense | 25 | 1 | 124 | 23 |
| Distributions on convertible preferred securities | - | 24 | - | - |
| <hr/> | | | | |
| Total costs and other deductions | 28 | 25 | 1,372 | 4,375 |
| Equity in earnings of subsidiaries | 658 | - | 560 | - |
| Earnings from equity investments | - | - | 10 | 118 |
| <hr/> | | | | |
| Earnings from continuing operations before income taxes and minority interests | 636 | - | 739 | 930 |
| <hr/> | | | | |
| Income taxes | (8) | - | 96 | 359 |
| Minority interests | - | - | - | 11 |
| <hr/> | | | | |
| Earnings from continuing operations | 644 | - | 643 | 560 |
| Earnings from discontinued operations | - | - | 16 | - |
| Cumulative effect of accounting change | - | - | (1) | - |
| <hr/> | | | | |
| Net earnings | \$ 644 | \$ - | \$ 658 | \$ 560 |

-15-

CONDENSED CONSOLIDATED EARNINGS STATEMENT
For the nine months ended September 30, 2000

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|---|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| <hr/> | | | | | |
| Revenues | | | | | |
| Sales and operating revenues | \$ - | \$ - | \$ 1,496 | \$ 5,766 | |
| Interest, dividends and miscellaneous income | 10 | 25 | 131 | 14 | |
| Gain on sales of assets | - | - | 64 | 4 | |
| <hr/> | | | | | |
| Total revenues | 10 | 25 | 1,691 | 5,784 | |
| Costs and other deductions | | | | | |
| Purchases, operating and other expenses | 2 | - | 1,021 | 4,758 | |
| Depreciation, depletion and amortization | - | - | 273 | 396 | |
| Dry hole costs | - | - | 39 | 59 | |
| Interest expense | 25 | 1 | 155 | 6 | |
| Distributions on convertible preferred securities | - | 24 | - | - | |
| <hr/> | | | | | |
| Total costs and other deductions | 27 | 25 | 1,488 | 5,219 | |
| Equity in earnings of subsidiaries | 598 | - | 507 | - | |
| Earnings from equity investments | - | - | 32 | 69 | |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | |
|---|--------|------|--------|--------|
| Earnings from continuing operations before income taxes and minority interests | 581 | - | 742 | 634 |
| Income taxes | (6) | - | 146 | 169 |
| Minority interests | - | - | (2) | (5) |
| Earnings from continuing operations | 587 | - | 598 | 470 |
| Earnings from discontinued operations | - | - | - | 37 |
| Net earnings | \$ 587 | \$ - | \$ 598 | \$ 507 |

-16-

CONDENSED CONSOLIDATED BALANCE SHEET
Period ended September 30, 2001

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|--|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ 1 | \$ - | \$ 195 | \$ 175 | |
| Accounts and notes receivable | - | - | 100 | 853 | |
| Inventories | - | - | 4 | 88 | |
| Other current assets | - | - | 144 | 42 | |
| Total current assets | 1 | - | 443 | 1,158 | |
| Investments and long-term receivables | 4,097 | - | 4,214 | 964 | |
| Properties - net | - | - | 2,094 | 5,250 | |
| Other assets | 53 | 541 | 284 | 1,727 | |
| Total assets | \$4,151 | \$ 541 | \$ 7,035 | \$ 9,099 | |
| Liabilities and Stockholders' Equity | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ - | \$ - | \$ 232 | \$ 662 | |
| Current portion of long-term debt and capital leases | - | - | - | 9 | |
| Other current liabilities | 41 | 3 | 208 | 374 | |
| Total current liabilities | 41 | 3 | 440 | 1,045 | |
| Long-term debt and capital leases | - | - | 2,181 | 669 | |
| Deferred income taxes | - | - | (16) | 679 | |
| Accrued abandonment, restoration and environmental liabilities | - | - | 293 | 302 | |
| Other deferred credits and liabilities | 541 | - | 383 | 2,275 | |
| Minority interests | - | - | - | 296 | |
| Company-obligated mandatorily redeemable convertible preferred securities of a subsidiary trust holding solely parent debentures | - | 522 | - | - | |
| Stockholders' equity | 3,569 | 16 | 3,754 | 3,833 | |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | |
|--|---------|--------|----------|----------|
| Total liabilities and stockholders' equity | \$4,151 | \$ 541 | \$ 7,035 | \$ 9,099 |
|--|---------|--------|----------|----------|

-17-

CONDENSED CONSOLIDATED BALANCE SHEET
Year ended December 31, 2000

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|--|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ 1 | \$ - | \$ 84 | \$ 150 | |
| Accounts and notes receivable | - | - | 165 | 1,134 | |
| Inventories | - | - | 13 | 75 | |
| Other current assets | - | - | 127 | 53 | |
| Total current assets | 1 | - | 389 | 1,412 | |
| Investments and long-term receivables | 3,620 | - | 3,765 | 781 | |
| Properties - net | - | - | 1,988 | 4,445 | |
| Other assets | 56 | 541 | 646 | 1,153 | |
| Total assets | \$3,677 | \$ 541 | \$ 6,788 | \$ 7,791 | |
| Liabilities and Stockholders' Equity | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ - | \$ - | \$ 283 | \$ 739 | |
| Current portion of long-term debt and capital leases | - | - | 105 | 9 | |
| Other current liabilities | 42 | 3 | 233 | 431 | |
| Total current liabilities | 42 | 3 | 621 | 1,179 | |
| Long-term debt and capital leases | - | - | 2,181 | 211 | |
| Deferred income taxes | - | - | (10) | 628 | |
| Accrued abandonment, restoration and environmental liabilities | - | - | 254 | 300 | |
| Other deferred credits and liabilities | 541 | - | 467 | 1,952 | |
| Minority interests | - | - | - | 287 | |
| Company-obligated mandatorily redeemable convertible preferred securities of a subsidiary trust holding solely parent debentures | - | 522 | - | - | |
| Stockholders' equity | 3,094 | 16 | 3,275 | 3,234 | |
| Total liabilities and stockholders' equity | \$3,677 | \$ 541 | \$ 6,788 | \$ 7,791 | |

-18-

CONDENSED CONSOLIDATED CASH FLOWS

Edgar Filing: UNOCAL CORP - Form 10-Q

Period ended September 30, 2001

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|--|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| Cash Flows from Operating Activities | \$132 | \$ - | \$ 694 | \$ 954 | |
| Cash Flows from Investing Activities | | | | | |
| Capital expenditures and major acquisitions (includes dry hole costs) | - | - | (526) | (1,267) | |
| Proceeds from sales of assets and discontinued operations | - | - | 47 | 4 | |
| Net cash used in investing activities | - | - | (479) | (1,263) | |
| Cash Flows from Financing Activities | | | | | |
| Change in long-term debt and capital leases | - | - | (105) | 351 | |
| Dividends paid on common stock | (146) | - | - | - | |
| Minority interests | - | - | - | (17) | |
| Other | 14 | - | 1 | - | |
| Net cash provided by (used in) financing activities | (132) | - | (104) | 334 | |
| Increase in cash and cash equivalents | - | - | 111 | 25 | |
| Cash and cash equivalents at beginning of year | 1 | - | 84 | 150 | |
| Cash and cash equivalents at end of year | \$ 1 | \$ - | \$ 195 | \$ 175 | |

CONDENSED CONSOLIDATED CASH FLOWS Period ended September 30, 2000

| Millions of dollars | Unocal (Parent) | Unocal Capital Trust | Union Oil (Parent) | Non- Guarantor Subsidiaries | E |
|--|--------------------|----------------------------|-----------------------|-----------------------------------|---|
| Cash Flows from Operating Activities | \$174 | \$ - | \$ 273 | \$ 810 | |
| Cash Flows from Investing Activities | | | | | |
| Capital expenditures and major acquisitions (includes dry hole costs) | - | - | (361) | (672) | |
| Proceeds from sales of assets and discontinued operations | - | - | 352 | 12 | |
| Net cash used in investing activities | - | - | (9) | (660) | |
| Cash Flows from Financing Activities | | | | | |
| Change in long-term debt and capital leases | - | - | (180) | (41) | |
| Dividends paid on common stock | (146) | - | - | - | |
| Minority interests | - | - | - | (19) | |
| Other | (28) | - | 1 | - | |
| Net cash provided by (used in) financing activities | (174) | - | (179) | (60) | |
| Increase in cash and cash equivalents | - | - | 85 | 90 | |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | |
|--|------|------|--------|--------|
| Cash and cash equivalents at beginning of year | 1 | - | 162 | 169 |
| Cash and cash equivalents at end of year | \$ 1 | \$ - | \$ 247 | \$ 259 |

-19-

(15) Segment Data

The Company has made changes in the reporting of its segments from the reporting utilized in the 2000 Annual Report on Form 10-K. The Company's reportable segments are now: Exploration and Production, Trade, Midstream, and Geothermal and Power Operations. General corporate overhead, unallocated costs and other miscellaneous operations, including real estate, carbon and minerals and those businesses that were sold, are included under the Corporate and Other heading. See also Management's Discussion and Analysis in Item 2 for further descriptions of the new segments.

Segment Information
For the Three Months
ended September 30, 2001
Millions of dollars

| | Exploration & Production | | | |
|---|--------------------------|--------|--------|--------------------|
| | Lower 48 | Alaska | Canada | Intern Far East |
| Sales & operating revenues | \$ 158 | \$ 86 | \$ 59 | \$ 254 |
| Other income (loss) (a) | - | - | (2) | (3) |
| Inter-segment revenues | 265 | - | - | 45 |
| Total | 423 | 86 | 57 | 296 |
| Earnings (loss) from equity investments | (2) | - | - | 10 |
| Earnings from continuing operations | 51 | 17 | 6 | 109 |
| Earnings from discontinued operations | - | - | - | - |
| Cumulative effect of accounting change | - | - | - | - |
| Net earnings | 51 | 17 | 6 | 109 |
| Assets (at September 30, 2001) | 3,337 | 333 | 1,025 | 2,433 |

| | Midstream | Geothermal & Power Operations | Admin & General | Corporate & Other Net Interest Expense | Environment & Litigation |
|----------------------------|-----------|-------------------------------------|-----------------------|---|--------------------------------|
| Sales & operating revenues | \$ 48 | \$ 46 | \$ - | \$ - | \$ - |
| Other income (loss) (a) | - | 6 | - | 6 | - |
| Inter-segment revenues | 2 | - | - | - | - |
| Total | 50 | 52 | - | 6 | - |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | | |
|--|-----|-----|------|------|------|
| Earnings (loss) from equity investments | 17 | (2) | - | - | - |
| Earnings (loss) from continuing operations | 13 | 2 | (19) | (31) | (28) |
| Earnings from discontinued operations | - | - | - | - | - |
| Cumulative effect of accounting change | - | - | - | - | - |
| Net earnings (loss) | 13 | 2 | (19) | (31) | (28) |
| Assets (at September 30, 2001) | 455 | 629 | - | - | - |

-20-

| Segment Information For the Three Months ended September 30, 2000 Millions of dollars | Exploration & Production | | | |
|--|--------------------------|--------|--------|----------|
| | Lower 48 | Alaska | Canada | Far East |
| Sales & operating revenues | \$ 102 | \$ 60 | \$ 9 | \$ 272 |
| Other income (loss) (a) | - | - | 1 | 1 |
| Inter-segment revenues | 378 | 15 | - | 56 |
| Total | 480 | 75 | 10 | 329 |
| Earnings (loss) from equity investments | 10 | - | - | 8 |
| Earnings (loss) from continuing operations | 104 | 22 | 16 | 120 |
| Earnings from discontinued operations | - | - | - | - |
| Net earnings (loss) | 104 | 22 | 16 | 120 |
| Assets (at December 31, 2000) | 2,701 | 315 | 1,019 | 2,251 |

| | Midstream | Geothermal & Power Operations | Admin & General | Corporate & Net Interest Expense | & Other Environment & Litigation |
|--|-----------|-------------------------------------|-----------------------|---|---|
| Sales & operating revenues | \$ 13 | \$ 36 | \$ - | \$ - | \$ - |
| Other income (a) | 1 | 4 | - | 7 | - |
| Inter-segment revenues | 2 | - | - | - | - |
| Total | 16 | 40 | - | 7 | - |
| Earnings from equity investments | 16 | - | - | - | - |
| Earnings (loss) from continuing operations | 16 | 4 | (19) | (36) | (17) |
| Earnings from discontinued operations | - | - | - | - | - |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | | | |
|-------------------------------|-----|-----|------|------|------|
| Net earnings (loss) | 16 | 4 | (19) | (36) | (17) |
| Assets (at December 31, 2000) | 416 | 574 | - | - | - |

-21-

| Segment Information For the Nine Months ended September 30, 2001 Millions of dollars | Exploration & Production | | | |
|---|--------------------------|--------|--------|----------|
| | Lower 48 | Alaska | Canada | Far East |
| Sales & operating revenues | \$ 486 | \$ 221 | \$ 188 | \$ 755 |
| Other income (loss) (a) | 1 | - | (1) | (9) |
| Inter-segment revenues | 1,237 | - | - | 155 |
| Total | 1,724 | 221 | 187 | 901 |
| Earnings from equity investments | 12 | - | - | 29 |
| Earnings from continuing operations | 434 | 49 | 17 | 328 |
| Earnings from discontinued operations | - | - | - | - |
| Cumulative effect of accounting change | - | - | - | - |
| Net earnings | 434 | 49 | 17 | 328 |
| Assets (at September 30, 2001) | 3,337 | 333 | 1,025 | 2,433 |

| | Midstream | Geothermal & Power Operations | Admin & General | Corporate & Other Net Interest Expense | Environment & Litigation |
|--|-----------|-------------------------------------|-----------------------|---|--------------------------------|
| Sales & operating revenues | \$ 187 | \$ 135 | \$ - | \$ - | \$ - |
| Other income (loss) (a) | 2 | 13 | - | 19 | - |
| Inter-segment revenues | 6 | - | - | - | - |
| Total | 195 | 148 | - | 19 | - |
| Earnings (loss) from equity investments | 45 | (2) | - | - | - |
| Earnings (loss) from continuing operations | 40 | 5 | (63) | (96) | (78) |
| Earnings from discontinued operations | - | - | - | - | - |
| Cumulative effect of accounting change | - | - | - | - | - |
| Net earnings (loss) | 40 | 5 | (63) | (96) | (78) |
| Assets (at September 30, 2001) | 455 | 629 | - | - | - |

Edgar Filing: UNOCAL CORP - Form 10-Q

-22-

| Segment Information For the Nine Months ended September 30, 2000 Millions of dollars | Exploration & Production | | | |
|---|--------------------------|--------|--------|----------|
| | North America | | Intern | |
| | Lower 48 | Alaska | Canada | Far East |
| Sales & operating revenues | \$ 159 | \$ 180 | \$ 73 | \$ 727 |
| Other income (loss) (a) | 65 | - | - | (3) |
| Inter-segment revenues | 1,051 | 48 | - | 168 |
| Total | 1,275 | 228 | 73 | 892 |
| Earnings from equity investments | 13 | - | - | 8 |
| Earnings from continuing operations | 301 | 69 | 8 | 290 |
| Earnings from discontinued operations | - | - | - | - |
| Net earnings | 301 | 69 | 8 | 290 |
| Assets (at December 31, 2000) | 2,701 | 315 | 1,019 | 2,251 |

| | Midstream | Geothermal & Power Operations | Admin & General | Corporate & Other Net Interest Expense | Environment & Litigation |
|--|-----------|-------------------------------------|-----------------------|---|--------------------------------|
| Sales & operating revenues | \$ 39 | \$ 119 | \$ - | \$ - | \$ - |
| Other income (a) | 2 | 6 | - | 21 | - |
| Inter-segment revenues | 8 | - | - | - | - |
| Total | 49 | 125 | - | 21 | - |
| Earnings (loss) from equity investments | 48 | (1) | - | - | - |
| Earnings (loss) from continuing operations | 47 | 18 | (62) | (109) | (55) |
| Earnings from discontinued operations | - | - | - | - | - |
| Net earnings (loss) | 47 | 18 | (62) | (109) | (55) |
| Assets (at December 31, 2000) | 416 | 574 | - | - | - |

OPERATING HIGHLIGHTS

Edgar Filing: UNOCAL CORP - Form 10-Q

Effective with the first quarter of 2001, the Company began reporting all production pursuant to production sharing contracts on the net-economic interests basis, which excludes host country shares. In previous reporting, production had included host country shares in Indonesia and the Democratic Republic of Congo. The Company also began reporting natural gas production on a dry basis, with natural gas liquids now included with crude oil and condensate production volumes. The production and price data in the table on the following page reflect these reclassifications:

-23-

OPERATING HIGHLIGHTS (UNAUDITED)

| | For the Three Months Ended September 30, | | For the N Ended Sep |
|--|---|----------|------------------------|
| | 2001 | 2000 | 2001 |
| <hr/> | | | |
| North America Net Daily Production | | | |
| Crude oil, condensate and natural gas liquids (thousand barrels) | | | |
| Lower 48 (a) | 60 | 53 | 58 |
| Alaska | 26 | 25 | 25 |
| Canada (a) | 16 | 16 | 15 |
| <hr/> | | | |
| Total crude oil, condensate and natural gas liquids | 102 | 94 | 98 |
| | | | |
| Natural gas - dry basis (million cubic feet) | | | |
| Lower 48 (a) | 939 | 777 | 922 |
| Alaska | 83 | 128 | 104 |
| Canada (a) | 92 | 96 | 105 |
| <hr/> | | | |
| Total natural gas | 1,114 | 1,001 | 1,131 |
| | | | |
| North America Average Prices (b) | | | |
| Crude oil, condensate and natural gas liquids (per barrel) | | | |
| Lower 48 | \$ 23.11 | \$ 28.45 | \$ 24.63 |
| Alaska | \$ 21.58 | \$ 25.70 | \$ 22.18 |
| Canada | \$ 20.89 | \$ 26.89 | \$ 20.74 |
| Average | \$ 22.37 | \$ 27.45 | \$ 23.39 |
| | | | |
| Natural gas (per mcf) | | | |
| Lower 48 | \$ 2.97 | \$ 4.26 | \$ 4.76 |
| Alaska | \$ 1.57 | \$ 1.20 | \$ 1.30 |
| Canada | \$ 2.76 | \$ 2.66 | \$ 3.40 |
| Average | \$ 2.85 | \$ 3.69 | \$ 4.29 |
| <hr/> | | | |
| International Net Daily Production | | | |
| Crude oil, condensate and natural gas liquids (thousand barrels) | | | |
| Far East | 49 | 47 | 49 |
| Other | 19 | 18 | 19 |
| <hr/> | | | |
| Total crude oil, condensate and natural gas liquids | 68 | 65 | 68 |
| | | | |
| Natural gas - dry basis (million cubic feet) | | | |
| Far East | 833 | 816 | 845 |
| Other | 66 | 52 | 64 |
| <hr/> | | | |

Edgar Filing: UNOCAL CORP - Form 10-Q

| | | | |
|--|----------|----------|----------|
| Total natural gas | 899 | 868 | 909 |
| International Average Prices (b) | | | |
| Crude oil, condensate and natural gas liquids (per barrel) | | | |
| Far East | \$ 23.04 | \$ 28.30 | \$ 24.02 |
| Other | \$ 25.27 | \$ 29.24 | \$ 26.04 |
| Average | \$ 23.65 | \$ 28.57 | \$ 24.60 |
| Natural gas (per mcf) | | | |
| Far East | \$ 2.62 | \$ 2.44 | \$ 2.54 |
| Other | \$ 2.80 | \$ 2.86 | \$ 2.90 |
| Average | \$ 2.63 | \$ 2.47 | \$ 2.57 |
| ----- | | | |
| Worldwide Net Daily Production (a) | | | |
| Crude oil, condensate and natural gas liquids (thousand barrels) | 170 | 159 | 166 |
| Natural gas - dry basis (million cubic feet) | 2,013 | 1,869 | 2,040 |
| Barrels oil equivalent (thousands) | 506 | 470 | 506 |
| Worldwide Average Prices (b) | | | |
| Crude oil, condensate and natural gas liquids (per barrel) | \$ 22.87 | \$ 27.90 | \$ 23.89 |
| Natural gas (per mcf) | \$ 2.75 | \$ 3.11 | \$ 3.51 |
| ----- | | | |

-24-

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

The following discussion and analysis of the consolidated financial condition and results of operations of Unocal should be read in conjunction with Management's Discussion and Analysis in Item 7 of the Company's 2000 Annual Report on Form 10-K and in Item 2 of Part I of the Company's First Quarter and Second Quarter 2001 Quarterly Reports on Form 10-Q.

Effective with the first quarter of 2001, the Pipelines business segment was combined with certain activities of the Company's gas storage businesses in Canada, which were previously reported in the Exploration and Production segment, into a new segment called Midstream. The Carbon and Minerals businesses are no longer disclosed as a separate segment and are now reported in the Corporate and Other heading. See note 15 to the consolidated financial statements in Item 1 of this report for revisions in the Company's reportable segments.

CONSOLIDATED RESULTS

| Millions of dollars | For the Three Months Ended September 30, | | For the N Ended Sep |
|--|---|--------|------------------------|
| | 2001 | 2000 | 2001 |
| Earnings from continuing operations | \$ 102 | \$ 176 | \$ 629 |
| Earnings from discontinued operations | - | 14 | 16 |
| Cumulative effect of accounting change | - | - | (1) |
| Net earnings | \$ 102 | \$ 190 | \$ 644 |
| ===== | | | |

Edgar Filing: UNOCAL CORP - Form 10-Q

Earnings from continuing operations totaled \$102 million in the third quarter of 2001, which was a decrease of \$74 million from the same period a year ago. The decrease was primarily due to lower worldwide average prices for natural gas and crude oil, condensate and natural gas liquids (liquids), a higher effective tax rate due to a change in the Thai baht/U.S. dollar exchange rate and higher receivable provisions related to geothermal operations in Indonesia. These negative factors were partially offset by higher worldwide natural gas production. The Company's worldwide average price for natural gas, including realized hedging activities, was \$2.75 per thousand cubic feet (mcf) in the third quarter of 2001, which was a decrease of 36 cents per mcf, or 12 percent, from the same period a year ago. The Company's worldwide average price for liquids, including realized hedging activities, was \$22.87 per barrel in the third quarter of 2001, which was a decrease of \$5.03 per barrel, or 18 percent, from the same period a year ago. The Company's worldwide natural gas production was 2,013 million cubic feet per day (mmcf/d) in the third quarter of 2001, which was an increase of 8 percent from the same period a year ago. The increase was primarily due to higher natural gas production from U.S. Lower 48 operations. In the third quarter of 2001, earnings from continuing operations included \$25 million in special item charges, primarily relating to environmental and litigation provisions, while the third quarter of 2000 included \$52 million in special item charges. The special items recorded in the third quarter of 2000 consisted of losses of \$40 million related to commodity derivative positions not accounted for as hedges and \$38 million in environmental and litigation charges, which were partially offset by \$26 million in net benefits related to foreign and U.S. deferred tax adjustments.

Sales and operating revenues were \$1,573 million for the third quarter of 2001, which was a decrease of \$760 million from the same period a year ago. This decrease was primarily due to lower marketing and trading activities in crude oil and condensate by the Company's Trade segment, as well as lower overall hydrocarbon commodity prices.

-25-

Earnings from continuing operations totaled \$629 million for the nine months period of 2001, which was an increase of \$79 million from the same period a year ago. This increase was primarily due to higher worldwide average natural gas prices and increased worldwide natural gas and liquids production. The Company's worldwide average natural gas price, including realized hedging activities, was \$3.51 per mcf for the nine months period of 2001, which was an increase of 83 cents per mcf, or 31 percent, from the same period a year ago. The Company's worldwide natural gas production increased by 11 percent from the same period a year ago, primarily due to higher natural gas production from U.S. Lower 48 and Far East operations. The Company's worldwide liquids production increased by 3 percent from the same period a year ago primarily from U.S. Lower 48 operations. These positive results were partially offset by lower worldwide average liquids prices, higher depreciation, depletion and amortization expense, higher receivable provisions related to geothermal operations in Indonesia, higher dry hole costs and a higher effective tax rate due to a change in the Thai baht/U.S. dollar exchange rate. The Company's worldwide average liquids price, including realized hedging activities, was \$23.89 per barrel for the nine months period of 2001, which was a decrease of \$1.48 per barrel, or 6 percent, from the same period a year ago. In the nine months period of 2001, earnings from continuing operations included \$66 million in special item charges, primarily relating to environmental and litigation provisions, while the nine months period of 2000 included \$13 million in special item benefits, detailed in the table on page 27.

Earnings from discontinued operations were \$16 million in the nine months period of 2001 compared with \$37 million in the same period a year ago. The Company

Edgar Filing: UNOCAL CORP - Form 10-Q

recorded pre-tax gains of \$25 million (\$16 million after-tax) in the nine months period of 2001 related to a participation agreement tied to its former West Coast refining, marketing and transportation assets, which were sold in 1997. The participation agreement covers price differences between California Air Resources Board Phase 2 gasoline and conventional gasoline. The maximum potential payments under this participation agreement are capped at \$100 million and extend to 2003. The results for the third quarter and nine months periods of 2000 reflected the Company's former agricultural products business, which was sold later in that year.

In 2001, the Company recorded a one-time non-cash \$1 million after-tax charge consisting of the cumulative effect of a change in accounting principle related to the initial adoption of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative instruments and Hedging Activities".

-26-

Special items represent certain significant transactions, presented in net earnings, that management determines to be unrelated to or not representative of the Company's ongoing operations. The following table is a reconciliation of consolidated adjusted (excluding special items) after-tax earnings to net earnings for the quarterly and nine months periods ended September 30:

| Millions of dollars | For the Three Months Ended September 30, | | For the N Ended Sep |
|---|---|--------|------------------------|
| | 2001 | 2000 | 2001 |
| Adjusted after-tax earnings (a) | \$ 127 | \$ 228 | \$ 695 |
| Special items: | | | |
| Continuing operations | | | |
| Gain on asset sales | - | - | - |
| Deferred tax adjustment | - | 46 | - |
| Environmental and litigation provisions/settlements | (26) | (38) | (71) |
| Executive stock purchase program | - | - | - |
| Insurance benefits related to environmental issues | - | - | - |
| Trading derivatives -- non-hedging (Northrock) | 1 | (40) | 5 |
| Provision for prior years income tax issues (Other) | - | (20) | - |
| Reformulated gasoline patent case | - | - | - |
| Restructuring costs | - | - | - |
| Total special items from continuing operations | (25) | (52) | (66) |
| Discontinued operations | | | |
| Gain on disposal - Agricultural products | - | 14 | - |
| Gain on disposal - Refining and marketing | - | - | 16 |
| Total special items from discontinued operations | - | 14 | 16 |
| Cumulative effect of accounting change | - | - | (1) |
| Net earnings (a) | \$ 102 | \$ 190 | \$ 644 |

-27-

EXPLORATION AND PRODUCTION

Edgar Filing: UNOCAL CORP - Form 10-Q

The Company engages in oil and gas exploration, development and production worldwide.

North America - Included in this category are oil and gas operations in the U.S. Lower 48, Alaska and Canada. The emphasis of the U.S. Lower 48 operations is on the onshore, continental shelf and deepwater areas of the Gulf of Mexico region. The U.S. Lower 48 also includes the consolidated results of Pure Resources, Inc. (Pure), a 65-percent owned subsidiary, which operates primarily in the Permian and San Juan Basins in West Texas and New Mexico, the Gulf Coast and the continental shelf area of the Gulf of Mexico. A substantial portion of the crude oil and natural gas produced in the U.S. Lower 48 operations, excluding those of Pure, is sold to the Company's Trade business segment. The remainder of North America production, including the production of Pure and the Company's Northrock Resources Ltd. (Northrock) Canadian subsidiary, is sold to third parties. In Alaska, natural gas production, pursuant to agreements with Agrium, Inc. (Agrium), is sold to Agrium's fertilizer plant in Kenai. In addition, Northrock and Pure take pricing positions in hydrocarbon derivative instruments in support of their oil and gas operations.

| Millions of dollars | For the Three Months Ended September 30, | | For the N Ended Sep |
|--|---|--------|------------------------|
| | 2001 | 2000 | 2001 |
| Adjusted after-tax earnings (loss) (before special items) | | | |
| Lower 48 (a) | \$ 51 | \$ 104 | \$ 434 |
| Alaska | 17 | 22 | 49 |
| Canada (b) | 5 | 10 | 12 |
| Adjusted after-tax earnings (before special items) (a) (b) | 73 | 136 | 495 |
| Special items: | | | |
| Gain on asset sales (Lower 48) | - | - | - |
| Deferred tax adjustment (Canada) | - | 46 | - |
| Trading derivatives- non-hedging (Northrock) | 1 | (40) | 5 |
| Total special items | 1 | 6 | 5 |
| After-tax earnings (a) (b) | \$ 74 | \$ 142 | \$ 500 |

After-tax earnings totaled \$74 million in the third quarter of 2001, which was a decrease of \$68 million from the same period a year ago. This decrease was primarily due to the Company's lower North America average prices for natural gas and liquids, the effect of which was partially offset by higher natural gas production. The Company's average North America natural gas price, including realized hedging activities, was \$2.85 per mcf in the third quarter of 2001, which was a decrease of 84 cents per mcf, or 23 percent, from the same period a year ago. The Company's average North America liquids price, including realized hedging activities, was \$22.37 per barrel in the third quarter of 2001, which was a decrease of \$5.08 per barrel, or 19 percent, from the same period a year ago. North America average net daily natural gas production was 1,114 mmcf/d in the third quarter of 2001, compared to 1,001 mmcf/d in the same period a year ago, which was an increase of 11 percent, primarily from the Lower 48 operations. The increase in the Lower 48 was primarily from higher Pure production and from the Company's production on Ship Shoal 295 Block (Muni field) in the Gulf of Mexico, which began production in the fourth quarter of 2000, as well as newly acquired properties in Mobile Bay and other Gulf of Mexico shelf areas. The third quarter 2001 results were also impacted by higher

Edgar Filing: UNOCAL CORP - Form 10-Q

depreciation, depletion and amortization expense. The third quarter of 2000 results benefited from a \$46 million deferred tax adjustment in Canada, which was partially offset by losses of \$40 million related to Northrock's commodity derivative positions not accounted for as hedges.

-28-

After-tax earnings totaled \$500 million for the nine months period of 2001, which was an increase of \$122 million from the same period a year ago. This increase was primarily due to the Company's higher North America average natural gas prices and higher natural gas production. The Company's average North America natural gas price, including realized hedging activities, was \$4.29 per mcf in the nine months period of 2001, which was an increase of \$1.35 per mcf, or 46 percent, from the same period a year ago. North America average net daily natural gas production was 1,131 mmcf/d for the nine months period of 2001 compared to 976 mmcf/d in the same period a year ago, which was an increase of 16 percent, primarily from the Lower 48 operations. The nine months period of 2001 also benefited from small gains related to non-hedging commodity derivative positions of Northrock in Canada versus losses in the same period a year ago. These positive results were partially offset by higher depreciation, depletion and amortization expense in the Lower 48 operations, lower North America average liquids prices, and higher dry hole costs primarily from the Gulf of Mexico shelf also in the Lower 48 operations. The Company's average North America liquids price, including realized hedging activities, was \$23.39 per barrel in the nine months period of 2001, which was a decrease of \$1.58 per barrel, or 6 percent, from the same period a year ago. The results of the nine months period of 2000 included the \$46 million deferred tax adjustment in Canada and a \$42 million after-tax gain related to the formation of Pure.

International - Unocal's International operations encompass oil and gas exploration and production activities outside of North America. The Company operates or participates in production operations in Thailand, Indonesia, Myanmar, Bangladesh, the Netherlands, Azerbaijan, the Democratic Republic of Congo and Brazil. International operations also include the Company's exploration activities and the development of energy projects primarily in Asia, Latin America and West Africa.

| Millions of dollars | For the Three Months Ended September 30, | | For the N Ended Sep |
|---------------------|---|--------|------------------------|
| | 2001 | 2000 | 2001 |
| Far East | \$ 109 | \$ 120 | \$ 328 |
| Other | 2 | 15 | 29 |
| After-tax earnings | \$ 111 | \$ 135 | \$ 357 |

After-tax earnings totaled \$111 million in the third quarter of 2001, which was a decrease of \$24 million from the same period a year ago. The decrease was primarily due to lower average liquids prices, higher dry hole costs and a higher effective tax rate due to changes in the Thai baht/U.S. dollar exchange rate, the effects of which were partially offset by higher natural gas prices. The average liquids price for International operations was \$23.65 per barrel in the third quarter of 2001, which was a decrease of \$4.92 per barrel, or 17 percent, from the same period a year ago. The average natural gas price for International operations was \$2.63 per mcf in the third quarter of 2001, which was an increase of 16 cents per mcf, or 6 percent, from the same period a year

Edgar Filing: UNOCAL CORP - Form 10-Q

ago.

After-tax earnings totaled \$357 million for the nine months period of 2001, which was an increase of \$35 million from the same period a year ago. The increase was primarily due to higher natural gas prices and natural gas production volumes in the Far East. The average natural gas price for International operations was \$2.57 per mcf for the nine months period of 2001, which was an increase of 17 cents per mcf, or 7 percent, from the same period a year ago. Natural gas production increased 6 percent for the nine months period of 2001 compared to the same period a year ago, primarily in the Far East. The average net daily natural gas production was 909 mmcf/d in the nine months period of 2001 compared to 855 mmcf/d for the same period a year ago. These positive results were partially offset by lower liquids prices and higher effective tax rates, primarily due to changes in the Thai baht/U.S. dollar exchange rate. The average liquids price for International operations was \$24.60 per barrel for the nine months period of 2001, which was a decrease of \$1.36 per barrel, or 5 percent, from the same period a year ago.

-29-

TRADE

The Trade segment conducts most of the Company's worldwide crude oil, condensate, natural gas and refined products trading and marketing activities, excluding those of Pure and Northrock. It is also responsible for commodity-specific risk management activities on behalf of most of the Company's Exploration and Production segment, excluding Pure. The Trade segment also purchases crude oil, condensate and natural gas from certain of the Company's royalty owners, joint venture partners and other unaffiliated oil and gas producing and trading companies for resale. In addition, the segment takes pricing positions in hydrocarbon derivative instruments.

After-tax results totaled \$3 million in the third quarter of 2001 compared to a loss of \$1 million in the same period a year ago. The increase in the third quarter of 2001 was primarily due to higher results from non-hedging commodity derivative positions related to domestic crude oil.

For the nine months ended September 30, 2001, after-tax results totaled \$10 million compared to \$3 million in the same period a year ago. The increase was primarily due to higher results from non-hedging commodity derivative positions related to crude oil and natural gas.

MIDSTREAM

The Midstream segment is comprised of the Pipelines business, which principally encompasses the Company's equity interests in affiliated petroleum pipeline companies and wholly-owned pipeline systems throughout the U.S., and the Company's North America gas storage business.

After-tax earnings totaled \$13 million for the third quarter of 2001 compared to \$16 million in the same period a year ago. The decrease was primarily due to lower results from the Company's North America gas storage business.

For the nine months ended September 30, 2001, after-tax earnings totaled \$40 million compared to \$47 million in the same period a year ago. The decrease was primarily due to a \$6 million asset write-down related to a Colonial Pipeline Company investment.

GEOHERMAL AND POWER OPERATIONS

Edgar Filing: UNOCAL CORP - Form 10-Q

The Geothermal and Power Operations segment produces geothermal steam for power generation, with operations in the Philippines and Indonesia. The segment's activities also include the operation of power plants in Indonesia and equity interests in gas-fired power plants in Thailand. The Company's non-exploration and production business development activities, primarily power-related, are also included in this segment.

After-tax earnings totaled \$2 million and \$5 million in the third quarter and nine months periods of 2001, respectively, which compared to \$4 million and \$18 million, respectively, for the same periods a year ago. The lower results in both the third quarter and nine months periods of 2001 were primarily due to higher receivable provisions related to geothermal operations in Indonesia. The receivable provisions were partially offset in both the third quarter and nine months periods by higher electricity generation and steam sales in Indonesia.

-30-

CORPORATE AND OTHER

Corporate and Other includes general corporate overhead, miscellaneous operations (including real estate activities, carbon and minerals) and other corporate unallocated costs. Net interest expense represents interest expense, net of interest income and capitalized interest.

| Millions of dollars | For the Three Months Ended September 30, | | For the N Ended Sep |
|---|---|----------|------------------------|
| | 2001 | 2000 | 2001 |
| <hr style="border-top: 1px dashed black;"/> | | | |
| Adjusted after-tax earnings effect (before special items) | | | |
| Administrative and general expense | \$ (19) | \$ (19) | \$ (63) |
| Net interest expense (a) | (31) | (36) | (96) |
| Environmental and litigation expense | (4) | (5) | (9) |
| Other (a) | (21) | (2) | (44) |
| <hr style="border-top: 1px dashed black;"/> | | | |
| Adjusted after-tax earnings effect (before special items) (a) | (75) | (62) | (212) |
| Special items: | | | |
| Asset sales (Other) | - | - | - |
| Environmental and litigation provisions | (26) | (38) | (71) |
| Other | | | |
| Executive stock purchase program | - | - | - |
| Insurance benefits related to environmental issues | - | - | - |
| Provision for prior year income tax issues | - | (20) | - |
| Reformulated gasoline patent case | - | - | - |
| Restructuring costs | - | - | - |
| <hr style="border-top: 1px dashed black;"/> | | | |
| Total special items | (26) | (58) | (71) |
| <hr style="border-top: 1px dashed black;"/> | | | |
| After-tax earnings effect (a) | \$ (101) | \$ (120) | \$ (283) |
| <hr style="border-top: 1px dashed black;"/> | | | |

The after-tax earnings effect in the third quarter of 2001 was a loss of \$101 million compared to a loss of \$120 million in the same period a year ago. Environmental and litigation provisions in the third quarter of 2001 were lower than in the third quarter of 2000. Net interest expense was also lower in the third quarter of 2001 versus the same period a year ago primarily due to higher

Edgar Filing: UNOCAL CORP - Form 10-Q

capitalized interest on development projects. The third quarter 2001 results also included a decrease in earnings from the Company's minerals businesses and higher employee benefit-related accruals, both reflected in the Other category. The third quarter 2000 results included a \$20 million provision for U.S. deferred taxes related to prior year income tax matters.

The after-tax earnings effect for the nine months period of 2001 was a loss of \$283 million compared to a loss of \$218 million in the same period a year ago. The results of the nine months period in 2000 benefited from a \$55 million after-tax gain related to payments received in the Company's reformulated gasoline patent infringement case and a \$21 million after-tax insurance recovery. In addition, the nine months 2001 period results were also lower due to higher employee benefit-related accruals and lower earnings from the minerals businesses. The Company also made a \$10 million pre-tax cash contribution in 2001, included in the Other category, to a charitable foundation. Net interest expense was lower for the nine months period of 2001, compared to the same period a year ago, primarily due to higher capitalized interest on development projects.

-31-

FINANCIAL CONDITION AND CAPITAL EXPENDITURES

| | At September 30, ----- 2001 | At December 31, 2000 | At September 30, 2000 |
|--|--------------------------------------|----------------------------|-----------------------------|
| Millions of dollars | 2001 | 2000 | 2000 |
| Current ratio | 1.0:1 | 1.0:1 | 1.1:1 |
| Total debt and capital leases | \$ 2,859 | \$ 2,506 | \$ 2,738 |
| Trust convertible preferred securities | 522 | 522 | 522 |
| Stockholders' equity | 3,201 | 2,719 | 2,593 |
| | ----- | | |
| Total capitalization | \$ 6,582 | \$ 5,747 | \$ 5,853 |
| | ===== | | |
| Total debt/total capitalization | 43% | 44% | 47% |
| Floating-rate debt/total debt | 6% | 3% | 7% |
| | ----- | | |

For the nine months period of 2001, net cash flow provided by operating activities was \$1,780 million compared with \$1,257 million in the same period a year ago. This increase primarily reflected the effects of higher worldwide average natural gas prices and higher worldwide natural gas production. Positive cash flow generated from reduced working capital was a reflection of a continuous decrease in crude oil prices during the first nine months of the year, lower crude oil trading activity by the Company's Trade business segment and the collection, in June 2001, of \$73 million from the Petroleum Authority of Thailand in settlement of its "take-or-pay" obligation for natural gas purchases from the Company's Yadana project in Myanmar.

Pre-tax proceeds from asset sales, including those classified as discontinued operations, were \$51 million for the nine months period of 2001. The proceeds included a \$25 million payment associated with a participation agreement involving certain gasoline margins realized by the Company's former West Coast refining, marketing and transportation assets, which were sold in 1997, \$14 million from the sale of certain oil and gas properties and \$12 million from the sale of miscellaneous assets.

Edgar Filing: UNOCAL CORP - Form 10-Q

Capital expenditures for the nine months period of 2001 were \$1,257 million, compared with \$872 million in the same period a year ago. The higher capital expenditures in 2001 were primarily due to higher exploratory expenditures and property acquisitions in the Gulf of Mexico and Brazil and higher development expenditures in Indonesia. The capital expenditures amount for the nine months period of 2001 excluded Pure's acquisition of properties from International Paper Company for \$271 million, Pure's cash outlay of \$172 million for the acquisition of all the shares of Hallwood Energy Corporation and Northrock's cash outlay of \$93 million for the acquisition of all the shares of Tethys Energy Inc. (see note 3 to the consolidated financial statements in Item 1 of this report). Capital expenditures for the nine months period of 2000 excluded \$161 million related to the acquisition of the remaining shares of Northrock.

For the full year 2001, total capital expenditures, excluding major acquisitions, are currently expected to be approximately \$1.7 billion. Of this total, about 58 percent is expected to be spent in support of North American exploration and development (E&P) programs, including the Company's Gulf of Mexico deepwater drilling program, and about 35 percent is expected to be spent for International E&P projects, with the remainder of the capital for non-E&P and Corporate-related expenditures.

-32-

Cash on hand plus cash generated from operating activities and asset sales have been and are expected to remain sufficient to cover the Company's operating expenses, ongoing capital expenditure program (exclusive of major acquisitions), anticipated dividend payments and repayment of maturing debt during the remainder of 2001.

The Company's long-term debt, including the current portion, was \$2.86 billion at September 30, 2001, compared with \$2.51 billion at year-end 2000. This increase reflected the borrowings made by Pure to fund its acquisition of properties from International Paper Company and the purchase of Hallwood Energy Corporation.

The Company has substantial borrowing capacity to meet unanticipated cash requirements. At the end of October 2001, the Company replaced its \$1 billion bank credit agreement with two new revolving credit facilities totaling \$1 billion. One of these credit facilities is a \$400 million 364-day credit agreement and the other credit facility is a \$600 million 5-year credit agreement. The credit facilities provide for the termination of their loan commitments and require the prepayment of all outstanding borrowings in the event that (1) any person or group becomes the beneficial owner of more than 30 percent of the then outstanding voting stock of Unocal other than in a transaction having the approval of the Company's board of directors, at least a majority of which are continuing directors, or (2) if continuing directors shall cease to constitute at least a majority of the board.

ENVIRONMENTAL MATTERS

At September 30, 2001, the Company's reserves for environmental remediation obligations totaled \$236 million, of which \$117 million was included in current liabilities. During the nine months period of 2001, cash payments of \$69 million were applied against the reserve and \$92 million in provisions were added to the reserve balance. The increase in the reserve provisions was primarily for the anticipated cleanup at former Company operated facilities, facilities sold with retained liabilities and closed Company facilities. The Company also estimated that it possibly could incur additional remediation costs aggregating approximately \$250 million (as discussed in note 12 to the consolidated financial statements in Item 1 of this report). The Company's total

Edgar Filing: UNOCAL CORP - Form 10-Q

environmental reserve amount is grouped into the following four categories.

Reserve Summary

| Millions of dollars | At September 30, 2001 |
|--|-----------------------------|
| Superfund and similar sites | \$ 16 |
| Active company facilities | 47 |
| Company facilities sold with retained liabilities and former company-operated sites | 73 |
| Inactive or closed company facilities | 100 |
| Total reserves | \$ 236 |

-33-

OUTLOOK

Certain of the statements in this discussion, as well as other forward-looking statements within this document, contain estimates and projections of amounts of or increases / decreases in future revenues, earnings, cash flows, capital expenditures, assets, liabilities and other financial items and of future levels of or increases / decreases in reserves, production, sales including related costs and prices, drilling activities and other statistical items; plans and objectives of management regarding the Company's future operations, products and services; and certain assumptions underlying such estimates, projection plans and objectives. While these forward-looking statements are made in good faith, future operating, market, competitive, legal, economic, political, environmental, and other conditions and events could cause actual results to differ materially from those in the forward-looking statements. See pages 47 through 49 of Management's Discussion and Analysis in Item 7 of the Company's 2000 Annual Report on Form 10-K for a discussion of certain of such conditions and events.

Volatile energy prices continue to impact financial results in the year 2001. The Company expects energy prices to remain volatile due to changes in climate conditions, worldwide demand, crude oil and natural gas inventory levels, production quotas set by OPEC, current and future worldwide political instability and security and other factors.

The Company expects adjusted (excluding special items) after-tax earnings to be between 25 and 35 cents per share for the fourth quarter of 2001, assuming average NYMEX benchmark commodity prices of \$22.25 per barrel of crude oil and \$2.55 per MMBtu for Lower 48 natural gas. The fourth quarter forecast is also dependent on the Company's drilling results and other factors. The Company expects net daily worldwide production for the fourth quarter of 2001 to average between 500,000 and 510,000 Barrels of Oil Equivalent (BOE).

The Discoverer Spirit drillship completed drilling of a delineation well on the discovery at the Mad Dog prospect on Green Canyon Block 826. The well was successful in proving the commerciality of the prospect, and the Company anticipates the development plan for Mad Dog to be approved by the end of this year or early next year. The Discoverer Spirit drillship is currently drilling the first appraisal well on the Trident prospect as a follow-up to the discovery made earlier this year. The Trident #2 well is located 1.25-miles northeast of the Trident discovery in 9,727 feet of water. The Company expects to complete the first appraisal well in about 60 to 75 days. The Company anticipates drilling a second Trident appraisal well in late 2002.

Edgar Filing: UNOCAL CORP - Form 10-Q

In August 2001, the Company signed a sublease agreement with a third party for the Discoverer Spirit drillship for a minimum period of 200 days. The third party will be responsible for making the lease payments directly to the lessor during the sublease period. The subleasing will give the Company the additional time necessary to incorporate its recent drilling activities into the overall evaluation of its deepwater portfolio. The Company anticipates the subleasing to commence in early 2002 after it has completed its drilling of the Trident #2 appraisal well.

In November 2001, the Company signed a memorandum of understanding with Forest Oil Corporation (Forest) to jointly explore and develop certain properties in the central Gulf of Mexico Shelf. Under the proposed transaction, the Company would acquire a portion of Forest's proved reserves and current production for \$120 million in cash. The Company would become the operator of the jointly owned properties. The two companies are currently negotiating the details of the transaction, which is expected to close by the end of 2001.

-34-

In the Cook Inlet of Alaska, the Company drilled four development oil wells from the King Salmon platform in the McArthur River field. One of the wells, the K-13, came on production in early July and is producing about 7,100 b/d. The Company expects to drill a follow-up to the K-13 well in late 2001. The Company holds a 56 percent working interest in this production zone in the McArthur River field.

The Company expects its Thailand operations to continue to perform strongly. In October 2001, the Company reached agreement with the Petroleum Authority of Thailand (PTT) to provide an incentive for it to take incremental natural gas quantities above contract production minimums from certain fields in the Gulf of Thailand over a 15-month period. The Company and its partners paid PTT \$15 million as an incentive for PTT to purchase 18 billion cubic feet of gas above the contract minimums between July 2001 and September 2002. At the end of the incentive period, if PTT fails to take any of the incremental volume, it shall refund to the Company and its partners the advance incentive amount paid on a pro-rata basis for any purchase volume short of the agreed incremental volume. The current contract pricing mechanism will continue for all quantities of gas taken under the contracts.

The Company also continues to develop its first oil fields in the Gulf of Thailand. The Company began crude oil production in July from its Plamuk field and is working on the development of the neighboring Yala field. The two fields are expected to produce a combined 15,000 b/d by early next year. The Company has a 71.25 percent working interest in these fields.

In Myanmar, average daily gas production is expected to exceed the daily contract quantity of 525 mmcf/d for the rest of 2001. The Company does not expect PTT to incur a "take-or-pay" obligation in 2001.

In September 2001, the Company announced that its Unocal Rapak, Ltd., subsidiary had drilled two successful exploration appraisal wells on the Ranggas prospect in the southern portion of the Rapak Production-Sharing Contract (PSC) area, offshore East Kalimantan, Indonesia. These two wells were a follow-up to the initial discovery well. Unocal Rapak, Ltd. is operator of the Rapak PSC area and holds an 80-percent working interest. The Ranggas-2 well was drilled to a total depth of 13,661 feet in 5,192 feet of water. The well encountered 155 feet of net oil pay and 118 feet of net gas pay. The well is located in the southern portion of the Ranggas structure, nearly a mile southwest of the discovery well. The Ranggas-3 well was drilled to a total depth of 13,248 feet in 5,368 feet of water. The well encountered 306 feet of net oil pay and 123 feet of net gas pay.

Edgar Filing: UNOCAL CORP - Form 10-Q

The well is located 3.4 miles north of the discovery well in the central portion of the Ranggas structure.

In the next phase of drilling, Unocal Rapak, Ltd. expects to drill four to eight wells beginning late in 2001 or early 2002 to further delineate the Ranggas discovery and test at least two adjacent prospects. The Company expects to determine commerciality and the size of production facilities by the end of this second drilling phase.

In the third quarter of 2001 the Azerbaijan International Operating Company (AIOC) consortium approved development of the "Phase 1" portion of offshore oil reserves in the Caspian Sea. This phase of the project will develop 1.5 billion barrels of crude oil reserves. Phase 1 production is scheduled to commence in early 2005 and is expected to peak at approximately 360,000 b/d. The company holds an approximate 10 percent working interest in AIOC.

In Gabon, the Company is participating in a multi-well program. The first two wells were drilled on the Astrid Block, the Renee #1 and the Judy #1 prospects, and did not encounter commercial quantities of hydrocarbons. The Company anticipates the drilling of two more wells starting in late 2001.

-35-

As of September 30, 2001, the Company had a gross receivable balance of approximately \$375 million related to its geothermal operations in Indonesia. Approximately \$156 million was related to Gunung Salak electric generating Units 1, 2, and 3, of which \$154 million represented past due amounts and accrued interest resulting from partial payments for March 1998 through September 2001. Although invoices generally have not been paid in full, amounts that have been paid have been received in a timely manner in accordance with the steam sales contract. The remaining \$219 million primarily relates to Salak electric generating Units 4, 5 and 6. Provisions covering a portion of these receivables have been recorded. The Company continues to pursue collection of the outstanding receivables.

The Company has entered into eight licensing agreements that grant motor gasoline refiners, blenders and importers (including CITGO Petroleum Corporation, Tesoro Petroleum Corporation and units of The Williams Companies, Inc.) the right to make cleaner-burning gasolines using formulations patented by the Company. The terms of the licensing agreements are confidential. The Company continues to negotiate with other refiners, blenders and importers on licensing agreements for the Company's cleaner-burning gasoline patents.

In February and March 2001, petitions were filed with the U.S. Patent and Trademark Office (PTO) by Washington, D.C., law firms, acting on behalf of unnamed parties, requesting reexamination of two of the Company's patents (the `126 and `393 patents, respectively). In May, the PTO denied the request for reexamination of the `126 patent and granted the petition to reexamine the `393 patent.

The Company anticipates that the PTO will initially reject all or some of the claims of the `393 patent, as such rejections occur in the overwhelming majority of cases where reexamination is granted. Subsequently, the Company will be able to present information and arguments in support of the validity of its patent claims. The reexamination process is expected to take several months, but the Company believes the `393 patent claims are valid and non-obvious and expects the patent to be sustained by the PTO.

In March 2001, ExxonMobil Corporation requested the U.S. Federal Trade Commission (FTC) to conduct an investigation into certain alleged unfair

Edgar Filing: UNOCAL CORP - Form 10-Q

competition practices allegedly engaged in by the Company in connection with its patents. ExxonMobil alleges that the Company engaged in anticompetitive conduct in the regulatory processes that established California and federal standards for reformulated gasolines (RFG) and thus gained "monopoly profits" in the RFG market. ExxonMobil requests that the FTC use its authority to fashion an appropriate remedy. In August 2001, the Company received notice that the FTC is conducting an investigation in conjunction with this matter. The Company has been cooperating with the FTC in its inquiry.

In October 2001, the Company was informed that the U.S. District Court in Los Angeles granted the Company's motion for summary judgement requesting an accounting of infringement of the `393 patent from August 1996 through December 2000 by the five defendants. The Company had requested that the court apply the 5.75 cents per gallon awarded in the original 1997 trial to the defendants' infringing volumes produced since August 1996. The court did not make findings of the specific amount owed to the Company in its order. The court also denied the defendants' motions that these damage proceedings be stayed pending the outcome of the `393 patent reexamination or, alternatively, that the defendants be granted a new trial as to damages. The Company is awaiting a definitive order.

-36-

Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," SFAS No. 142 "Goodwill and Other Intangible Assets," and SFAS No. 143 "Accounting for Asset Retirement Obligations". SFAS No. 141 eliminates the pooling method of accounting for a business combination, except for qualifying business combinations that were initiated prior to July 1, 2001, and requires that all combinations be accounted for using the purchase method. SFAS No. 142, which is effective for fiscal years beginning after December 15, 2001, addresses accounting for identifiable intangible assets, eliminates the amortization of goodwill and provides specific steps for testing the impairment of goodwill. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. SFAS No. 143, which is effective for fiscal years beginning after June 15, 2002, requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred as a capitalized cost of the long-lived asset and to depreciate it over its useful life. The Company is currently in the process of evaluating the impact that SFAS No. 142 and 143 will have on its financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121 and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The Company is currently in the process of evaluating the impact that SFAS No. 144 will have on its financial position and results of operations.

-37-

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk generally represents the risk that losses may occur in the values of financial instruments as a result of movements in interest rates, foreign

Edgar Filing: UNOCAL CORP - Form 10-Q

currency exchange rates and commodity prices. As part of its overall risk management strategies, the Company uses derivative financial instruments to manage and reduce risks associated with these factors. The Company also pursues outright pricing positions in certain hydrocarbon derivative instruments, such as futures contracts.

Interest Rate Risk - From time to time the Company temporarily invests its excess cash in interest-bearing securities issued by high-quality issuers. Company policies limit the amount of investment in securities of any one financial institution. Due to the short time the investments are outstanding and their general liquidity, these instruments are classified as cash equivalents in the consolidated balance sheet and do not represent a material interest rate risk to the Company. The Company's primary market risk exposure for changes in interest rates relates to the Company's long-term debt obligations. The Company manages its exposure to changing interest rates principally through the use of a combination of fixed and floating rate debt. Interest rate risk sensitive derivative financial instruments, such as swaps or options may also be used depending upon market conditions.

The Company evaluated the potential effect that near term changes in interest rates would have had on the fair value of its interest rate risk sensitive financial instruments at September 30, 2001. Assuming a ten percent decrease in the Company's weighted average borrowing costs at September 30, 2001, the potential increase in the fair value of the Company's debt obligations and associated interest rate derivative instruments, including the Company's net interests in the debt obligations and associated interest rate derivative instruments of its subsidiaries, would have been approximately \$111 million at September 30, 2001.

Foreign Exchange Rate Risk - The Company conducts business in various parts of the world and in various foreign currencies. To limit the Company's foreign currency exchange rate risk related to operating income, foreign sales agreements generally contain price provisions designed to insulate the Company's sales revenues against adverse foreign currency exchange rates. In most countries, energy products are valued and sold in U.S. dollars and foreign currency operating cost exposures have not been significant. In other countries, the Company is paid for product deliveries in local currencies but at prices indexed to the U.S. dollar. These funds, less amounts retained for operating costs, are converted to U.S. dollars as soon as practicable. The Company's Canadian subsidiaries are paid in Canadian dollars for their crude oil and natural gas sales.

From time to time the Company may purchase foreign currency options or enter into foreign currency swap or foreign currency forward contracts to limit the exposure related to its foreign currency debt or other obligations. At September 30, 2001, the Company had various foreign currency swaps and foreign currency forward contracts outstanding to hedge its debt and other local currency obligations in Canada, Thailand and The Netherlands. The Company evaluated the effect that near term changes in foreign exchange rates would have had on the fair value of the Company's combined foreign currency position related to its outstanding foreign currency swaps and forward contracts. Assuming an adverse change of ten percent in foreign exchange rates at September 30, 2001, the potential decrease in fair value of the Company's foreign currency forward contracts, foreign-currency denominated debt, foreign currency swaps and foreign currency forward contracts of its subsidiaries, would have been approximately \$7 million at September 30, 2001.

Edgar Filing: UNOCAL CORP - Form 10-Q

Commodity Price Risk - The Company is a producer, purchaser, marketer and trader of certain hydrocarbon commodities such as crude oil and condensate, natural gas and refined products and is subject to the associated price risks. The Company uses hydrocarbon price-sensitive derivative instruments (hydrocarbon derivatives), such as futures contracts, swaps and options to mitigate its overall exposure to fluctuations in hydrocarbon commodity prices. The Company may also enter into hydrocarbon derivatives to hedge contractual delivery commitments and future crude oil and natural gas production against price exposure. The Company also actively trades hydrocarbon derivatives, primarily exchange regulated futures and options contracts, subject to internal policy limitations.

The Company uses a variance-covariance value at risk model to assess the market risk of its hydrocarbon derivatives. Value at risk represents the potential loss in fair value the Company would experience on its hydrocarbon derivatives, using calculated volatilities and correlations over a specified time period with a given confidence level. The Company's risk model is based upon historical data and uses a three-day time interval with a 97.5-percent confidence level. The model includes offsetting physical positions for hydrocarbon derivatives related to the Company's fixed price pre-paid crude oil and pre-paid natural gas sales. The model also includes the Company's net interests in its subsidiaries' crude oil and natural gas hydrocarbon derivatives and forward sales contracts. Based upon the Company's risk model, the value at risk related to hydrocarbon derivatives held for purposes other than trading was approximately \$8 million at September 30, 2001. The value at risk related to hydrocarbon derivatives held for trading purposes was approximately \$5 million at September 30, 2001.

-39-

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

There is incorporated by reference: the information with respect to certain legal proceedings pending or threatened against the Company previously reported in Item 3 of Unocal's Annual Report on Form 10-K for the year ended December 31, 2000 (2000 Form 10-K), and in Item 1 of Part II of Unocal's Quarterly Reports on Form 10-Q for the quarters ended March 31 (First Quarter 2001 Form 10-Q), and June 30, 2001; the information regarding environmental remediation reserves in note 11 to the consolidated financial statements in Item 1 of Part I of this report; the discussion of such reserves in the Environmental Matters section of Management's Discussion and Analysis in Item 2 of Part I; and the information regarding certain legal proceedings and other contingent liabilities in note 12 to the consolidated financial statements. Information with respect to recent developments in certain of such proceedings is set forth below:

1. In September 2001, the California Superior Court denied the Company's demurrers which sought to have the court dismiss the complaints in the matters pending in that court captioned John Roe III, et al. v. Unocal Corp., et al. and John Doe I, et al. v. Unocal Corp., et al., which were described in Paragraph 4 of Item 3 of the 2000 Form 10-K. Subsequently, the Company filed its answers denying the allegations in the complaints.

The plaintiffs' appeals from the dismissals of their prior lawsuits in the U.S. District Court for the Central District of California are scheduled to be heard by the U.S. Court of Appeals for the Ninth Circuit in December 2001.

Edgar Filing: UNOCAL CORP - Form 10-Q

Certain Environmental Matters Involving Civil Penalties

2. In October 2001, the Company reached an agreement with the U.S. Department of Justice and the U.S. Environmental Protection Agency to settle the action in the U.S. District Court for the Central District of California that alleged violations of the federal Clean Air Act at the Company's former Los Angeles refinery marine terminal, which action was described in Paragraph 10 of Item 3 of the 2000 Form 10-K and in Paragraph 1 of Item I of Part II of the First Quarter 2001 Form 10-Q. The settlement provides for the payment by the Company of civil penalties aggregating \$1,750,000, for which the Company had previously established a reserve.

ITEM 5. OTHER INFORMATION.

On October 31, 2001, the Company's board of directors elected Charles R. Williamson as chairman of the board effective on that date. Mr. Williamson will also continue as the Company's chief executive officer. Mr. Williamson succeeded John W. Creighton, Jr., who resigned as a non-executive chairman but will continue as a director of the Company.

-40-

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

- (a) Exhibits: The Exhibit Index on page 43 of this report lists the exhibits that are filed as part of this report.

- (b) Reports on Form 8-K:

Filed during the third quarter of 2001:

- (1) Current Report on Form 8-K, dated August 22, 2001, and filed September 6, 2001, for the purpose of reporting, under Item 5, the Company's drilling results in Gulf of Mexico and Indonesia and the Company's forecasts for production and reserves.

Filed during the fourth quarter of 2001 to the date hereof:

- (1) Current Report on Form 8-K, dated October 24, 2001, and filed October 30, 2001, for the purpose of reporting, under Item 5, the Company's third quarter and nine months 2001 results and the Company's earnings forecast for the fourth quarter of 2001.

-41-

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the

Edgar Filing: UNOCAL CORP - Form 10-Q

registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNOCAL CORPORATION
(Registrant)

Dated: November 14, 2001

By: /s/JOE D. CECIL

Joe D. Cecil
Vice President and Comptroller
(Duly Authorized Officer
Principal Accounting Officer)

-42-

EXHIBIT INDEX

- 3 Bylaws of Unocal, as amended through October 31, 2001 and currently in effect.
- 10.1 Amendment to the Revised Incentive Compensation Plan, effective December 5, 2000.
- 10.2 Form of Nonqualified Stock Option Grant under the Long-Term Incentive Plan of 1998, effective August 20, 2001 (subject to stockholders approval), between Unocal and Terry G. Dallas as to 240,000 shares of Unocal Common Stock with an exercise price of \$36.22.
- 12.1 Statement regarding computation of ratio of earnings to fixed charges of Unocal Corporation for the nine months ended September 30, 2001 and 2000.
- 12.2 Statement regarding computation of ratio of earnings to fixed charges of Union Oil Company of California for the nine months ended September 30, 2001 and 2000.
- 99 Summary of change-of-control provisions in certain stock-based compensation plans.

Copies of exhibits will be furnished upon request. Requests should be addressed to the Corporate Secretary.

-43-