

Edgar Filing: UNOCAL CORP - Form 10-Q

UNOCAL CORP
Form 10-Q
August 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 June 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
(State or other jurisdiction of incorporation or organization)

95-3825062
(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 July 31, 2001:
243,583,207

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	23
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	24
Item 3 Quantative and Qualitative Disclosures about Market Risk.....	35
PART II	
Item 1 Legal Proceedings.....	37
Item 4 Submission of Matters to a Vote of Security Holders.....	37
Item 6 Exhibits and Reports on Form 8-K.....	38
SIGNATURES.....	39
EXHIBIT INDEX.....	40

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED EARNINGS
(UNAUDITED)

	For the Three Months Ended June 30,	
	2001	2000
Millions of dollars except per share amounts		

Revenues		
Sales and operating revenues	\$ 1,684	\$ 2,025
Interest, dividends and miscellaneous income	11	126
Gain on sales of assets	1	65

Total revenues	1,696	2,216
Costs and other deductions		
Crude oil, natural gas and product purchases	537	1,144
Operating expense	329	288
Selling, administrative and general expense	27	37
Depreciation, depletion and amortization	268	224
Dry hole costs	47	37
Exploration expense	32	37

Edgar Filing: UNOCAL CORP - Form 10-Q

Interest expense	48	53
Property and other operating taxes	20	17
Distributions on convertible preferred securities of subsidiary trust	8	8
<hr/>		
Total costs and other deductions	1,316	1,845
<hr/>		
Earnings from equity investments	49	32
<hr/>		
Earnings from continuing operations before income taxes and minority interests	429	403
<hr/>		
Income taxes	180	159
Minority interests	14	(6)
<hr/>		
Earnings from continuing operations	235	250
Discontinued operations		
Gain on disposal (net of tax)	12	14
<hr/>		
Earnings from discontinued operations	12	14
Cumulative effect of accounting change (net of tax)	-	-
<hr/>		
Net earnings	\$ 247	\$ 264
<hr/>		
Basic earnings per share of common stock (a)		
Continuing operations	\$ 0.98	\$ 1.03
Discontinued operations	0.04	0.05
<hr/>		
Net earnings	\$ 1.02	\$ 1.08
<hr/>		
Diluted earnings per share of common stock (b)		
Continuing operations	\$ 0.95	\$ 1.00
Discontinued operations	0.04	0.05
<hr/>		
Net earnings	\$ 0.99	\$ 1.05
<hr/>		
Cash dividends declared per share of common stock	\$ 0.20	\$ 0.20
<hr/>		

See Notes to Consolidated Financial Statements.

-1-

CONSOLIDATED BALANCE SHEET

	June 30,
Millions of dollars	2001 (a)
<hr/>	
Assets	
Current assets	
Cash and cash equivalents	\$ 540
Accounts and notes receivable	998
Inventories	76
Deferred income taxes	177
Other current assets	21
<hr/>	
Total current assets	1,812
Investments and long-term receivables	1,444
Properties - net (b)	7,179

Edgar Filing: UNOCAL CORP - Form 10-Q

Deferred income taxes	116
Other assets	167

Total assets	\$ 10,718
=====	
Liabilities and Stockholders' Equity	
Current liabilities	
Accounts payable	\$ 796
Taxes payable	236
Interest payable	55
Current portion of environmental liabilities	144
Current portion of long-term debt and capital leases	189
Other current liabilities	250

Total current liabilities	1,670
Long-term debt and capital leases	2,770
Deferred income taxes	611
Accrued abandonment, restoration and environmental liabilities	563
Other deferred credits and liabilities	994
Minority interests	433
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	538
Unearned portion of restricted stock issued	(22)
Retained earnings	2,913
Accumulated other comprehensive income (loss)	(76)
Notes receivable - key employees	(41)
Treasury stock - at cost (d)	(411)

Total stockholders' equity	3,155

Total liabilities and stockholders' equity	\$ 10,718
=====	

See Notes to the Consolidated Financial Statements.

-2-

CONSOLIDATED CASH FLOWS
(UNAUDITED)

Millions of dollars

Cash Flows from Operating Activities	
Net earnings	\$
Adjustments to reconcile net earnings to net cash provided by operating activities	
Depreciation, depletion and amortization	
Dry hole costs	
Deferred income taxes	
Gain on sales of assets (pre-tax)	
Gain on disposal of discontinued operations (pre-tax)	

Edgar Filing: UNOCAL CORP - Form 10-Q

Earnings applicable to minority interests	
Other	
Working capital and other changes related to operations	
Accounts and notes receivable	
Inventories	
Accounts payable	(
Taxes payable	
Other	
<hr style="border-top: 1px dashed black;"/>	
Net cash provided by operating activities	1,
<hr style="border-top: 1px dashed black;"/>	
Cash Flows from Investing Activities	
Capital expenditures (includes dry hole costs)	(
Major acquisitions	(
Proceeds from sales of assets	
Proceeds from sale of discontinued operations	
<hr style="border-top: 1px dashed black;"/>	
Net cash used in investing activities	(1,
<hr style="border-top: 1px dashed black;"/>	
Cash Flows from Financing Activities	
Long-term borrowings	
Reduction of long-term debt and capital lease obligations	(
Minority interests	
Proceeds from issuance of common stock	
Dividends paid on common stock	
Loans to key employees	
Other	
<hr style="border-top: 1px dashed black;"/>	
Net cash provided by (used in) financing activities	
<hr style="border-top: 1px dashed black;"/>	
Increase (decrease) in cash and cash equivalents	
<hr style="border-top: 1px dashed black;"/>	
Cash and cash equivalents at beginning of year	
<hr style="border-top: 1px dashed black;"/>	
Cash and cash equivalents at end of period	\$
<hr style="border-top: 3px double black;"/>	

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.

Edgar Filing: UNOCAL CORP - Form 10-Q

For the purpose of this report, Unocal Corporation (Unocal) and its consolidated 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 six months ended June 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.

(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 loss in its consolidated balance sheet, of which \$28 million is expected to be reclassified to earnings during the current year. 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.

-4-

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 and natural gas prices.

Edgar Filing: UNOCAL CORP - Form 10-Q

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 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 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 inceptions 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 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

Edgar Filing: UNOCAL CORP - Form 10-Q

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.

-5-

(3) Major Acquisitions

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 11), and other obligations. The acquisition was accounted for as a purchase and was funded through the combination of a new line of credit and borrowings under Pure's existing revolving credit facilities. This acquisition added to Pure's positions in its business areas of the San Juan and Permian Basins and the Gulf Coast region.

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 \$267 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 11). This acquisition expanded Pure's business areas into the Gulf Coast region and offshore in the Gulf of Mexico.

(4) Restructuring Costs

Activities related to the restructuring plan adopted in the first quarter of 2000 are completed. The amount of unpaid benefits remaining on the consolidated balance sheet at June 30, 2001 is immaterial and is scheduled to be paid over the next few months.

(5) Other Financial Information

During the second quarters of 2001 and 2000, approximately 25 percent and 53 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 six months ended June 30, 2001 and 2000, these percentages were approximately 32 percent and 53 percent, respectively. Related purchase costs are classified as expense in the crude oil, natural gas and product purchases category on the consolidated earnings statement. The lower resale activity in both the second quarter and six months periods of 2001 as compared to the same periods a year ago reflect decreases primarily related to the marketing and trading of crude oil and condensate.

Capitalized interest totaled \$6 million and \$3 million for the second quarters of 2001 and 2000, respectively, and \$11 million and \$5 million for the six months ended 2001 and 2000, respectively.

(6) Income Taxes

Edgar Filing: UNOCAL CORP - Form 10-Q

Income taxes on earnings from continuing operations for the second quarter and first six months of 2001 were \$180 million and \$370 million, respectively, compared with \$159 million and \$242 million for the comparable periods of 2000. The effective income tax rates for the second quarter and first six months of 2001 were 43 percent and 41 percent, respectively, compared with 39 percent and 39 percent for the comparable periods of 2000. The higher income tax rates in 2001 reflected the effects of changes in the mix of foreign versus domestic earnings, currency-related adjustments in Thailand and adjustments related to prior year U.S. income tax matters.

-6-

(7) 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 reflect the Company's former agricultural products business, which was sold later in that year.

(8) Earnings Per Share

The following are reconciliations of the numerators and denominators of the basic and diluted earnings per share (EPS) computations for earnings from continuing operations for the second quarters and the six months ended June 30, 2001 and 2000:

Millions except per share amounts	Earnings (Numerator)	S (Denominator)
<hr style="border-top: 1px dashed black;"/>		
Three months ended June 30, 2001		
Earnings from continuing operations	\$ 235	
Basic EPS		
Effect of dilutive securities		
Options and common stock equivalents		
	<hr style="border-top: 1px dashed black;"/>	
	235	
Distributions on subsidiary trust preferred securities (after-tax)	7	
	<hr style="border-top: 1px dashed black;"/>	
Diluted EPS	\$ 242	
Three months ended June 30, 2000		
Earnings from continuing operations	\$ 250	
Basic EPS		
Effect of dilutive securities		
Options and common stock equivalents		
	<hr style="border-top: 1px dashed black;"/>	
	250	
Distributions on subsidiary trust preferred securities (after-tax)	7	
	<hr style="border-top: 1px dashed black;"/>	
Diluted EPS	\$ 257	
Six months ended June 30, 2001		

Edgar Filing: UNOCAL CORP - Form 10-Q

Earnings from continuing operations	\$ 527
Basic EPS	
Effect of dilutive securities	
Options and common stock equivalents	

	527
Distributions on subsidiary trust preferred securities (after-tax)	13

Diluted EPS	\$ 540
Six months ended June 30, 2000	
Earnings from continuing operations	\$ 374
Basic EPS	
Effect of dilutive securities	
Options and common stock equivalents	

	374
Distributions on subsidiary trust preferred securities (after-tax)	13

Diluted EPS	\$ 387

-7-

Not included in the computation of diluted EPS at June 30, 2001, were options to purchase approximately 5.0 million shares 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 exercise prices of these options ranged from \$36.16 to \$45.25 per share. These options will expire periodically through 2011. The diluted EPS computation at June 30, 2000 did not include options outstanding to purchase approximately 7.3 million shares of common stock because their exercise prices were greater than the year-to-date average market price of \$31.58 for the common shares. The exercise prices of these options ranged from \$32.16 to \$51.01 per share.

(9) Comprehensive Income

The Company's comprehensive income was:

Millions of dollars	For the Three Months		For
	Ended June 30,		
	2001	2000	
Net earnings	\$247	\$264	
Cumulative effect of change in accounting principle			
SFAS 133 adoption (a)	-	-	
Change in unrealized loss on hedging instruments (b)	41	-	
Reclassification adjustment for settled hedging contracts (c)	2	-	
Change in foreign currency translation adjustments	15	(8)	
	-----	-----	
Comprehensive income	\$305	\$256	
	=====	=====	

Edgar Filing: UNOCAL CORP - Form 10-Q

(10) Restricted Cash

Of the total amounts of Cash and Cash Equivalents reported at June 30, 2001, cash in the amount of \$28 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, \$4 million at June 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 June 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 owner's portion of crude oil produced from certain federal 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 during the second half of 2001.

(11) Long Term Debt and Credit Agreements

During the first six months of 2001, the Company's consolidated debt, including the current portion, increased by \$453 million. This was substantially due to an increase of \$467 million in long term debt 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 holders of the senior notes hold registration rights which require Pure to register the notes by the end 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).

-8-

The remainder of the increase in Pure's debt consisted of borrowings under two separate \$250 million unsecured credit facilities. At June 30, 2001, \$168 million was outstanding under the five year revolving credit facility due September 29, 2005. In addition, \$20 million was outstanding under the 364 day revolving credit facility, which converts in September 2001 to a term loan due September 29, 2002.

(12) Accrued Abandonment, Restoration and Environmental Liabilities

At June 30, 2001, the Company had accrued \$475 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 June 30, 2001 totaled \$232 million, of which \$144 million was included in current liabilities.

(13) Commitments and Contingencies

The Company has certain contingent liabilities with respect to material existing or potential claims, lawsuits and other proceedings, including those involving

Edgar Filing: UNOCAL CORP - Form 10-Q

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.

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 12, at June 30, 2001, the Company had accrued \$232 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 \$230 million.

-9-

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

Edgar Filing: UNOCAL CORP - Form 10-Q

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 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, times 110 percent, less funded debt, as defined. At June 30, 2001, Pure estimated that the amount which it would have to repurchase under these agreements was approximately \$144 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.

Other matters - The Company has a five-year lease agreement relating to its Discoverer Spirit deepwater drill ship. The future remaining minimum lease payment obligation was approximately \$323 million at June 30, 2001. The drillship has a minimum daily rate of approximately \$210,000.

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 amount 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.

-10-

Edgar Filing: UNOCAL CORP - Form 10-Q

Fair values of debt and other long-term instruments - The estimated fair value of the Company's long-term debt at June 30, 2001, including the current portion, was approximately \$3.060 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 \$505 million at June 30, 2001. The fair value was based on the trading prices of the preferred securities on June 29, 2001, as reported to the Company.

Commodity hedging activities - During the second quarter of 2001, the Company recognized \$5 million in after-tax losses for the ineffectiveness of both cash flow and fair value hedges. At June 30, 2001, the Company's various subsidiaries had approximately \$10 million after-tax deferred in accumulated other comprehensive income related to cash flow hedges for future commodity sales for the period beginning July 2001 through October 2004. Of this amount, approximately \$7 million in after-tax gains are expected to be reclassified to earnings during the next twelve months.

-11-

(15) 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 June 30, 2001

Millions of dollars	Unocal (Parent)	Unocal Capital Trust	Union Oil (Parent)	Non- Guarantor Subsidiaries	E
<hr/>					
Revenues					
Sales and operating revenues	\$ -	\$ -	\$ 487	\$ 1,604	
Interest, dividends and miscellaneous income	-	9	4	8	
Gain on sales of assets	-	-	1	-	
<hr/>					
Total revenues	-	9	492	1,612	
Costs and other deductions					
Purchases, operating and other expenses	1	-	260	1,101	
Depreciation, depletion and amortization	-	-	103	165	
Dry hole costs	-	-	24	23	
Interest expense	9	1	40	8	
Distributions on convertible preferred securities	-	8	-	-	
<hr/>					
Total costs and other deductions	10	9	427	1,297	
<hr/>					
Equity in earnings of subsidiaries	252	-	202	-	
Earnings from equity investments	-	-	10	39	
<hr/>					

Edgar Filing: UNOCAL CORP - Form 10-Q

Earnings from continuing operations before income taxes and minority interests	242	-	277	354
Income taxes	(4)	-	37	147
Minority interests	-	-	-	5
Earnings from continuing operations	246	-	240	202
Earnings from discontinued operations	-	-	12	-
Cumulative effect of accounting change	-	-	-	-
Net earnings	\$ 246	\$ -	\$ 252	\$ 202

-12-

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

Millions of dollars	Unocal (Parent)	Unocal Capital Trust	Union Oil (Parent)	Non- Guarantor Subsidiaries	E
Revenues					
Sales and operating revenues	\$ -	\$ -	\$ 554	\$ 1,836	
Interest, dividends and miscellaneous income	-	9	129	(3)	
Gain on sales of assets	-	-	66	(1)	
Total revenues	-	9	749	1,832	
Costs and other deductions					
Purchases, operating and other expenses	-	-	409	1,479	
Depreciation, depletion and amortization	-	-	93	131	
Dry hole costs	-	-	7	30	
Interest expense	9	1	53	(1)	
Distributions on convertible preferred securities	-	8	-	-	
Total costs and other deductions	9	9	562	1,639	
Equity in earnings of subsidiaries	267	-	157	-	
Earnings from equity investments	-	-	9	20	
Earnings from continuing operations before income taxes and minority interests	258	-	353	213	
Income taxes	(3)	-	85	77	
Minority interests	-	-	1	(7)	
Earnings from continuing operations	261	-	267	143	
Earnings from discontinued operations	-	-	-	14	
Net earnings	\$ 261	\$ -	\$ 267	\$ 157	

-13-

CONDENSED CONSOLIDATED EARNINGS STATEMENT
For the six months ended June 30, 2001

Edgar Filing: UNOCAL CORP - Form 10-Q

Millions of dollars	Unocal (Parent)	Unocal Capital Trust	Union Oil (Parent)	Non- Guarantor Subsidiaries	E
Revenues					
Sales and operating revenues	\$ -	\$ -	\$ 1,180	\$ 3,686	
Interest, dividends and miscellaneous income	5	17	3	13	
Gain on sales of assets	-	-	1	-	
Total revenues	5	17	1,184	3,699	
Costs and other deductions					
Purchases, operating and other expenses	2	-	645	2,711	
Depreciation, depletion and amortization	-	-	199	314	
Dry hole costs	-	-	34	53	
Interest expense	17	1	85	13	
Distributions on convertible preferred securities	-	16	-	-	
Total costs and other deductions	19	17	963	3,091	
Equity in earnings of subsidiaries	551	-	413	-	
Earnings from equity investments	-	-	8	83	
Earnings from continuing operations before income taxes and minority interests	537	-	642	691	
Income taxes	(5)	-	106	269	
Minority interests	-	-	-	9	
Earnings from continuing operations	542	-	536	413	
Earnings from discontinued operations	-	-	16	-	
Cumulative effect of accounting change	-	-	(1)	-	
Net earnings	\$ 542	\$ -	\$ 551	\$ 413	

-14-

CONDENSED CONSOLIDATED EARNINGS STATEMENT
For the six months ended June 30, 2000

Millions of dollars	Unocal (Parent)	Unocal Capital Trust	Union Oil (Parent)	Non- Guarantor Subsidiaries	E
Revenues					
Sales and operating revenues	\$ -	\$ -	\$ 1,010	\$ 3,539	
Interest, dividends and miscellaneous income	10	17	126	9	
Gain on sales of assets	-	-	63	-	
Total revenues	10	17	1,199	3,548	
Costs and other deductions					
Purchases, operating and other expenses	1	-	722	2,881	
Depreciation, depletion and amortization	-	-	179	251	
Dry hole costs	-	-	13	38	
Interest expense	17	1	105	2	
Distributions on convertible preferred securities	-	16	-	-	
Total costs and other deductions	18	17	1,019	3,172	

Edgar Filing: UNOCAL CORP - Form 10-Q

Equity in earnings of subsidiaries	401	-	292	-
Earnings from equity investments	-	-	21	36

Earnings from continuing operations before income taxes and minority interests	393	-	493	412

Income taxes	(3)	-	92	153
Minority interests	-	-	-	(10)

Earnings from continuing operations	396	-	401	269
Earnings from discontinued operations	-	-	-	23

Net earnings	\$ 396	\$ -	\$ 401	\$ 292
=====				

-15-

CONDENSED CONSOLIDATED BALANCE SHEET
Period ended June 30, 2001

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

Assets					
Current assets					
Cash and cash equivalents	\$ -	\$ -	\$ 306	\$ 234	
Accounts and notes receivable	-	-	135	863	
Inventories	-	-	8	68	
Other current assets	-	-	156	42	

Total current assets	-	-	605	1,207	
Investments and long-term receivables	4,068	-	4,086	955	
Properties - net	-	-	2,083	5,096	
Other assets	54	541	391	1,649	

Total assets	\$4,122	\$ 541	\$ 7,165	\$ 8,907	
=====					
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	\$ -	\$ -	\$ 240	\$ 556	
Current portion of long-term debt and capital leases	-	-	180	9	
Other current liabilities	46	3	230	406	

Total current liabilities	46	3	650	971	
Long-term debt and capital leases	-	-	2,101	669	
Deferred income taxes	-	-	(13)	624	
Accrued abandonment, restoration and environmental liabilities	-	-	263	300	
Other deferred credits and liabilities	541	-	416	2,398	
Minority interests	-	-	-	294	

Company-obligated mandatorily redeemable convertible preferred securities of a subsidiary trust holding solely parent debentures	-	522	-	-	

Stockholders' equity	3,535	16	3,748	3,651	

Edgar Filing: UNOCAL CORP - Form 10-Q

Total liabilities and stockholders' equity	\$4,122	\$ 541	\$ 7,165	\$ 8,907
--------------------------------------------	---------	--------	----------	----------

-16-

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	

-17-

CONDENSED CONSOLIDATED CASH FLOWS
Period ended June 30, 2001

	Unocal	Unocal Capital	Union Oil	Non- Guarantor
--	--------	-------------------	-----------	-------------------

Edgar Filing: UNOCAL CORP - Form 10-Q

Millions of dollars	(Parent)	Trust	(Parent)	Subsidiaries	E
Cash Flows from Operating Activities	\$ 83	\$ -	\$ 572	\$ 589	
Cash Flows from Investing Activities					
Capital expenditures and acquisitions (includes dry hole costs)	-	-	(373)	(868)	
Proceeds from sales of assets and discontinued operations	-	-	28	2	
Net cash used in investing activities	-	-	(345)	(866)	
Cash Flows from Financing Activities					
Change in long-term debt and capital leases	-	-	(5)	371	
Dividends paid on common stock	(97)	-	-	-	
Minority interests	-	-	-	(10)	
Other	13	-	-	-	
Net cash provided by (used in) financing activities	(84)	-	(5)	361	
Increase (decrease) in cash and cash equivalents	(1)	-	222	84	
Cash and cash equivalents at beginning of year	1	-	84	150	
Cash and cash equivalents at end of year	\$ -	\$ -	\$ 306	\$ 234	

CONDENSED CONSOLIDATED CASH FLOWS
Period ended June 30, 2000

Millions of dollars	Unocal (Parent)	Unocal Capital Trust	Union Oil (Parent)	Non- Guarantor Subsidiaries	E
Cash Flows from Operating Activities	\$103	\$ -	\$ 161	\$ 504	
Cash Flows from Investing Activities					
Capital expenditures and acquisitions (includes dry hole costs)	-	-	(227)	(492)	
Proceeds from sales of assets and discontinued operations	25	-	68	(1)	
Net cash used in investing activities	25	-	(159)	(493)	
Cash Flows from Financing Activities					
Change in long-term debt and capital leases	-	-	(159)	(14)	
Dividends paid on common stock	(97)	-	-	-	
Minority interests	-	-	-	(14)	
Other	(31)	-	-	-	
Net cash provided by (used in) financing activities	(128)	-	(159)	(28)	
Increase (decrease) in cash and cash equivalents	-	-	(157)	(17)	
Cash and cash equivalents at beginning of year	1	-	162	169	
Cash and cash equivalents at end of year	\$ 1	\$ -	\$ 5	\$ 152	

Edgar Filing: UNOCAL CORP - Form 10-Q

-18-

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, Global 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 June 30, 2001
Millions of dollars

	Exploration & Production			
	Lower 48	Alaska	Canada	Far North America
Sales & operating revenues	\$ 167	\$ 63	\$ 97	\$ 2
Other income (loss) (a)	-	-	2	
Inter-segment revenues	406	-	-	
Total	573	63	99	3
Earnings from equity investments	8	-	-	
Earnings (loss) from continuing operations	142	13	14	1
Earnings from discontinued operations	-	-	-	
Cumulative effect of accounting change	-	-	-	
Net earnings (loss)	142	13	14	1
Assets (at June 30, 2001)	3,316	315	935	2,3

	Midstream	Geothermal & Power Operations	Admin & General	Corporate & Other Net Interest Expense	Other Environ & Litiga
Sales & operating revenues	\$ 39	\$ 45	\$ -	\$ -	\$
Other income (loss) (a)	1	4	-	7	
Inter-segment revenues	2	-	-	-	
Total	42	49	-	7	
Earnings from equity investments	19	-	-	-	
Earnings (loss) from continuing operations	18	2	(21)	(32)	(
Earnings from discontinued operations	-	-	-	-	

Edgar Filing: UNOCAL CORP - Form 10-Q

Cumulative effect of accounting change	-	-	-	-
Net earnings (loss)	18	2	(21)	(32)
Assets (at June 30, 2001)	440	608	-	-

-19-

Segment Information For the Three Months ended June 30, 2000 Millions of dollars	Exploration & Product North America			
	Lower 48	Alaska	Canada	Far
Sales & operating revenues	\$ 33	\$ 59	\$ 20	\$ 2
Other income (loss) (a)	67	-	(1)	
Inter-segment revenues	372	16	-	
Total	472	75	19	2
Earnings (loss) from equity investments	1	-	-	
Earnings (loss) from continuing operations	134	24	(11)	
Earnings from discontinued operations	-	-	-	
Net earnings (loss)	134	24	(11)	
Assets (at December 31, 2000)	2,701	315	1,019	2,2

	Midstream	Geothermal & Power Operations	Admin & General	Corporate & Other Net Interest Expense	& Other Environ & Litiga
Sales & operating revenues	\$ 13	\$ 44	\$ -	\$ -	\$
Other income (loss) (a)	-	(1)	-	8	
Inter-segment revenues	3	-	-	-	
Total	16	43	-	8	
Earnings (loss) from equity investments	17	(1)	-	-	
Earnings (loss) from continuing operations	15	5	(21)	(37)	
Earnings from discontinued operations	-	-	-	-	
Net earnings (loss)	15	5	(21)	(37)	

Edgar Filing: UNOCAL CORP - Form 10-Q

Assets (at December 31, 2000) 416 574 - -

-20-

Segment Information For the Six Months ended June 30, 2001 Millions of dollars	Exploration & Product			
	Lower 48	Alaska	Canada	Far
Sales & operating revenues	\$ 328	\$ 135	\$ 129	\$ 50
Other income (loss) (a)	1	-	1	(
Inter-segment revenues	972	-	-	11
Total	1,301	135	130	60
Earnings from equity investments	14	-	-	1
Earnings (loss) from continuing operations	383	32	11	21
Earnings from discontinued operations	-	-	-	-
Cumulative effect of accounting change	-	-	-	-
Net earnings (loss)	383	32	11	21
Assets (at June 30, 2001)	3,316	315	935	2,33

	Midstream	Geothermal & Power Operations	Admin & General	Corporate & Other Net Interest Expense	Environ & Litiga
Sales & operating revenues	\$ 139	\$ 89	\$ -	\$ -	\$
Other income (loss) (a)	2	7	-	13	
Inter-segment revenues	4	-	-	-	
Total	145	96	-	13	
Earnings from equity investments	28	-	-	-	
Earnings (loss) from continuing operations	27	3	(44)	(65)	(5)
Earnings from discontinued operations	-	-	-	-	
Cumulative effect of accounting change	-	-	-	-	
Net earnings (loss)	27	3	(44)	(65)	(5)
Assets (at June 30, 2001)	440	608	-	-	

Edgar Filing: UNOCAL CORP - Form 10-Q

-21-

Segment Information
For the Six Months
ended June 30, 2000
Millions of dollars

	Exploration & Product			
	Lower 48	Alaska	Canada	Far
Sales & operating revenues	\$ 57	\$ 120	\$ 64	\$ 45
Other income (loss) (a)	65	-	(1)	(1)
Inter-segment revenues	673	33	-	11
Total	795	153	63	56
Earnings (loss) from equity investments	3	-	-	-
Earnings (loss) from continuing operations	197	47	(8)	17
Earnings from discontinued operations	-	-	-	-
Net earnings (loss)	197	47	(8)	17
Assets (at December 31, 2000)	2,701	315	1,019	2,25

	Midstream	Geothermal & Power Operations	Admin & General	Corporate & Other Net Interest Expense	Environ & Litiga
Sales & operating revenues	\$ 26	\$ 83	\$ -	\$ -	\$ -
Other income (loss) (a)	1	2	-	14	-
Inter-segment revenues	6	-	-	-	-
Total	33	85	-	14	-
Earnings (loss) from equity investments	32	(1)	-	-	-
Earnings (loss) from continuing operations	31	14	(43)	(73)	(3)
Earnings from discontinued operations	-	-	-	-	-
Net earnings (loss)	31	14	(43)	(73)	(3)
Assets (at December 31, 2000)	416	574	-	-	-

OPERATING HIGHLIGHTS

Effective with the first quarter of 2001, the Company began reporting all

Edgar Filing: UNOCAL CORP - Form 10-Q

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 amounts in the table on the following page reflect these restatements:

-22-

OPERATING HIGHLIGHTS
(UNAUDITED)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2001	2000	2001	2000
North America Net Daily Production				
Crude oil, condensate and natural gas liquids (thousand barrels)				
Lower 48 (a)	59	52	57	57
Alaska	24	27	24	24
Canada (a)	15	17	15	15

Total crude oil, condensate and natural gas liquids	98	96	96	96
Natural gas - dry basis (million cubic feet)				
Lower 48 (a)	954	726	911	711
Alaska	93	135	115	141
Canada (a)	85	92	112	99

Total natural gas	1,132	953	1,138	951
North America Average Prices (b)				
Crude oil, condensate and natural gas liquids (per barrel)				
Lower 48	\$ 24.57	\$ 25.14	\$ 25.47	\$ 25.14
Alaska	\$ 22.27	\$ 23.79	\$ 22.55	\$ 23.27
Canada	\$ 20.84	\$ 21.48	\$ 20.65	\$ 20.00
Average	\$ 23.45	\$ 24.12	\$ 23.96	\$ 23.77
Natural gas (per mcf)				
Lower 48	\$ 4.62	\$ 3.41	\$ 5.69	\$ 2.91
Alaska	\$ 1.20	\$ 1.20	\$ 1.20	\$ 1.20
Canada	\$ 2.48	\$ 1.73	\$ 3.65	\$ 1.66
Average	\$ 4.16	\$ 2.91	\$ 5.01	\$ 2.57

International Net Daily Production				
Crude oil, condensate and natural gas liquids (thousand barrels)				
Far East	48	47	49	49
Other	19	18	19	19

Total crude oil, condensate and natural gas liquids	67	65	68	68
Natural gas - dry basis (million cubic feet)				
Far East	908	817	851	799
Other	69	57	63	57

Total natural gas	977	874	914	856
International Average Prices (b)				
Crude oil, condensate and natural gas liquids (per barrel)				
Far East	\$ 24.91	\$ 24.40	\$ 24.57	\$ 24.00

Edgar Filing: UNOCAL CORP - Form 10-Q

Other	\$ 27.51	\$ 26.38	\$ 26.36	\$ 26.1
Average	\$ 25.61	\$ 25.07	\$ 25.10	\$ 24.6
Natural gas (per mcf)				
Far East	\$ 2.54	\$ 2.31	\$ 2.51	\$ 2.3
Other	\$ 2.92	\$ 2.80	\$ 2.90	\$ 2.7
Average	\$ 2.56	\$ 2.35	\$ 2.54	\$ 2.3

Worldwide Net Daily Production (a)				
Crude oil, condensate and ngl's (thousand barrels)	165	161	164	163
Natural gas - dry basis (million cubic feet)	2,109	1,827	2,052	1,807
Barrels oil equivalent (thousands)	516	466	506	464
Worldwide Average Prices (b)				
Crude oil, condensate and ngl's (per barrel)	\$ 24.33	\$ 24.53	\$ 24.45	\$ 24.0
Natural gas (per mcf)	\$ 3.41	\$ 2.64	\$ 3.89	\$ 2.4

-23-

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 2001 Quarterly Report on Form 10-Q.

The Pipelines business segment 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. 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 16 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 June 30,		For the S Ended J
	2001	2000	2001
Earnings from continuing operations	\$ 235	\$ 250	\$ 527
Earnings from discontinued operations	12	14	16
Cumulative effect of accounting change	-	-	(1)
Net earnings	\$ 247	\$ 264	\$ 542

Earnings from continuing operations totaled \$235 million in the second quarter of 2001, which was a decrease of \$15 million from the same period a year ago. The second quarter 2001 results benefited from higher worldwide average natural gas prices and higher worldwide natural gas production compared to the same period in 2000. The Company's worldwide average natural gas price, including realized hedging activities, was \$3.41 per thousand cubic feet (mcf)

Edgar Filing: UNOCAL CORP - Form 10-Q

in the second quarter of 2001, which was an increase of 77 cents per mcf, or 29 percent, from the same period a year ago. The Company's worldwide natural gas production was 2,109 million cubic feet per day (mmcf/d) in the second quarter of 2001, which was an increase of 15 percent from the same period a year ago. The increase was primarily due to higher natural gas production from the U.S. Lower 48 and Far East. These positive results in the second quarter of 2001 were more than offset by special items that benefited the results of the second quarter of 2000. These items included a \$55 million after-tax gain related to payments received pursuant to a judgement in its reformulated gasoline patent infringement case, a \$42 million after-tax gain related to the formation of Pure Resources, Inc. (Pure), and a \$21 million after-tax insurance recovery related to environmental issues.

Sales and operating revenues were \$1,684 million for the second quarter of 2001, which was a decrease of \$341 million from the same period a year ago. This decrease was primarily due to lower marketing and trading activities of crude oil and condensate by the Company's Global Trade segment which more than offset the increase in revenues generated by the Exploration and Production segment.

Earnings from continuing operations totaled \$527 million for the first six months of 2001, which was an increase of \$153 million from the same period a year ago. This increase was primarily due to higher worldwide average natural gas prices and increased natural gas production. The Company's worldwide average natural gas price, including realized hedging activities, was \$3.89 per mcf for the first six months of 2001, which was an increase of \$1.44 per mcf, or 59 percent, from the same period a year ago. The Company's worldwide natural gas production increased by 14 percent from the same period a year ago, primarily due to higher natural gas production from the U.S. Lower 48 and Far East. These positive results were partially offset by higher dry hole costs and higher depreciation, depletion and amortization expense. The first six months of 2000 results included the second quarter special item benefits described above.

-24-

Earnings from discontinued operations were \$12 million and \$16 million in the second quarter and first six months periods of 2001, respectively, compared with \$14 million and \$23 million for the same periods a year ago. The Company recorded pre-tax gains of \$18 million and \$25 million in the second quarter and first six months periods of 2001, respectively, 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 second quarter and six months periods of 2000 results 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 change in accounting principle related to the initial adoption of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities".

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 six months periods ended June 30:

For the Three Months

For the S

Edgar Filing: UNOCAL CORP - Form 10-Q

Millions of dollars	Ended June 30,		Ended J
	2001	2000	2001
Adjusted after-tax earnings (a)	\$ 228	\$ 170	\$ 568
Special items:			
Continuing operations			
Gain on asset sales	-	42	-
Environmental and litigation provisions/settlements	(14)	(29)	(45)
Executive stock purchase program	-	(9)	-
Insurance benefits related to environmental issues	-	21	-
Trading derivatives- non-hedging (Northrock)	21	-	4
Reformulated gasoline patent case	-	55	-
Restructuring costs	-	-	-
Total special items from continuing operations	7	80	(41)
Discontinued operations			
Gain on disposal - Agricultural products	-	14	-
Gain on disposal - Refining and marketing	12	-	16
Total special items from discontinued operations	12	14	16
Cumulative effect of accounting change	-	-	(1)
Net earnings (a)	\$ 247	\$ 264	\$ 542
(a) Includes minority interests of:	\$ (14)	\$ 6	\$ (30)

-25-

EXPLORATION AND PRODUCTION

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 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 Global 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 June 30,		For the S Ended J
	2001	2000	2001
Adjusted after-tax earnings (loss) (before special items)			
Lower 48 (a)	\$ 142	\$ 92	\$ 383
Alaska	13	23	32

Edgar Filing: UNOCAL CORP - Form 10-Q

Canada (b)	(7)	(11)	7
Adjusted after-tax earnings (before special items) (a) (b)	148	104	422
Special items:			
Gain on asset sales (Lower 48)	-	42	-
Litigation provisions (Alaska)	-	1	-
Trading derivatives- non-hedging (Northrock)	21	-	4
Total special items	21	43	4
After-tax earnings (a) (b)	\$ 169	\$ 147	\$ 426
(a) Includes minority interests of:	\$ (15)	\$ (6)	\$ (32)
(b) Includes minority interests of:	\$ -	\$ 12	\$ -

After-tax earnings totaled \$169 million in the second quarter of 2001, which was an increase of \$22 million from the same period a year ago. This increase was primarily due to higher North America average natural gas prices and higher natural gas production. Average North America natural gas prices, including realized hedging activities, were \$4.16 per mcf in the second quarter of 2001, which was an increase of \$1.25 per mcf, or 43 percent, from the same period a year ago. North America average net daily natural gas production was 1,132 mmcf/d in the second quarter of 2001 compared to 953 mmcf/d in the same period a year ago, which was an increase of 19 percent, primarily behind strong results from the Lower 48. The increase in the Lower 48 was from the Company's production on Ship Shoal 295 Block (Muni field) in the Gulf of Mexico, which began production in the third quarter of 2000, as well as newly acquired properties in Mobile Bay and other Gulf of Mexico shelf areas and the production increases by Pure. These positive results were partially offset by higher depreciation, depletion and amortization expense and higher dry hole costs from the Gulf of Mexico deepwater drilling program. The second quarter 2001 results also benefited from gains related to non-hedging commodity derivative positions of Northrock in Canada versus losses in the same period a year ago. The second quarter 2000 results included a \$42 million after-tax gain related to the formation of Pure.

-26-

After-tax earnings totaled \$426 million for the first six months of 2001, which was an increase of \$190 million from the same period a year ago. This increase was primarily due to higher North America average natural gas prices and higher natural gas production. Average North America natural gas prices, including realized hedging activities, were \$5.01 per mcf in the first six months of 2001, which was an increase of \$2.46 per mcf, or 96 percent, from the same period a year ago. North America average net daily natural gas production was 1,138 mmcf/d for the first six months of 2001 compared to 958 mmcf/d in the same period a year ago, which was an increase of 19 percent, primarily behind the strong results from the Lower 48. The first six months of 2001 also benefited from 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 and higher dry hole costs from the Gulf of Mexico deepwater drilling program and Gulf of Mexico shelf. The first six months of 2000 results included the \$42 million after-tax gain related to the formation of Pure.

International - Unocal's International operations include 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

Edgar Filing: UNOCAL CORP - Form 10-Q

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 June 30,		For the S Ended J
	2001	2000	2001
Adjusted after-tax earnings (before special items)			
Far East	\$ 113	\$ 88	\$ 219
Other	5	19	27
Adjusted after-tax earnings (before special items)			
Special items:	-	-	-
After-tax earnings			
	\$ 118	\$ 107	\$ 246

After-tax earnings totaled \$118 million in the second quarter of 2001, which was an increase of \$11 million from the same period a year ago. The increase was primarily due to higher natural gas production volumes and higher natural gas prices. Natural gas production increased 12 percent in the second quarter of 2001 compared to the same period a year ago, primarily in the Far East, boosted by strong electricity demand in the Thailand market. The average net daily natural gas production in the Far East was 908 mmcf/d in the second quarter of 2001 compared to 817 mmcf/d for the same period a year ago, which was an increase of 11 percent. The average natural gas price for International operations was \$2.56 per mcf in the second quarter of 2001, which was an increase of 21 cents per mcf, or nine percent, from the same period a year ago. The second quarter of 2001 results also had lower dry hole costs compared to the same period a year ago. These positive results were partially offset by lower crude oil sales volumes due to timing of liftings and higher effective tax rates, primarily due to a change in the Thai baht/U.S. dollar exchange rate.

After-tax earnings totaled \$246 million for the first six months of 2001, which was an increase of \$59 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 \$2.54 per mcf for the first six months of 2001, which was an increase of 20 cents per mcf, or nine percent, from the same period a year ago. Natural gas production increased about eight percent for the first six months of 2001 compared to the same period a year ago, primarily in the Far East. The average net daily natural gas production in the Far East was 851 mmcf/d in the first six months of 2001 compared to 790 mmcf/d for the same period a year ago, which was an increase of eight percent.

-27-

GLOBAL TRADE

The Global 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. Global Trade 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

Edgar Filing: UNOCAL CORP - Form 10-Q

trading companies for resale. In addition, Global Trade takes pricing positions in hydrocarbon derivative instruments.

Millions of dollars	For the Three Months Ended June 30,		For the S Ended J
	2001	2000	2001
Adjusted after-tax earnings (before special items)	\$ 4	\$ 6	\$ 7
Special items:	-	-	-
After-tax earnings (loss)	\$ 4	\$ 6	\$ 7

After-tax results totaled \$4 million in the second quarter of 2001, which was a decrease of \$2 million from the same period a year ago. The decrease in the second quarter of 2001 was primarily due to lower results from non-hedging commodity derivative positions related to crude oil.

For the six months ended June 30, 2001, after-tax results totaled \$7 million, which was an increase of \$3 million from the same period a year ago. The increase was primarily due to higher results from non-hedging commodity derivative positions related to 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.

Millions of dollars	For the Three Months Ended June 30,		For the S Ended J
	2001	2000	2001
Adjusted after-tax earnings (before special items)	\$ 18	\$ 15	\$ 27
Special items:	-	-	-
After-tax earnings	\$ 18	\$ 15	\$ 27

After-tax earnings totaled \$18 million for the second quarter of 2001, which was an increase of \$3 million from the same period a year ago. The increase was primarily due to improved results from the Company's North America gas storage business.

For the six months ended June 30, 2001, after-tax earnings totaled \$27 million, which was a decrease of \$4 million from 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.

Edgar Filing: UNOCAL CORP - Form 10-Q

GEOHERMAL AND POWER OPERATIONS

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.

Millions of dollars	For the Three Months Ended June 30,		For the S Ended J
	2001	2000	2001
Adjusted after-tax earnings (before special items)	\$ 2	\$ 5	\$ 3
Special items:	-	-	-
After-tax earnings	\$ 2	\$ 5	\$ 3

After-tax earnings totaled \$2 million and \$3 million in the second quarter and first six months of 2001, respectively, which were decreases of \$3 million and \$11 million, respectively, from the same periods a year ago. The decreases were primarily due to higher receivable provisions related to operations in Indonesia.

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 June 30,		For the S Ended J
	2001	2000	2001
Adjusted after-tax earnings effect (before special items)			
Administrative and general expense	\$ (21)	\$ (21)	\$ (44)
Net interest expense (a)	(32)	(37)	(65)
Environmental and litigation expense	(2)	(3)	(5)
Other (a)	(7)	(6)	(23)
Adjusted after-tax earnings effect (before special items) (a)	(62)	(67)	(137)
Special items:			
Environmental and litigation provisions	(14)	(30)	(45)
Other			
Executive stock purchase program	-	(9)	-
Insurance benefits related to environmental issues	-	21	-
Reformulated gasoline patent case	-	55	-
Restructuring costs	-	-	-
Total special items	(14)	37	(45)
After-tax earnings effect (a)	\$ (76)	\$ (30)	\$ (182)

Edgar Filing: UNOCAL CORP - Form 10-Q

(a) Includes minority interests of: \$ 1 \$ - \$ 2

The after-tax earnings effect was a loss of \$76 million in the second quarter of 2001 compared to a loss of \$30 million in the same period a year ago. The second quarter 2000 results benefited from a \$55 million after-tax gain related to payments received pursuant to a judgement in the Company's reformulated gasoline patent infringement case and a \$21 million after-tax insurance recovery related to environmental issues. Environmental and litigation provisions in the second quarter of 2001 were lower than the second quarter of 2000. Net interest expense was also lower in the second quarter of 2001 from the same period a year ago primarily due to higher capitalized interest.

-29-

The after-tax earnings effect was a loss of \$182 million for the first six months of 2001 compared to a loss of \$98 million from the same period a year ago. The results of the six months period in 2000 benefited from the \$55 million after-tax gain related to payments received in the Company's reformulated gasoline patent infringement case and the \$21 million after-tax insurance recovery. Environmental and litigation provisions were higher in the first six months of 2001 compared to the same period a year ago, primarily due to higher estimated costs related to the cleanup of former Company operated sites and facilities sold with retained liabilities. Net interest expense was also lower for the first six months of 2001, compared to the same period a year ago primarily due to a lower balance on a limited-recourse loan and higher capitalized interest. The Company also made a \$10 million pre-tax cash contribution in 2001, included in the Other category, to fund a charitable foundation.

FINANCIAL CONDITION AND CAPITAL EXPENDITURES

	At June 30, 2001	At December 31, 2000
Millions of dollars	2001	2000
Current ratio	1.1:1	1.0:1
Total debt and capital leases	\$ 2,959	\$ 2,506
Trust convertible preferred securities	522	522
Stockholders' equity	3,155	2,719
 Total capitalization	 \$ 6,636	 \$ 5,747
Total debt/total capitalization	45%	44%
Floating-rate debt/total debt	6%	3%

For the first six months of 2001, net cash flow provided by operating activities was \$1,244 million compared with \$768 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. Cash flow generated by operating activities reflected a reduction of commodity prices during the first six months of the year, lower crude oil trading activity by the Company's Global Trade business segment and the collection, in June 2001, of \$73 million from the Petroleum Authority of Thailand in settlement of its

Edgar Filing: UNOCAL CORP - Form 10-Q

"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 \$30 million for the first six months of 2001. The proceeds included \$12 million from the sale of certain oil and gas properties, \$11 million from the sale of miscellaneous assets and a \$7 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.

Capital expenditures for the first six months of 2001 were \$824 million, compared with \$558 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. The capital expenditures amount for the first six months of 2001 excluded Pure's acquisition of properties from International Paper Company for \$267 million and Pure's cash outlay of \$150 million, as of June 30, 2001, for the acquisition of Hallwood Energy Corporation (see note 3 to the consolidated financial statements in Item 1 of this report). Capital expenditures for the first six months of 2000 excluded \$161 million related to the Northrock acquisition.

For the full year 2001, total capital expenditures, excluding major acquisitions, are currently expected to be approximately \$1.7 billion. Of this total, about 56 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 36 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.

-30-

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), scheduled dividend payments and repayment of maturing debt during the remainder of 2001.

The Company's long-term debt, including the current portion, was \$2.96 billion at June 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 (including \$1 billion of undrawn credit facilities available under its bank credit agreement) to meet unanticipated cash requirements.

ENVIRONMENTAL MATTERS

At June 30, 2001, the Company's reserves for environmental remediation obligations totaled \$232 million, of which \$144 million was included in current liabilities. During the first six months of 2001, cash payments of \$41 million were applied against the reserve and \$60 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 and facilities sold with retained liabilities. The Company also estimated that it possibly could incur additional remediation costs aggregating approximately \$230 million (as discussed in note 13 to the consolidated financial statements in Item 1 of this report). The Company's total environmental reserve amount is grouped into the

Edgar Filing: UNOCAL CORP - Form 10-Q

following four categories.

Reserve Summary

Millions of dollars	At June 30, 2001
-----	-----
Superfund and similar sites	\$ 14
Active company facilities	45
Company facilities sold with retained liabilities and former company-operated sites	83
Inactive or closed company facilities	90
-----	-----
Total reserves	\$ 232
=====	=====

-31-

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, 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 and other factors.

The Company expects adjusted (excluding special items) after-tax earnings to be between 50 and 60 cents per share for the third quarter of 2001, assuming average NYMEX benchmark commodity prices of \$25.70 per barrel of crude oil and \$3.00 per MMBtu for natural gas. The Company also expects adjusted after-tax earnings for the full year of 2001 to be between \$3.20 and \$3.40 per share, assuming average NYMEX benchmark commodity prices of \$27 per barrel of crude oil and \$4.50 per MMBtu for natural gas. The third quarter and full year forecasts are also dependent on the Company's deepwater drilling results and other factors. The Company expects net daily worldwide production for the third quarter of 2001 to average between 515,000 and 525,000 Barrels of Oil Equivalent (BOE). For full-year 2001, the Company expects net worldwide daily production of about 505,000 to 515,000 BOE.

The Company made a discovery on the Trident prospect, located on Alaminos Canyon Block 903 in the Gulf of Mexico, with the Discoverer Spirit drillship. The well was drilled in 9,687 feet of water to a total depth of 20,500 feet. The well encountered more than 300 feet of hydrocarbon-bearing pay section and additional zones of interest. The Company has a 59.5 percent working interest in the seven

Edgar Filing: UNOCAL CORP - Form 10-Q

block prospect. The Company is now engaged in the extended evaluation of the discovery and evaluating the location for the first appraisal well. The Discoverer Spirit drillship is now drilling a delineation well on the discovery at the Mad Dog prospect on Green Canyon Block 826.

In the Cook Inlet, Alaska, the Company drilled two 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 holds a 56 percent working interest in this production zone in the McArthur River field.

In July 2001, the Company's Northrock subsidiary successfully completed the acquisition of all the common shares of Tethys Energy, Inc., a Canadian exploration and production company. Each shareholder of Tethys received C\$4.25 (US\$2.76) for each share deposited. The cash consideration for the transaction was approximately C\$145 million (US\$95 million) in addition to C\$30 million (US\$20 million) in assumed debt.

-32-

The Company expects its Thailand operations to continue to perform strongly. Gas demand in the Kingdom of Thailand continues to rise due to increased power consumption and as it continues to convert its power plants from imported fuel oil to indigenous natural gas. The Company began producing crude oil from its Plamuk field, located in the Pattani Basin in the Gulf of Thailand, in late July 2001. Crude production from the neighboring Yala field will be added once the production application is approved by the Thai government. The Plamuk field is currently producing about 2,500 b/d to 3,000 b/d and the production from the two fields is expected to ramp up to 15,000 b/d to 18,000 b/d in the first quarter of 2002. 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 mscf/d for the rest of 2001.

The Company is involved in a multiple well delineation drilling program on the Ranggas prospect offshore East Kalimantan in Indonesia. The Ranggas discovery, announced in January 2001, is located in the Rapak Production Sharing Contract area in which the Company holds an 80 percent working interest.

In Brazil, deepwater drilling continues on the Lagosta prospect in Block BES-2, where the Company has a 30 percent working interest. The Company drilled two deepwater wells in its operated Block BC-9, where it has a 35 percent working interest. The Kitty Hawk and Eagle wells were drilled in the second quarter 2001 and did not encounter commercial quantities of hydrocarbons. The wells were subsequently plugged and abandoned. In addition, the Company completed its acquisition of an interest in the Pescada-Arabaiana oil and gas project in the Potiguar basin in May 2001 and the Company began recording its share of oil and gas production starting in the second quarter of 2001.

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 drilling two more wells late in 2001 or early 2002.

As of June 30, 2001, the Company had a gross receivable balance of approximately \$343 million related to its geothermal operations in Indonesia. Approximately \$141 million was related to Gunung Salak electric generating Units 1, 2, and 3, of which \$140 million represented past due amounts and accrued interest resulting from partial payments for March 1998 through June 2001. Although

Edgar Filing: UNOCAL CORP - Form 10-Q

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 \$202 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.

-33-

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 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. On August 13, 2001, the Company received notice that the FTC is conducting an investigation in conjunction with this matter.

In mid-September 2001, the U.S. District Court in Los Angeles is scheduled to hear the Company's motion for the award of additional damages with respect to the defendants' infringement of the `393 patent from August 1996 through December 2000. The Company will request 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 defendants' motions that these damage proceedings be stayed pending the outcome of the `393 reexamination or, alternatively, that the court allow additional evidence on damages are scheduled to be heard on the same date.

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

Edgar Filing: UNOCAL CORP - Form 10-Q

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.

-34-

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 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 June 30, 2001. Assuming a ten percent decrease in the Company's weighted average borrowing costs at June 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 \$117 million at June 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

Edgar Filing: UNOCAL CORP - Form 10-Q

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 June 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 June 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 \$10 million at June 30, 2001.

-35-

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 \$12 million at June 30, 2001. The value at risk related to hydrocarbon derivatives held for trading purposes was approximately \$10 million at June 30, 2001.

-36-

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 and in Item 1 of Part II of Unocal's Quarterly Report on Form 10-Q for the

Edgar Filing: UNOCAL CORP - Form 10-Q

quarter ended March 31, 2001; the information regarding environmental remediation reserves in note 12 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 13 to the consolidated financial statements.

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

The 2001 Annual Meeting of Stockholders of Unocal was held on May 21, 2001. The following actions were taken by the stockholders at the Annual Meeting, for which proxies were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934, as amended:

1. The four nominees proposed by the board of directors were elected as directors by the following votes for three-year terms expiring at the 2004 Annual Meeting of Stockholders, or until their successors are duly elected and qualified:

Name	Votes For	Votes Withheld
Frank C. Herringer	215,009,977	4,153,753
Charles R. Larson	214,901,597	4,262,133
Marina v.N. Whitman	214,927,684	4,236,046
Charles R. Williamson	215,073,307	4,090,423

2. A proposal to ratify the appointment of PricewaterhouseCoopers LLP as Unocal's independent accountants for 2001 was passed by a vote of 216,364,714 for versus 1,803,259 against and 995,757 abstentions. There were no broker non-votes.
3. A proposal to approve the 2001 Directors' Deferred Compensation and Stock Award Plan was passed by a vote of 193,387,663 for versus 23,876,365 against and 1,899,702 abstentions. There were no broker non-votes.
4. A stockholder proposal to urge the Board of Directors to adopt, implement and enforce a code of conduct based on the International Labor Organization's Conventions on Workplace Human Rights failed to pass, with a vote of 42,872,530 for versus 140,453,276 against and 11,808,298 abstentions. There were 24,029,626 broker non-votes.
5. A stockholder proposal to link compensation and bonus packages of Unocal's executives to the Company's ethical and social performance failed to pass, with a vote of 30,044,283 for versus 161,899,934 against and 3,189,887 abstentions. There were 24,029,626 broker non-votes.
6. A stockholder proposal to require the Board to provide a report four months from the date of the Annual Meeting describing its efforts, criteria and process of achieving Board inclusiveness failed to pass, with a vote of 27,797,705 for versus 160,971,396 against and 6,365,002 abstentions. There were 24,029,627 broker non-votes.

-37-

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

- (a) Exhibits: The Exhibit Index on page 39 of this report lists the exhibits

Edgar Filing: UNOCAL CORP - Form 10-Q

that are filed as part of this report.

(b) Reports on Form 8-K:

Filed during the second quarter of 2001:

- (1) Current Report on Form 8-K, dated March 27, 2001, and filed April 5, 2001, for the purpose of reporting, under Item 5, Unocal Bylaw amendments, filed as an exhibit under Item 7, and effective March 27, 2001.

There were no filings during the third quarter of 2001 to the date hereof.

-38-

SIGNATURE

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

UNOCAL CORPORATION
(Registrant)

Dated: August 14, 2001

By: /s/JOE D. CECIL

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

-39-

EXHIBIT INDEX

- 10.1 2001 Directors' Deferred Compensation and Stock Award Plan (incorporated by reference to Exhibit B to Unocal's Proxy Statement dated April 9, 2001, for its 2001 Annual Meeting of Stockholders, File No. 1-8483).
- 10.2 Amendment to Long Term Incentive Plan of 1998, as amended (subject to stockholder approval).
- 10.3 Form of Nonqualified Stock Option Grant under the Long Term Incentive Plan of 1998, effective July 27, 2001 (subject to stockholder approval), between Unocal and each of Charles R. Williamson (as to 450,000 shares of Unocal Common Stock), Timothy H. Ling (as to 240,000 shares of Unocal Common Stock) and Dennis P.R. Codon (as to 150,000 shares of Unocal Common Stock), each with an exercise price of \$35.355 per share.
- 12.1 Statement regarding computation of ratio of earnings to fixed charges of Unocal Corporation for the six months ended June 30, 2001 and 2000.

Edgar Filing: UNOCAL CORP - Form 10-Q

12.2 Statement regarding computation of ratio of earnings to fixed charges of Union Oil Company of California for the six months ended June 30, 2001 and 2000.

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

-40-