UNION PACIFIC CORP
Form 10-Q
November 01, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

- 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 1-6075

UNION PACIFIC CORPORATION

(Exact name of registrant as specified in its charter)

UTAH	**13-2626465**
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)

1400 DOUGLAS STREET, OMAHA, NEBRASKA

(Address of principal executive offices)

68179

(Zip Code)

(402) 544-5000

(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.

þ Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

¨ Yes þ No

As of October 31, 2006, there were 269,719,931 shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Consolidated Statements of Income (Unaudited)

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, Except Per Share Amounts,

For the Three Months Ended September 30,	*2006*	*2005*
Operating revenue	$ 3,983	$ 3,461
Operating expenses:		
Salaries, wages, and employee benefits	1,161	1,093
Fuel and utilities	821	673
Equipment and other rents	371	356
Depreciation	311	294
Materials and supplies	178	140
Casualty costs	83	109
Purchased services and other costs	306	315
Total operating expenses	3,231	2,980
Operating income	752	481
Other income	22	42
Interest expense	(119)	(124)
Income before income taxes	655	399
Income taxes	(235)	(30)
Net income	$ 420	$ 369
Share and Per Share		
Earnings per share basic	$ 1.56	$ 1.40
Earnings per share diluted	$ 1.54	$ 1.38
Weighted average number of shares basic	269.8	264.0
Weighted average number of shares diluted	271.9	267.1
Dividends declared per share	$ 0.30	$ 0.30

The accompanying notes are an integral part of these Consolidated Financial Statements.

Consolidated Statements of Income (Unaudited)

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, Except Per Share Amounts,

For the Nine Months Ended September 30,	*2006*	*2005*
Operating revenue	$ 11,616	$ 9,957
Operating expenses:		
Salaries, wages, and employee benefits	3,430	3,267
Fuel and utilities	2,307	1,809
Equipment and other rents	1,109	1,049
Depreciation	922	875
Materials and supplies	520	403
Casualty costs	303	308
Purchased services and other costs	951	984
Total operating expenses	9,542	8,695
Operating income	2,074	1,262
Other income	61	91
Interest expense	(359)	(384)
Income before income taxes	1,776	969
Income taxes	(655)	(239)
Net income	$ 1,121	$ 730
Share and Per Share		
Earnings per share basic	$ 4.17	$ 2.78
Earnings per share diluted	$ 4.13	$ 2.75
Weighted average number of shares basic	269.1	262.7
Weighted average number of shares diluted	271.7	265.7
Dividends declared per share	$ 0.90	$ 0.90

The accompanying notes are an integral part of these Consolidated Financial Statements.

Consolidated Statements of Financial Position (Unaudited)

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, Except Share and Per Share Amounts		*September 30, 2006*		*December 31, 2005*
Assets				
Current assets:				
Cash and cash equivalents	$	719	$	773
Accounts receivable, net		770		747
Materials and supplies		427		331
Current deferred income taxes		268		304
Other current assets		181		170
Total current assets		2,365		2,325
Investments:				
Investments in and advances to affiliated companies		846		789
Other investments		12		17
Total investments		858		806
Properties:				
Road		35,206		33,812
Equipment		7,605		7,675
Other		193		210
Total cost		43,004		41,697
Accumulated depreciation		(10,360)		(9,722)
Net properties		32,644		31,975
Other assets		505		514
Total assets	$	36,372	$	35,620
Liabilities and Common Shareholders Equity				
Current liabilities:				
Accounts payable	$	666	$	783
Accrued wages and vacation		421		415
Accrued casualty costs		425		478
Income and other taxes		268		212
Dividends and interest		214		252
Debt due within one year		393		656
Equipment rents payable		119		130
Other current liabilities		597		458
Total current liabilities		3,103		3,384
Debt due after one year		6,657		6,760
Deferred income taxes		9,582		9,482
Accrued casualty costs		869		876
Retiree benefits obligation		839		855
Other long-term liabilities		552		556
Commitments and contingencies (Note 8)				
Total liabilities		21,602		21,913
Common shareholders equity:				
Common shares, par value $2.50 per share; 500,000,000 shares authorized; 275,962,961 and 275,798,611 shares issued, respectively		690		689
Paid-in-surplus		3,935		3,915
Retained earnings		10,811		9,932
Treasury stock		(436)		(599)
Accumulated other comprehensive loss		(230)		(230)
Total common shareholders equity		14,770		13,707
Total liabilities and common shareholders equity	$	36,372	$	35,620

The accompanying notes are an integral part of these Consolidated Financial Statements.

Consolidated Statements of Cash Flows (Unaudited)

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars,

For the Nine Months Ended September 30,	*2006*	*2005*
Operating Activities		
Net income	$ 1,121	$ 730
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	922	875
Deferred income taxes	143	152
Stock-based compensation expense	27	17
Net gains from non-operating asset sales	(34)	(84)
Other, net	(52)	23
Changes in current assets and liabilities, net	(148)	(18)
Cash provided by operating activities	1,979	1,695
Investing Activities		
Capital investments	(1,695)	(1,676)
Proceeds from asset sales	89	132
Other investing activities, net	40	(74)
Cash used in investing activities	(1,566)	(1,618)
Financing Activities		
Dividends paid	(241)	(235)
Debt repaid	(371)	(662)
Net proceeds from equity compensation plans	122	172
Excess tax benefits from equity compensation plans	23	-
Other financing activities, net	-	8
Cash used in financing activities	(467)	(717)
Net change in cash and cash equivalents	(54)	(640)
Cash and cash equivalents at beginning of period	773	977
Cash and cash equivalents at end of period	$ 719	$ 337
Changes in Current Assets and Liabilities, Net		
Accounts receivable, net	$ (23)	$ (190)
Materials and supplies	(96)	(68)
Other current assets	(11)	(22)
Accounts, wages, and vacation payable	(111)	144
Other current liabilities	93	118
Total	$ (148)	$ (18)
Supplemental Cash Flow Information:		
Non-cash financing activity, cash dividends declared but not yet paid	$ 79	$ 78
Cash paid during the period for:		
Interest	$ (399)	$ (419)
Income taxes, net	(400)	(67)

The accompanying notes are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Changes in Common Shareholders Equity (Unaudited)

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars							*Accumulated Other Comprehensive Income/(Loss)*			
							Minimum Pension	*Foreign Currency*		
Thousands of Shares	*Common Shares*	*Treasury Shares*	*Common Shares*	*Paid-in-Surplus*	*Retained Earnings*	*Treasury Stock*	*Liability Adj.*	*Trans. Adj.*	*Derivative Adj.*	*Total*
Balance at January 1, 2006	275,799	(9,164)	$689	$3,915	$9,932	$(599)	$(211)	$(13)	$(6)	$13,707
Comprehensive income:										
Net income			-	-	1,121	-	-	-	-	1,121
Other comp. income/(loss) [a]			-	-	-	-	2	(3)	1	-
Total comprehensive income/(loss)			-	-	1,121	-	2	(3)	1	1,121
Conversion, exercises of stock options, forfeitures, and other	164	2,665	1	20	-	163	-	-	-	184
Dividends declared ($0.90 per share)	-	-	-	-	(242)	-	-	-	-	(242)
Balance at September 30, 2006	275,963	(6,499)	$690	$3,935	$10,811	$(436)	$(209)	$(16)	$(5)	$14,770

[a] Net of tax of $(1).

The accompanying notes are an integral part of these Consolidated Financial Statements.

UNION PACIFIC CORPORATION AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For purposes of this report, unless the context otherwise requires, all references herein to the Corporation , UPC , we , us , and our mean U
Pacific Corporation and its subsidiaries, including Union Pacific Railroad Company, which will be separately referred to herein as UPRR or the Railroad .

1. Responsibilities for Financial Statements Our Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal and recurring adjustments) that are, in the opinion of management, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America. Our Consolidated Statement of Financial Position at December 31, 2005, is derived from audited financial statements. This quarterly report on Form 10-Q should be read in conjunction with our Consolidated Financial Statements and notes thereto contained in our 2005 annual report on Form 10-K. The results of operations for the three and nine months ended September 30, 2006, are not necessarily indicative of the results for the entire year ending December 31, 2006. Certain prior year amounts have been reclassified to conform to the 2006 Consolidated Financial Statement presentation. These reclassifications were not material, individually or in aggregate.

2. Stock-Based Compensation We have several stock-based compensation plans under which employees and non-employee directors receive stock options, nonvested retention shares, and nonvested stock units. We refer to the nonvested shares and stock units collectively as retention awards . There were 18 million shares authorized and available for grant as stock-based compensation at September 30, 2006.

We issue treasury shares to cover option exercises and stock unit vestings, while new shares are issued when retention shares vest. We do not currently intend to repurchase any shares in 2006 to replace treasury shares issued as stock-based compensation.

We adopted Financial Accounting Standards Board (FASB) Statement No. 123(R), *Share-Based Payment* (FAS 123(R)), on January 1, 2006. FAS 123(R) requires us to measure and recognize compensation expense for all stock-based awards made to employees and directors, including stock options. Compensation expense is based on the calculated fair value of the awards as measured at the grant date and is expensed ratably over the service period of the awards (generally the vesting period). The fair value of retention awards is the stock price on the date of grant, while the fair value of stock options is determined by using the Black-Scholes option pricing model. We elected to use the modified prospective transition method as permitted by FAS 123(R) and did not restate financial results for prior periods. We did not make an adjustment for the cumulative effect of these estimated forfeitures, as the impact was not material.

As a result of the adoption of FAS 123(R), we recognized expense for stock options in the first nine months of 2006, in addition to retention awards, which were expensed prior to 2006. Stock-based compensation expense for the three and nine months ended September 30, 2006 was $5 million and $17 million, respectively, after tax, or $0.02 and $0.06 per basic and diluted share, respectively. This includes $2 million and $7 million for stock options and $3 million and $10 million for retention awards for the three- and nine-month periods, respectively. Before taxes, stock-based compensation expense included $3 million and $11 million for stock options and $4 million and $16 million for retention awards for the three- and nine-month periods, respectively. We recorded $23 million of excess tax benefits as an inflow of financing activities in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2006.

Prior to the adoption of FAS 123(R), we applied the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. No stock-based employee compensation expense related to stock option grants was reflected in net income, as all options granted under those plans had a grant price equal to the market value of our common stock on the date of grant. Stock-based compensation expense related to retention shares, stock units, and other incentive plans was reflected in net income. The following table details the effect on net income and earnings per share had compensation expense for all of our stock-based awards, including stock options, been recorded in the three and nine months ended September 30, 2005 based on the fair value method under FASB Statement No. 123, *Accounting for Stock-Based Compensation*.

Millions of Dollars, Except Per Share Amounts	*Three Months Ended September 30, 2005*	*Nine Months Ended September 30, 2005*
Net income, as reported	$ 369	$ 730
Stock-based employee compensation expense included in reported net income, net of tax	3	11
Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax [a]	(7)	(36)
Pro forma net income	$ 365	$ 705
EPS basic, as reported	$ 1.40	$ 2.78
EPS basic, pro forma	$ 1.38	$ 2.68
EPS diluted, as reported	$ 1.38	$ 2.75
EPS diluted, pro forma	$ 1.37	$ 2.65

[a] *Stock options for executives granted in 2002 and 2003 included a reload feature. This reload feature allowed executives to exercise their options using shares of Union Pacific Corporation common stock that they already owned and obtain a new grant of options in the amount of the shares used for exercise plus any shares withheld for tax purposes. The reload feature of these option grants could only be exercised if the price of our common stock increased at least 20% from the price at the time of the reload grant. During the nine months ended September 30, 2005, reload option grants represented $12 million of the pro forma expense noted above. During the three months ended September 30, 2005, there were no reload option grants represented in the pro forma expense noted above. There were no reload option grants during 2006 as stock options exercised after January 1, 2006 are not eligible for the reload feature.*

Stock Options We estimate the fair value of our stock option awards using the Black-Scholes option pricing model. Groups of employees and non-employee directors that have similar historical and expected exercise behavior are considered separately for valuation purposes. The table below shows the year-to-date weighted-average of the assumptions used when valuing these separate groups:

	2006	*2005*
Risk-free interest rate	4.5%	3.7%
Dividend yield	1.4%	1.9%
Expected life (years)	6.0	4.8
Volatility	25.3%	21.0%
Weighted-average grant-date fair value of options granted	$ 24.97	$ 12.30

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant; the dividend yield is calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant; the expected life computation is based on historical and expected exercise behavior; and expected volatility is based on the historical volatility of our stock price, over a time period that is consistent with the expected life of the option.

A summary of stock option activity during the first nine months of 2006 is presented below:

	Shares	*Weighted-Average Exercise Price*
Outstanding at January 1, 2006	12,436,209	$ 59.41
Granted	1,402,200	86.04
Exercised	(2,886,262)	56.27
Forfeited or expired	(38,350)	66.15
Outstanding at September 30, 2006	10,913,797	$ 63.64
Options exercisable at September 30, 2006	9,464,447	$ 60.39

The weighted-average remaining contractual terms of options outstanding and exercisable at September 30, 2006 were 6.0 years and 5.4 years, respectively. The aggregate intrinsic value of options outstanding and exercisable at September 30, 2006 was $260 million and $256 million, respectively.

Stock options are granted at market price on the date of grant, have ten-year contractual terms, and vest no later than three years from the date of grant. While the majority of the options that were granted in 2006 will vest over a three-year service period, a smaller percentage of options awarded in 2006 and the nonvested options that were awarded in prior years will vest two years from the grant date. None of the stock options outstanding at September 30, 2006 are subject to performance or market-based vesting conditions.

At September 30, 2006, there was $26 million of unrecognized compensation expense related to nonvested stock options, which is expected to be recognized over a weighted-average period of 2.0 years. Additional information regarding stock option exercises appears in the table below:

	Three Months Ended September 30,		*Nine Months Ended September 30,*	
Millions of Dollars	2006	2005	2006	2005
Aggregate grant-date fair value of stock options vested	$ -	$ -	$ 26	$ 31
Intrinsic value of stock options exercised	7	28	94	85
Cash received from option exercises	7	78	138	195
Tax benefit realized from option exercises	3	10	35	31

Retention Awards The fair value of retention awards is based on the market price of the stock at the grant date.

Changes in our retention awards during the first nine months of 2006 were as follows:

	Shares	*Weighted-Average Grant-Date Fair Value*
Nonvested at January 1, 2006	1,005,276	$ 58.88
Granted	449,550	86.03
Vested	(538,453)	56.46
Forfeited	(14,049)	70.26
Nonvested at September 30, 2006	902,324	$ 73.68

Retention awards, which we grant at no cost to the employee or non-employee director, vest over periods lasting up to four years. With the exception of the awards granted under the Long Term Plan, which is discussed below, the majority of awards granted in 2006 will vest over a four-year service period. Most nonvested awards that were granted in prior years also vest over four years.

In January 2006, our Board of Directors approved a new Long Term Plan (LTP). Under the LTP, selected employees were awarded stock units subject to continued employment through January 2009 and the attainment of certain levels of return on invested capital (ROIC) as defined in the LTP. Over the course of the 3-year performance period, the participants can earn up to 122,400 stock units, which had a grant-date fair value of $86.05 each and are included within the granted shares shown in the table above. We will expense the fair value (grant-date stock price) of the units that are probable of being earned based on our forecasted ROIC over the 3-year performance period.

At September 30, 2006, there was $37 million of total unrecognized compensation expense related to nonvested retention awards, which is expected to be recognized over a weighted-average period of 1.9 years. A portion of this expense is subject to achievement of the performance criteria under the LTP.

3. Operations and Segmentation The Railroad, along with its subsidiaries and rail affiliates, is our one reportable business segment. Although revenue is analyzed by commodity, we analyze the net financial results of the Railroad as one segment due to the integrated nature of the rail network.

4. Financial Instruments

Strategy and Risk We may use derivative financial instruments in limited instances for other than trading purposes to assist in managing our overall exposure to fluctuations in interest rates and fuel prices. We are not a party to leveraged derivatives and, by policy, do not use derivative financial instruments for speculative purposes. Derivative financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. We formally document the nature and relationships between the hedging instruments and hedged items, as well as our risk-management objectives, strategies for undertaking the various hedge transactions, and method of assessing hedge effectiveness. Changes in the fair market value of derivative financial instruments that do not qualify for hedge accounting are reflected in earnings. We may use swaps, collars, futures, and/or forward contracts to mitigate the risk of adverse movements in interest rates and fuel prices; however, the use of these derivative financial instruments may limit future benefits from favorable price movements.

Market and Credit Risk We address market risk by selecting derivative financial instruments with value fluctuations that highly correlate with the underlying hedged item. Credit risk related to derivative financial instruments, which is minimal, is managed by requiring high credit standards for counterparties and periodic settlements. At September 30, 2006 and December 31, 2005, we were not required to provide collateral, nor had we received collateral, relating to our hedging activities.

Determination of Fair Value We determined the fair values of our derivative financial instrument positions at September 30, 2006 and December 31, 2005, based upon current fair values as quoted by recognized dealers or developed based upon the present value of expected future cash flows.

Interest Rate Fair Value Hedges We manage our overall exposure to fluctuations in interest rates by adjusting the proportion of fixed and floating rate debt instruments within our debt portfolio over a given period. We generally manage the mix of fixed and floating rate debt through the issuance of targeted amounts of each as debt matures or as we require incremental borrowings. We employ derivatives, primarily swaps, as one of the tools to obtain the targeted mix. In addition, we also obtain flexibility in managing interest costs and the interest rate mix within our debt portfolio by evaluating the issuance of and managing outstanding callable fixed-rate debt securities.

Swaps allow us to convert debt from fixed rates to variable rates and thereby hedge the risk of changes in the debt s fair value attributable to the changes in interest rates. We account for swaps as fair value hedges using the short-cut method pursuant to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities;* therefore, we do not record any ineffectiveness within our Consolidated Financial Statements.

The following is a summary of our interest rate derivatives qualifying as fair value hedges:

Millions of Dollars, Except Percentages	*September 30, 2006*	*December 31, 2005*
Interest rate fair value hedging:		
Amount of debt hedged	$ 750	$ 750
Percentage of total debt portfolio	11%	10%
Gross fair value liability position	$ (20)	$ (17)

The use of interest rate hedging increased our interest expense by $3 million and $6 million during the respective three- and nine-month periods ended September 30, 2006; whereas, the use of interest rate hedging reduced our interest expense by $5 million during the nine-month period ended September 30, 2005. The use of interest rate hedging did not impact our interest expense during the three-month period ended September 30, 2005.

Interest Rate Cash Flow Hedges We report changes in the fair value of cash flow hedges in accumulated other comprehensive loss until the hedged item affects earnings. At September 30, 2006, we had a reduction of $5 million recorded as an accumulated other comprehensive loss that is being amortized on a straight-line basis through September 30, 2014. As of September 30, 2006 and December 31, 2005, we had no interest rate cash flow hedges outstanding.

Fuel Swaps We entered into two fuel basis swaps for the period August 2006 through July 2008, which cover a total of 3.6 million barrels of diesel fuel. These commodity basis swaps require us to make payments to, or receive payments from, the counterparty based on the difference between certain price indices. Changes in the fair market value of these swaps are reflected in fuel expense. We reported a derivative asset of approximately $1.6 million at September 30, 2006, which represents the fair value of the swaps. The swaps reduced fuel expense for the third quarter of 2006 by $1.5 million, which included monthly net settlements with the counterparty and the fair value recognition at September 30, 2006.

Sale of Receivables The Railroad transfers most of its accounts receivable to Union Pacific Receivables, Inc. (UPRI), a bankruptcy-remote subsidiary, as part of a sale of receivables facility. UPRI sells, without recourse, an undivided interest in such accounts receivable to investors. The total capacity to sell undivided interests to investors under the facility was $600 million at both September 30, 2006 and December 31, 2005. The value of the outstanding undivided interest held by investors under the facility was $600 million at both September 30, 2006 and December 31, 2005. The value of the outstanding undivided interest held by investors is not included in our Consolidated Financial Statements. The value of the undivided interest held by investors was supported by $1,234 million and $1,226 million of accounts receivable held by UPRI at September 30, 2006 and December 31, 2005, respectively. At September 30, 2006 and December 31, 2005, the value of the interest retained by UPRI was $634 million and $626 million, respectively. The interest in accounts receivable held by UPRI is included in accounts receivable in our Consolidated Financial Statements, whereas the interest sold to investors is sold at carrying value, which approximates fair value, and there is no gain or loss recognized from the transaction.

The value of the outstanding undivided interest held by investors could fluctuate based upon the availability of eligible receivables and is directly affected by changing business volumes and credit risks, including default and dilution. If default or dilution percentages were to increase one percentage point, the amount of eligible receivables would decrease by $6 million. Should our credit rating fall below investment grade, the value of the outstanding undivided interest held by investors would be reduced, and, in certain cases, the investors would have the right to discontinue the facility.

The Railroad services the sold receivables; however, the Railroad does not recognize any servicing asset or liability as the servicing fees adequately compensate the Railroad for its responsibilities. The Railroad collected approximately $11 billion and $10 billion during the nine months ended September 30, 2006 and 2005, respectively. UPRI used certain of these proceeds to purchase new receivables under the facility.

The costs of the sale of receivables program are included in other income and were $9 million and $6 million for the three months ended September 30, 2006 and 2005, respectively, and $25 million and $16 million for the nine months ended September 30, 2006 and 2005, respectively. The costs include interest, program fees paid to banks, commercial paper issuing costs, and fees for unused commitment availability.

The investors have no recourse to the Railroad s other assets except for customary warranty and indemnity claims. Creditors of the Railroad have no recourse to the assets of UPRI. The sale of receivables program expires in August 2007.

5. Debt

Credit Facilities On September 30, 2006, we had $2 billion in revolving credit facilities available, including $1 billion under a five-year facility expiring in March 2009 and $1 billion under a five-year facility expiring in March 2010 (collectively, the facilities). The facilities are designated for general corporate purposes and support the issuance of commercial paper. Neither of the facilities were drawn as of September 30, 2006. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers. These facilities allow for borrowings at floating rates based on London Interbank Offered Rates, plus a spread, depending upon our senior unsecured debt ratings. The facilities require the maintenance of a minimum net worth and a debt to net worth coverage ratio. At September 30, 2006, we were in compliance with these covenants. The facilities do not include any other financial restrictions, credit rating triggers (other than rating-dependent pricing), or any other provision that could require the posting of collateral.

In addition to our revolving credit facilities, we also had $150 million in uncommitted lines of credit available, including $75 million that expires in March 2007 and $75 million expiring in July 2007. Neither of these lines of credit were drawn on as of September 30, 2006. We must have equivalent credit available under our five-year facilities to draw on the $75 million lines of credit.

Shelf Registration Statement Under a current shelf registration statement, we may issue any combination of debt securities, preferred stock, common stock, or warrants for debt securities or preferred stock in one or more offerings. At September 30, 2006, we had $500 million remaining for issuance under the current shelf registration statement. We have no immediate plans to issue any securities; however, we routinely consider and evaluate opportunities to replace existing debt or access capital through issuances of debt securities under this shelf registration, and, therefore, we may issue debt securities at any time.

6. Retirement Plans

Pension and Other Postretirement Benefits

Pension Plans We provide defined benefit retirement income to eligible non-union employees through qualified and non-qualified (supplemental) pension plans. Qualified and non-qualified pension benefits are based on years of service and the highest compensation during the latest years of employment, with specific reductions made for early retirements.

Other Postretirement Benefits (OPEB) We provide defined contribution medical and life insurance benefits for eligible retirees. These benefits are funded as medical claims and life insurance premiums are paid.

See note 10 to the Consolidated Financial Statements for a discussion of FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158).

Expense Both pension and OPEB expense are determined based upon the annual service cost of benefits (the actuarial cost of benefits earned during a period) and the interest cost on those liabilities, less the expected return on plan assets. The expected long-term rate of return on plan assets is applied to a calculated value of plan assets that recognizes changes in fair value over a five-year period. This practice is intended to reduce year-to-year volatility in pension expense, but it can have the effect of delaying the recognition of differences between actual returns on assets and expected returns based on long-term rate of return assumptions. Differences in actual experience in relation to assumptions are not recognized immediately, but are deferred and, if necessary, amortized as pension or OPEB expense.

The components of our net periodic pension costs were as follows:

	Pension			
	Three Months Ended September 30,		*Nine Months Ended September 30,*	
Millions of Dollars	*2006*	*2005*	*2006*	*2005*
Service cost	$ 9	$ 6	$ 25	$ 23
Interest cost	30	28	88	87
Expected return on plan assets	(33)	(33)	(101)	(100)

Amortization of:				
Transition obligation	-	(1)	-	(1)
Prior service cost	1	1	5	5
Actuarial loss	6	-	15	5
Total net periodic benefit cost	$ 13	$ 1	$ 32	$ 19

The components of our net periodic OPEB cost/(credit) were as follows:

	OPEB			
	Three Months Ended September 30,		*Nine Months Ended September 30,*	
Millions of Dollars	*2006*	*2005*	*2006*	*2005*
Service cost	$ 1	$ -	$ 4	$ 3
Interest cost	4	6	18	19
Amortization of:				
Prior service cost (credit)	(10)	(9)	(24)	(21)
Actuarial loss	3	4	11	10
Total net periodic benefit cost/(credit)	$ (2)	$ 1	$ 9	$ 11

Cash Contributions In January 2006, we made a $50 million voluntary contribution to the qualified pension plan. The contribution was made with cash generated from operations.

In August of 2006 the Pension Protection Act (PPA) was signed into law. The intent of the legislation is to require companies to fund 100 percent of their pension liability. Annual cash funding is expected to equal the value of benefits accrued during the year plus one-seventh of any underfunded amount. We are currently evaluating the effects of this legislation.

7. Earnings Per Share The following table provides a reconciliation between basic and diluted earnings per share:

	Three Months Ended September 30,		*Nine Months Ended September 30,*	
Millions, Except Per Share Amounts	*2006*	*2005*	*2006*	*2005*
Net income	$ 420	$ 369	$ 1,121	$ 730
Weighted average number of shares outstanding:				
Basic	269.8	264.0	269.1	262.7
Dilutive effect of stock options	1.7	1.5	2.1	1.4
Dilutive effect of retention awards	0.4	1.6	0.5	1.6
Diluted	271.9	267.1	271.7	265.7
Earnings per share basic	$ 1.56	$ 1.40	$ 4.17	$ 2.78
Earnings per share diluted	$ 1.54	$ 1.38	$ 4.13	$ 2.75

Common stock options totaling 1.4 million shares for both the three and nine months ended September 30, 2006, and 0.1 million and 1.7 million shares for the three and nine months ended September 30, 2005, respectively, were excluded from the computation of diluted earnings per share because the effect of their inclusion would be antidilutive.

8. Commitments and Contingencies

Asserted and Unasserted Claims Various claims and lawsuits are pending against us and certain of our subsidiaries. It is not possible at this time for us to determine fully the effect of all unasserted claims on our consolidated results of operations, financial condition, or liquidity; however, to the extent possible, where unasserted claims are considered probable and where such claims can be reasonably estimated, we have recorded a liability. We do not expect that any known lawsuits, claims, environmental costs, commitments, contingent liabilities, or guarantees will have a material adverse effect on our consolidated results of operations, financial condition, or liquidity after taking into account liabilities previously recorded for these matters.

Personal Injury The cost of personal injuries to employees and others related to our activities is charged to expense based on estimates of the ultimate cost and number of incidents each year. We use third-party actuaries to assist us in measuring the expense and liability, including unasserted claims. Compensation for work-related accidents is governed by the Federal Employers Liability Act (FELA). Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements.

Our personal injury liability activity was as follows:

	Nine Months Ended September 30,	
Millions of Dollars	*2006*	*2005*
Beginning balance	$619	$639
Accruals	205	199
Payments	(189)	(204)
Ending balance	$635	$634
Current portion, ending balance	$272	$274

Our personal injury liability is discounted to present value using applicable U.S. Treasury rates.

Asbestos We are a defendant in a number of lawsuits in which current and former employees allege exposure to asbestos. Additionally, we have received claims for asbestos exposure that have not been litigated. The claims and lawsuits (collectively referred to as claims) allege occupational illness resulting from exposure to asbestos-containing products. In most cases, the claimants do not have credible medical evidence of physical impairment resulting from the alleged exposures. Additionally, most claims filed against us do not specify an amount of alleged damages.

The greatest potential for asbestos exposure in the railroad industry existed while steam locomotives were used. The railroad industry, including UPRR and its predecessors, phased out steam locomotives between 1955 and 1960. The use of asbestos-containing products in the railroad industry was substantially reduced after steam locomotives were discontinued, although it was not completely eliminated. Some asbestos-containing products were still manufactured in the building trade industry and were used in isolated component parts on locomotives and railroad cars during the 1960s and 1970s. By the early 1980s, manufacturers of building materials and locomotive component parts developed non-asbestos alternatives for their products and ceased manufacturing asbestos-containing materials.

Prior to 2004, we concluded it was not possible to reasonably estimate the cost of disposing of asbestos-related claims that might be filed against us in the future, due to a lack of sufficient comparable history from which to reasonably estimate unasserted asbestos-related claims. As a result, we recorded a liability for asbestos-related claims only when the claims were asserted.

Since 2004, we have used a third party with extensive experience in estimating resolution costs for asbestos-related claims to assist us in assessing the number and value of these unasserted claims through 2034, based on our average claims experience over a multi-year period. The liability for resolving both asserted and unasserted claims is based on the following assumptions:

The number of claims to be filed against us will decline each year after 2005.

The average settlement values for asserted and unasserted claims will be equivalent to those experienced between 2002 and 2004.

The percentage of claims dismissed between 2002 and 2004 will continue through 2034.

Our asbestos-related liability activity was as follows:

	Nine Months Ended	
	September 30,	
Millions of Dollars	*2006*	*2005*
Beginning balance	$ 311	$ 324
Accruals	-	-
Payments	(7)	(9)
Ending balance	$ 304	$ 315
Current portion, ending balance	$ 16	$ 17

Our liability for asbestos-related claims is not discounted to present value due to the uncertainty surrounding the timing of future payments. At September 30, 2006 and December 31, 2005, approximately 16% of the recorded liability related to asserted claims, and approximately 84% related to unasserted claims. These claims are expected to be paid out through 2034. During the third quarter of 2006, our third-party consultants assisted us in reviewing our actual asbestos claim and settlement experience through the first half of 2006 compared to the assumptions used in the 2004 estimate, and we determined that no adjustment to our estimate was necessary. We will continue to review actual experience and adjust our estimate as warranted.

Insurance coverage reimburses us for a portion of the costs incurred to resolve asbestos-related claims, and we have recognized an asset for estimated insurance recoveries.

We believe that our liability estimates for asbestos-related claims and the estimated insurance recoveries reflect reasonable and probable estimates. The amounts recorded for asbestos-related liabilities and related insurance recoveries were based on currently known facts. However, future events, such as the number of new claims to be filed each year, average settlement costs, and insurance coverage issues could cause the actual costs and insurance recoveries to be higher or lower than the projected amounts. Estimates may also vary due to changes in the litigation environment, federal and state law governing compensation of asbestos claimants, and the level of payments made to claimants by other defendants.

Additionally, we have a legal obligation to properly dispose of asbestos-containing materials. The estimated fair value of this obligation is $5 million at both September 30, 2006 and December 31, 2005, which was recorded as a long-term liability.

Environmental Costs We are subject to federal, state, and local environmental laws and regulations. We have identified approximately 376 sites at which we are or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 41 sites that are the subject of actions taken by the U.S. government, 23 of which are currently on the Superfund National Priorities List. Certain federal legislation imposes joint and several liability for the remediation of identified sites; consequently, our ultimate environmental liability may include costs relating to activities of other parties, in addition to costs relating to our own activities at each site.

Environmental assessments are performed by our consultants and us when environmental issues have been identified with respect to property owned, leased, or otherwise used in the conduct of our business. We expense the cost of the assessments as incurred. We accrue the cost of remediation where our obligation is probable and such costs can be reasonably estimated. We do not discount our environmental liabilities when the timing of the anticipated cash payments is not fixed or readily determinable.

Our environmental liability activity was as follows:

	Nine Months Ended September 30,	
Millions of Dollars	*2006*	*2005*
Beginning balance	$ 213	$ 201
Accruals	26	33
Payments	(28)	(26)
Ending balance	$ 211	$ 208
Current portion, ending balance	$ 49	$ 49

The environmental liability includes costs for remediation and restoration of sites, as well as for ongoing monitoring costs, but excludes any anticipated recoveries from third parties. Cost estimates are based on information available for each site, financial viability of other potentially responsible parties, and existing technology, laws, and regulations. We believe that we have adequately accrued for our ultimate share of costs at sites subject to joint and several liability. However, the ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties involved, site-specific cost sharing arrangements with other potentially responsible parties, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites, and the speculative nature of remediation costs. Estimates may also vary due to changes in federal, state, and local laws governing environmental remediation. We do not expect current obligations to have a material adverse effect on our consolidated results of operations, financial condition, or liquidity.

Guarantees At September 30, 2006, we were contingently liable for $455 million in guarantees. We have recorded a liability of $6 million for the fair value of certain of these obligations as of September 30, 2006. We entered into these contingent guarantees in the normal course of business, and they include guaranteed obligations related to the financing of our headquarters building, equipment financings, and affiliated operations. The final guarantee expires in 2022. We are not aware of any existing event of default that would require us to satisfy any of these guarantees. We do not expect that these guarantees will have a material adverse effect on our consolidated results of operations, financial condition, or liquidity.

Income Taxes As previously reported in note 3 to our Consolidated Financial Statements, Item 8, in our 2005 annual report on Form 10-K, the Internal Revenue Service (IRS) completed its examinations and issued notices of deficiency for tax years 1995 through 2002. Among their proposed adjustments is the disallowance of tax deductions claimed in connection with certain donations of property. In 2005, the IRS national office issued a Technical Advice Memorandum that left unresolved whether the deductions were proper pending further factual development by the IRS examination team. We continue to dispute the donation issue, as well as many of the other proposed adjustments, and will contest the associated tax deficiencies through the IRS appeals process, and, if necessary, litigation. We do not expect that the ultimate resolution of these examinations will have a material adverse effect on our operating results, financial condition, or liquidity. In addition, tax years 2003 and 2004 are currently under examination by the IRS.

As reported in the Corporation s Forms 10-Q for quarters ended June 30, 2005, and September 30, 2005, the final settlements for pre-1995 tax years, along with the IRS Examination Reports for tax years 1995 through 2002, among other things, were considered in a review and re-evaluation of the Corporation s estimated deferred tax assets and liabilities. This review resulted in a reduction of deferred income tax liabilities and income tax expense of $118 million in the third quarter of 2005.

9. Other Income Other income included the following for the three and nine months ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Millions of Dollars	*2006*	*2005*	*2006*	*2005*
Net gains from non-operating asset sales	$19	$42	$34	$84
Rental income	14	14	55	41
Interest income	7	2	15	13
Sale of receivables program fees	(9)	(6)	(25)	(16)
Non-operating environmental costs and other	(9)	(10)	(18)	(31)
Total	$22	$42	$61	$91

10. Accounting Pronouncements In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). The interpretation limits the amount we recognize to no more than the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement of a tax position. The interpretation is effective for us beginning in the first quarter of 2007. Any change in uncertain tax positions required upon adoption of the interpretation will be an adjustment to beginning retained earnings. We are currently assessing the impact FIN 48 may have on our Consolidated Financial Statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurement* (FAS 157). While this statement does not require new fair value measurements, it provides guidance on applying fair value and expands required disclosures. FAS 157 is effective for us beginning in the first quarter of 2008. We are currently assessing the impact FAS 157 may have on our Consolidated Financial Statements.

In September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 requires us to recognize the funded status of our pension and postretirement plans in the balance sheet, along with a corresponding noncash, after-tax adjustment to shareholders equity. Funded status is determined as the difference between the fair value of plan assets and the benefit obligation. Changes in the funded status will be recognized in other comprehensive loss. We will adopt FAS 158 at the end of 2006. We do not expect the adoption of FAS 158 to have a material impact on our Consolidated Financial Statements, liquidity or compliance with debt covenants.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB 108 requires registrants to quantify misstatements using both an income statement and balance sheet approach and then evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial are now considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior year s financial statements are not restated, the cumulative effect adjustment is recorded in opening accumulated earnings (deficit) as of the beginning of the fiscal year of adoption. SAB 108 is effective for us at the end of 2006. We do not expect the adoption of SAB 108 will have a material impact on our Consolidated Financial Statements.

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

UNION PACIFIC CORPORATION AND SUBSIDIARY COMPANIES

RESULTS OF OPERATIONS

Three and Nine Months Ended September 30, 2006 Compared to

Three and Nine Months Ended September 30, 2005

For purposes of this report, unless the context otherwise requires, all references herein to UPC , Corporation , we , us , and our shall mean U Pacific Corporation and its subsidiaries, including Union Pacific Railroad Company, which we separately refer to as UPRR or the Railroad .

The following discussion should be read in conjunction with the Consolidated Financial Statements and applicable notes to the Consolidated Financial Statements, Item 1, and other information included in this report. Our Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal and recurring adjustments) that are, in the opinion of management, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (GAAP).

The Railroad, along with its subsidiaries and rail affiliates, is our one reportable business segment. Although revenue is analyzed by commodity, we analyze the net financial results of the Railroad as one segment due to the integrated nature of the rail network.

Available Information

Our Internet website is www.up.com. We make available free of charge on our website (under the Investors caption link) our annual reports on Form 10-K; our quarterly reports on Form 10-Q; our current reports on Form 8-K; our proxy statements; Forms 3, 4, and 5, filed on behalf of directors and executive officers; and amendments to such reports filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). We also make available on our website previously filed SEC reports and exhibits via a link to EDGAR on the SEC s Internet site at www.sec.gov. Additionally, our corporate governance materials, including Board Committee charters, governance guidelines and policies, and codes of conduct and ethics for directors, officers, and employees are on our website. From time to time, the corporate governance materials on our website may be updated as necessary to comply with rules issued by the SEC and the New York Stock Exchange (NYSE) or as desirable to promote the effective and efficient governance of our company. Any security holder wishing to receive, without charge, a copy of any of our SEC filings or corporate governance materials should send a written request to: Secretary, Union Pacific Corporation, 1400 Douglas Street, Omaha, NE 68179.

References to our website address in this report, including references in Management s Discussion and Analysis of Financial Condition and Results of Operations, Item 2, are provided as a convenience and do not constitute, and should not be deemed, an incorporation by reference of the information contained on, or available through, the website. Therefore, such information should not be considered part of this report.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our Consolidated Financial Statements. The preparation of these financial statements requires estimation and judgment that affect the reported amounts of revenue, expenses, assets, and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. If these estimates differ materially from actual results, the impact on the Consolidated Financial Statements may be material. Our critical accounting policies are available in Item 7 of our 2005 annual report on Form 10-K. There have been no significant changes with respect to these policies during the first nine months of 2006.

RESULTS OF OPERATIONS

Quarterly Summary

We reported earnings of $1.54 per diluted share, or net income of $420 million, in the third quarter of 2006 compared to earnings of $1.38 per diluted share, or net income of $369 million, for the third quarter of 2005. Year-to-date 2006 net income was $1.1 billion versus $730 million for the same period in 2005. We recognized a non-cash income tax expense reduction of $118 million in the third quarter of 2005.

Improved yields, fuel surcharges, and record commodity volume levels drove a 56% and 64% increase in operating income for the third quarter and year-to-date periods, respectively. In addition, network management initiatives and capacity expansion contributed to improved financial results compared to the first nine months of 2005. Results in 2005 were affected by several weather and operational issues, reducing net income by approximately $77 million. The January West Coast storm reduced net income by approximately $34 million in the first quarter of 2005, the Southern Powder River Basin (SPRB) Joint Line (track jointly owned by UPRR and BNSF Railway Company (BNSF)) disruption, which began in mid-May, reduced net income by approximately $24 million in the second quarter of 2005, and Hurricanes Katrina and Rita (primarily the latter) lowered third quarter 2005 net income by approximately $19 million. We also recognized the settlement of all insurance claims related to the 2005 January West Coast storm and lower personal injury expense during the third quarter of 2006. Substantially higher fuel prices; volume-related expenses; and wage, benefit, and materials inflation partially offset the higher revenues, insurance settlement, and lower personal injury expense.

In conjunction with robust demand for our rail services, we continue to focus on increasing velocity, improving asset utilization, and expanding our capacity. We handled record third quarter volumes in 2006, exceeding the previous 2005 record by 3%. Despite these record volumes, we continued to see improvement in key operating metrics, including average terminal dwell and freight car utilization, which improved 7% and 3%, respectively, compared to the third quarter of 2005. Our Unified Plan and terminal processing initiatives were key drivers of lower dwell times and improved asset utilization.

As our operations improved, we handled the volume more efficiently and converted the strong demand and yield increases into improved financial results. This is evident in our record operating income of $752 million and a 5.0 percentage point improvement of our operating ratio in the third quarter of 2006 versus the same period in 2005. Record volumes combined with scheduled maintenance in our key corridors; disruptions on the Sunset corridor; and congestion and maintenance on the SPRB Joint Line all affected our average train speed for the third quarter of 2006.

During the third quarter of 2006, we completed a number of capital projects focused on improving operational fluidity and capacity on our network. On the Sunset corridor, we initiated operations on over 11 miles of new double track. In south Texas, we upgraded signals, track, and terminals to improve flows on our rock network and support increased traffic associated with the start-up of a Toyota plant in San Antonio. In addition, we added centralized traffic control on parts of our network in Iowa and finished two ethanol support projects in that state.

Operating Revenue

	Three Months Ended			*Nine Months Ended*		
	September 30,		*%*	*September 30,*		*%*
Millions of Dollars	*2006*	*2005*	*Change*	*2006*	*2005*	*Change*
Commodity revenue	$ 3,802	$ 3,302	15%	$ 11,087	$ 9,502	17%
Other revenue	181	159	14	529	455	16
Total operating revenue	$ 3,983	$ 3,461	15%	$ 11,616	$ 9,957	17%

Operating revenue includes commodity revenue and other revenue. Other revenue consists primarily of revenue earned by our subsidiaries, revenue from our commuter rail operations, and accessorial revenue, which we earn when customers retain equipment owned or controlled by the Railroad. We recognize commodity revenue on a percentage-of-completion basis as freight moves from origin to destination. We allocate commodity revenue between reporting periods based on the relative transit time in each reporting period and recognize expenses as incurred. We recognize other revenue as service is performed or contractual obligations are met.

All six commodity groups experienced double digit revenue growth during the third quarter of 2006. Fuel surcharges, price increases, and index-based contract escalators all contributed to higher average revenue per car (ARC). Our fuel surcharge programs (excluding index-based contract escalators that contain some provision for fuel) generated an additional $222 million in commodity revenue compared to the same period in 2005, contributing 7% to commodity revenue growth. Volume increased 3% during the third quarter led by solid growth in energy and intermodal shipments, which was partially offset by lower shipments of industrial products and chemicals. Business disruptions caused by Hurricane Rita constrained volume growth during the third quarter of 2005 for chemicals, energy, and industrial products shipments.

Revenue growth during the first nine months of 2006 resulted from fuel surcharges, higher volumes, and index-based contract escalators in comparison to the same period in 2005. The year-over-year growth is also partially attributable to lower volume in 2005 due to the January West Coast storm, SPRB Joint Line disruptions, and Hurricane Rita. Our fuel surcharge programs generated an additional $599 million in commodity revenue for the first nine months of 2006 compared to 2005, contributing 6% to commodity revenue growth.

Subsidiary and accessorial revenue increased in the third quarter and year-to-date periods of 2006, mainly driven by higher volumes. In addition, we generated higher subsidiary revenue from Bay Pacific Financial L.L.C. (Bay Pacific), an intermodal equipment leasing entity, as we acquired our joint venture partner s interest in Bay Pacific during the third quarter of 2005.

The following tables summarize the year-over-year changes in commodity revenue, revenue carloads, and average revenue per car by commodity type:

	Three Months Ended			*Nine Months Ended*		
Commodity Revenue	*September 30,*		*%*	*September 30,*		*%*
Millions, Except for Percent Changes	*2006*	*2005*	*Change*	*2006*	*2005*	*Change*
Agricultural	$ 597	$ 502	19%	$ 1,725	$1,413	22%
Automotive	328	299	10	1,079	921	17
Chemicals	540	473	14	1,578	1,373	15
Energy	763	651	17	2,195	1,948	13
Industrial products	831	724	15	2,429	2,073	17
Intermodal	743	653	14	2,081	1,774	17
Total	$3,802	$3,302	15%	$11,087	$9,502	17%

	Three Months Ended			*Nine Months Ended*		
Revenue Carloads	*September 30,*		*%*	*September 30,*		*%*
Thousands, Except for Percent Changes	*2006*	*2005*	*Change*	*2006*	*2005*	*Change*
Agricultural	227	224	1%	686	655	5%
Automotive	191	186	3	626	589	6
Chemicals	229	230	(1)	681	694	(2)
Energy	584	546	7	1,709	1,645	4
Industrial products	371	384	(4)	1,124	1,140	(1)
Intermodal	907	863	5	2,586	2,401	8
Total	2,509	2,433	3%	7,412	7,124	4%

	Three Months Ended			*Nine Months Ended*		
Average Revenue	*September 30,*		*%*	*September 30,*		*%*
Per Car, Except for Percent Changes	*2006*	*2005*	*Change*	*2006*	*2005*	*Change*
Agricultural	$2,635	$2,236	18%	$2,515	$2,156	17%
Automotive	1,715	1,611	6	1,725	1,566	10
Chemicals	2,366	2,055	15	2,318	1,979	17
Energy	1,308	1,192	10	1,284	1,184	8
Industrial products	2,237	1,881	19	2,161	1,818	19
Intermodal	819	757	8	805	739	9
Total	$1,515	$1,357	12%	$1,496	$1,334	12%

Agricultural Price increases, volume growth, and fuel surcharges increased commodity revenue in the third quarter and nine-month periods of 2006 versus 2005. Strong gulf exports and higher freight charges for barge traffic, which shifted feed grain shipments to rails, drove these increases. Shipments of ethanol and its co-products (primarily livestock feed) also experienced strong growth in the third quarter and year-to-date periods of 2006, reflecting strong demand in the growing ethanol sector. Conversely, wheat shipments declined in both periods due to extremely low production levels in 2006 primarily due to sustained drought conditions in wheat producing states. Price and fuel surcharge increases drove ARC improvement in both periods.

Automotive Revenue increased in the third quarter of 2006 due to fuel surcharges, volume growth, and price increases. Finished vehicle shipments were flat in the third quarter versus 2005 as high shipments by most manufacturers were offset by reduced shipments by one manufacturer, which waited until the end of the quarter to release a large number of vehicles for shipment. Year-to-date, finished vehicle shipments grew 7% as higher manufacturer inventories at the end of 2005 translated into strong demand for transportation in the first quarter of

2006. Shipments of finished vehicles were also strong through the second quarter as plants manufacturing new vehicles ramped up production. Automotive parts shipments grew 8% and 5% in the third quarter and year-to-date periods of 2006, respectively, due to strong growth of intermodal shipments. Fuel surcharges and price increases drove the ARC improvement. Additionally, the increase of auto parts shipments, which have a lower ARC, had a negative impact on ARC during the third quarter.

Chemicals Revenue increased in the third quarter and year-to-date periods of 2006 primarily due to price increases, fuel surcharges, and index-based contract escalators, which also drove ARC improvement. Volume was down in the third quarter due to softer export markets for fertilizer and lower phosphate rock shipments, partially offset by solid growth in petroleum products shipments including asphalt, natural gas, and diesel fuel shipments. Mild weather and road construction projects fueled the increase in asphalt shipments; refinery capacity drove natural gas movements higher; and new EPA mandates for ultra-low sulfur diesel fuel resulted in increased diesel fuel shipments. Business interruptions in the third quarter of 2005, primarily attributable to Hurricane Rita, also impacted volume comparisons for the third quarter of 2006.

Energy Revenue increased in the third quarter and year-to-date periods of 2006 due to volume growth, fuel surcharges, price increases, and index-based contract escalators. ARC in the third quarter and year-to-date periods of 2006 improved due to fuel surcharges, price increases, and index-based contract escalators. Coal shipments over the SPRB Joint Line were up 8% and 6% during the third quarter and year-to-date periods, respectively. These increases in 2006 partially reflect lower volumes in the comparable periods as SPRB Joint Line disruptions and network disruptions resulting from Hurricane Rita hampered coal shipments in 2005. Conversely, shipments from the Colorado and Utah mines declined 1% and 9% during the third quarter and year-to-date periods, respectively, due to mine shutdowns that occurred in the first quarter of 2006, along with the impact of mining production problems and network maintenance through the third quarter.

Industrial Products Price increases, fuel surcharges, and the positive impact of transporting more shipments with a higher average ARC all combined to generate revenue growth in the third quarter and nine-month periods of 2006. Volume levels decreased in the third quarter and year-to-date periods due to lower lumber, paper, and newsprint shipments, which were partially offset by higher steel shipments. The softening housing market, lower production levels, and general market uncertainty drove the reduction in lumber shipments. Conversely, strong domestic markets drove the increase in construction-related steel materials and steel pipe, particularly those materials used in oil and gas drilling. Although flat in the third quarter, stone shipments were higher for the year-to-date period. Unseasonably hot weather limited the productivity of road construction crews in Texas, which reduced demand for stone shipments during the third quarter. This demand shortfall and train delays caused by several facility improvement projects on our network combined to constrain third quarter volumes. Strong demand during the first half of the year, car cycle time improvements, and the use of larger rock trains offset the third quarter decline and drove the increase of stone shipments for the nine-month period. Hurricane Rita reduced volumes of industrial products in the third quarter of 2005, which affected volume comparisons with the third quarter of 2006.

Intermodal Strong volume growth, fuel surcharges, price increases, and index-based contract escalators led to higher revenue in the third quarter and year-to-date periods of 2006. Carloadings during both periods grew due to strong imports, primarily from Asia. Domestic traffic volume declined in the third quarter due to competition from the trucking sector, which had a greater supply of resources, a softness in the eastbound market from Los Angeles, and overall softening of the domestic economy.

Mexico Business Each business group discussed above includes revenue from shipments to and from Mexico. Revenue from Mexico business increased 25% to $339 million in the third quarter of 2006 and 23% to $992 million for the first nine months of 2006 versus 2005. Price increases, fuel surcharges, and volume growth in finished vehicles, automotive parts, import beer, dry feed ingredients, and plastics drove revenue growth in both the quarterly and year-to-date periods.

Operating Expenses

	Three Months Ended			*Nine Months Ended*		
	September 30,		*%*	*September 30,*		*%*
Millions, Except for Percent Changes	*2006*	*2005*	*Change*	*2006*	*2005*	*Change*
Salaries, wages, and employee benefits	$1,161	$1,093	6%	$3,430	$3,267	5%
Fuel and utilities	821	673	22	2,307	1,809	28
Equipment and other rents	371	356	4	1,109	1,049	6
Depreciation	311	294	6	922	875	5
Materials and supplies	178	140	27	520	403	29
Casualty costs	83	109	(24)	303	308	(2)
Purchased services and other costs	306	315	(3)	951	984	(3)
Total	$3,231	$2,980	8%	$9,542	$8,695	10%

Operating expenses increased $251 million and $847 million in the third quarter and nine-month periods of 2006, respectively, versus the comparable periods in 2005. Locomotive fuel prices increased 20% and 26% during the third quarter and year-to-date periods, respectively, which accounted for $130 million and $441 million of these increases. Our fuel surcharge programs helped offset these expenses in the form of higher revenue, recovering approximately 89% and 87% of the additional expense incurred above our base fuel price of $0.75 per gallon for the third quarter and year-to-date periods of 2006, respectively. We base a majority of our fuel surcharges on the average U.S. diesel fuel price effective two months prior. The recovery percentage improved from 80% in the second quarter of 2006 due to the effect of this two-month timing lag as fuel prices declined during the latter half of the third quarter. Inflation of wages, benefits, and materials and supplies; a larger workforce; volume-related expenses; higher locomotive and freight car maintenance and lease expenses; and increased management compensation costs accounted for most of the additional increase in the two periods. Settlement of all insurance claims related to the 2005 January West Coast storm, lower casualty costs, an improved fuel consumption rate, and improved car cycle times (which reduced freight car rental expense) partially offset the cost increases. Finally, the comparability of the year-to-date operating expenses is affected by the 2005 January West Coast storm, which resulted in additional clean-up and restoration costs in 2005.

Salaries, Wages, and Employee Benefits General wage and benefit inflation increased expenses in the third quarter and year-to-date periods of 2006, reflecting higher salaries and wages and the impact of higher healthcare and other benefit costs. A larger workforce, driven by higher volume levels, and increased management compensation costs (in part driven by stock compensation expense) also contributed to higher expenses. Higher crew training costs resulting from the year-over-year increase in hiring activity drove expenses in the third quarter of 2006 versus 2005, whereas 2006 year-to-date crew training costs were lower compared to 2005. Conversely, reduced protection costs and operational improvements, boosted by network management initiatives and investment in capacity, partially offset these cost increases. Protection costs represent the differential payment when the wage earned for active employment is lower than an employee s protected rate of pay. An individual s protected rate is imposed by the Surface Transportation Board for employees adversely affected by a merger or is established by collective bargaining agreements with our labor unions in certain cases. Year-to-date expenses in 2006 were also comparatively lower as we had higher labor expenses for clean-up and restoration work in the first quarter of 2005 associated with the January West Coast storm.

Fuel and Utilities Fuel and utilities include locomotive fuel, utilities other than telephone, and gasoline and other fuels. Higher diesel fuel prices, which averaged $2.27 per gallon (including taxes and transportation costs) in the third quarter of 2006 compared to $1.88 per gallon in the same period in 2005, increased expenses by $130 million. A 3% increase in gross ton-miles resulted in $16 million of additional expenses, which was partially offset by a 1% improvement in our consumption rate due to the use of newer, more fuel-efficient locomotives, and our fuel conservation programs. Gasoline, utilities, and propane and other fuel expenses increased $4 million in the third quarter of 2006 due to higher prices. Year-to-date, higher diesel prices of $2.09 per gallon compared to $1.66 per gallon in 2005 contributed $441 million of increased expense. A 2% improvement in our consumption rate partially offset a 3% increase in gross ton-miles, which added $49 million of fuel expenses.

Equipment and Other Rents Equipment and other rents primarily include rental expense the Railroad pays for freight cars owned by other railroads or private companies; freight car, intermodal, and locomotive leases; other specialty equipment leases; and office and other rentals. Lease expense increased in the third quarter and year-to-date periods of 2006 compared to 2005 as we leased more locomotives and freight cars.

Solid automotive and intermodal volume growth also increased our short-term freight car rental expense. Improved car cycle times driven by network management initiatives partially offset these increases, which lowered short-term freight car rental expense.

Depreciation A majority of depreciation relates to track structure, including rail, ties, and other track material. A higher depreciable asset base, reflecting higher capital spending in recent years, increased depreciation expense in the third quarter and first nine months of 2006.

Materials and Supplies Materials used to maintain the Railroad s lines, structures, and equipment are the principal component of materials and supplies expense. This expense item also includes small tools, office supplies, other materials, and the costs of freight services to ship Railroad materials. During the third quarter and year-to-date periods of 2006, materials and supplies expense increased, primarily due to locomotive and freight car maintenance. We used more materials at higher component costs to repair and maintain freight cars and our fleet of locomotives, including a growing number of units not covered by warranties. In addition, in the year-to-date period of 2006, we performed more maintenance on locomotives that were maintained internally and not subject to maintenance contracts with third-party contractors compared to the third quarter of 2005.

Casualty Costs Personal injury expense, freight and property damage, insurance, and environmental costs are the primary components of casualty costs. Lower personal injury expense drove the decrease in third quarter casualty costs compared to 2005 due to a recent actuarial study that projected lower than expected settlement costs for incidents that have occurred and are pending resolution. Lower bad debt expense due to improved collection rates and a reduction in freight damage expenses also drove lower third quarter and year-to-date expenses. Higher personal injury expense, mainly due to adverse developments on a small number of existing claims during the first half of 2006, partially offset the year-to-date reduction in expenses.

Purchased Services and Other Costs Purchased services and other costs include the costs of services purchased from outside contractors, state and local taxes, net costs of operating facilities jointly used by UPRR and other railroads, transportation and lodging for train crew employees, trucking and contracting costs for intermodal containers, leased automobile maintenance expenses, telephone and cellular expense, employee travel expense, and computer and other general expenses. Settlement of insurance claims related to the 2005 January West Coast storm reduced expenses by $23 million in the third quarter of 2006. Lower locomotive contract maintenance costs and lower expenses associated with jointly-owned operating facilities also reduced expenses in the third quarter and year-to-date periods of 2006 versus the same periods of 2005. In addition, the gain from the sale of two airplanes and increased repair work on privately and foreign owned freight cars, which was reimbursed by third parties, also reduced expenses in the nine-month period of 2006 compared to 2005. Conversely, volume-related expenses, including crew transportation costs and contracting costs for intermodal containers, increased in the third quarter and year-to-date periods driven by 3% and 4% carloading growth in the periods, respectively. Higher state and local taxes (primarily sales and use taxes) also drove expenses higher in the third quarter and year-to-date periods compared to 2005. Additionally, clean-up and restoration costs related to the January West Coast storm added expenses in the first nine months of 2005, which also reduced year-over-year expenses.

Non-Operating Items

	Three Months Ended			*Nine Months Ended*		
	September 30,		*%*	*September 30,*		*%*
Millions, Except for Percent Changes	*2006*	*2005*	*Change*	*2006*	*2005*	*Change*
Other income	$22	$42	(48)%	$61	$91	(33)%
Interest expense	(119)	(124)	(4)	(359)	(384)	(7)
Income taxes	(235)	(30)	683	(655)	(239)	174

Other Income Lower net gains from non-operating asset sales and higher expenses due to rising interest rates associated with our sale of receivables program resulted in a reduction in other income in the third quarter and year-to-date periods of 2006 compared to 2005.

Interest Expense Interest expense was lower in the third quarter and nine-month periods of 2006 primarily due to declining weighted-average debt levels of $7.1 billion and $7.2 billion, respectively, compared to $7.6 billion and $7.9 billion in the corresponding periods of 2005. A higher effective interest rate of 6.8% and 6.7% in the third quarter and year-to-date periods of 2006, respectively, versus 6.5% in both comparable periods of 2005 partially offset the effects of the lower debt levels.

Income Taxes Income tax expense was higher in the third quarter and year-to-date periods of 2006. Income tax expense in 2005 was lower due to a $118 million one-time reduction, which was primarily related to final settlements with the Internal Revenue Service for pre-1995 tax years and the impact those settlements had on post-1995 years. Higher income tax expense in 2006 also resulted from higher pretax income; partially offsetting this increase was a net $12 million reduction primarily related to deferred state income tax adjustments for additional deductions of track investment, a reversal of a valuation allowance for state tax credits, and changes in the distribution of taxable income between states. Our effective tax rate was 35.9% and 36.9% in the third quarter and year-to-date periods of 2006, respectively, compared to 7.5% and 24.7% in the corresponding periods of 2005.

OTHER OPERATING AND FINANCIAL STATISTICS

We report key Railroad performance measures weekly to the Association of American Railroads, including carloads, average train speed, average daily inventory of rail cars on our system, and average terminal dwell time. The operating data are available on our website at www.up.com/investors/reports/index.shtml.

	Three Months Ended			*Nine Months Ended*		
	September 30,		*%*	*September 30,*		*%*
	2006	*2005*	*Change*	*2006*	*2005*	*Change*
Average train speed (miles per hour)	21.3	21.6	(1)%	21.3	21.3	-%
Average terminal dwell time (hours)	26.2	28.1	(7)	27.6	28.3	(2)
Gross ton-miles (billions)	270.0	263.4	3	805.1	781.8	3
Revenue ton-miles (billions)	141.7	138.2	3	424.4	412.5	3
Average full-time equivalent employees	51,278	50,106	2	50,874	49,831	2

Average Train Speed Average train speed is calculated by dividing train miles by hours operated on our main lines between terminals. Ongoing network management initiatives and capacity expansion allowed us to move 3% and 4% more carloads in the third quarter and year-to-date periods of 2006, respectively, while average train speed decreased slightly compared to 2005.

Average Terminal Dwell Time Average terminal dwell time is the average time that a rail car spends at our terminals. Lower average terminal dwell time is favorable. Average terminal dwell improved in both periods versus 2005 as a result of ongoing network management initiatives and directed efforts to more timely deliver rail cars off-line to our interchange partners and customers.

Gross and Revenue Ton-Miles Gross ton-miles are calculated by multiplying the weight of loaded or empty freight cars by the number of miles hauled. Revenue ton-miles are calculated by multiplying the weight of freight by the number of tariff miles. In the third quarter of 2006, gross and revenue ton-miles grew 3% in relation to the 3% increase in carloadings as volume growth was balanced between the higher and lower density commodities. In the nine-month period of 2006, both gross and revenue ton-miles also grew 3%, while carloadings increased 4%. Stronger volume growth in the lower density commodity groups of intermodal and automotive, combined with volume decreases in the higher density commodities of chemicals and industrial products impacted growth rates of gross and revenue ton-miles in relation to carloading growth.

Average Full-Time Equivalent Employees Employee levels in the third quarter and year-to-date periods of 2006 include more employees to maintain our larger locomotive and freight car fleet, the addition of employees needed to complete increased track repair and replacement programs, the hiring of operations management personnel, including an expanded management training program, and train and engine personnel to manage current demand.

Debt to Capital/Lease Adjusted Debt to Capital

Debt to Capital

Millions of Dollars, except Percentages	*September 30, 2006*	*December 31, 2005*	*Change*
Debt	$ 7,050	$ 7,416	$(366)
Equity	14,770	13,707	1,063
Capital	$21,820	$21,123	$ 697
Debt to capital	32.3%	35.1%	(2.8) pt

Lease Adjusted Debt to Capital

Millions of Dollars, except Percentages	*September 30, 2006*	*December 31, 2005*	*Change*
Debt	$ 7,050	$ 7,416	$ (366)
Net present value of operating leases	3,530	3,185	345
Lease adjusted debt	10,580	10,601	(21)
Equity	14,770	13,707	1,063
Lease adjusted capital	$25,350	$24,308	$1,042
Lease adjusted debt to capital	41.7%	43.6%	(1.9) pt

Lease adjusted debt to capital is considered a non-GAAP measure by SEC Regulation G. We believe this measure is important in evaluating the total amount of leverage in our capital structure including off-balance sheet lease obligations. We monitor the ratio of lease adjusted debt to capital as we manage our capital structure to balance cost effective and efficient access to the capital markets with the Company s overall cost of capital. Lease adjusted debt to capital should be considered in addition to, rather than as a substitute for, debt to capital. The table above provides support for the lease adjusted debt to capital calculation. Our debt to capital ratios improved as a result of a $366 million reduction in our debt level from December 31, 2005, and an increase in retained earnings due to higher net income in 2006.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows	*Nine Months Ended September 30,*		
Millions of Dollars	*2006*	*2005*	*Change*
Cash provided by operating activities	$1,979	$1,695	$284
Cash used in investing activities	(1,566)	(1,618)	52
Cash used in financing activities	(467)	(717)	250
Net change in cash and cash equivalents	$ (54)	$ (640)	$586

Cash Provided by Operating Activities Higher income in the first nine months of 2006 drove the increase in cash provided by operating activities, which was partially offset by higher income tax payments; higher material and supply inventories (primarily fuel price driven); a $50 million voluntary pension contribution; and higher management incentive payments in 2006.

Cash Used in Investing Activities The insurance settlement for the 2005 January West Coast storm and lower work in process balances decreased the amount of cash used in investing activities. Higher capital investments and less proceeds from asset sales partially offset the decrease.

The following table details capital expenditures for the nine months ended September 30:

Capital Expenditures	*Nine Months Ended September 30,*	
Millions of Dollars	*2006*	*2005*
Track program	$1,184	$1,165
Capacity and commercial facilities	359	382
Locomotives and freight cars	95	75
Other	57	54
Total	$1,695	$1,676

Cash Used in Financing Activities The decrease in cash used in financing activities resulted from lower debt repayments ($371 million in the first nine months of 2006 compared to $662 million in the same period of 2005) partially offset by lower net proceeds from equity compensation plans ($122 million and $172 million in the first nine months of 2006 and 2005, respectively).

Free Cash Flow	*Nine Months Ended September 30,*	
Millions of Dollars	*2006*	*2005*
Cash provided by operating activities	$ 1,979	$ 1,695
Cash used in investing activities	(1,566)	(1,618)
Dividends paid	(241)	(235)
Free cash flow	$ 172	$ (158)

Free Cash Flow Free cash flow is considered a non-GAAP financial measure by SEC Regulation G. We believe free cash flow is important in evaluating our financial performance and measures our ability to generate cash without incurring additional external financings. Free cash flow should be considered in addition to, rather than as a substitute for, cash provided by operating activities. The table above reconciles cash provided by operating activities (GAAP measure) to free cash flow (non-GAAP measure).

Capital Expenditures Outlook We expect our 2006 capital expenditures to be approximately $2.8 billion, including $500 million of long-term operating leases. We are evaluating plans to increase our total capital expenditures for 2007 by about 15% to approximately $3.2 billion, including any long-term operating leases. The additional spending would target capacity expansion to support growth opportunities for commodities with strong demand forecasts and expected financial returns, including intermodal, coal, and agricultural products. We currently expect that cash generated from operations will support this additional spending. However, we will continue to monitor our performance and may adjust capital expenditures as necessary.

Credit Facilities On September 30, 2006, we had $2 billion in revolving credit facilities available, including $1 billion under a five-year facility expiring in March 2009 and $1 billion under a five-year facility expiring in March 2010 (collectively, the facilities). The facilities are designated for general corporate purposes and support the issuance of commercial paper. Neither of the facilities were drawn as of September 30, 2006. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers. These facilities allow for borrowings at floating rates based on London Interbank Offered Rates, plus a spread, depending upon our senior unsecured debt ratings. The facilities require the maintenance of a minimum net worth and a debt to net worth coverage ratio. At September 30, 2006, we were in compliance with these covenants. The facilities do not include any other financial restrictions, credit rating triggers (other than rating-dependent pricing), or any other provision that could require the posting of collateral.

In addition to our revolving credit facilities, we also had $150 million in uncommitted lines of credit available, including $75 million that expires in March 2007 and $75 million expiring in July 2007. Neither of these lines of credit were drawn on as of September 30, 2006. We must have equivalent credit available under our five-year facilities to draw on the $75 million lines of credit.

Shelf Registration Statement Under a current shelf registration statement, we may issue any combination of debt securities, preferred stock, common stock, or warrants for debt securities or preferred stock in one or more offerings. At September 30, 2006, we had $500 million remaining for issuance under the current shelf registration statement. We have no immediate plans to issue any securities; however, we routinely consider and evaluate opportunities to replace existing debt or access capital through issuances of debt securities under this shelf registration, and, therefore, we may issue debt securities at any time.

Ratio of Earnings to Fixed Charges For the three and nine months ended September 30, 2006, our ratio of earnings to fixed charges was 4.5 and 4.2, respectively, compared to 3.1 and 2.7 for the three and nine months ended September 30, 2005, respectively. The ratio of earnings to fixed charges was computed on a consolidated basis. Earnings represent net income, less equity earnings net of distributions, plus fixed charges and income taxes. Fixed charges represent interest charges, amortization of debt discount, and an estimated amount representing the interest portion of rental charges.

Operating Lease Activities As of September 30, 2006, the Railroad, as lessee, entered into long-term operating lease arrangements covering 200 locomotives and 2,100 freight cars, which represent the majority of new equipment that the Railroad plans to acquire in 2006. Through the date of this report, the lessors under these lease arrangements purchased all 200 locomotives and 1,920 freight cars from the Corporation through various financing transactions with a total equipment cost of approximately $511 million. In the fourth quarter, we anticipate financing the remaining freight cars under these lease arrangements with a total equipment cost of approximately $12 million. In total, these new lease arrangements will provide for minimum total rental payments of approximately $777 million, with a present value of approximately $427 million.

The lessors financed the purchase of the locomotives and freight cars, in part, by the issuance of equipment notes that are non-recourse to the Railroad and are secured by assignments of the underlying leases and security interests in the various types of equipment. Neither the Railroad nor UPC guarantees payment of the equipment notes. The Railroad s obligations to make operating lease payments under the leases are recourse obligations and are not recorded in the Consolidated Statements of Financial Position.

The Railroad has certain renewal and purchase options with respect to the locomotives and freight cars. If the Railroad does not exercise any such options, the equipment will be returned to the lessors at the end of the lease term.

Off-Balance Sheet Arrangements, Contractual Obligations, and Commercial Commitments

As described in the notes to the Consolidated Financial Statements and as referenced in the tables below, we have contractual obligations and commercial commitments that may affect our financial condition. However, based on our assessment of the underlying provisions and circumstances of our material contractual obligations and commercial commitments, including material sources of off-balance sheet and structured finance arrangements, there is no known trend, demand, commitment, event, or uncertainty that is reasonably likely to occur that would have a material adverse effect on our consolidated results of operations, financial condition, or liquidity. In addition, the commercial obligations, financings, and commitments made by us are customary transactions that are similar to those of other comparable corporations, particularly within the transportation industry.

The following tables identify material obligations and commitments as of September 30, 2006:

		Payments Due by September 30,					
							After
Contractual Obligations Millions of Dollars	*Total*	*2007*	*2008*	*2009*	*2010*	*2011*	*2011*
Debt [a]	$ 9,457	$ 649	$1,304	$ 953	$ 595	$ 673	$ 5,283
Operating leases	5,485	565	548	502	460	449	2,961

Capital lease obligations [b]	1,916	184	177	170	150	157	1,078
Purchase obligations [c]	4,481	1,277	638	538	208	179	1,641
Other postretirement benefits [d]	479	42	45	46	48	49	249
Total contractual obligations	$21,818	$2,717	$2,712	$2,209	$1,461	$1,507	$11,212

[a] *Excludes capital lease obligations of $1,236 million, unamortized discount of $(103) million, and market value adjustments of $(15) million for debt with qualifying hedges that are recorded as liabilities on the Consolidated Statements of Financial Position. Includes an interest component of $3,525 million.*

[b] *Represents total obligations, including interest component of $680 million.*

[c] *Includes locomotive maintenance contracts; purchase commitments for locomotives, freight cars, ties, ballast, and track; and agreements to purchase other goods and services.*

[d] *Includes estimated other postretirement, medical, and life insurance payments and payments made under the unfunded pension plan for the next ten years. No amounts are included for funded pension as no contributions are currently required.*

	Amount of Commitment Expiration by September 30,						
							After
Other Commercial Commitments Millions of Dollars	*Total*	*2007*	*2008*	*2009*	*2010*	*2011*	*2011*
Credit facilities [a]	$2,000	$ -	$-	$1,000	$1,000	$ -	$ -
Sale of receivables [b]	600	600	-	-	-	-	-
Guarantees [c]	455	5	5	18	45	61	321
Standby letters of credit [d]	37	37	-	-	-	-	-
Total commercial commitments	$3,092	$642	$5	$1,018	$1,045	$61	$321

[a] None of the credit facilities was used as of September 30, 2006.
[b] $600 million of the facility was utilized at September 30, 2006.
[c] Includes guaranteed obligations related to our headquarters, equipment financings, and affiliated operations.
[d] None of the letters of credit was drawn upon as of September 30, 2006.

Sale of Receivables The Railroad transfers most of its accounts receivable to Union Pacific Receivables, Inc. (UPRI), a bankruptcy-remote subsidiary, as part of a sale of receivables facility. UPRI sells, without recourse, an undivided interest in such accounts receivable to investors. The total capacity to sell undivided interests to investors under the facility was $600 million at both September 30, 2006 and December 31, 2005. The value of the outstanding undivided interest held by investors under the facility was $600 million at both September 30, 2006 and December 31, 2005. The value of the outstanding undivided interest held by investors is not included in our Consolidated Financial Statements. The value of the undivided interest held by investors was supported by $1,234 million and $1,226 million of accounts receivable held by UPRI at September 30, 2006 and December 31, 2005, respectively. At September 30, 2006 and December 31, 2005, the value of the interest retained by UPRI was $634 million and $626 million, respectively. The interest in accounts receivable held by UPRI is included in accounts receivable in our Consolidated Financial Statements, whereas the interest sold to investors is sold at carrying value, which approximates fair value, and there is no gain or loss recognized from the transaction.

The value of the outstanding undivided interest held by investors could fluctuate based upon the availability of eligible receivables and is directly affected by changing business volumes and credit risks, including default and dilution. If default or dilution percentages were to increase one percentage point, the amount of eligible receivables would decrease by $6 million. Should our credit rating fall below investment grade, the value of the outstanding undivided interest held by investors would be reduced, and, in certain cases, the investors would have the right to discontinue the facility.

The Railroad services the sold receivables; however, the Railroad does not recognize any servicing asset or liability as the servicing fees adequately compensate the Railroad for its responsibilities. The Railroad collected approximately $11 billion and $10 billion during the nine months ended September 30, 2006 and 2005, respectively. UPRI used certain of these proceeds to purchase new receivables under the facility.

The costs of the sale of receivables program are included in other income and were $9 million and $6 million for the three months ended September 30, 2006 and 2005, respectively, and $25 million and $16 million for the nine months ended September 30, 2006 and 2005, respectively. The costs include interest, program fees paid to banks, commercial paper issuing costs, and fees for unused commitment availability.

The investors have no recourse to the Railroad s other assets except for customary warranty and indemnity claims. Creditors of the Railroad have no recourse to the assets of UPRI. The sale of receivables program expires in August 2007.

OTHER MATTERS

Asserted and Unasserted Claims Various claims and lawsuits are pending against us and certain of our subsidiaries. It is not possible at this time for us to determine fully the effect of all unasserted claims on our consolidated results of operations, financial condition, or liquidity; however, to the extent possible, where unasserted claims are considered probable and where such claims can be reasonably estimated, we have recorded a liability. We do not expect that any known lawsuits, claims, environmental costs, commitments, contingent liabilities, or guarantees will have a material adverse effect on our consolidated results of operations, financial condition, or liquidity after taking into account liabilities previously recorded for these matters.

Income Taxes - As previously reported in note 3 to our Consolidated Financial Statements, Item 8, in our 2005 annual report on Form 10-K, the Internal Revenue Service (IRS) completed its examinations and issued notices of deficiency for tax years 1995 through 2002. Among their proposed adjustments is the disallowance of tax deductions claimed in connection with certain donations of property. In 2005, the IRS national office issued a Technical Advice Memorandum that left unresolved whether the deductions were proper pending further factual development by the IRS examination team. We continue to dispute the donation issue, as well as many of the other proposed adjustments, and will contest the associated tax deficiencies through the IRS appeals process, and, if necessary, litigation. We do not expect that the ultimate resolution of these examinations will have a material adverse effect on our operating results, financial condition, or liquidity. In addition, tax years 2003 and 2004 are currently under examination by the IRS.

As reported in the Corporation s Forms 10-Q for quarters ended June 30, 2005, and September 30, 2005, the final settlements for pre-1995 tax years, along with the IRS Examination Reports for tax years 1995 through 2002, among other things, were considered in a review and re-evaluation of the Corporation s estimated deferred tax assets and liabilities. This review resulted in a reduction of deferred income tax liabilities and income tax expense of $118 million in the third quarter of 2005.

Accounting Pronouncements In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). The interpretation limits the amount we recognize to no more than the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement of a tax position. The interpretation is effective for us beginning in the first quarter of 2007. Any change in uncertain tax positions required upon adoption of the interpretation will be an adjustment to beginning retained earnings. We are currently assessing the impact FIN 48 may have on our Consolidated Financial Statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurement* (FAS 157). While this statement does not require new fair value measurements, it provides guidance on applying fair value and expands required disclosures. FAS 157 is effective for us beginning in the first quarter of 2008. We are currently assessing the impact FAS 157 may have on our Consolidated Financial Statements.

In September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 requires us to recognize the funded status of our pension and postretirement plans in the balance sheet, along with a corresponding noncash, after-tax adjustment to shareholders equity. Funded status is determined as the difference between the fair value of plan assets and the benefit obligation. Changes in the funded status should be recognized in other comprehensive loss. We will adopt FAS 158 at the end of 2006. We do not expect the adoption of FAS 158 to have a material impact on our Consolidated Financial Statements, liquidity or compliance with debt covenants.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB 108 requires registrants to quantify misstatements using both an income statement and balance sheet approach and then evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial are now considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior year s financial statements are not restated, the cumulative effect adjustment is recorded in opening accumulated earnings (deficit) as of the beginning of the fiscal year of adoption. SAB 108 is effective for us at the end of 2006. We do not expect the adoption of SAB 108 will have a material impact on our Consolidated Financial Statements.

CAUTIONARY INFORMATION

Certain statements in this report, and statements in other material filed or to be filed with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by us), are, or will be, forward-looking statements as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. These forward-looking statements include, without limitation, statements regarding: expectations as to operational or service improvements; statements concerning expectations of the effectiveness of steps taken or to be taken to improve operations, service, or to stabilize the rail system, infrastructure improvements, transportation plan modifications, and management of customer traffic on the system to meet demand; expectations as to cost savings, revenue growth, and earnings; the time by which certain objectives will be achieved; statements or information concerning projections, predictions, expectations, estimates, or forecasts as to our business, financial and operational results, future economic performance, and general economic conditions; statements of management s goals and objectives; proposed new products and services; estimates of costs relating to environmental remediation and restoration; expectations that claims, lawsuits, environmental costs, commitments, contingent liabilities, labor negotiations or agreements, or other matters will not have a material adverse effect on our consolidated financial condition, results of operations, or liquidity and any other similar expressions concerning matters that are not historical facts.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times that, or by which, such performance or results will be achieved, including expectations as to improvement of operational, service, and network fluidity improvements. Forward-looking information is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements.

The following important factors, in addition to those discussed in Risk Factors in Item 1A of our 2005 annual report on Form 10-K, filed with the SEC on February 24, 2006, could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements:

whether we are successful in implementing our financial and operational initiatives, including gaining new customers, retaining existing ones, increasing prices for our services, and containing operating costs;

whether we are successful in improving network operations and service by improving infrastructure; reviewing, assessing, and, as necessary, redesigning our transportation plan; managing network volume, and undertaking other efficiency and productivity initiatives;

claims and litigation, including those related to environmental contamination, personal injuries, and occupational illnesses arising from hearing loss, repetitive motion, and exposure to asbestos and diesel fumes;

legislative and regulatory developments, including possible legislation to re-regulate the rail industry;

any adverse economic or operational repercussions related to the transportation of hazardous materials, which we are required to transport under federal law;

natural events such as severe weather, fire, hurricanes, floods, earthquakes, or other disruptions of our operating systems, structures, and equipment;

the impact of ongoing track maintenance and restoration in the Southern Powder River Basin of Wyoming;

changes in fuel prices, including price increases caused by the effects of severe weather, other events, or disruptions of domestic refining capacity, or changes to our ability to recover fuel costs;

material adverse changes in economic and industry conditions, both within the United States and globally;

adverse economic conditions affecting customer demand and the industries and geographic areas that produce and consume commodities we carry;

transportation industry competition, conditions, performance, and consolidation;

changes in labor costs, including healthcare cost increases, and labor difficulties, including stoppages affecting either our operations or our customers abilities to deliver goods to us for shipment;

legislative, regulatory, or legal developments involving taxation, including new federal or state income tax rates, revisions of controlling authority, and tax claims and litigation;

changes in securities and capital markets; and

terrorist activities, or other similar events, and any governmental response thereto; war or risk of war.

Forward-looking statements speak only as of the date the statement was made. We assume no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect thereto or with respect to other forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

None.

Item 4. Controls and Procedures

As of the end of the period covered by this report, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation s management, including the Corporation s Chief Executive Officer (CEO) and Executive Vice President Finance and Chief Financial Officer (CFO), of the effectiveness of the design and operation of the Corporation s disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Based upon that evaluation, the CEO and the CFO concluded that, as of the end of the period covered by this report, the Corporation s disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC, and that such information is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Additionally, the CEO and CFO determined that there have been no significant changes to the Corporation s internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Corporation is involved in legal proceedings, claims, and litigation that occur in connection with the Corporation s business. Management routinely assesses the Corporation s liabilities and contingencies in connection with these matters based upon the latest information available. Consistent with SEC rules and requirements, the Corporation describes below material pending legal proceedings (other than ordinary routine litigation incidental to the business of the Corporation), material proceedings known to be contemplated by governmental authorities, other proceedings arising under federal, state, or local environmental laws and regulations (including governmental proceedings involving potential fines, penalties, or other monetary sanctions in excess of $100,000) and such other pending matters that the Corporation may determine to be appropriate.

Other Matters

As we reported in our Current Report on Form 8-K filed on April 12, 2005, we received a complaint in a purported shareholder derivative lawsuit. The Corporation initially received a demand letter on or about September 8, 2004, from counsel for a shareholder asserting that the Railroad failed to properly report certain accidents to the appropriate regulatory authorities and had failed to comply with safety standards set by the Federal Rail Administration. The demand letter requested that the Corporation take legal action against its directors and certain other defendants. On September 30, 2004, the Board of Directors established a Special Committee of the Board to investigate the claims alleged in the demand letter and determine what, if any, action should be taken in response to the letter. The Special Committee initiated its investigation, and, prior to completing this task, the plaintiff filed a derivative complaint in Utah. The complaint was filed in state court in Salt Lake County, Utah, on April 5, 2005, and alleged that the director defendants breached their fiduciary duty to the Corporation and its shareholders by, among other things, disregarding problems relating to railroad safety, compliance with governmental regulations, including reporting requirements with respect to rail accidents, and the handling of evidence in rail accident cases. The complaint contended that, as a consequence of such alleged breach of duty, the Corporation suffered substantial monetary losses and other injuries and sought, among other things, an award of compensatory damages against the defendant directors, other non-monetary remedies and relief, and an award of the plaintiff s reasonable expenses and attorney s fees.

The Special Committee expanded its investigation to include the additional matters raised in the subsequent complaint. Following the investigation, the Special Committee delivered a report to the Court, dated August 15, 2005, that concluded there was no reasonable prospect of success in establishing any of the claims in the complaint, and that it was not in the best interest of the Corporation to pursue the matter. Upon issuance of the report and consistent with this conclusion, the Corporation, acting at the direction of the Special Committee, filed a motion to dismiss on August 18, 2005.

In the course of conducting discovery in connection with several matters raised by the motion to dismiss, the parties engaged in arm s length discussions regarding possible settlement of the matter. On August 4, 2006, the Corporation and the individual defendants entered into a Stipulation of Compromise and Settlement with the plaintiff (the Stipulation), providing for the settlement of the complaint and the dismissal of all the claims set forth in the complaint. The Corporation and the individual defendants entered into the Stipulation for the purpose of avoiding the additional expense, inconvenience, and burden of pursuing such litigation, and their decision to enter into the Stipulation did not constitute, and pursuant to the Stipulation may not be deemed or construed as, an admission, concession, or evidence of any liability or wrongdoing of any of the defendants, which liability and wrongdoing have consistently been, and continue to be, denied. Under the terms of the Stipulation, which were described in detail in a notice to the shareholders, (i) the Corporation will retain an outside consultant to review and recommend changes or improvements, if any, with respect to grade crossing safety and the metrics used by the Board and its Audit Committee to monitor safety performance, (ii) the Railroad will formally designate a Chief Safety Officer, and (iii) the Corporation will make changes to its corporate governance guidelines and policies, codes of business conduct and ethics, and certain Board committee charters designed to emphasize and make more formal the continuing commitment of the Company and the Railroad to improving operational safety and regulatory compliance. At a hearing on October 19, 2006, following notice to shareholders, the Court approved the proposed settlement set forth in the Stipulation and awarded attorney s fees and expenses in the amount of $1,125,000 to the counsel for the plaintiff, which fees will be paid by the Corporation. On August 9, 2006, the U.S. government filed a complaint in the U.S. District Court for the District of Eastern California against the Railroad, claiming unspecified damages for destruction of, or harm to, natural resources and related fire suppression costs in connection with a fire near the Railroad s right of way. The fire occurred on August 17, 2000, in the Plumas National Forest, in the Lassen National Forest, and on private timberland near Storrie, California. On October 17, 2006, the U.S. government indicated in a court filing that it is seeking damages in excess of $246 million. The Railroad disputes the amount of the claim, which significantly exceeds the initial claim delivered to the Railroad by the U.S. government, and believes that it has adequate insurance coverage for any expected liability. Therefore, the Railroad currently does not believe that any liability arising from this proceeding would have a material adverse impact on any of its results of operations, financial condition, or liquidity.

Environmental Matters

As we reported in our Annual Report on Form 10-K for 2005, the State of Washington Department of Ecology notified the Railroad on October 25, 2005, that it assessed a penalty of $106,000 against the Railroad for a November 15, 2003, incident near Kelso, Washington. In that incident, a UPRR train collided with a BNSF train, derailing three of our locomotives. The Department of Ecology contended that diesel fuel and lube oil from the derailed locomotives entered waters of the State of Washington. The Railroad asked the state to reconsider the penalty amount. On April 10, 2006, the Department of Ecology notified the Railroad that its request had been denied, and the amount of the penalty was affirmed. The Railroad appealed the penalty. On September 22, 2006, the Department of Ecology and the Railroad entered into a settlement agreement. Pursuant to the settlement, UPRR agreed, without admitting liability, to pay the Department of Ecology $20,000 and to contribute $78,000 toward a Supplemental Environmental Project.

As we reported in our Annual Report on Form 10-K for 2003, the District Attorneys of Merced, Madera, and Stanislaus Counties in California filed a criminal case against the Railroad relating to a series of alleged releases of calcium oxide (lime). The criminal case was dismissed in the last quarter of 2003 and was subsequently refiled as a civil action by several counties in the San Joaquin County Superior Court. The refiled suit sought civil penalties against the Railroad in connection with the release of lime from an unidentified rail car between Chowchilla and Sacramento, California, on December 27, 2001, and another incident in which lime leaked from a rail car between Chowchilla and Stockton, California, on February 21, 2002. The suit contended that regulatory violations occurred by virtue of the Railroad s alleged failure to timely report the release of a hazardous material, its alleged disposal of hazardous waste, and the alleged release of material into the waters of the State of California. On September 20, 2004, the Court dismissed the suit with prejudice. The State appealed this decision. On August 2, 2006, the Court of Appeals issued its decision, reversing the judgment and remanding the case for further proceedings consistent with its opinion. The Court of Appeals held that the State of California s claims against the Railroad for civil penalties were preempted by the Hazardous Materials Transportation Act (HMTA), with the exception of its claims, which were based upon the Railroad s alleged failure to timely report the releases of calcium oxide to state and local authorities. With respect to these claims, the Court held that while they were not preempted by the HMTA on their face, it remained possible that those claims might ultimately be preempted once the trial court developed a record. The Railroad and the State requested that the California Supreme Court review the decision of the Court of Appeals. The California Supreme Court has not indicated whether it will hear the case.

As we reported in our Annual Report on Form 10-K for 2003, the United States Attorney for the Central District of California notified the Railroad that the office intended to pursue criminal charges against us for alleged violations of federal environmental laws, including the federal Clean Water Act, in connection with releases of oil contaminated wastewater from our Taylor Yard in 2001 and 2003. On July 31, 2006, the United States Attorney filed criminal misdemeanor charges against us for these releases in the United States District Court for the Central District of California, and we received the Summons from the Court on August 8, 2006. We will vigorously defend the charges.

Item 1A. Risk Factors

There were no material changes from the risk factors previously disclosed in our 2005 annual report on Form 10-K.

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

Purchases of Equity Securities We do not currently intend to repurchase any shares in 2006 to replace treasury shares issued as stock-based compensation. The purchased shares presented below relate solely to our equity compensation plans described in note 7 to the Consolidated Financial Statements and Supplementary Data, Item 8 in our 2005 annual report on Form 10-K. The following table presents common stock repurchases during each month for the third quarter:

Period	*Total Number of Shares Purchased*	*Average Price Paid per Share*	*Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program*	*Maximum Number of Shares That May Yet Be Purchased Under the Plan or Program*
July 1 through July 31 Employee transactions [a]	4,027	$ 88.89	N/A	N/A
August 1 through August 31 Employee transactions [a]	1,150	86.92	N/A	N/A
September 1 through September 30 Employee transactions [a]	41,207	85.55	N/A	N/A
Total	46,384	$ 85.88	N/A	N/A

[a] *Includes shares delivered or attested to UPC to pay stock option exercise prices or to satisfy tax withholding obligations for stock option exercises or vesting of retention shares or stock units.*

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Description of Exhibits Filed with this Statement
3(a)	By-Laws of UPC, as amended, effective October 1, 2006.
12(a)	Ratio of Earnings to Fixed Charges for the Three Months Ended September 30, 2006 and 2005.

12(b) Ratio of Earnings to Fixed Charges for the Nine Months Ended September 30, 2006 and 2005.

31(a) Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 James R. Young.

31(b) Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Robert M. Knight, Jr.

32 Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 James R. Young and Robert M. Knight, Jr.

Description of Exhibits Incorporated by Reference

3(b) Revised Articles of Incorporation of UPC, as amended through April 25, 1996, are incorporated herein by reference to Exhibit 3 to the Corporation s Quarterly Report on Form 10-Q for the quarter ended March 31, 1996.

SIGNATURES

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

Dated: November 1, 2006

UNION PACIFIC CORPORATION (Registrant)

By /s/ Robert M. Knight, Jr.
Robert M. Knight, Jr.,

Executive Vice President Finance and

Chief Financial Officer

(Principal Financial Officer)

By /s/ Richard J. Putz
Richard J. Putz,

Vice President and Controller

(Principal Accounting Officer)