

NETWORK MANAGEMENT

In 2005, Union Pacific increased network capacity to meet record demand by hiring new employees, adding locomotives and investing capital in key corridors. The Company reduced network workload and complexity through implementation of the Unified Plan and eliminated chokepoints in terminals utilizing industrial engineering concepts. The Marketing and Operating departments also worked together to create the Customer Inventory Management System (CIMS) and improve the overall business planning process. Each of these initiatives are “evergreen,” setting the stage in 2006 and beyond for further operating improvements in the face of record volume growth.

Unified Plan

In the second half of 2004, the Railroad began analyzing the rail network; taking a “clean sheet” approach to redesign the transportation plan. The goals of this ongoing effort, called the Unified Plan, are to increase system velocity, decrease terminal dwell and improve asset utilization. Key elements of the plan were the elimination of more than 10 percent of mainline work events and a 5 percent reduction in intermediate switch events. In April 2005, the Company began implementation of the first phase of the Unified Plan by modifying shipments in the Automotive network. Over the next several months, the Railroad made changes to its vast manifest network. In August, the Company implemented changes to the Intermodal network. Intermodal terminals in Chicago and on the West Coast now handle either domestic or international freight, simplifying both terminal and train operations.

These operating changes directly link to improvements in terminal dwell time and freight car inventory achieved in 2005. The Unified Plan process continues as the Railroad strives to match demand with capacity and identify opportunities to improve operational efficiency through network design.

Industrial Engineering

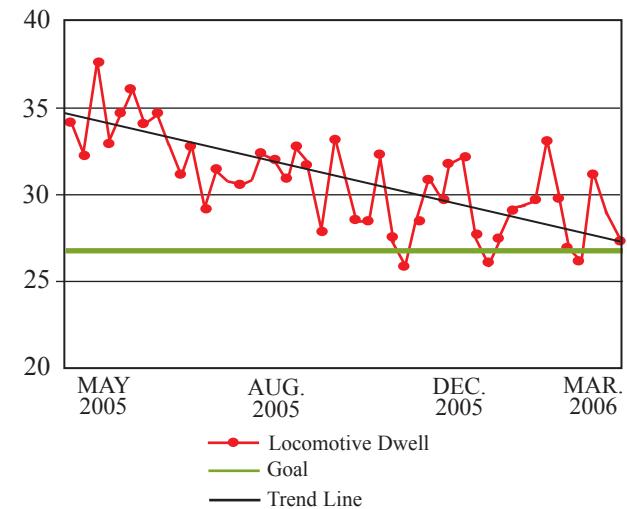
Over the last two years, Union Pacific expanded its in-house industrial engineering capabilities and applied Toyota’s Lean management techniques to improve operations. The Lean process is a specialized part of industrial engineering that focuses on

opportunities to improve efficiency by reducing movements, inventories, defects and rework. The process has been applied at major terminals and is continuing to be expanded. The results of these projects increase capacity with little or no capital investment.

As an example, during 2005 the Lean team began a project to improve locomotive utilization at six of the Railroad’s largest terminals - North Platte, Los Angeles, Houston, Chicago, Fort Worth and Roseville. The project focused on reducing locomotive terminal dwell time by analyzing movements and decision points between locomotive arrival and departure. Since May 2005, North Platte dwell times decreased an average of 15 percent, freeing over 40 locomotives to serve customers and haul freight.

North Platte Locomotive Dwell

(Hours)



During 2005, the Railroad spent nearly \$2.4 billion on over 1.3 billion gallons of diesel fuel. In order to control this cost and improve consumption rates, the industrial engineering group studied ways to conserve fuel use. Past Company efforts included increasing the number of trains utilizing Distributed Power, adding Automatic Engine Start/Stop technology to locomotives, acquiring new more fuel-efficient locomotives and expanding locomotive engineer training. In 2004, the Railroad piloted a fuel conservation program called “Fuel Masters” on the 175-

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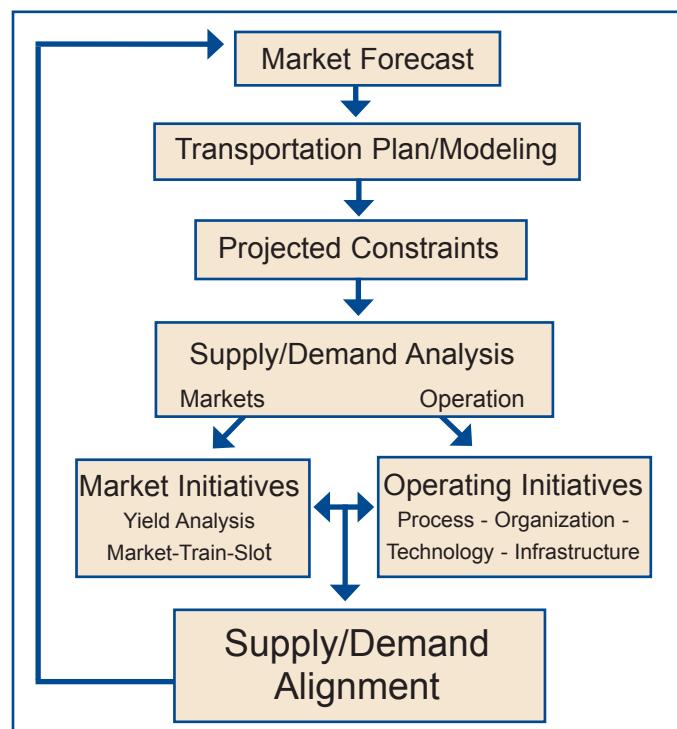
mile run between North Platte and South Morrill, Nebraska. The program rewards the fuel-saving efforts of locomotive engineers with fuel gift cards to offset their rising personal fuel costs. Results of the pilot showed a 6 percent decrease in fuel consumption. The program has been expanded to more than 3,000 locomotive engineers and the Company is targeting system-wide implementation by year-end 2007.

CIMS

Complementing the Lean initiatives, the Marketing and Operating organizations jointly developed CIMS in 2005. The system is used to proactively manage terminal inventory, creating terminal fluidity and increased asset utilization. CIMS matches rail and customer capacity by monitoring customer inventory and storage capabilities, freight cars enroute and freight cars awaiting final delivery to customers. The Railroad conducted the initial pilot in Phoenix and subsequently rolled out the system to major terminals in Los Angeles, Las Vegas, San Antonio and Houston. Results include significant reductions in terminal inventory of 25 to 40 percent, dwell time reductions of 20 to 25 percent and improved customer switching performance. During 2006, the Railroad plans to implement CIMS in additional terminals including Salt Lake City, Roseville, Portland, Seattle, Fort Worth, Kansas City and Little Rock.

Business Planning Process

During 2005, the Company enhanced its business planning process to better match demand forecasts with network capacity. The process starts in the Marketing and Sales organization with accurate and detailed shipment forecasts. The Operating department models the forecasts to determine if the proposed business levels fit the capacity of the specified lanes. Where projected demand exceeds supply, the Operating and Marketing organizations develop and review alternatives and apply contingencies. In 2006, the Company is implementing a new software program to improve volume forecasts. This application will utilize statistical models to generate volume forecasts from historical volumes, economic assumptions and final input from the Marketing and Sales organization.



CAPITAL INVESTMENTS

Union Pacific's 2006 cash capital budget is \$2.25 billion. Annual track improvements across the Railroad's system will total roughly \$1.5 billion. The Company plans to remove and install 4.2 million ties, spread 5.7 million tons of rock ballast, replace 970 miles of rail and surface 9,250 miles.

The Railroad also plans to invest \$305 million on growth capacity projects, targeting areas where volume growth exceeds current capacity or where future growth expectations are greatest. UP will add approximately 52 miles of double track to the Sunset route in 2006, bringing this key route between Los Angeles and El Paso to nearly 50 percent double tracked. The budget also includes siding extensions in Iowa and South Texas, as well as in routes between Las Vegas and Salt Lake City, and Denver and Grand Junction. Four new sidings in Iowa, Missouri, and Texas will further increase capacity and efficiency.

Coal operations will benefit from capacity expansion on the Southern Powder River Basin Joint Line with 18 miles of triple track added during 2006. Signal upgrades across Iowa, Nebraska and Texas will enhance train dispatching and terminal expansions in key locations should increase throughput.

Union Pacific is investing \$180 million during 2006 on commercial facilities. Support track construction for ethanol plants in Iowa and Minnesota is in the second year of a multi-year project. In addition, improvements are planned for intermodal facilities in Chicago and West Memphis, Arkansas and automotive unloading facilities in Salt Lake City and Houston.

The Company plans to acquire 200 new high-horsepower long-haul locomotives and 2,700 freight cars through various operating lease arrangements.

