UNION PACIFIC RAILROAD COMPANY and CONSOLIDATED SUBSIDIARY COMPANIES

Consolidated Financial Statements as of December 31, 2008 and 2007 and for the Three Years Ended December 31, 2008, and Report of Independent Registered Public Accounting Firm

UNION PACIFIC RAILROAD COMPANY and
CONSOLIDATED SUBSIDIARY COMPANIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Union Pacific Railroad Company, its Directors, and Shareholders:

We have audited the accompanying consolidated statements of financial position of Union Pacific Railroad Company (an indirect wholly owned subsidiary of Union Pacific Corporation) and Consolidated Subsidiary Companies (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in common shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Union Pacific Railroad Company and Consolidated Subsidiary Companies as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 4 to the consolidated financial statements, in 2006 the Company adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 5, 2009 expressed an unqualified opinion on the Company's internal control over financial reporting.

Deloitte & Touche LLP

Omaha, Nebraska
February 5, 2009

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Union Pacific Railroad Company (an indirect wholly-owned subsidiary of Union Pacific Corporation) and Consolidated Subsidiary Companies (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). The Company's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework.* Based on our assessment management believes that, as of December 31, 2008, the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent registered public accounting firm has issued an attestation report on the effectiveness of the Company's internal control over financial reporting. This report appears on page 5.

February 4, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Union Pacific Railroad Company, its Directors, and Shareholders:

We have audited the internal control over financial reporting of Union Pacific Railroad Company (an indirect wholly owned subsidiary of Union Pacific Corporation) and Consolidated Subsidiary Companies (the Company) as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

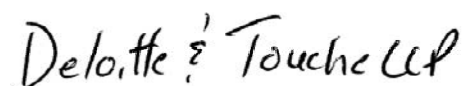
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2008 of the Company and our report dated February 5, 2009 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the Company's adoption, in 2006, of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.



Omaha, Nebraska
February 5, 2009

CONSOLIDATED STATEMENTS OF INCOME

Union Pacific Railroad Company and Consolidated Subsidiary Companies

Millions of Dollars, for the Years Ended December 31,	***2008***	*2007*	*2006*
Operating revenues:			
Freight revenues	**$ 17,118**	$ 15,486	$ 14,791
Other revenues	**817**	763	755
Total operating revenues	**17,935**	16,249	15,546
Operating expenses:			
Compensation and benefits	**4,398**	4,469	4,461
Fuel	**3,982**	3,104	2,968
Purchased services and materials	**1,887**	1,845	1,745
Depreciation	**1,387**	1,321	1,237
Equipment and other rents	**1,323**	1,365	1,393
Other	**889**	778	862
Total operating expenses	**13,866**	12,882	12,666
Operating income	**4,069**	3,367	2,880
Other income (note 5)	**75**	71	93
Interest expense	**(418)**	(447)	(489)
Income before income taxes	**3,726**	2,991	2,484
Income taxes (note 6)	**(1,351)**	(1,143)	(914)
Net income	**$ 2,375**	$ 1,848	$ 1,570

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Union Pacific Railroad Company and Consolidated Subsidiary Companies

Millions of Dollars, as of December 31,	***2008***	*2007*
Assets		
Current assets:		
Cash and cash equivalents	**$ 295**	$ 256
Accounts receivable, net	**517**	604
Materials and supplies	**450**	453
Current deferred income taxes (note 6)	**274**	393
Other current assets	**249**	261
Total current assets	**1,785**	1,967
Investments	**957**	923
Net properties (note 9)	**35,692**	34,148
Other assets	**162**	314
Total assets	**$ 38,596**	$ 37,352
Liabilities and Common Shareholders' Equity		
Current liabilities:		
Accounts payable and other current liabilities (note 10)	**$ 2,174**	$ 2,677
Third-party debt due within one year (note 12)	**220**	139
Total current liabilities	**2,394**	2,816
Intercompany borrowings from UPC (note 12)	**3,801**	4,415
Third-party debt due after one year (note 12)	**1,507**	1,506
Deferred income taxes (note 6)	**10,237**	9,965
Other long-term liabilities	**2,624**	1,862
Mandatory redeemable preference shares	**3**	6
Commitments and contingencies (note 14)		
Total liabilities	**20,566**	20,570
Common shareholders' equity (note 7):		
Common shares, $10.00 par value, 9,200 authorized; 4,465 outstanding		
Class A stock, $10.00 par value, 800 authorized: 388 outstanding		
Paid-in-surplus	**4,782**	4,782
Retained earnings	**13,952**	12,074
Accumulated other comprehensive loss (note 8)	**(704)**	(74)
Total common shareholders' equity	**18,030**	16,782
Total liabilities and common shareholders' equity	**$ 38,596**	$ 37,352

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Union Pacific Railroad Company and Consolidated Subsidiary Companies

Millions of Dollars, for the Years Ended December 31,	***2008***	*2007*	*2006*
Operating Activities			
Net income	**$ 2,375**	$ 1,848	$ 1,570
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	**1,387**	1,321	1,237
Deferred income taxes and unrecognized tax benefits	**555**	323	199
Stock-based compensation expense	**46**	32	23
Net gain from asset sales	**(41)**	(47)	(72)
Other operating activities, net	**62**	(364)	(191)
Changes in current assets and liabilities, net	**(401)**	82	(50)
Cash provided by operating activities	**3,983**	3,195	2,716
Investing Activities			
Capital investments	**(2,780)**	(2,495)	(2,241)
Proceeds from asset sales	**93**	117	124
Acquisition of equipment pending financing	**(20)**	(14)	-
Proceeds from sale of assets financed	**20**	14	-
Other investing activities, net	**(61)**	(54)	68
Cash used in investing activities	**(2,748)**	(2,432)	(2,049)
Financing Activities			
Debt repaid	**(158)**	(142)	(148)
Dividends paid to UPC	**(497)**	(400)	(323)
Intercompany (payments) borrowings, net	**(614)**	(462)	(205)
Other financing activities, net	**73**	97	6
Cash used in financing activities	**(1,196)**	(907)	(670)
Net change in cash and cash equivalents	**39**	(144)	(3)
Cash and cash equivalents at beginning of year	**256**	400	403
Cash and cash equivalents at end of year	**$ 295**	$ 256	$ 400
Changes in Current Assets and Liabilities			
Accounts receivable, net	**$ 87**	$ 45	$ 17
Materials and supplies	**3**	(58)	(64)
Other current assets	**12**	(82)	(35)
Accounts payable and other current liabilities	**(503)**	177	32
Total	**$ (401)**	$ 82	$ (50)
Supplemental Cash Flow Information			
Non-cash investing and financing activities:			
Capital lease financings	**$ 175**	$ 82	$ 16
Capital investments accrued but not yet paid	**93**	126	106
Cash paid during the year for:			
Interest, net of amounts capitalized	**$ (421)**	$ (446)	$ (475)
Income taxes, net of refunds	**(796)**	(866)	(618)

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

CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY

Union Pacific Railroad Company and Consolidated Subsidiary Companies

Millions of Dollars *Thousands of Shares*	*Common Shares*	*Class A Shares*	*Common Shares*	*Paid-in-Surplus*	*Retained Earnings*	*Accumulated Other Comprehensive Income/(Loss) (note 8)*	*Total*
Balance at January 1, 2006	4,465	388	$ -	$4,782	$ 9,414	$(230)	$13,966
Comprehensive income:							
Net income			-	-	1,570	-	1,570
Other comp. income			-	-	-	167	167
Total comp. income (note 8)			-	-	1,570	167	1,737
FAS 158 adoption (note 4)			-	-	-	(79)	(79)
Dividends declared			-	-	(323)	-	(323)
Balance at December 31, 2006	4,465	388	-	4,782	10,661	(142)	15,301
Cumulative effect of adoption of FIN 48 (note 6)			-	-	(35)	-	(35)
Balance at January 1, 2007	4,465	388	-	4,782	10,626	(142)	15,266
Comprehensive income:							
Net income			-	-	1,848	-	1,848
Other comp. income			-	-	-	68	68
Total comp. income (note 8)			-	-	1,848	68	1,916
Dividends declared			-	-	(400)	-	(400)
Balance at December 31, 2007	4,465	388	-	4,782	12,074	(74)	16,782
Comprehensive income:			-	-	-	-	-
Net income			-	-	2,375	-	2,375
Other comp. income/(loss)			-	-	-	(630)	(630)
Total comp. income (note 8)			-	-	2,375	(630)	1,745
Dividends declared			-	-	(497)	-	(497)
Balance at December 31, 2008	**4,465**	**388**	$ -	**$4,782**	**$13,952**	**$(704)**	**$18,030**

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

For purposes of this report, unless the context otherwise requires, all references herein to the "Company", "we", "us", and "our" mean Union Pacific Railroad Company and Consolidated Subsidiary Companies. Union Pacific Railroad Company, together with our wholly-owned and majority-owned subsidiaries, is an indirect wholly-owned subsidiary of Union Pacific Corporation, herein "the Corporation" or "UPC".

1. Nature of Operations and Significant Accounting Policies

Operations and Segmentation – We are a Class I railroad that operates in the United States. We have 32,012 route miles, linking Pacific Coast and Gulf Coast ports with the Midwest and eastern United States gateways and providing several corridors to key Mexican gateways. We serve the western two-thirds of the country and maintain coordinated schedules with other rail carriers for the handling of freight to and from the Atlantic Coast, the Pacific Coast, the Southeast, the Southwest, Canada, and Mexico. Export and import traffic is moved through Gulf Coast and Pacific Coast ports and across the Mexican and Canadian borders.

We have one reportable operating segment. Although revenues are analyzed by commodity group, we analyze the net financial results as one segment due to the integrated nature of our rail network. The following table provides revenue by commodity group:

Millions of Dollars	***2008***	*2007*	*2006*
Agricultural	**$ 3,174**	$ 2,605	$ 2,385
Automotive	**1,344**	1,458	1,427
Chemicals	**2,494**	2,287	2,084
Energy	**3,810**	3,134	2,949
Industrial Products	**3,273**	3,077	3,135
Intermodal	**3,023**	2,925	2,811
Total freight revenues	**17,118**	15,486	14,791
Other revenues	**817**	763	755
Total operating revenues	**$ 17,935**	$ 16,249	$ 15,546

Basis of Presentation – Certain prior year amounts have been reclassified to conform to the current period financial statement presentation. The reclassifications include reporting freight revenues instead of commodity revenues. The amounts reclassified from freight revenues to other revenues totaled $30 million and $71 million for the years ended December 31, 2007, and December 31, 2006, respectively. In addition, we modified our operating expense categories to report fuel used in railroad operations as a stand-alone category, to combine purchased services and materials into one line, and to reclassify certain other expenses among operating expense categories. These reclassifications had no impact on previously reported operating revenues, total operating expenses, operating income or net income.

Significant Accounting Policies

Principles of Consolidation – The Consolidated Financial Statements include the accounts of Union Pacific Railroad Company and all of its subsidiaries. Investments in affiliated companies (20% to 50% owned) are accounted for using the equity method of accounting. All significant intercompany transactions are eliminated. The Company evaluates its less than majority-owned investments for consolidation pursuant to Financial Accounting Standards Board (FASB) Interpretation No. 46 (Revised

2003), *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46(R)). We currently have no less than majority-owned investments that require consolidation under FIN 46(R).

Cash and Cash Equivalents – Cash equivalents consist of investments with original maturities of three months or less.

Materials and Supplies – Materials and supplies are carried at the lower of average cost or market.

Property and Depreciation – See note 9.

Impairment of Long-lived Assets – We review long-lived assets, including identifiable intangibles, for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the long-lived assets, the carrying value is reduced to the estimated fair value as measured by the discounted cash flows.

Revenue Recognition – We recognize freight revenues on a percentage-of-completion basis as freight moves from origin to destination. The allocation of revenue between reporting periods is based on the relative transit time in each reporting period with expenses recognized as incurred. Other revenues are recognized as service is performed or contractual obligations are met. Customer incentives, which are primarily provided for shipping a specified cumulative volume or shipping to/from specific locations, are recorded as a reduction to operating revenues based on actual or projected future customer shipments.

Translation of Foreign Currency – Our portion of the assets and liabilities related to foreign investments are translated into U.S. dollars at the exchange rates in effect at the balance sheet date. Revenue and expenses are translated at the average rates of exchange prevailing during the year. Unrealized gains or losses are reflected within common shareholders' equity as accumulated other comprehensive income or loss.

Financial Instruments – The carrying value of our non-derivative financial instruments approximates fair value. The fair value of financial instruments is generally determined by reference to market values as quoted by recognized dealers or developed based upon the present value of expected future cash flows.

We periodically use derivative financial instruments, for other than trading purposes, to manage risk related to changes in fuel prices and interest rates.

Stock-Based Compensation – We participate in the Corporation's stock-based incentive programs. The Corporation has 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". The Corporation has elected to issue treasury shares to cover option exercises and stock unit vestings, while new shares are issued when retention shares vest.

We adopted 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 closing 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 estimated forfeitures, as the impact was not material.

Information regarding stock-based compensation appears in the table below:

Millions of Dollars	***2008***	*2007*	*2006*
Stock-based compensation, before tax:			
Stock options	**$ 17**	$ 15	$ 9
Retention awards	**29**	17	14
Total stock-based compensation, before tax	**46**	32	23
Total stock-based compensation, after tax	**$ 28**	$ 20	$ 14

Use of Estimates – Our Consolidated Financial Statements include estimates and assumptions regarding certain assets, liabilities, revenue, and expenses and the disclosure of certain contingent assets and liabilities. Actual future results may differ from such estimates.

Income Taxes – As required under FASB Statement No. 109, *Accounting for Income Taxes*, we account for income taxes by recording taxes payable or refundable for the current year and deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. These expected future tax consequences are measured based on provisions of tax law as currently enacted; the effects of future changes in tax laws are not anticipated. Future tax law changes, such as a change in the corporate tax rate, could have a material impact on our financial condition and liquidity.

When appropriate, we record a valuation allowance against deferred tax assets to offset future tax benefits that may not be realized. In determining whether a valuation allowance is appropriate, we consider whether it is more likely than not that all or some portion of our deferred tax assets will not be realized, based on management's judgments regarding the best available evidence about future events.

When we have claimed tax benefits that may be challenged by a tax authority, these uncertain tax positions are accounted for under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, *an Interpretation of FASB Statement No. 109* (FIN 48). We adopted FIN 48 beginning January 1, 2007. Prior to 2007, income tax contingencies were accounted for under FASB Statement No. 5, *Accounting for Contingencies*.

Under FIN 48, we recognize tax benefits only for tax positions that are more likely than not to be sustained upon examination by tax authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely to be realized upon settlement. A liability for "unrecognized tax benefits" is recorded for any tax benefits claimed in our tax returns that do not meet these recognition and measurement standards.

Pension and Postretirement Benefits – We incur certain employment-related expenses associated with pensions and postretirement health benefits. In order to measure the expense associated with these benefits, we must make various assumptions including discount rates used to value certain liabilities, expected return on plan assets used to fund these expenses, salary increases, employee turnover rates, anticipated mortality rates, and expected future healthcare costs. The assumptions used by us are based on our historical experience as well as current facts and circumstances. We use third-party actuaries to assist us in properly measuring the expense and liability associated with these benefits.

Personal Injury – The cost of injuries to employees and others on our property 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 properly measuring the expense and liability. Our personal injury liability is discounted to

present value using applicable U.S. Treasury rates. Legal fees and incidental costs are expensed as incurred.

Environmental – When environmental issues have been identified with respect to property currently or formerly owned, leased, or otherwise used in the conduct of our business, we and our consultants perform environmental assessments on such property. 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. Legal fees and incidental costs are expensed as incurred.

Asbestos – We estimate a liability for asserted and unasserted asbestos-related claims based on an assessment of the number and value of those claims. We use an external consulting firm to assist us in properly measuring the expense and liability. Our liability for asbestos-related claims is not discounted to present value due to the uncertainty surrounding the timing of future payments. Legal fees and incidental costs are expensed as incurred.

2. Transactions with Affiliates

At December 31, 2008 and 2007, we had $609 million and $849 million working capital deficit balances, respectively, relating to UPC's management of our cash position. As part of UPC's cash management activities, we advance excess cash (cash available after satisfying all of our obligations and paying dividends to UPC) to UPC. We declare and pay dividends to UPC that typically approximate the dividends UPC declares to its shareholders; however, there is no formal requirement to do so. The dividend declaration between us and UPC is determined solely by our Board of Directors. To the extent we require additional cash for use in our operations, UPC makes such funds available to us for borrowing. We treat these transactions as intercompany borrowings in the Consolidated Statements of Financial Position.

The majority of our intercompany borrowings from UPC relate to the acquisitions of the Chicago and North Western Transportation Company and Southern Pacific Rail Corporation that were funded by UPC on our behalf. We assumed these acquisition costs in the form of intercompany borrowings from UPC. In December of 2008, the Corporation established a borrowing limit based on the Railroad's borrowing capacity and implemented a market based interest rate. Currently, the annual rate is 5.8%. Prior to December 2008 the intercompany borrowings accrued interest at an annual rate of 7.5%. Interest accrues quarterly and is payable on demand. We do not expect to be required by UPC to pay back the intercompany borrowings within the next 12 months. Intercompany borrowings are unsecured and rank equally with all of our other unsecured indebtedness.

UPC provides us with various services, including strategic planning, legal, treasury, accounting, auditing, insurance, human resources, and corporate affairs. Pursuant to a services agreement, UPC provides services to us, and we pay our share of the costs as determined by an independent review. Billings for these services were $62 million, $56 million, and $69 million for the years ended December 31, 2008, 2007, and 2006, respectively.

3. Stock Options and Other Stock Plans

On May 28, 2008, UPC completed a two-for-one stock split, effected in the form of a 100% stock dividend. The stock split entitled all UPC shareholders of record at the close of business on May 12, 2008, to receive one additional share of UPC's common stock, par value $2.50 per share, for each share of common stock held on that date. All references to common shares and per share amounts in this footnote have been restated to reflect the stock split for all periods presented. We participate in the Corporation's stock incentive programs.

There are 141,580 options outstanding for our participants under the 1993 Stock Option and Retention Stock Plan of Union Pacific Corporation (1993 Plan). The Corporation no longer grants options or awards of retention shares and units under these plans.

The Union Pacific Corporation 2001 Stock Incentive Plan (2001 Plan) was approved by the shareholders in April 2001. The 2001 Plan reserved 24,000,000 shares of our common stock (12,000,000 pre-split) for issuance to eligible employees of the Corporation and its subsidiaries in the form of non-qualified options, incentive stock options, retention shares, stock units, and incentive bonus awards. As of December 31, 2008, 1,604,501 options were outstanding for our participants under the 2001 Plan. The Corporation no longer grants any stock options or other stock or unit awards under this plan.

The Union Pacific Corporation 2004 Stock Incentive Plan (2004 Plan) was approved by shareholders in April 2004. The 2004 Plan reserved 42,000,000 shares of our common stock (21,000,000 pre-split) for issuance, plus any shares subject to awards made under the 2001 Plan and the 1993 Plan that were outstanding on April 16, 2004, and became available for re-grant pursuant to the terms of the 2004 Plan. Under the 2004 Plan, non-qualified options, stock appreciation rights, retention shares, stock units, and incentive bonus awards may be granted to eligible employees of the Corporation and its subsidiaries. As of December 31, 2008, 4,446,688 options and 2,243,372 retention shares and stock units were outstanding for our participants under the 2004 Plan.

Pursuant to the above plans 36,961,123; 38,601,728; and 39,088,490 shares of the Corporation's common stock were authorized and available for grant at December 31, 2008, 2007, and 2006, respectively.

Stock Options – We estimate the fair value of our stock option awards using the Black-Scholes option pricing model. Groups of employees that have similar historical and expected exercise behavior are considered separately for valuation purposes. The table below shows the annual weighted-average assumptions used for valuation purposes:

Weighted-Average Assumptions	***2008***	*2007*	*2006*
Risk-free interest rate	**2.8%**	4.9%	4.5%
Dividend yield	**1.4%**	1.4%	1.4%
Expected life (years)	**5.3**	4.6	5.7
Volatility	**22.2%**	20.9%	24.7%
Weighted-average grant-date fair value of options granted	**$ 13.35**	$ 11.20	$ 11.97

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 dividends paid per share of common stock to the stock price on the date of grant; the expected life is based on historical and expected exercise behavior; and volatility is based on the historical volatility of UPC's stock price over the expected life of the option.

Stock options are granted at the closing price on the date of grant, have ten-year contractual terms, and vest no later than three years from the date of grant. None of the stock options outstanding at December 31, 2008 are subject to performance or market-based vesting conditions.

At December 31, 2008, there was $13 million of unrecognized compensation expense related to nonvested stock options, which is expected to be recognized over a weighted-average period of 0.8 years. Additional information regarding stock option exercises appears in the table below:

Millions of Dollars	***2008***	*2007*	*2006*
Intrinsic value of stock options exercised	**$ 124**	$ 152	$ 97
UPC tax benefit realized from option exercises	**46**	56	35
Aggregate grant-date fair value of stock options vested	**16**	6	18

Retention Awards – The fair value of retention awards is based on the closing price of the stock on the grant date. Dividend equivalents are paid to participants during the vesting periods. Retention awards are granted at no cost to the employee and vest over periods lasting up to four years. At December 31, 2008, there was $44 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.

Performance Retention Awards – In January 2008, UPC's Board of Directors approved performance stock unit grants. Other than higher performance targets, the basic terms of these performance stock units are identical to those granted in January 2006 and January 2007, including using annual return on invested capital (ROIC) as the performance measure. Stock units awarded to selected employees under these grants are subject to continued employment for 37 months and the attainment of certain levels of ROIC. We expense the fair value of the units that are probable of being earned based on our forecasted ROIC over the 3-year performance period. We measure the fair value of these performance stock units based upon the closing price of the underlying common stock as of the date of grant, reduced by the present value of estimated future dividends. Dividend equivalents are paid to participants only after the units are earned.

The assumptions used to calculate the present value of estimated future dividends related to the January 2008 grant were as follows:

	2008
UPC's dividend per share per quarter	$ 0.22
Risk-free interest rate at date of grant	2.3%

At December 31, 2008, there was $11 million of total unrecognized compensation expense related to nonvested performance retention awards, which is expected to be recognized over a weighted-average period of 1.2 years. A portion of this expense is subject to achievement of the ROIC levels established for the performance stock unit grants.

4. Retirement Plans

Pension and Other Postretirement Benefits

Pension Plans – We provide defined benefit retirement income to eligible non-union employees through the Corporation's 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 through the Corporation's programs. These benefits are funded as medical claims and life insurance premiums are paid.

Funded Status

We adopted FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158), at the end of 2006, which required us to separately recognize the overfunded or underfunded status of our pension and OPEB plans as an asset or liability. The funded status represents the difference between the projected benefit obligation (PBO) and the fair value of the plan assets. The PBO is the present value of benefits earned to date by plan participants, including the effect of assumed future salary increases. The PBO of the OPEB plan is equal to the accumulated benefit obligation, as the present value of the OPEB liabilities is not affected by salary increases. Plan assets are measured at fair value. We use a December 31 measurement date for plan assets and obligations for all our retirement plans.

Changes in our PBO and plan assets are as follows for the years ended December 31:

Funded Status	*Pension*		*OPEB*	
Millions of Dollars	***2008***	*2007*	***2008***	*2007*
Projected Benefit Obligation				
Projected benefit obligation at beginning of year	**$ 2,112**	$ 2,113	**$ 326**	$ 374
Service cost	**34**	34	**3**	3
Interest cost	**137**	124	**24**	20
Plan amendments	**-**	-	**(9)**	(10)
Actuarial loss (gain)	**132**	(33)	**101**	(34)
Gross benefits paid	**(143)**	(126)	**(27)**	(27)
Projected benefit obligation at end of year	**$ 2,272**	$ 2,112	**$ 418**	$ 326
Plan Assets				
Fair value of plan assets at beginning of year	**$ 2,058**	$ 1,989	**$ -**	$ -
Actual return on plan assets	**(592)**	183	**-**	-
Voluntary funded pension plan contributions	**200**	-	**-**	-
Other funded pension plan contributions	**8**	-	**-**	-
Non-qualified plan benefit contributions	**12**	12	**27**	27
Gross benefits paid	**(143)**	(126)	**(27)**	(27)
Fair value of plan assets at end of year	**$ 1,543**	$ 2,058	**$ -**	$ -
Funded status at end of year	**$ (729)**	$ (54)	**$ (418)**	$ (326)

Amounts recognized in the statement of financial position as of December 31, 2008 and 2007 consist of:

	Pension		*OPEB*	
Millions of Dollars	***2008***	*2007*	***2008***	*2007*
Noncurrent assets	**$ -**	$ 120	**$ -**	$ -
Current liabilities	**(12)**	(11)	**(30)**	(27)
Noncurrent liabilities	**(717)**	(163)	**(388)**	(299)
Net amounts recognized at end of year	**$ (729)**	$ (54)	**$ (418)**	$ (326)

Pre-tax amounts recognized in accumulated other comprehensive income/(loss) as of December 31, 2008 consist of:

Millions of Dollars	*Pension*	*OPEB*	*Total*
Prior service (cost)/credit	$ (12)	$ 111	$ 99
Net actuarial loss	(1,023)	(172)	(1,195)
Total	$ (1,035)	$ (61)	$ (1,096)

Pre-tax amounts recognized in accumulated other comprehensive income/(loss) as of December 31, 2007 consist of:

Millions of Dollars	*Pension*	*OPEB*	*Total*
Prior service (cost)/credit	$ (18)	$ 137	$ 119
Net actuarial loss	(158)	(85)	(243)
Total	$ (176)	$ 52	$ (124)

Other pre-tax changes recognized in other comprehensive income during 2008 were as follows:

Millions of Dollars	*Pension*	*OPEB*	*Total*
Prior service credit arising during the year	$ -	$ (9)	$ (9)
Net actuarial loss arising during the year	875	101	976
Amortization of prior service (cost)/credit	(6)	34	28
Amortization of actuarial (loss)	(10)	(13)	(23)
Total	$ 859	$ 113	$ 972

Amounts included in accumulated other comprehensive income expected to be amortized into net periodic cost (benefit) during 2009:

Millions of Dollars	*Pension*	*OPEB*	*Total*
Prior service cost (credit)	$ 5	$ (35)	$ (30)
Net actuarial loss	26	15	41
Total	$ 31	$ (20)	$ 11

Underfunded Accumulated Benefit Obligation – The accumulated benefit obligation (ABO) is the present value of benefits earned to date, assuming no future salary growth. The underfunded accumulated benefit obligation represents the difference between the ABO and the fair value of plan assets. At December 31, 2007, the only pension plan that was underfunded was our non-qualified (supplemental) plan, which is not funded by design. At December 31, 2008, the non-qualified (supplemental) plan ABO was $189 million. The PBO, ABO, and fair value of plan assets for pension plans with accumulated benefit obligations in excess of the fair value of the plan assets were as follows for the years ended December 31:

Underfunded Accumulated Benefit Obligation *Millions of Dollars*	***2008***	*2007*
Projected benefit obligation	**$ (2,272)**	$ (175)
Accumulated benefit obligation	**$ (2,201)**	$ (172)
Fair value of plan assets	**1,543**	-
Underfunded Accumulated Benefit Obligation	**$ (658)**	$ (172)

The ABO for all defined benefit pension plans was $2.2 billion and $2.0 billion at December 31, 2008 and 2007, respectively.

Assumptions – The weighted-average actuarial assumptions used to determine benefit obligations at December 31:

	Pension		*OPEB*	
Percentages	***2008***	*2007*	***2008***	*2007*
Discount rate	**6.25%**	6.50%	**6.25%**	6.50%
Salary increase	**3.50%**	3.50%	**N/A**	N/A
Health care cost trend rate for next year (employees under 65)	**N/A**	N/A	**6.60%**	8.00%
Health care cost trend rate for next year (employees over 65)	**N/A**	N/A	**9.40%**	10.00%
Ultimate health care cost trend rate	**N/A**	N/A	**4.50%**	5.00%
Year ultimate trend rate reached	**N/A**	N/A	**2028**	2013

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 in net income immediately, but are deferred and, if necessary, amortized as pension or OPEB expense.

The components of our net periodic pension and OPEB cost/(benefit) were as follows for the years ended December 31:

	Pension			OPEB		
Millions of Dollars	***2008***	*2007*	*2006*	***2008***	*2007*	*2006*
Net Periodic Benefit Cost:						
Service cost	**$ 34**	$ 34	$ 35	**$ 3**	$ 3	$ 4
Interest cost	**137**	124	117	**24**	20	21
Expected return on plan assets	**(152)**	(144)	(134)	**-**	-	-
Amortization of:						
Prior service cost/(credit)	**6**	6	7	**(35)**	(33)	(33)
Actuarial loss	**10**	18	21	**13**	8	13
Net periodic benefit cost/(benefit)	**$ 35**	$ 38	$ 46	**$ 5**	$ (2)	$ 5

Assumptions – The weighted-average actuarial assumptions used to determine expense were as follows for the years ended December 31:

	Pension			OPEB		
Percentages	***2008***	*2007*	*2006*	***2008***	*2007*	*2006*
Discount rate	**6.50%**	6.00%	5.75%	**6.50%**	6.00%	5.75%
Expected return on plan assets	**8.00%**	8.00%	8.00%	**N/A**	N/A	N/A
Salary increase	**3.50%**	3.00%	2.75%	**N/A**	N/A	N/A
Health care cost trend rate for next year (employees under 65)	**N/A**	N/A	N/A	**8.00%**	9.00%	9.00%
Health care cost trend rate for next year (employees over 65)	**N/A**	N/A	N/A	**10.00%**	11.00%	9.00%
Ultimate healthcare cost trend rate	**N/A**	N/A	N/A	**5.00%**	5.00%	5.00%
Year ultimate trend reached	**N/A**	N/A	N/A	**2013**	2013	2010

For 2008, the discount rate was based on a Mercer yield curve of high quality corporate bonds with cash flows matching our plans' expected benefit payments. For 2007 and 2006, the discount rate was based on a hypothetical portfolio of high quality corporate bonds with cash flows matching our plans' expected benefit payments. The expected return on plan assets is based on our asset allocation mix and our historical return, taking into account current and expected market conditions. The actual return (loss) on pension plan assets, net of fees, was approximately (30)% in 2008, 9% in 2007, and 14% in 2006.

Assumed healthcare cost trend rates have a significant effect on the expense and liabilities reported for healthcare plans. The assumed healthcare cost trend rate is based on historical rates and expected market conditions. A one-percentage point change in the assumed healthcare cost trend rates would have the following effects on OPEB:

Millions of Dollars	*One % pt. Increase*	*One % pt. Decrease*
Effect on total service and interest cost components	$ 3	$ (2)
Effect on accumulated benefit obligation	42	(35)

Cash Contributions

The following table details our cash contributions for the qualified pension plan and the benefit payments for the non-qualified and OPEB plans:

	Pension		
Millions of Dollars	*Qualified*	*Non-qualified*	*OPEB*
2007	$ -	$ 12	$ 27
2008	208	12	27
2009 Expected	25 [a]	12	30

[a] While we do not expect any required contributions during 2009, we intend to fund at least $25 million. This amount may be higher based on cash generated from operations and financial market considerations.

Our policy with respect to funding the qualified plans is to fund at least the minimum required by the Pension Protection Act of 2006 and not more than the maximum amount deductible for tax purposes. All contributions made to the qualified pension plans in 2008 were voluntary and were made with cash generated from operations.

The OPEB plans are not funded and are not subject to any minimum regulatory funding requirements. Benefit payments for each year represent claims paid for medical and life insurance, and we anticipate our 2009 OPEB payments will be made from cash generated from operations.

Benefit Payments

The following table details expected benefit payments for the years 2009 through 2018:

Millions of Dollars	*Pension*	*OPEB*
2009	$ 132	$ 30
2010	136	30
2011	142	31
2012	147	31
2013	154	32
Years 2014 -2018	857	161

Asset Allocation Strategy

Our pension plan asset allocation at December 31, 2008 and 2007, and target allocation for 2009, are as follows:

	Target Allocation 2009	*Percentage of Plan Assets December 31,*	
		2008	*2007*
Equity securities	60% to 70%	**68%**	68%
Debt securities	20% to 30%	**23**	23
Real estate	2% to 8%	**6**	4
Commodities	4% to 6%	**3**	5
Total		**100%**	100%

The investment strategy for pension plan assets is to maintain a broadly diversified portfolio designed to achieve our target of an average long-term rate of return of 8%. While we believe we can achieve a long-term average rate of return of 8%, we cannot be certain that the portfolio will perform to our expectations. Assets are strategically allocated among equity, debt, and other investments in order to achieve a diversification level that dampens fluctuations in investment returns. Asset allocation target ranges for equity, debt, and other portfolios are evaluated at least every three years with the assistance of an independent external consulting firm. Actual asset allocations are monitored monthly, and rebalancing actions are executed at least quarterly, if needed.

The pension plan investments are held in a Master Trust, with The Northern Trust Company. Investments in the Master Trust are valued at fair value, which has been determined based on fair value of the underlying investments of the Master Trust. Investments in securities traded on public security exchanges are valued at their closing market prices on the valuation date; where no sale was made on the valuation date, the security is generally valued at its most recent bid price. Certain short-term investments are carried at cost, which approximates fair value. Investments in registered investment companies and common trust funds, which primarily invest in stocks, bonds, and commodity futures, are valued using publicly available market prices for the underlying investments held by these entities.

The majority of pension plan assets are invested in equity securities, because equity portfolios have historically provided higher returns than debt and other asset classes over extended time horizons, and are expected to do so in the future. Correspondingly, equity investments also entail greater risks than other investments. Equity risks are balanced by investing a significant portion of the plan's assets in high quality debt securities. The average quality rating of the debt portfolio exceeded AA as of December 31, 2008 and 2007. The debt portfolio is also broadly diversified and invested primarily in U.S. Treasury, mortgage, and corporate securities with an intermediate average maturity. The weighted-average maturity of the debt portfolio was 5 years at both December 31, 2008 and 2007, respectively.

The investment of pension plan assets in securities issued by UPC is specifically prohibited for both the equity and debt portfolios, other than through index fund holdings.

Other Retirement Programs

Thrift Plan – The Corporation provides a defined contribution plan (thrift plan) to eligible non-union employees and makes matching contributions to the thrift plan. We match 50 cents for each dollar contributed by employees up to the first six percent of compensation contributed. The thrift plan contributions were $14 million in 2008, $14 million in 2007, and $13 million in 2006.

Railroad Retirement System – Our employees are covered by the Railroad Retirement System (the System). Contributions made to the System are expensed as incurred and amounted to approximately $620 million in 2008, $616 million in 2007, and $615 million in 2006.

Collective Bargaining Agreements – Under collective bargaining agreements, we provide certain postretirement healthcare and life insurance benefits for eligible union employees. Premiums under the plans are expensed as incurred and amounted to $49 million in 2008 and $40 million in both 2007 and 2006.

5. Other Income

Other income included the following for the years ended December 31:

Millions of Dollars	***2008***	*2007*	*2006*
Rental income	**$ 86**	$ 68	$ 83
Net gain on non-operating asset dispositions	**41**	47	72
Interest income	**5**	13	5
Sale of receivables fees	**(23)**	(35)	(33)
Non-operating environmental costs and other	**(34)**	(22)	(34)
Total	**$ 75**	$ 71	$ 93

6. Income Taxes

We are included in the consolidated income tax return of UPC. The consolidated income tax liability of UPC is allocated among the parent and its subsidiaries on the basis of the separate contributions to the consolidated income tax liability, with benefits of tax losses and credits utilized in consolidation allocated to the companies generating such losses and credits.

Components of income tax expense/(benefit) were as follows for the years ended December 31:

Millions of Dollars	***2008***	*2007*	*2006*
Current	**$ 796**	$ 820	$ 715
Deferred	**781**	349	199
Unrecognized tax benefits	**(226)**	(26)	N/A
Total income tax expense	**$ 1,351**	$ 1,143	$ 914

For the years ended December 31, reconciliation between statutory and effective tax rates is as follows:

Tax Rate Percentages	***2008***	*2007*	*2006*
Federal statutory tax rate	**35.0%**	35.0%	35.0%
State statutory rates, net of federal benefits	**3.0**	2.9	2.9
Deferred tax adjustments	**(0.8)**	1.0	(0.5)
Tax credits	**(0.9)**	(0.6)	(1.0)
Other	**-**	(0.1)	0.4
Effective tax rate	**36.3%**	38.2%	36.8%

In the third quarter of 2007, the State of Illinois enacted legislation that changed how we determine the amount of our income subject to Illinois tax. This legislation caused an increase to our deferred tax expense of $27 million for 2007. In January of 2008, Illinois enacted technical corrections legislation that made additional changes in how we determine the amount of our income subject to Illinois tax. This technical corrections legislation resulted in a reduction of deferred tax expense of $16 million in the first quarter of 2008.

Deferred tax assets and liabilities are recorded for the expected future tax consequences of events that are reported in different periods for financial reporting and income tax purposes. The majority of our deferred tax liabilities relate to differences between the tax bases and financial reporting amounts of our land and depreciable property, due to accelerated tax depreciation, revaluation of assets in purchase accounting transactions, and differences in capitalization methods.

Deferred income tax liabilities/(assets) were comprised of the following at December 31:

Millions of Dollars	***2008***	*2007*
Net current deferred income tax asset	**$ (274)**	$ (393)
Property	**10,007**	9,473
State taxes, net of federal benefits	**674**	683
Other	**(444)**	(191)
Net long-term deferred income tax liabilities	**10,237**	9,965
Net deferred income tax liability	**$ 9,963**	$ 9,572

Under FIN 48, tax benefits are recognized only for tax positions that are more likely than not to be sustained upon examination by tax authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely to be realized upon settlement. Unrecognized tax benefits are tax benefits claimed in our tax returns that do not meet these recognition and measurement standards.

We adopted FIN 48 on January 1, 2007. At adoption, the Corporation had total liabilities for unrecognized tax benefits of $227 million pre-tax, or $173 million after including tax benefits for the deductibility of interest and state taxes. Of this amount, $7 million was recorded as a decrease to beginning retained earnings for the cumulative effect of adopting FIN 48. The remaining $166 million had been previously accrued under either FASB Statement No. 5, *Accounting for Contingencies*, or FASB Statement No. 109, *Accounting for Income Taxes*. The entire $173 million was classified as non-current in the Corporation's Consolidated Statement of Financial Position and includes unrecognized tax benefits generated by the Corporation and its subsidiaries other than us.

As part of the adoption of FIN 48, we recorded a $35 million decrease to beginning retained earnings. After adoption, we had total liabilities of $459 million pre-tax, or $357 million after tax that are payable to the Corporation for our estimated allocation of unrecognized tax benefits included under FIN 48. The entire $357 million was classified as non-current in the Consolidated Statement of Financial Position.

A reconciliation of changes in unrecognized tax benefits liabilities/(assets) from the beginning to the end of the reporting period is as follows:

Millions of Dollars	***2008***	*2007*
Unrecognized tax benefits at January 1	**$ 386**	$ 459
Increases for positions taken in current year	**9**	15
Increases for positions taken in prior years	**2**	6
Decreases for positions taken in prior years	**(16)**	(45)
Decreases for positions expected to be taken in future years	**-**	(41)
Settlements with taxing authorities	**(45)**	(1)
Increases (decreases) for interest and penalties	**(176)**	(1)
Other increases (decreases)	**-**	(6)
Unrecognized tax benefits at December 31	**$ 160**	$ 386

A portion of our unrecognized tax benefits would, if recognized, reduce our effective tax rate. The remaining unrecognized tax benefits relate to tax positions for which only the timing of the benefit is uncertain. Recognition of these tax benefits would reduce our effective tax rate only through a reduction of accrued interest and penalties. The unrecognized tax benefits that would reduce our effective tax rate are as follows:

Millions of Dollars	***2008***	*2007*
Unrecognized tax benefits that would reduce the effective tax rate	**$ 100**	$ 301
Unrecognized tax benefits that would not reduce the effective tax rate	**60**	85
Total unrecognized tax benefits	**$ 160**	$ 386

We recognize interest and penalties as part of income tax expense. Total accrued liabilities for interest and penalties were $34 million and $211 million at December 31, 2008 and 2007, respectively. Total interest and penalties recognized as part of income tax expense (benefit) were $(1) million for 2008 and $(1) million for 2007.

For all federal income tax years prior to 1995, the Internal Revenue Service (IRS) examinations have been completed and the statute of limitations bars any additional tax assessments. Some interest calculation issues remain open back to 1986. In the third quarter of 2008, the Corporation signed a closing agreement resolving all tax matters at IRS Appeals for tax years 1995 through 1998. In connection with the settlement, in the fourth quarter of 2008 the Corporation paid the IRS $52 million of tax and $67 million of interest, which substantially reduced its liability for unrecognized tax benefits. We paid the Corporation $43 million of tax and $171 million of interest for our allocated share of the settlement. The settlement had an immaterial effect on our income tax expense. The statute of limitations for these years will expire in 2009, except for calculations of interest.

The IRS has completed its examinations and issued notices of deficiency for tax years 1999 through 2004. The Corporation disagrees with many of their proposed adjustments and is at IRS Appeals for these years.

The IRS is examining the Corporation's tax returns for tax years 2005 and 2006. Additionally, several state tax authorities are examining our state income tax returns for tax years 2000 through 2006.

We do not expect that the amount of unrecognized tax benefits will change significantly during the next 12 months, although it is reasonably possible that we may resolve several state tax disputes that could reduce unrecognized tax benefits by approximately $5-$10 million. Of the $160 million balance at December 31, 2008, $7 million is classified as current in the Consolidated Statement of Financial Position, primarily for state payments related to the settlement for tax years 1995 through 1998 described above.

7. Capital Stock and Dividend Restrictions

Our Board of Directors has restricted the availability of retained earnings for payment of dividends by $131 million. This represents (a) the amount by which the estimated fair value of our investment in certain subsidiaries, as determined by our Board of Directors, exceeded the net book value of such investment, which was transferred to the Corporation by means of a dividend in June 1971 ($110 million) and (b) the amount by which the fair market value exceeded the book value of certain investment securities which were transferred to the Corporation by means of a dividend in November 1972 ($21 million).

Our capital structure consists of Class A Stock, Common Stock, and Mandatorily Redeemable Preference Shares (Series A). The Class A Stock is entitled to a cash dividend whenever a dividend is declared on the Common Stock, in an amount which equals 8 percent of the sum of the dividends on both the Class A Stock and the Common Stock. All of our Common Stock and our Class A Stock, which constitutes all of the voting capital stock, is owned by the Corporation or a wholly-owned subsidiary of the Corporation, and all of the Mandatorily Redeemable Preference Shares, which are non-voting stock, are owned by the Federal Railroad Administration. Accordingly, there is no market for our capital stock.

The number of shares shown in the Statements of Changes in Common Shareholders' Equity in the Consolidated Financial Statements, excludes 2,665 shares of Common Stock and 232 shares of Class A Stock owned by Southern Pacific Rail Corporation, whose results are included in the Consolidated Financial Statements.

8. Comprehensive Income/(Loss)

Comprehensive income/(loss) was as follows:

Millions of Dollars	***2008***	*2007*	*2006*
Net income	**$ 2,375**	$ 1,848	$ 1,570
Other comprehensive income/(loss):			
Defined benefit plans	**(604)**	65	170
Foreign currency translation	**(26)**	2	(4)
Derivatives	**-**	1	1
Total other comprehensive income/(loss) [a]	**(630)**	68	167
Total comprehensive income	**$ 1,745**	$ 1,916	$ 1,737

[a] Net of deferred taxes of $390 million, $52 million, and $102 million during 2008, 2007, and 2006, respectively.

The after-tax components of accumulated other comprehensive loss were as follows:

Millions of Dollars	***Dec. 31, 2008***	*Dec. 31, 2007*
Defined benefit plans	**$ (659)**	$ (55)
Foreign currency translation	**(41)**	(15)
Derivatives	**(4)**	(4)
Total	**$ (704)**	$ (74)

9. Properties

The following table lists the major categories of property and equipment, as well as the average composite depreciation rate for each category:

Millions of Dollars, Except Percentages	***Dec. 31, 2008***	*Dec. 31, 2007*	*Depreciation Rate for 2008*
Land	**$ 4,857**	$ 4,756	N/A
Road			
Rail and other track material	**11,366**	10,622	4.2%
Ties	**6,827**	6,354	2.7%
Ballast	**3,635**	3,369	2.9%
Other [a]	**12,520**	11,865	2.3%
Total Road	**34,348**	32,210	3.1%
Equipment			
Locomotives	**5,157**	5,092	4.7%
Freight cars	**1,985**	2,059	4.1%
Work equipment and other	**158**	157	3.6%
Total Equipment	**7,300**	7,308	4.5%
Technology and other	**457**	428	13.1%
Construction in progress	**938**	935	N/A
Total properties	**47,900**	45,637	N/A
Accumulated depreciation	**(12,208)**	(11,489)	N/A
Net properties	**$ 35,692**	$ 34,148	N/A

[a] Other includes grading, bridges and tunnels, signals, buildings, and other road assets.

Property and Depreciation – Our rail operations are highly capital intensive. Each year we develop a capital program for the acquisition or construction of fixed assets. Assets purchased or constructed throughout the year that were not part of the original program are capitalized if they meet applicable minimum units of property criteria, which are approved by the STB. Properties are carried at cost, and we follow the group method of depreciation. Our large base of homogeneous, network-type assets turns over on a continuous basis. The group method of depreciation treats each asset class as a pool of resources, not as singular items. Under group depreciation, all items with similar physical characteristics, use, and expected life are grouped together in a single asset class, and are depreciated using composite depreciation rates. The cost (net of salvage) of depreciable rail property retired or replaced in the ordinary course of business is charged to accumulated depreciation and no gain or loss is recognized. A gain or

loss is recognized in other income for all other property upon disposition because the gain or loss is not part of rail operations.

We compute depreciation principally on the straight-line method based on estimated service lives of depreciable property. We use a unit of production convention to depreciate rail in high-density traffic corridors. We calculate service lives using Company-specific retirement data. We perform and submit depreciation rate studies to the STB at least every three years for equipment and every six years for road property (i.e., rail and other track material, ties, and ballast). These rate studies, are reviewed and approved by the STB. These studies are used to develop our approved composite depreciation rates by asset class.

When we purchase an asset, we capitalize all costs necessary to make the asset ready for its intended use. However, many of our assets are self-constructed. A large portion of our capital expenditures is for track structure expansion (capacity projects) and replacement (program projects), which is typically performed by our employees. Approximately 13% of our full-time equivalent employees are dedicated to the construction of capital assets. Costs that are directly attributable or overhead costs that relate directly to capital projects are capitalized. Direct costs that are capitalized as part of self-constructed assets include material, labor, and work equipment. Indirect costs are capitalized if they clearly relate to the construction of the asset. These costs are allocated using appropriate statistical bases. The capitalization of indirect costs is consistent with FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects.*

General and administrative expenditures are expensed as incurred. Normal repairs and maintenance are also expensed as incurred, while costs incurred that extend the useful life of an asset, improve the safety of our operations or improve operating efficiency are capitalized.

Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Amortization expense is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the period of the related lease.

10. Accounts Payable and Other Current Liabilities

Millions of Dollars	***Dec. 31, 2008***	*Dec. 31, 2007*
Accounts payable	**$ 625**	$ 729
Accrued wages and vacation	**365**	391
Accrued casualty costs	**323**	351
Income and other taxes	**207**	507
Dividend and interest	**65**	61
Equipment rents payable	**92**	103
Other	**497**	535
Total accounts payable and other current liabilities	**$ 2,174**	$ 2,677

11. 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 at inception, 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 charged to 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 related to derivative financial instruments by selecting instruments with value fluctuations that highly correlate with the underlying hedged item. We manage credit risk related to derivative financial instruments, which is minimal, by requiring high credit standards for counterparties and periodic settlements. At December 31, 2008 and 2007, we were not required to provide collateral, nor had we received collateral, relating to our hedging activities.

Determination of Fair Value – We determine the fair values of our derivative financial instrument positions based upon current fair values as quoted by recognized dealers or the present value of expected future cash flows.

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 both December 31, 2008 and 2007, we had reductions of $4 million recorded as an accumulated other comprehensive loss that is being amortized on a straight-line basis through September 30, 2014. As of December 31, 2008 and 2007, we had no interest rate cash flow hedges outstanding.

Fair Value of Debt Instruments – The fair value of our short- and long-term debt was estimated using quoted market prices, where available, or current borrowing rates. At December 31, 2008, the fair value of total debt is approximately $72 million less than the carrying value. At December 31, 2007, the fair value of total debt exceeded the carrying value by approximately $39 million. At both December 31, 2008 and 2007, approximately $164 million of fixed-rate debt securities contained call provisions that allowed us to retire the debt instruments prior to final maturity, with the payment of fixed call premiums, or in certain cases, at par.

Sale of Receivables – We transfer most of our accounts receivable to Union Pacific Receivables, Inc. (UPRI), a bankruptcy-remote subsidiary, as part of a sale of receivables facility. UPRI sells, without recourse on a 364-day revolving basis, an undivided interest in such accounts receivable to investors. The total capacity to sell undivided interests to investors under the facility was $700 million and $600 million at December 31, 2008 and 2007, respectively. The value of the outstanding undivided interest held by investors under the facility was $584 million and $600 million at December 31, 2008 and 2007, respectively. UPRI reduced the outstanding undivided interest held by investors due to a decrease in available receivables at December 31, 2008. 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 $1,015 million and $1,071 million of accounts receivable held by UPRI at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the value of the interest retained by UPRI was $431 million and $471 million, respectively. This retained interest is included in accounts receivable in our Consolidated Financial Statements. 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 UPC's 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.

We have been designated to service the sold receivables; however, we do not recognize any servicing asset or liability as the servicing fees adequately compensate us for these responsibilities. We collected approximately $17.8 billion and $16.1 billion during the years ended December 31, 2008 and 2007, 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 $23 million, $35 million, and $33 million for 2008, 2007, and 2006, 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 our other assets except for customary warranty and indemnity claims. Our creditors have no recourse to the assets of UPRI. In October 2008, we extended the sale of receivables program to August 2009 without any significant changes in terms, except to increase the capacity to sell undivided interests to $660 million. The capacity was increased to $700 million in December 2008. At January 16, 2009 the amount utilized under the sale of receivables program was $560 million.

12. Debt

Total debt as of December 31, 2008 and 2007, net of interest rate swaps designated as fair value hedges, is summarized below:

Millions of Dollars	***2008***	*2007*
Intercompany borrowings from UPC, 5.8%	**$ 3,801**	$ 4,415
Notes and debentures, 3.0% to 5.0% due through 2054	**115**	117
Capitalized leases, 4.7% to 9.5% due through 2028	**1,270**	1,219
Equipment obligations, 6.2% to 8.1% due through 2031	**255**	291
Mortgage bonds, 4.8% due through 2030	**58**	59
Tax-exempt financings, 4.0% to 5.1% due through 2015	**29**	32
Other [a]	**76**	-
Unamortized discount	**(76)**	(73)
Total debt	**5,528**	6,060
Less current portion	**(220)**	(139)
Total long-term debt	**$ 5,308**	$ **5,921**

[a] This amount was repaid during January of 2009.

Debt Maturities – The following table presents aggregate debt maturities as of December 31, 2008, excluding market value adjustments.

Millions of Dollars	
2009	$ 220
2010	129
2011	146
2012	91
2013	114
Thereafter	1,027
Total debt	$ 1,727

Mortgaged Properties – Equipment with a carrying value of approximately $2.7 billion and $2.8 billion at December 31, 2008 and 2007, respectively, serves as collateral for capital leases and other types of equipment obligations in accordance with the secured financing arrangements utilized to acquire such railroad equipment.

As a result of the merger of Missouri Pacific Railroad Company (MPRR) with and into the Company on January 1, 1997, and pursuant to the underlying indentures for the MPRR mortgage bonds, the Company must maintain the same value of assets after the merger in order to comply with the security requirements of the mortgage bonds. As of the merger date, the value of the MPRR assets that secured the mortgage bonds was approximately $6.0 billion. In accordance with the terms of the indentures, this collateral value must be maintained during the entire term of the mortgage bonds irrespective of the outstanding balance of such bonds.

Income-Based Securities – We have certain debt instruments which contain provisions that limit the payment of interest, require sinking fund installments, and impose certain restrictions in the event that all interest is not paid based upon available income levels. Other debt instruments contain provisions that may impose restrictions on the Company's ability to declare dividends on certain classes of capital stock (note 7).

13. Leases

We lease certain locomotives, freight cars, and other property. Future minimum lease payments for operating and capital leases with initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2008 were as follows:

Millions of Dollars	*Operating Leases*	*Capital Leases*
2009	$ 655	$ 188
2010	613	168
2011	578	178
2012	464	122
2013	389	152
Later years	3,205	1,090
Total minimum lease payments	$ 5,904	$ 1,898
Amount representing interest	N/A	(628)
Present value of minimum lease payments	N/A	$ 1,270

The majority of capital lease payments relate to locomotives. Rent expense for operating leases with terms exceeding one month was $744 million in 2008, $807 million in 2007, and $795 million in 2006. When cash rental payments are not made on a straight-line basis, we recognize variable rental expense on a straight-line basis over the lease term. Contingent rentals and sub-rentals are not significant.

14. Commitments and Contingencies

Asserted and Unasserted Claims – Various claims and lawsuits are pending against us and certain of our subsidiaries. We cannot fully determine the effect of all asserted and unasserted claims on our consolidated results of operations, financial condition, or liquidity; however, to the extent possible, where asserted and 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 and insurance recoveries 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. The Federal Employers' Liability Act (FELA) governs compensation for work-related accidents. Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements. We offer a comprehensive variety of services and rehabilitation programs for employees who are injured at work.

Our personal injury liability is discounted to present value using applicable U.S. Treasury rates. Approximately 88% of the recorded liability related to asserted claims, and approximately 12% related to unasserted claims at December 31, 2008. Because of the uncertainty surrounding the ultimate outcome of personal injury claims, it is reasonably possible that future costs to settle these claims may range from approximately $620 million to $676 million. We believe that the $620 million liability recorded at December 31, 2008, is the best estimate of the present value of the future settlement costs of personal injury claims. Our personal injury liability activity was as follows:

Millions of Dollars	***2008***	*2007*	*2006*
Beginning balance	**$ 592**	$ 629	$ 614
Accruals	**201**	165	243
Payments	**(173)**	(202)	(228)
Ending balance at December 31	**$ 620**	$ 592	$ 629
Current portion, ending balance at December 31	**$ 185**	$ 203	$ 232

Asbestos – We are a defendant in a number of lawsuits in which current and former employees and other parties allege exposure to asbestos. We engage a third party with extensive experience in estimating resolution costs for asbestos-related claims to assist us in assessing our potential liability. This liability is updated annually and excludes future defense and processing costs. The liability for resolving both asserted and unasserted claims was based on the following assumptions:

- The ratio of future claims by alleged disease would be consistent with historical averages.
- The number of claims filed against us will decline each year.
- The average settlement values for asserted and unasserted claims will be equivalent to historical averages.
- The percentage of claims dismissed in the future will be equivalent to historical averages.

Millions of Dollars	***2008***	*2007*	*2006*
Beginning balance	**$ 265**	$ 302	$ 311
Accruals/(credits)	**(42)**	(20)	-
Payments	**(10)**	(17)	(9)
Ending balance at December 31	**$ 213**	$ 265	$ 302
Current portion, ending balance at December 31	**$ 12**	$ 11	$ 13

Our liability for asbestos-related claims is not discounted to present value due to the uncertainty surrounding the timing of future payments. Approximately 17% of the recorded liability related to asserted claims and approximately 83% related to unasserted claims at December 31, 2008. These claims are expected to be paid out over the next 30 years. In conjunction with the liability update performed in 2008, we also reassessed estimated insurance recoveries. We have recognized an asset for estimated insurance recoveries at December 31, 2008 and 2007. We will continue to review actual experience and adjust our estimate as warranted.

We believe that our estimates of liability for asbestos-related claims and insurance recoveries are reasonable and probable. 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 also may vary in the future if strategies, activities, and outcomes of asbestos litigation materially change; federal and state laws governing asbestos litigation increase or decrease the probability or amount of compensation of claimants; and there are material changes with respect to payments made to claimants by other defendants.

Environmental – We are subject to federal, state, and local environmental laws and regulations. We identified 339 sites at which we are or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 33 sites that are the subject of actions taken by the U.S. government, 18 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. Our environmental liability activity was as follows:

Millions of Dollars	***2008***	*2007*	*2006*
Beginning balance	**$ 209**	$ 210	$ 213
Accruals	**46**	41	39
Payments	**(46)**	(42)	(42)
Ending balance at December 31	**$ 209**	$ 209	$ 210
Current portion, ending balance at December 31	**$ 58**	$ 63	$ 54

When we identify an environmental issue with respect to property owned, leased, or otherwise used in our business, we and our consultants perform environmental assessments on the property. We expense the cost of the assessments as incurred. We accrue the cost of remediation where our obligation is probable and we can reasonably estimate such costs. We do not discount our environmental liabilities when the timing of the anticipated cash payments is not fixed or readily determinable. At December 31, 2008, approximately 13% of our environmental liability was discounted at 3.53%, while approximately 13% of our environmental liability was discounted at 4.15% at December 31, 2007.

The liability includes future costs for remediation and restoration of sites, as well as 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. The ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties, 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 of liability may vary over time due to changes in federal, state, and local laws governing environmental remediation. Current obligations are not expected to have a material adverse effect on our consolidated results of operations, financial condition, or liquidity.

Guarantees – At December 31, 2008, we were contingently liable for $437 million in guarantees. We have recorded a liability of $4 million and $5 million for the fair value of these obligations as of December 31, 2008 and 2007, respectively. We entered into these contingent guarantees in the normal course of business, and they include guaranteed obligations related to 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 these guarantees. We do not expect that these

guarantees will have a material adverse effect on our consolidated financial condition, results of operations, or liquidity.

Indemnities – Our maximum potential exposure under indemnification arrangements, including certain tax indemnifications, can range from a specified dollar amount to an unlimited amount, depending on the nature of the transactions and the agreements. Due to uncertainty as to whether claims will be made or how they will be resolved, we cannot reasonably determine the probability of an adverse claim or reasonably estimate any adverse liability or the total maximum exposure under these indemnification arrangements. We do not have any reason to believe that we will be required to make any material payments under these indemnity provisions.

15. Accounting Pronouncements

In March 2008, FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (FAS 161). FAS 161 amends and expands the disclosure requirements of FAS 133 to clarify how and why companies use derivative instruments. In addition, FAS 161 requires more disclosures regarding how companies account for derivative instruments and the impact derivatives have on a company's financial statements. This statement is effective for us beginning in 2009 and will only impact our disclosures. It will have no impact on our financial position, results of operations and cash flows.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). FAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. FAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "*The Meaning of 'Present Fairly in Conformity with Generally Accepted Accounting Principles*'". FAS 162 is not expected to have a material impact on our financial statements.

In December 2008, the FASB issued FSP FAS 132(R)-1, *Employers' Disclosure about Postretirement Benefit Plan Assets*, which amends Statement 132(R) to require more detailed disclosures about employers' pension plan assets. New disclosures will include more information on investment strategies, major categories of plan assets, concentrations of risk within plan assets and valuation techniques used to measure the fair value of plan assets. This new standard requires new disclosures only, and will have no impact on our consolidated financial position, results of operations or cash flows. These new disclosures will be required for us beginning in our 2009 consolidated financial statements.