DOW CHEMICAL CO /DE/
Form 10-Q
October 31, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended SEPTEMBER 30, 2006

Commission File Number: 1-3433

THE DOW CHEMICAL COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**38-1285128**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2030 DOW CENTER, MIDLAND, MICHIGAN 48674

(Address of principal executive offices) (Zip Code)

989-636-1000

(Registrant s telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

Class	Outstanding at September 30, 2006
Common Stock, par value $2.50 per share	955,192,111 shares

The Dow Chemical Company

QUARTERLY REPORT ON FORM 10-Q
For the quarterly period ended September 30, 2006

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The Dow Chemical Company and Subsidiaries

Consolidated Statements of Income

In millions, except per share amounts (Unaudited)	Three Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Nine Months Ended Sept. 30, 2005
Net Sales	$ 12,359	$ 11,261	$ 36,888	$ 34,390
Cost of sales	10,600	9,610	31,027	28,247
Research and development expenses	291	264	856	790
Selling, general and administrative expenses	420	379	1,210	1,153
Amortization of intangibles	13	13	37	40
Restructuring charges	579		579	
Equity in earnings of nonconsolidated affiliates	317	240	717	739
Sundry income net	4	39	87	178
Interest income	48	42	128	98
Interest expense and amortization of debt discount	155	168	462	543
Income before Income Taxes and Minority Interests	670	1,148	3,649	4,632
Provision for income taxes	137	328	831	1,153
Minority interests share in income	21	19	69	60
Net Income Available for Common Stockholders	$ 512	$ 801	$ 2,749	$ 3,419
Share Data				
Earnings per common share basic	$ 0.53	$ 0.83	$ 2.85	$ 3.55
Earnings per common share diluted	$ 0.53	$ 0.82	$ 2.82	$ 3.51
Common stock dividends declared per share of common stock	$ 0.375	$ 0.335	$ 1.125	$ 1.005
Weighted-average common shares outstanding basic	959.1	965.2	963.5	962.1
Weighted-average common shares outstanding diluted	969.9	978.4	975.5	974.2
Depreciation	$ 492	$ 454	$ 1,418	$ 1,378
Capital Expenditures	$ 420	$ 400	$ 1,118	$ 1,050

See Notes to the Consolidated Financial Statements.

The Dow Chemical Company and Subsidiaries

Consolidated Balance Sheets

In millions (Unaudited)	**Sept. 30, 2006**	**Dec. 31, 2005**
Assets		
Current Assets		
Cash and cash equivalents	$ 3,134	$ 3,806
Marketable securities and interest-bearing deposits	35	32
Accounts and notes receivable:		
Trade (net of allowance for doubtful receivables 2006: $132; 2005: $169)	5,278	5,124
Other	3,046	2,802
Inventories	6,118	5,319
Deferred income tax assets current	269	321
Total current assets	17,880	17,404
Investments		
Investment in nonconsolidated affiliates	2,623	2,285
Other investments	2,096	2,156
Noncurrent receivables	272	274
Total investments	4,991	4,715
Property		
Property	43,374	41,934
Less accumulated depreciation	30,016	28,397
Net property	13,358	13,537
Other Assets		
Goodwill	3,230	3,140
Other intangible assets (net of accumulated amortization 2006: $612; 2005: $552)	441	443
Deferred income tax assets noncurrent	3,486	3,658
Asbestos-related insurance receivables noncurrent	750	818
Deferred charges and other assets	2,441	2,219
Total other assets	10,348	10,278
Total Assets	$ 46,577	$ 45,934
Liabilities and Stockholders Equity		
Current Liabilities		
Notes payable	$ 181	$ 241
Long-term debt due within one year	828	1,279
Accounts payable:		
Trade	3,580	3,931
Other	1,772	1,829
Income taxes payable	642	493
Deferred income tax liabilities current	217	201
Dividends payable	362	347
Accrued and other current liabilities	2,506	2,342
Total current liabilities	10,088	10,663
Long-Term Debt	9,199	9,186
Other Noncurrent Liabilities		
Deferred income tax liabilities noncurrent	1,084	1,395
Pension and other postretirement benefits noncurrent	3,400	3,308
Asbestos-related liabilities noncurrent	1,273	1,384
Other noncurrent obligations	3,387	3,338
Total other noncurrent liabilities	9,144	9,425
Minority Interest in Subsidiaries	354	336
Preferred Securities of Subsidiaries	1,000	1,000
Stockholders Equity		
Common stock	2,453	2,453

Additional paid-in capital	777	661
Unearned ESOP shares		(1)
Retained earnings	16,371	14,719
Accumulated other comprehensive loss	(1,738)	(1,949)
Treasury stock at cost	(1,071)	(559)
Net stockholders equity	16,792	15,324
Total Liabilities and Stockholders Equity	$ 46,577	$ 45,934

See Notes to the Consolidated Financial Statements.

The Dow Chemical Company and Subsidiaries

Consolidated Statements of Cash Flows

In millions (Unaudited)	**Nine Months Ended Sept. 30, 2006**	**Sept. 30, 2005**
Operating Activities		
Net Income Available for Common Stockholders	$ 2,749	$ 3,419
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,544	1,507
Provision for deferred income tax	246	440
Earnings of nonconsolidated affiliates in excess of dividends received	(239)	(294)
Minority interests share in income	69	60
Pension contributions	(395)	(634)
Net (gain) loss on sales of investments	2	(15)
Net gain on sales of property and businesses	(48)	(54)
Other net loss		37
Restructuring charges	579	
Net gain on sale of ownership interest in nonconsolidated affiliate		(98)
Tax benefit nonqualified stock option exercises		66
Changes in assets and liabilities that provided (used) cash:		
Accounts and notes receivable	(304)	(29)
Inventories	(811)	(371)
Accounts payable	(435)	(604)
Other assets and liabilities	(53)	104
Cash provided by operating activities	2,904	3,534
Investing Activities		
Capital expenditures	(1,118)	(1,050)
Proceeds from sales of property and businesses	69	82
Purchase of previously leased assets	(205)	
Investments in consolidated companies	(109)	(105)
Investments in nonconsolidated affiliates	(56)	(208)
Proceeds from sales of nonconsolidated affiliates		89
Distributions from nonconsolidated affiliates	4	41
Purchases of investments	(1,079)	(725)
Proceeds from sales of investments	1,172	687
Cash used in investing activities	(1,322)	(1,189)
Financing Activities		
Changes in short-term notes payable	9	81
Payments on long-term debt	(598)	(1,422)
Proceeds from issuance of long-term debt		4
Purchases of treasury stock	(650)	(48)
Proceeds from sales of common stock	97	323
Distributions to minority interests	(54)	(66)
Dividends paid to stockholders	(1,044)	(964)
Cash used in financing activities	(2,240)	(2,092)
Effect of Exchange Rate Changes on Cash	(14)	(182)
Summary		
Increase (Decrease) in cash and cash equivalents	(672)	71
Cash and cash equivalents at beginning of year	3,806	3,108
Cash and cash equivalents at end of period	$ 3,134	$ 3,179

See Notes to the Consolidated Financial Statements.

The Dow Chemical Company and Subsidiaries

Consolidated Statements of Comprehensive Income

	Three Months Ended		Nine Months Ended	
In millions (Unaudited)	**Sept. 30, 2006**	**Sept. 30, 2005**	**Sept. 30, 2006**	**Sept. 30, 2005**
Net Income Available for Common Stockholders	$ 512	$ 801	$ 2,749	$ 3,419
Other Comprehensive Income (Loss), Net of Tax				
Net unrealized gains (losses) on investments	42	(1)	17	(15)
Translation adjustments	(39)	(51)	325	(860)
Minimum pension liability adjustments			(2)	11
Net gains (losses) on cash flow hedging derivative instruments	(89)	120	(129)	152
Total other comprehensive income (loss)	(86)	68	211	(712)
Comprehensive Income	$ 426	$ 869	$ 2,960	$ 2,707

See Notes to the Consolidated Financial Statements.

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(Unaudited) **Notes to the Consolidated Financial Statements**

NOTE A CONSOLIDATED FINANCIAL STATEMENTS

The unaudited interim consolidated financial statements of The Dow Chemical Company and its subsidiaries (Dow or the Company) were prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and reflect all adjustments (including normal recurring accruals) which, in the opinion of management, are considered necessary for the fair presentation of the results for the periods presented. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, and the Current Report on Form 8-K filed on July 11, 2006, reflecting a change in the composition of the Company s reported segments.

NOTE B ACCOUNTING CHANGES

Accounting for Stock-Based Compensation

On January 1, 2006, the Company adopted revised Statement of Financial Accounting Standards (SFAS) No. 123 (SFAS No. 123R), Share-Based Payment. Because the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and SFAS No. 123R were materially consistent under the Company s equity plans, the adoption of this standard had an immaterial impact on the Company s consolidated financial statements.

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. 123R-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. The FSP, which became effective in November 2005, requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123R or the alternative transition method described in the FSP. An entity that adopts SFAS No. 123R using the modified prospective application may make a one-time election to adopt the transition method described in the FSP, and may take up to one year from the latter of its initial adoption of SFAS No. 123R or the effective date of the FSP to evaluate the available transition alternatives and make its one-time election. The Company has adopted the alternative transition method provided in the FSP for calculating the tax effects of stock-based compensation under SFAS No. 123R.

See Note H for disclosures related to stock-based compensation.

Accounting for Conditional Asset Retirement Obligations

In March 2005, the FASB issued FASB Interpretation (FIN) No. 47, Accounting for Conditional Asset Retirement Obligations, which clarifies the term *conditional asset retirement obligation* as used in SFAS No. 143, Accounting for Asset Retirement Obligations, as a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. FIN No. 47 was effective no later than the end of fiscal years ending after December 15, 2005.

Dow has 156 manufacturing sites in 37 countries. Most of these sites contain numerous individual manufacturing operations, particularly at the Company s larger sites. Asset retirement obligations are recorded in the period in which they are incurred and reasonably estimable, including those obligations for which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. Retirement of assets may involve such efforts as remediation and treatment of asbestos, contractually required demolition, and other related activities, depending on the nature and location of the assets, and are typically realized only upon demolition of those facilities. In identifying asset retirement obligations, the Company considers identification of legally enforceable obligations, changes in existing law, estimates of potential settlement dates and the calculation of an appropriate discount rate to be used in calculating the fair value of the obligations. Dow has a well-established global process to identify, approve and track the demolition of retired or to-be-retired facilities; no assets are retired from service until this process has been followed. Dow typically forecasts demolition projects based on the usefulness of the assets; environmental, health and safety concerns; and other similar considerations. Under this process, as demolition projects are identified and approved, reasonable estimates may then be determined for the time frames during which any related asset retirement obligations are expected to be settled. For those assets where a range of potential settlement dates may be reasonably estimated, obligations are recorded.

Assets that have not been submitted/reviewed for potential demolition activities are considered to have continued usefulness and are generally still operating normally. Therefore, without a plan to demolish the assets or the expectation of a plan, such as shortening the useful life of assets for depreciation purposes under the requirements of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, Dow is unable to reasonably forecast a time frame to use for present value calculations. As such, Dow has not recognized obligations for individual plants/buildings at its 156 manufacturing sites where estimates of potential settlement dates cannot be reasonably made. In addition, the Company

has not recognized conditional asset retirement obligations for the capping of its approximately 50 underground storage wells at Dow-owned sites when there are no plans or expectations of plans to exit the sites. Dow routinely reviews all changes to the list of items under consideration for demolition to determine if an adjustment to the value of the asset retirement obligation is required.

Adoption of FIN No. 47 on December 31, 2005 resulted in the recognition of an asset retirement obligation of $34 million and a charge of $20 million (net of tax of $12 million), which was included in Cumulative effect of changes in accounting principles in the fourth quarter of 2005. The discount rate used to calculate the Company s asset retirement obligations was 4.6 percent.

In accordance with FIN No. 47, the Company has recognized conditional asset retirement obligations related to asbestos encapsulation as a result of planned demolition and remediation activities at manufacturing and administrative sites in the United States, Canada and Europe. At December 31, 2005, the aggregate carrying amount of conditional asset retirement obligations recognized by the Company was $34 million. These obligations are included in the consolidated balance sheets as Other noncurrent obligations.

If the conditional asset retirement obligation measurement and recognition provisions of FIN No. 47 had been in effect on January 1, 2005, the aggregate carrying amount of those obligations on that date would have been $32 million. If the amortization of asset retirement cost and accretion of asset retirement obligation provisions of FIN No. 47 had been in effect during 2005, the impact on Income before Cumulative Effect on Changes in Accounting Principles and Net Income Available for Common Stockholders would have been immaterial. Further, the impact on earnings per common share (both basic and diluted) would have been less than $0.01.

See Note E for the Company s disclosures related to asset retirement obligations.

Other Accounting Changes

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) and also requires that the allocation of fixed production overhead be based on the normal capacity of the production facilities. SFAS No. 151 was effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Because the Company previously used nameplate capacity to calculate product costs, the adoption of SFAS No. 151 on January 1, 2006 had an immaterial favorable impact on the Company s consolidated financial statements in the first quarter of 2006.

In September 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) with respect to EITF Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty. EITF Issue No. 04-13 is effective for new arrangements entered into, and modifications or renewals of existing arrangements, in the first interim or annual period beginning after March 15, 2006. The Company has determined that its current accounting treatment for purchases and sales of inventory with the same counterparty is consistent with the guidance in EITF Issue No. 04-13; therefore, the issue had no impact on the Company s consolidated financial statements.

In November 2005, the FASB issued FSP Nos. FAS 115-1 and 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, which addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment. The FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in the FSP amends SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, SFAS No. 124, Accounting for Certain Investments Held by Not-for-Profit Organizations, and Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. The Company has reviewed the guidance of FSP Nos. FAS 115-1 and 124-1 and has determined that its practices are consistent with the FSP; therefore, the adoption of the FSP on January 1, 2006 had no impact on the Company s consolidated financial statements.

In April 2006, the FASB issued FSP No. FIN 46(R)-6, Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R). The guidance in this FSP was applicable prospectively to all entities (including newly created entities) and when a reconsideration event has occurred pursuant to paragraph 7 of FIN No. 46(R), beginning the first day of the first reporting period beginning after June 15, 2006. Beginning July 1, 2006, the Company will apply the guidance of this FSP as it applies FIN No. 46(R).

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of adopting this interpretation.

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In September 2006, the U.S. Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin (SAB) No. 108, which expresses the views of the SEC staff regarding the process of quantifying financial statement misstatements. SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The guidance of this SAB is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, which is December 31, 2006 for the Company. SAB No. 108 is not expected to have an impact on the Company s consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements and is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting this Statement.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R). This Statement, which is effective December 31, 2006 for the Company, requires employers to recognize the funded status of defined benefit postretirement plans as an asset or liability on the balance sheet and to recognize changes in that funded status through comprehensive income. SFAS No. 158 also establishes the measurement date of plan assets and obligations as the date of the employer s fiscal year end, and provides for additional annual disclosures. Dow currently uses a December 31 measurement date for all of its plans, consistent with its fiscal year end. The Company is currently evaluating the impact of adopting this Statement.

NOTE C INVENTORIES

The following table provides a breakdown of inventories:

Inventories In millions	**Sept. 30, 2006**	**Dec. 31, 2005**
Finished goods	$ 3,367	$ 2,941
Work in process	1,447	1,247
Raw materials	734	645
Supplies	570	486
Total inventories	$ 6,118	$ 5,319

The reserves reducing inventories from the first-in, first-out (FIFO) basis to the last-in, first-out (LIFO) basis amounted to $1,270 million at September 30, 2006 and $1,149 million at December 31, 2005.

NOTE D GOODWILL AND OTHER INTANGIBLE ASSETS

The following table shows the carrying amount of goodwill by operating segment:

Goodwill **In millions**	**Performance Plastics**	**Performance Chemicals**	**Agricultural Sciences**	**Basic Plastics**	**Hydrocarbons and Energy**	**Total**
Balance at December 31, 2005	$ 913	$ 750	$ 1,320	$ 94	$ 63	$ 3,140
Goodwill related to acquisition of Zhejiang Omex Environmental Engineering Co. LTD		90				90
Balance at September 30, 2006	$ 913	$ 840	$ 1,320	$ 94	$ 63	$ 3,230

On July 11, 2006, FilmTec Corporation, a wholly owned subsidiary of the Company, completed the acquisition of Zhejiang Omex Environmental Engineering Co. LTD. The initial recording of the acquisition resulted in goodwill of $90 million. Final determination of the fair values to be assigned may result in adjustments to the preliminary values assigned at the date of acquisition.

The following table provides information regarding the Company s other intangible assets:

Other Intangible Assets	**At September 30, 2006**			**At December 31, 2005**		
In millions	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**
Intangible assets with finite lives:						
Licenses and intellectual property	$ 245	$ (147)	$ 98	$ 264	$ (138)	$ 126
Patents	151	(117)	34	147	(103)	44
Software	409	(255)	154	362	(224)	138
Trademarks	134	(40)	94	136	(37)	99
Other	114	(53)	61	86	(50)	36
Total	$ 1,053	$ (612)	$ 441	$ 995	$ (552)	$ 443

In the third quarter of 2006, the Company wrote off obsolete technology assets (from Licenses and intellectual property in the above table) with a net book value of $18 million in conjunction with other restructuring activities (see Note F). The write-off was included in Restructuring charges in the consolidated statements of income and reflected in the Performance Plastics segment ($15 million) and Unallocated and Other ($3 million).

In the third quarter of 2006, the Company entered into a non-competition agreement with an estimated fair value of $31 million associated with the acquisition of Zhejiang Omex Environmental Engineering Co. LTD (included in Other in the above table). The amortization period is the five-year term of the agreement.

During the first nine months of 2006, the Company acquired software for $44 million. The weighted-average amortization period for the acquired software is five years.

The following table provides information regarding amortization expense:

Amortization Expense	**Three Months Ended**		**Nine Months Ended**	
In millions	**Sept. 30, 2006**	**Sept. 30, 2005**	**Sept. 30, 2006**	**Sept. 30, 2005**
Other intangible assets, excluding software	$ 13	$ 13	$ 37	$ 40
Software, included in Cost of sales	12	10	33	32

Total estimated amortization expense for 2006 and the five succeeding fiscal years is as follows:

Estimated Amortization Expense	
In millions	
2006	$ 93
2007	82
2008	77
2009	69
2010	32
2011	14

NOTE E COMMITMENTS AND CONTINGENT LIABILITIES

Litigation

Breast Implant Matters

On May 15, 1995, Dow Corning Corporation (Dow Corning), in which the Company is a 50 percent shareholder, voluntarily filed for protection under Chapter 11 of the Bankruptcy Code to resolve litigation related to Dow Corning s breast implant and other silicone medical products. On June 1, 2004, Dow Corning s Joint Plan of Reorganization (the Joint Plan) became effective and Dow Corning emerged from bankruptcy. The

Joint Plan contains release and injunction provisions resolving all tort claims brought against various entities, including the Company, involving Dow Corning s breast implant and other silicone medical products.

To the extent not previously resolved in state court actions, cases involving Dow Corning s breast implant and other silicone medical products filed against the Company were transferred to the U.S. District Court for the Eastern District of Michigan (the District Court) for resolution in the context of the Joint Plan. On October 6, 2005, all such cases then pending in the District Court against the Company were dismissed. Should cases involving Dow Corning s breast implant and other silicone medical products be filed against the Company in the future, they will be accorded similar treatment. It is the opinion of the Company s management that the possibility is remote that a resolution of all future cases will have a material adverse impact on the Company s consolidated financial statements.

As part of the Joint Plan, Dow and Corning Incorporated have agreed to provide a credit facility to Dow Corning in an aggregate amount of $300 million. The Company s share of the credit facility is $150 million and is subject to the terms and conditions stated in the Joint Plan. At September 30, 2006, no draws had been taken against the credit facility.

DBCP Matters

Numerous lawsuits have been brought against the Company and other chemical companies, both inside and outside of the United States, alleging that the manufacture, distribution or use of pesticides containing dibromochloropropane (DBCP) has caused personal injury and property damage, including contamination of groundwater. It is the opinion of the Company s management that the possibility is remote that the resolution of such lawsuits will have a material adverse impact on the Company s consolidated financial statements.

Environmental Matters

Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. At September 30, 2006, the Company had accrued obligations of $368 million for environmental remediation and restoration costs, including $30 million for the remediation of Superfund sites. This is management s best estimate of the costs for remediation and restoration with respect to environmental matters for which the Company has accrued liabilities, although the ultimate cost with respect to these particular matters could range up to twice that amount. Inherent uncertainties exist in these estimates primarily due to unknown conditions, changing governmental regulations and legal standards regarding liability, and evolving technologies for handling site remediation and restoration. At December 31, 2005, the Company had accrued obligations of $339 million for environmental remediation and restoration costs, including $41 million for the remediation of Superfund sites. The increase in accrued environmental obligations from year-end 2005 was primarily related to restructuring activities at the Company s manufacturing facilities in Canada (see Note F to the Consolidated Financial Statements).

On June 12, 2003, the Michigan Department of Environmental Quality (MDEQ) issued a Hazardous Waste Operating License (the License) to the Company s Midland, Michigan manufacturing site (the Midland site), which included provisions requiring the Company to conduct an investigation to determine the nature and extent of off-site contamination in Midland area soils; Tittabawassee and Saginaw River sediment and floodplain soils; and Saginaw Bay. The License required the Company, by August 11, 2003, to propose a detailed Scope of Work for the off-site investigation for review and approval by the MDEQ. Revised Scopes of Work were approved by the MDEQ on October 18, 2005. Discussions between the Company and the MDEQ that occurred in 2004 and early 2005 regarding how to proceed with off-site corrective action under the License resulted in the execution of the Framework for an Agreement Between the State of Michigan and The Dow Chemical Company (the Framework) on January 20, 2005. The Framework committed the Company to take certain immediate interim remedial actions in the City of Midland and along the Tittabawassee River, conduct certain studies, and propose a remedial investigation work plan by the end of 2005. The interim remedial actions required by the Framework are currently underway. The Company submitted Remedial Investigation Work Plans for the City of Midland and for the Tittabawassee River on December 29, 2005. By letters dated March 2, 2006 and April 13, 2006, the MDEQ provided two Notices of Deficiency (Notices) to the Company regarding the Remedial Investigation Work Plans. The Company responded, as required, to some of the items in the Notices on May 1, 2006, and is required to respond to the balance of the items and revise the Remedial Investigation Work Plans by December 1, 2006. On July 12, 2006, the MDEQ approved the sampling for the first six miles of the Tittabawassee River. The Framework also contemplates that the Company, the State of Michigan and other federal and tribal governmental entities will negotiate the terms of an agreement or agreements to resolve potential governmental claims against the Company related to historical off-site contamination associated with the Midland site. The Company and the governmental parties began to meet in the fall of 2005 and entered into a Confidentiality Agreement in December 2005. At the end of 2005, the Company had an accrual for off-site corrective action of $3 million (included in the total accrued obligation of $339 million at December 31, 2005) based on the range of activities that the Company proposed and discussed implementing with the MDEQ and which is set forth in the Framework. At September 30, 2006, the accrual for off-site corrective action was $12 million (included in the total accrued obligation of $368 million at September 30, 2006).

It is the opinion of the Company s management that the possibility is remote that costs in excess of those disclosed will have a material adverse impact on the Company s consolidated financial statements.

Asbestos-Related Matters of Union Carbide Corporation

Union Carbide Corporation (Union Carbide), a wholly owned subsidiary of the Company, is and has been involved in a large number of asbestos-related suits filed primarily in state courts during the past three decades. These suits principally allege personal injury resulting from exposure to asbestos-containing products and frequently seek both actual and punitive damages. The alleged claims primarily relate to products that Union Carbide sold in the past, alleged exposure to asbestos-containing products located on Union Carbide s premises, and Union Carbide s responsibility for asbestos suits filed against a former Union Carbide subsidiary, Amchem Products, Inc. (Amchem). In many cases, plaintiffs are unable to demonstrate that they have suffered any compensable loss as a result of such exposure, or that injuries incurred in fact resulted from exposure to Union Carbide s products.

Influenced by the bankruptcy filings of numerous defendants in asbestos-related litigation and the prospects of various forms of state and national legislative reform, the rate at which plaintiffs filed asbestos-related suits against various companies, including Union Carbide and Amchem, increased in 2001, 2002 and the first half of 2003. Since then, the rate of filing has significantly abated. Union Carbide expects more asbestos-related suits to be filed against Union Carbide and Amchem in the future, and will aggressively defend or reasonably resolve, as appropriate, both pending and future claims.

Based on a study completed by Analysis, Research & Planning Corporation (ARPC) in January 2003, Union Carbide increased its December 31, 2002 asbestos-related liability for pending and future claims for the 15-year period ending in 2017 to $2.2 billion, excluding future defense and processing costs. At each balance sheet date, Union Carbide compares current asbestos claim and resolution activity to the assumptions in the most recent ARPC study to determine whether the accrual continues to be appropriate.

In November 2004, Union Carbide requested ARPC to review Union Carbide s historical asbestos claim and resolution activity and determine the appropriateness of updating its January 2003 study. In response to that request, ARPC reviewed and analyzed data through November 14, 2004, and again concluded that it was not possible to estimate the full range of the cost of resolving future asbestos-related claims against Union Carbide and Amchem because of various uncertainties associated with the litigation of those claims. ARPC did advise Union Carbide, however, that it was reasonable and feasible to construct a new estimate of the cost to Union Carbide of resolving current and future asbestos-related claims using the same two widely used forecasting methodologies used by ARPC in its January 2003 study, if certain assumptions were made. As a result, the following assumptions were made and then used by ARPC:

- The number of future claims to be filed annually against Union Carbide and Amchem is unlikely to exceed the level of claims experienced during 2004.

- The number of claims filed against Union Carbide and Amchem annually from 2001 to 2003 is considered anomalous for the purpose of estimating future filings.

- The number of future claims to be filed against Union Carbide and Amchem will decline at a fairly constant rate each year from 2005.

- The average resolution value for pending and future claims will be equivalent to those experienced during 2003 and 2004 (excluding settlements from closed claims filed in Madison County, Illinois with respect to future claims, as changes in the judicial environment in Madison County caused the historical experience of claims in that jurisdiction to not be predictive of results for future claims).

The resulting study completed by ARPC in January 2005 stated that the undiscounted cost to Union Carbide of resolving pending and future asbestos-related claims against Union Carbide and Amchem, excluding future defense and processing costs, through 2017 was estimated to be between approximately $1.5 billion and $2.0 billion, depending on which of two accepted methodologies was used. At December 31, 2004, Union Carbide s recorded asbestos-related liability for pending and future claims was $1.6 billion. Based on the low end of the range in the January 2005 study, Union Carbide s recorded asbestos-related liability for pending and future claims at December 31, 2004 would be sufficient to resolve asbestos-related claims against Union Carbide and Amchem into 2019. As in its January 2003 study, ARPC provided estimates for a longer period of time in its January 2005 study, but also reaffirmed its prior advice that forecasts for shorter periods of time are more accurate than those for longer periods of time. Based on ARPC s studies, Union Carbide s asbestos litigation experience, and the uncertainties surrounding asbestos litigation and legislative reform efforts, Union Carbide s management determined that no change to the accrual was required at December 31, 2004.

In November 2005, Union Carbide requested ARPC to review Union Carbide s 2005 asbestos claim and resolution activity and determine the appropriateness of updating the January 2005 study. In response to that request, ARPC reviewed and analyzed data through October 31, 2005. In January 2006, ARPC stated that an update of the study would not provide a more likely estimate of future events than the estimate reflected in its study of the previous year and, therefore, the estimate in that study remained applicable.

Based on Union Carbide s own review of the asbestos claim and resolution activity and ARPC s response, Union Carbide determined that no change to the accrual was required at December 31, 2005. Union Carbide s asbestos-related liability for pending and future claims was $1.5 billion at December 31, 2005. Approximately 39 percent of the recorded liability related to pending claims and approximately 61 percent related to future claims.

Based on Union Carbide s review of 2006 activity, Union Carbide determined that no change to the accrual was required at September 30, 2006. Union Carbide s asbestos-related liability for pending and future claims was $1.4 billion at September 30, 2006. Approximately 35 percent of the recorded liability related to pending claims and approximately 65 percent related to future claims.

At December 31, 2002, Union Carbide increased the receivable for insurance recoveries related to its asbestos liability to $1.35 billion, substantially exhausting its asbestos product liability coverage. The insurance receivable related to the asbestos liability was determined by Union Carbide after a thorough review of applicable insurance policies and the 1985 Wellington Agreement, to which Union Carbide and many of its liability insurers are signatory parties, as well as other insurance settlements, with due consideration given to applicable deductibles, retentions and policy limits, and taking into account the solvency and historical payment experience of various insurance carriers. The Wellington Agreement and other agreements with insurers are designed to facilitate an orderly resolution and collection of Union Carbide s insurance policies and to resolve issues that the insurance carriers may raise.

Union Carbide s receivable for insurance recoveries related to its asbestos liability was $478 million at September 30, 2006 and $535 million at December 31, 2005. At September 30, 2006, $477 million ($398 million at December 31, 2005) of the receivable for insurance recoveries was related to insurers that are not signatories to the Wellington Agreement and/or do not otherwise have agreements in place regarding their asbestos-related insurance coverage.

In addition, Union Carbide had receivables for defense and resolution costs submitted to insurance carriers for reimbursement as follows:

Receivables for Costs Submitted to Insurance Carriers

In millions	Sept. 30, 2006	Dec. 31, 2005
Receivables for defense costs	$ 9	$ 73
Receivables for resolution costs	342	327
Total	$ 351	$ 400

Union Carbide expenses defense costs as incurred. The pretax impact for defense and resolution costs, net of insurance, was $1 million in the third quarter of 2006 ($24 million in the third quarter of 2005) and $29 million in the first nine months of 2006 ($56 million in the first nine months of 2005), and was reflected in Cost of sales.

In September 2003, Union Carbide filed a comprehensive insurance coverage case, now proceeding in the Supreme Court of the State of New York, County of New York, seeking to confirm its rights to insurance for various asbestos claims and to facilitate an orderly and timely collection of insurance proceeds. Although Union Carbide already has settlements in place concerning coverage for asbestos claims with many of its insurers, including those covered by the 1985 Wellington Agreement, this lawsuit was filed against insurers that are not signatories to the Wellington Agreement and/or do not otherwise have agreements in place with Union Carbide regarding their asbestos-related insurance coverage, in order to facilitate an orderly resolution and collection of such insurance policies and to resolve issues that the insurance carriers may raise. The insurance carriers are contesting this litigation. Through the third quarter of 2006, Union Carbide reached settlements with several of the carriers involved in this litigation. After a further review of its insurance policies, with due consideration given to applicable deductibles, retentions and policy limits, after taking into account the solvency and historical payment experience of various insurance carriers; existing insurance settlements; and the advice of outside counsel with respect to the applicable insurance coverage law relating to the terms and conditions of its insurance policies, Union Carbide continues to believe that its recorded receivable for insurance recoveries from all insurance carriers is probable of collection.

The amounts recorded by Union Carbide for the asbestos-related liability and related insurance receivable described above were based upon current, known facts. However, future events, such as the number of new claims to be filed and/or received each year, the average cost of disposing of each such claim, coverage issues among insurers, and the continuing solvency of various insurance companies, as well as the numerous uncertainties surrounding asbestos litigation in the United States, could cause the actual costs and insurance recoveries for Union Carbide to be higher or lower than those projected or those recorded.

Because of the uncertainties described above, Union Carbide s management cannot estimate the full range of the cost of resolving pending and future asbestos-related claims facing Union Carbide and Amchem. Union Carbide s management believes that it is reasonably possible that the cost of disposing of Union Carbide s asbestos-related claims, including future defense costs, could have a material adverse impact on Union Carbide s results of operations and cash flows for a particular period and on the consolidated financial position of Union Carbide.

It is the opinion of Dow s management that it is reasonably possible that the cost of Union Carbide disposing of its asbestos-related claims, including future defense costs, could have a material adverse impact on the Company s results of operations and cash flows for a particular period and on the consolidated financial position of the Company.

Synthetic Rubber Industry Matters

In 2003, the U.S., Canadian and European competition authorities initiated separate investigations into alleged anticompetitive behavior by certain participants in the synthetic rubber industry. Certain subsidiaries of the Company (but as to the investigation in Europe only) have responded, or are in the process of responding, to requests for documents and are otherwise cooperating in the investigations. Separately, related civil actions have been filed in various U.S. federal and state courts. Certain of these actions have named the Company.

On June 10, 2005, the Company received a Statement of Objections from the European Commission stating that it believed that the Company and certain subsidiaries of the Company, together with other participants in the synthetic rubber industry, engaged in conduct in violation of European competition laws. It is expected that the European Commission will seek to impose a fine on the Company, the amount of which will be calculated taking into account the gravity of the violation, the role played by the participants, the duration of their participation and their importance in the synthetic rubber industry.

Polyurethane Subpoena Matter

On February 16, 2006, the Company, among others, received a subpoena from the U.S. Department of Justice as part of an investigation of polyurethane chemicals, including methylene diphenyl diisocyanate (MDI), toluene diisocyanate (TDI) and polyols. The Company is fully cooperating with the investigation.

Other Litigation Matters

In addition to breast implant, DBCP, environmental, synthetic rubber industry, and polyurethane subpoena matters, the Company is party to a number of other claims and lawsuits arising out of the normal course of business with respect to commercial matters, including product liability, governmental regulation and other actions. Certain of these actions purport to be class actions and seek damages in very large amounts. All such claims are being contested. Dow has an active risk management program consisting of numerous insurance policies secured from many carriers at various times. These policies provide coverage that will be utilized to minimize the impact, if any, of the contingencies described above.

Summary

Except for the possible effect of Union Carbide s asbestos-related liability described above, it is the opinion of the Company s management that the possibility is remote that the aggregate of all claims and lawsuits will have a material adverse impact on the Company s consolidated financial statements.

Purchase Commitments

At December 31, 2005, the Company had 15 major agreements (16 in 2004 and seven in 2003) for the purchase of ethylene-related products globally. The purchase prices are determined on a cost-of-service basis, which, in addition to covering all operating expenses and debt service costs, provides the owner of the manufacturing plants with a specified return on capital. Total purchases under these agreements were $1,175 million in 2005, $1,063 million in 2004 and $676 million in 2003. The Company s commitments associated with all of these agreements are included in the table below.

At December 31, 2005, the Company had various outstanding commitments for take or pay and throughput agreements, including the purchase agreements referred to above. Such commitments were at prices not in excess of current market prices. The terms of all but two of these agreements extend from one to 25 years. One agreement has terms extending to 75 years; another has indefinite terms. The determinable future commitments for these latter two agreements are included for 10 years in the following table which presents the fixed and determinable portion of obligations under the Company s purchase commitments at December 31, 2005:

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Fixed and Determinable Portion of Take or Pay and Throughput Obligations at December 31, 2005

In millions	
2006	$ 2,390
2007	2,204
2008	2,031
2009	1,791
2010	1,566
2011 and beyond	6,512
Total	$ 16,494

In addition to the take or pay obligations at December 31, 2005, the Company had outstanding commitments which ranged from one to six years for steam, electrical power, materials, property and other items used in the normal course of business of approximately $156 million. Such commitments were at prices not in excess of current market prices.

Guarantees

The Company provides a variety of guarantees, as described more fully in the following sections.

Guarantees

Guarantees arise during the ordinary course of business from relationships with customers and nonconsolidated affiliates when the Company undertakes an obligation to guarantee the performance of others (via delivery of cash or other assets) if specified triggering events occur. With guarantees, such as commercial or financial contracts, non-performance by the guaranteed party triggers the obligation of the Company to make payments to the beneficiary of the guarantee. The majority of the Company s guarantees relates to debt of nonconsolidated affiliates, which have expiration dates ranging from less than one year to nine years, and trade financing transactions in Latin America, which typically expire within one year of their inception.

Residual Value Guarantees

The Company provides guarantees related to leased assets specifying the residual value that will be available to the lessor at lease termination through sale of the assets to the lessee or third parties.

The following table provides a summary of the final expiration, maximum future payments and recorded liability reflected in the consolidated balance sheets for each type of guarantee:

Guarantees at September 30, 2006 In millions	**Final Expiration**	**Maximum Future Payments**	**Recorded Liability**
Guarantees	2014	$ 287	$ 11
Residual value guarantees	2015	1,044	6
Total guarantees		$ 1,331	$ 17

Guarantees at December 31, 2005 In millions	**Final Expiration**	**Maximum Future Payments**	**Recorded Liability**
Guarantees	2014	$ 401	$ 19
Residual value guarantees	2015	1,158	5
Total guarantees		$ 1,559	$ 24

Asset Retirement Obligations

In accordance with SFAS No. 143, as interpreted by FIN No. 47, the Company has recognized asset retirement obligations for the following activities: demolition and remediation activities at manufacturing sites in the United States and Europe; capping activities at landfill sites in the United States, Canada, Italy and Brazil; and asbestos encapsulation as a result of planned demolition and remediation activities at manufacturing and administrative sites in the United States, Canada and Europe. See Note B for additional information.

The aggregate carrying amount of asset retirement obligations recognized by the Company was $106 million at September 30, 2006 and $92 million at December 31, 2005.

The following table shows changes in the aggregate carrying amount of the Company s asset retirement obligations:

Asset Retirement Obligations

In millions	2006
Balance at January 1	$ 92
Additional accruals (1)	22
Liabilities settled	(11)
Accretion expense	1
Revisions in estimated cash flows	
Other	2
Balance at September 30	$ 106

(1) Includes $14 million for asbestos abatement related to the shutdown of assets announced in the third quarter of 2006. See Note F for additional information.

As described in Note B, the Company has not recognized conditional asset retirement obligations for which a fair value cannot be reasonably estimated in its consolidated financial statements. It is the opinion of the Company s management that the possibility is remote that such conditional asset retirement obligations, when estimable, will have a material adverse impact on the Company s consolidated financial statements based on current costs.

NOTE F RESTRUCTURING

On August 29, 2006, the Company s Board of Directors approved a plan to shut down a number of assets around the world as the Company continues its drive to improve the competitiveness of its global operations. As a consequence of these shutdowns, which are scheduled to be completed by the end of 2008, and other optimization activities, the Company recorded pretax restructuring charges totaling $579 million in the third quarter of 2006. The charges consisted of asset write-downs and write-offs of $327 million, costs associated with exit or disposal activities of $171 million and severance costs of $81 million. The impact of the charges is shown as Restructuring charges in the consolidated statements of income and was reflected in the Company s segment results as follows:

Restructuring Charges by Operating Segment

In millions	Impairment of Long-Lived Assets and Other Intangible Assets	Costs associated with Exit or Disposal Activities	Severance Costs	Total
Performance Plastics	$ 174	$ 68		$ 242
Performance Chemicals	10	1		11
Basic Plastics	15	1		16
Basic Chemicals	110	55		165
Unallocated and Other	18	46	$ 81	145
Total	$ 327	$ 171	$ 81	$ 579

Details regarding the components of the restructuring charges are included below:

Impairment of Long-Lived Assets and Other Intangible Assets

The restructuring charges related to the write-down or write-off of assets totaled $327 million in the third quarter of 2006 and included the impact of plant closures of $250 million. The most significant plant closures will take place at Dow s facilities in Porto Marghera, Italy, and Fort Saskatchewan and Sarnia, Canada. Details regarding these shutdowns are as follows:

- In Porto Marghera, Italy, the Company s toluene diisocyanate (TDI) plant was shut down for planned maintenance in early August 2006. Business fundamentals in the TDI business remain weak due to excess global capacity. As a result, the Company decided to permanently close the facility at the end of August, resulting in a $115 million write-down of the net book value of the related buildings, machinery and equipment against the Performance Plastics segment in the third quarter of 2006.

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- Substantial capital costs would be required to address efficiency issues at the Company s chlor-alkali and direct chlorination ethylene dichloride plants in Fort Saskatchewan, Alberta, Canada. Based on an analysis of the discounted future cash flows, management determined that an investment in these facilities could not be justified. As a result, the Company decided to shut down the facilities by the end of October 2006, resulting in a $74 million write-down of the net book value of the related buildings, machinery and equipment against the Basic Chemicals segment in the third quarter of 2006.

- Assessments by the businesses located in Sarnia, Ontario, Canada, were triggered by the recent suspension of ethylene shipments through the Cochin Pipeline, a subsidiary of BP Canada Energy Resources Company, due to safety concerns. The assessments highlighted a variety of issues related to the effectiveness, efficiency and long-term sustainability of the Sarnia-based assets. Based on these assessments, the Company decided to cease all production activity at the Sarnia site by the end of 2008 as follows:

- The low density polyethylene plant was shut down in the third quarter of 2006.

- Polystyrene production will cease by the end of 2006.

- Latex production from the UES facility and the polyols plant will shut down by year-end 2008.

The closure of manufacturing plants in 2006 resulted in a $24 million write-down of the net book value of the machinery and equipment in the third quarter of 2006 (with $11 million reflected in Performance Plastics, $10 million in Basic Plastics, and $3 million in Unallocated and Other).

In addition to the larger shutdowns described above, the restructuring charges for plant closures included $37 million related to the shutdown of several small production facilities, a terminal, and a research and development facility.

The restructuring charges in the third quarter of 2006 also included the write-off of capital project spending ($47 million) and technology assets ($18 million) which the Company determined to be of no further value, as well as spare parts and catalyst inventories ($12 million) associated with the plant closures. These write-offs were principally related to the businesses involved in the shutdown of assets and were therefore reflected in the results of various operating segments.

Costs Associated with Exit or Disposal Activities

The restructuring charges for costs associated with exit or disposal activities totaled $171 million in the third quarter of 2006 and included contract termination fees of $64 million, environmental remediation of $60 million, pension curtailment costs and termination benefits of $33 million, and asbestos abatement of $14 million.

Contract termination fees of $64 million represent the Company s best estimate of the fair value to negotiate the settlement of the early cancellation of several supply agreements related to the shutdown of manufacturing assets within the Performance Plastics segment.

The restructuring charges for environmental remediation of $60 million and asbestos abatement of $14 million principally relate to the shutdown of the Company s facilities in Canada. The charges were therefore reflected in various operating segments.

According to the restructuring plan for Canada, the Sarnia site will undergo a complete shutdown by the end of 2008 and the chlor-alkali and direct chlorination ethylene dichloride plants in Fort Saskatchewan will be shut down by the end of October 2006. As such, for purposes of calculating the Company s obligation associated with Dow s defined benefit plans in Canada, the expected years of future service of active employees has been significantly reduced. In addition, the Company is obligated to provide certain termination benefits. As a result, the restructuring charge included pension curtailment costs and termination benefits of $33 million in the third quarter of 2006. These costs were reflected in Unallocated and Other.

Severance Costs

As a result of the Company s plans to shutdown assets around the world, and conduct other optimization activities principally in Europe, the restructuring charges recorded in the third quarter of 2006 included severance of $81 million for the separation of approximately 940 employees. Severance benefits will be provided to employees under the terms of Dow s existing separation plans over the next three years. These costs were charged against Unallocated and Other.

The following table summarizes the activities related to the Company s restructuring reserve:

Restructuring Activities

In millions	Impairment of Long-Lived Assets and Other Intangible Assets	Costs associated with Exit or Disposal Activities	Severance Costs	Total
Restructuring charges incurred in third quarter of 2006	$ 327	$ 171	$ 81	$ 579
Cash payments				
Non-cash adjustments	(327)			(327)
Reserve balance at Sept. 30, 2006		$ 171	$ 81	$ 252

Dow expects to incur future costs related to its restructuring activities, as the Company continually looks for ways to enhance the efficiency and cost effectiveness of its operations, to ensure competitiveness across its businesses and across geographic areas. Future costs are expected to include demolition costs related to the closed facilities, which will be recognized as incurred. The Company also expects to incur additional employee-related costs, including involuntary termination benefits, related to its other optimization activities, and pension plan settlement costs. These costs cannot be reasonably estimated at this time.

NOTE G PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

Net Periodic Benefit Cost for All Significant Plans

In millions	Three Months Ended Sept. 30, 2006	Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Sept. 30, 2005
Defined Benefit Pension Plans:				
Service cost	$ 71	$ 71	$ 212	$ 215
Interest cost	208	202	619	611
Expected return on plan assets	(276)	(263)	(824)	(794)
Amortization of prior service cost	5	6	15	18
Amortization of net loss	56	28	166	85
Termination benefits/curtailment costs (1)	33		33	
Net periodic benefit cost	$ 97	$ 44	$ 221	$ 135
Other Postretirement Benefits:				
Service cost	$ 6	$ 6	$ 18	$ 18
Interest cost	29	31	87	93
Expected return on plan assets	(7)	(7)	(21)	(21)
Amortization of prior service credit	(2)	(2)	(6)	(6)
Amortization of net loss	2	3	6	9
Net periodic benefit cost	$ 28	$ 31	$ 84	$ 93

(1) See Note F for information regarding termination benefits/curtailment costs recorded in the third quarter of 2006.

Employer Contributions

Pension Plans

The Company has defined benefit pension plans that cover employees in the United States and a number of other countries. The U.S. funded plan covering the parent company is the largest plan. Benefits are based on length of service and the employee s three highest consecutive years of compensation.

The Company s funding policy is to contribute to those plans when pension laws and economics either require or encourage funding. Dow expects to contribute $500 million to its pension plans in 2006. Contributions of $395 million were made in the first nine months of 2006.

Other Postretirement Benefits

The Company provides certain health care and life insurance benefits to retired employees. The Company has one non-U.S. plan, which is insignificant; therefore, this discussion relates to the U.S. plans only. The plans provide health care benefits, including hospital, physicians services, drug and major medical expense coverage, and life insurance benefits. For employees hired before January 1, 1993, the plans provide benefits supplemental to Medicare when retirees are eligible for these benefits. The Company and the retiree share the cost of these benefits, with the Company portion increasing as the retiree has increased years of credited service. There is a cap on the Company portion. The Company has the ability to change these benefits at any time.

The Company funds most of the cost of these health care and life insurance benefits as incurred. Dow does not expect to contribute assets to its other postretirement benefits plan trusts in 2006. Consistent with that expectation, no contributions were made in the first nine months of 2006. Benefit payments to retirees under these plans are expected to be $201 million in 2006. Payments of $123 million were made in the first nine months of 2006.

NOTE H STOCK-BASED COMPENSATION

Accounting for Stock-Based Compensation

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment, which replaced SFAS No. 123, Accounting for Stock-Based Compensation, and superseded APB Opinion No. 25, Accounting for Stock Issued to Employees. This statement, which requires that the cost of all share-based payment transactions be recognized in the financial statements, established fair value as the measurement objective and required entities to apply a fair-value-based measurement method in accounting for share-based payment transactions. As issued, the statement applied to all awards granted, modified, repurchased or cancelled after July 1, 2005, and unvested portions of previously issued and outstanding awards. On April 14, 2005, the SEC announced the adoption of a new rule that amended the compliance date for SFAS No. 123R, allowing companies to implement the statement at the beginning of their next fiscal year that began after June 15, 2005, which was January 1, 2006 for the Company. Effective January 1, 2006, the Company began expensing stock-based compensation newly issued in 2006 to employees in accordance with the fair-value-based measurement method of accounting set forth in SFAS No. 123R, using the modified prospective method.

The Company grants stock-based compensation awards which vest over a specified period or upon employees meeting certain performance and retirement eligibility criteria. The Company has historically amortized these awards over the specified vesting period and recognizes any unrecognized compensation cost at the date of retirement (the nominal vesting period approach). The Company will continue applying the nominal vesting period approach for the remaining portion of unvested outstanding awards as of December 31, 2005. SFAS No. 123R specifies that an award is vested when the employee s right to the award is no longer contingent upon providing additional service (the non-substantive vesting period approach). The Company began applying this approach to all stock-based compensation awarded after December 31, 2005. The fair value of equity instruments issued to employees is measured on the date of grant and is recognized over the vesting period or from the grant date to the date on which retirement eligibility provisions have been met and additional service is no longer required. The Company has determined that application of the nominal vesting period approach to the unvested outstanding awards at the end of 2005 and application of the non-substantive vesting period approach to stock-based compensation awarded beginning in 2006 did not have a material impact on the Company s consolidated financial statements.

Prior to the adoption of SFAS No. 123R, the Company expensed stock options granted after January 1, 2003, when the fair value provisions of SFAS No. 123 were adopted for new grants of equity instruments (which include stock options, deferred stock grants, and subscriptions to purchase shares under the Company s Employees Stock Purchase Plan [ESPP]) to employees. Prior to the adoption of SFAS No. 123, the Company accounted for its stock-based awards in accordance with APB Opinion No. 25. The following table provides pro forma results as if the fair-value-based measurement method had been applied to all outstanding and unvested awards, including stock options, deferred stock grants, and subscriptions to purchase shares under the Company s ESPP, in each period presented:

In millions, except per share amounts	Three Months Ended Sept. 30, 2006	Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Sept. 30, 2005
Net income, as reported	$ 512	$ 801	$ 2,749	$ 3,419
Add: Stock-based compensation expense included in reported net income, net of tax	51	44	128	218
Deduct: Total stock-based compensation expense determined using the fair-value-based measurement method for all awards, net of tax	(51)	(43)	(128)	(186)
Pro forma net income	$ 512	$ 802	$ 2,749	$ 3,451
Earnings per share (in dollars):				
Basic as reported	$ 0.53	$ 0.83	$ 2.85	$ 3.55
Basic pro forma	0.53	0.83	2.85	3.59
Diluted as reported	0.53	0.82	2.82	3.51
Diluted pro forma	0.53	0.82	2.82	3.54

Prior to 2006, the Company estimated the fair value of stock options and subscriptions to purchase shares under the ESPP using a binomial option-pricing model. Beginning in 2006, the Company is using a lattice-based option valuation model to estimate the fair value of stock options and subscriptions to purchase shares under the ESPP. The weighted-average assumptions used to calculate total stock-based compensation are included in the following table:

	Three Months Ended Sept. 30, 2006	Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Sept. 30, 2005
Dividend yield	3.83 %	2.97 %	3.33 %	2.59 %
Expected volatility	27.72 %	23.34 %	25.67 %	22.22 %
Risk-free interest rate	5.11 %	3.85 %	4.55 %	3.65 %
Expected life of stock options granted during period	6 years	5 years	6 years	5 years
Life of Employees Stock Purchase Plan	N/A (1)	N/A (2)	6.6 months	5 months

(1) The annual plan for 2006 was granted in the first quarter of 2006 with a participation period of 10 months.

(2) The annual plan for 2005 was granted in the second quarter of 2005 with a participation period of 5 months

The dividend yield assumption for all periods was based on the Company s current declared dividend as a percentage of the stock price on the grant date. The expected volatility assumption for the current year was based on an equal weighting of the historical daily volatility and current implied volatility from exchange-traded options for the contractual term of the options. The expected volatility assumption determined in the prior year was based entirely on the historical daily volatility of the Company s stock. The risk-free interest rate in the current year was based on the weighted-average of U.S. Treasury strip rates over the contractual term of the options. The risk-free interest rate in the prior year was based on zero-coupon U.S. Treasury securities with maturities equal to the expected life of the option. Based on an analysis of historical exercise patterns, exercise rates were developed that resulted in an average life of 6 years for the current year. The expected life of the option in the prior year was based on historical data resulting in a 5-year life.

Employees Stock Purchase Plans

On February 13, 2003, the Board of Directors authorized a 10-year ESPP, which was approved by shareholders at the Company s annual meeting on May 8, 2003. Prior to that authorization, annual ESPPs were authorized only by the Board of Directors. Under each annual offering, most employees are eligible to purchase shares of common stock of the Company valued at up to 10 percent of their annual base earnings. The value is determined using the plan price multiplied by the number of shares subscribed to by the employee. The plan price of the stock is set each year at no less than 85 percent of market price. Approximately 52 percent of the eligible employees enrolled in the annual plan for 2006; approximately 40 percent of the eligible employees enrolled in 2005.

Employees Stock Purchase Plans

Shares in thousands	Shares	Exercise Price*
Outstanding at January 1, 2006		
Granted	4,398	$ 35.21
Exercised	(673)	35.21
Forfeited/Expired	(144)	35.21
Outstanding and exercisable at September 30, 2006	3,581	$ 35.21
Fair value of purchase rights granted during the period		$ 7.83

*Weighted-average per share

Additional Information about ESPPs

In millions, except per share amounts	Three Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Nine Months Ended Sept. 30, 2005
Weighted-average fair value per share of purchase rights granted			$ 7.83	$ 6.77
Total compensation expense for ESPPs	$ 9	$ 2	$ 29	$ 14
Related tax benefit	$ 4	$ 1	$ 11	$ 5
Total amount of cash received from the exercise of ESPPs	$ 3	$ 9	$ 24	$ 94
Total intrinsic value of ESPPs exercised*		$ 3	$ 3	$ 41
Related tax benefit		$ 1	$ 1	$ 15

*Difference between the market price at exercise and the price paid by the employee to exercise the ESPPs

Stock Option Plans

Under the 1988 Award and Option Plan (the 1988 Plan), a plan approved by stockholders, the Company may grant options or shares of common stock to its employees subject to certain annual and individual limits. The terms of the grants are fixed at the grant date. At September 30, 2006, there were 23,403,550 shares available for grant under this plan.

No additional grants will be made under the 1994 Non-Employee Directors Stock Plan, which previously allowed the Company to grant up to 300,000 options to non-employee directors. At September 30, 2006, there were 59,850 options outstanding under this plan.

No additional grants will be made under the 1998 Non-Employee Directors Stock Plan, which previously allowed the Company to grant up to 600,000 options to non-employee directors. At September 30, 2006, there were 168,150 options outstanding under this plan.

The exercise price of each stock option equals the market price of the Company s stock on the date of grant. Options vest from one to three years, and have a maximum term of 10 years.

The following table provides year-to-date stock option activity for 2006:

Stock Options

Shares in thousands; dollars in millions	Shares	Exercise Price*	Remaining Contractual Life*	Aggregate Intrinsic Value
Outstanding at January 1, 2006	45,489	$ 35.42		
Granted	7,715	43.64		
Exercised	(2,607)	29.44		
Forfeited/Expired	(336)	43.87		
Outstanding at September 30, 2006	50,261	$ 36.94	5.72 years	$ 251
Exercisable at September 30, 2006	37,092	$ 33.57	4.61 years	$ 251

*Weighted-average per share

Additional Information about Stock Options

In millions, except per share amounts	Three Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Nine Months Ended Sept. 30, 2005
Weighted-average fair value per share of options granted	$ 9.23	$ 8.72	$ 10.31	$ 10.48
Total compensation expense for stock option plans	$ 23	$ 17	$ 62	$ 49
Related tax benefit	$ 9	$ 6	$ 23	$ 18
Total amount of cash received from the exercise of options	$ 17	$ 21	$ 75	$ 279
Total intrinsic value of options exercised*	$ 6	$ 12	$ 31	$ 192
Related tax benefit	$ 2	$ 4	$ 11	$ 71

*Difference between the market price at exercise and the price paid by the employee to exercise the options

Total unrecognized compensation cost related to unvested stock option awards was $76 million at September 30, 2006 and is expected to be recognized over a weighted-average period of 1.2 years.

Deferred and Restricted Stock

Under the 1988 Plan, the Company grants deferred stock to certain employees. The grants vest after a designated period of time, generally two to five years.

Deferred Stock

Shares in thousands	Shares	Grant Date Fair Value*
Nonvested at January 1, 2006	5,349	$ 42.13
Granted		