NORFOLK SOUTHERN CORP
Form 10-Q
October 24, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended **SEPT. 30, 2008**

OR

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

For the transition period from _________ to _________

Commission file number 1-8339

NORFOLK SOUTHERN CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	- **52-1188014**
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)

Three Commercial Place

23510-2191

Norfolk, Virginia

(Address of principal executive offices) (Zip Code)

(757) 629-2680

(Registrant's telephone number, including area code)

No Change

(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.
Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X] Accelerated filer [ ]

Non-accelerated filer [ ] (Do not check if smaller reporting company) Smaller reporting company [ ]

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Indicate by checkmark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	**Outstanding at Sept. 30, 2008**
Common Stock (par value $1.00)	370,279,291 (excluding 20,606,674 shares held by the

registrant's consolidated subsidiaries)

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NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

(Unaudited)

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2008	2007	2008	2007
	($ in millions, except per share amounts)			
Railway operating revenues				
Coal	$ 876	$ 578	$ 2,313	$ 1,714
General merchandise	1,458	1,291	4,268	3,839
Intermodal	560	484	1,578	1,425
Total railway operating revenues	2,894	2,353	8,159	6,978
Railway operating expenses				
Compensation and benefits	708	619	2,075	1,929
Purchased services and rents	419	391	1,194	1,155
Fuel	474	289	1,369	816
Depreciation	201	194	598	578
Materials and other	198	179	652	601
Total railway operating expenses	2,000	1,672	5,888	5,079

Income from railway operations	894	681	2,271	1,899
Other income – net	39	31	92	59
Interest expense on debt	111	107	332	333
Income before income taxes	822	605	2,031	1,625
Provision for income taxes	302	219	767	560
Net income	$ 520	$ 386	$ 1,264	$ 1,065
Per share amounts				
Net income				
Basic	$ 1.39	$ 0.99	$ 3.37	$ 2.71
Diluted	$ 1.37	$ 0.97	$ 3.30	$ 2.66
Dividends	$ 0.32	$ 0.26	$ 0.90	$ 0.70

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

(Unaudited)

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		Sept. 30, 2008		Dec. 31, 2007
		($ in millions)		
Assets				
Current assets:				
Cash and cash equivalents	$	557	$	206
Accounts receivable – net		1,076		942
Materials and supplies		210		176
Deferred income taxes		172		190
Other current assets		67		161
Total current assets		2,082		1,675
Investments		1,827		1,974
Properties less accumulated depreciation		22,032		21,583
Other assets		776		912
Total assets	$	26,717	$	26,144
Liabilities and stockholders' equity				
Current liabilities:				
Accounts payable	$	1,225	$	1,139
Income and other taxes		297		203
Other current liabilities		293		237
Current maturities of long-term debt		488		369
Total current liabilities		2,303		1,948

Long-term debt		5,983		5,999
Other liabilities		1,783		2,039
Deferred income taxes		6,602		6,431
Total liabilities		16,671		16,417
Stockholders' equity:				
Common stock $1.00 per share par value, 1,350,000,000				
shares authorized; outstanding 370,279,291 and				
379,297,891 shares, respectively, net of treasury shares		371		380
Additional paid-in capital		1,689		1,466
Accumulated other comprehensive loss		(389)		(399)
Retained income		8,375		8,280
Total stockholders' equity		10,046		9,727
Total liabilities and stockholders' equity	$	26,717	$	26,144

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended Sept. 30,	
	2008	**2007**
	($ in millions)	
Cash flows from operating activities		
Net income	$ 1,264	$ 1,065
Reconciliation of net income to net cash provided by operating activities:		
Depreciation	606	587
Deferred income taxes	181	19
Gains on properties and investments	(24)	(36)
Changes in assets and liabilities affecting operations:		
Accounts receivable	63	(21)
Materials and supplies	(34)	(22)
Other current assets	93	80
Current liabilities other than debt	(80)	67
Other – net	6	72
Net cash provided by operating activities	2,075	1,811
Cash flows from investing activities		
Property additions	(1,104)	(895)
Property sales and other transactions	74	105
Investments, including short-term	(34)	(568)
Investment sales and other transactions	254	758
Net cash used in investing activities	(810)	(600)

Cash flows from financing activities				
Dividends		(338)		(276)
Common stock issued – net		224		166
Purchase and retirement of common stock		(899)		(769)
Proceeds from borrowings		1,225		--
Debt repayments		(1,126)		(454)
Net cash used in financing activities		(914)		(1,333)
Net increase (decrease) in cash and cash equivalents		351		(122)
Cash and cash equivalents				
At beginning of year		206		527
At end of period	$	557	$	405
Cash paid during the period for:				
Interest (net of amounts capitalized)	$	254	$	279
Income taxes (net of refunds)	$	401	$	386

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

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In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly Norfolk Southern Corporation (Norfolk Southern) and subsidiaries' (collectively, NS) financial condition as of Sept. 30, 2008, its results of operations for the three and nine months ended Sept. 30, 2008 and 2007, and its cash flows for the nine months ended Sept. 30, 2008 and 2007, in conformity with U.S. generally accepted accounting principles.

These Consolidated Financial Statements should be read in conjunction with the financial statements and notes included in NS' latest Annual Report on Form 10 K.

1. Stock-based Compensation

In the first quarter of 2008, a committee of non-employee directors of Norfolk Southern's Board of Directors granted stock options, restricted stock units and performance share units (PSUs) pursuant to the Long-Term Incentive Plan (LTIP) and granted stock options pursuant to the Thoroughbred Stock Option Plan (TSOP) as discussed below. Stock-based compensation expense was $23 million during the third quarter of 2008 and $14 million during the same period of 2007. For the first nine months of 2008 and 2007, stock-based compensation expense was $118 million and $82 million, respectively. The total tax effect recognized in income in relation to stock-based compensation were benefits of $8 million and $5 million for the quarters ended Sept. 30, 2008 and 2007, respectively, and benefits of $40 million and $27 million for the first nine months of 2008 and 2007, respectively.

Stock Options

In the first quarter of 2008, 1,162,600 options were granted under the LTIP and 250,000 options were granted under the TSOP. In each case, the grant price was $50.74, which was the fair market value of Norfolk Southern Corporation common stock (Common Stock) on the date of grant. The options have a term of ten years but may not be exercised prior to the third anniversary of the date of grant. Holders of the options granted under the LTIP who remain actively employed receive cash dividend equivalent payments for five years in an amount equal to the regular quarterly dividends paid on Common Stock.

The fair value of each option award in 2008 was measured on the date of grant using a lattice-based option valuation model. Expected volatilities are based on implied volatilities from traded options on Common Stock and historical volatility of Common Stock. NS uses historical data to estimate option exercises and employee terminations within the valuation model. The average expected option life is derived from the output of the valuation model and represents the period of time that options granted are expected to be outstanding. The average risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. For options granted that include dividend equivalent payments, a dividend yield of zero was used. The assumptions for the 2008 LTIP grant are shown in the following table:

	2008
Expected volatility range	25% - 32%
Average expected volatility	32%
Average expected option life	5.9 years
Average risk-free interest rate	3.68%
Per-share grant-date fair value	$19.32

The grant-date fair value of the 2008 TSOP grant was $16.29 using the same assumptions as the 2008 LTIP grant, except a dividend yield of 2.29% was used because no dividend equivalent payments are made on these options and the average expected option life was 8.0 years.

For the first nine months of 2008, options relating to 5,557,576 shares were exercised, yielding $132 million of cash proceeds and $73 million of tax benefits recognized as additional paid-in capital. For the first nine months of 2007, option exercises resulted in $114 million of cash proceeds and $52 million of tax benefits.

Restricted Stock Units and Restricted Shares

There were 299,950 restricted stock units granted in 2008, with an average grant-date fair value of $50.47 and a five-year restriction period. The restricted stock units granted in 2008 will be settled through the issuance of shares of Common Stock. There were no restricted shares granted in 2008.

Performance Share Units

PSUs provide for awards based on achievement of certain predetermined corporate performance goals at the end of a three-year cycle. There were 1,162,600 PSUs granted with a grant-date fair value of $50.47 during the first quarter of 2008. One-half of any PSUs earned will be paid in the form of shares of Common Stock, with the other half to be paid in cash.

For the first nine months of 2008, 1,013,999 PSUs were earned and paid out, one-half in shares of Common Stock, and one-half in cash. These PSUs had a grant-date fair value of $34.10 per unit and a fair value at pay out of $50.47 per unit. The total related tax benefit was $2 million for the first nine months of 2008.

2. Income Taxes

In the third quarter of 2008, NS' balance of unrecognized tax benefits decreased $28 million to $134 million primarily due to the resolution of the Internal Revenue Service (IRS) examination of NS' 2004 and 2005 federal income tax returns. Of the $134 million unrecognized tax benefits remaining, $54 million would affect the effective tax rate if recognized. NS' resolution of the 2004 and 2005 examination did not have a material effect on income tax expense. NS' consolidated federal income tax returns for 2006 and 2007 are being audited by the IRS.

Interest expense related to the overpayment and underpayment of income taxes, which is included in "Other income – net," was reduced by $11 million during the third quarter of 2008 and $21 million for the first nine months of 2008. The decrease for the quarter was primarily due to the resolution of the 2004 and 2005 IRS examination, while the first nine months also reflected the second quarter resolutions of certain refund claims submitted to the IRS and NS' appeal of the 2002 and 2003 tax years.

3. Earnings Per Share

The following tables set forth the calculation of basic and diluted earnings per share:

	Three Months Ended		**Nine Months Ended**	
	Sept. 30,		**Sept. 30,**	
	2008	**2007**	**2008**	**2007**
	($ in millions except per share, shares in millions)			

Basic earnings per share:				
Income available to common stockholders	$ 518	$ 384	$ 1,260	$ 1,061
Weighted-average shares outstanding	372.5	389.0	374.4	392.3
Basic earnings per share	$ 1.39	$ 0.99	$ 3.37	$ 2.71

Income available to common stockholders reflects a reduction for the after-tax effect of dividend equivalent payments made to holders of vested stock options as follows: $2 million in the third quarter of 2008 and 2007, and $4 million for the first nine months of 2008 and 2007.

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2008	**2007**	**2008**	**2007**
	($ in millions except per share, shares in millions)			
Diluted earnings per share:				
Income available to common stockholders	$ 520	$ 386	$ 1,264	$ 1,065
Weighted-average shares outstanding per above	372.5	389.0	374.4	392.3
Dilutive effect of outstanding options, PSUs and restricted shares (as determined by the application of the treasury stock method)	8.0	8.4	8.2	8.2
Adjusted weighted-average shares outstanding	380.5	397.4	382.6	400.5
Diluted earnings per share	$ 1.37	$ 0.97	$ 3.30	$ 2.66

The diluted calculations exclude options having exercise prices exceeding the average market price of Common Stock as follows: none in the third, second and first quarters of 2008 and 2007.

4. Stockholders' Equity

Common Stock is reported net of shares held by consolidated subsidiaries (treasury shares) of Norfolk Southern. Treasury shares at Sept. 30, 2008, and Dec. 31, 2007, totaled 20,606,674 and 20,683,686, respectively, with a cost of $20 million at both Sept. 30, 2008 and Dec. 31, 2007.

5. Share Repurchase Program

In March 2007, Norfolk Southern's Board of Directors amended NS' share repurchase program, increasing the authorized amount of share repurchases from 50 million to 75 million shares and shortening the term of the program from 2015 to 2010. The timing and volume of purchases is guided by management's assessment of market conditions and other pertinent facts. Near-term purchases under the program are expected to be made with internally generated cash or proceeds from borrowings. NS repurchased and retired 15.2 million and 15.1 million shares of its Common Stock under this program in the first nine months of 2008 and 2007, respectively, at a cost of $899 million and $769 million for each of those periods, respectively. Since inception of the program in 2006, NS has repurchased and retired 60.5 million shares of common stock at a total cost of $3.1 billion.

6. Investment in Conrail

Through a limited liability company, Norfolk Southern and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). NS has a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. NS' investment in Conrail was $922 million at Sept. 30, 2008, and $899 million at Dec. 31, 2007.

CRC owns and operates certain properties (the Shared Assets Areas) for the joint and exclusive benefit of Norfolk Southern Railway Company (NSR) and CSX Transportation, Inc. (CSXT). The costs of operating the Shared Assets Areas are borne by NSR and CSXT based on usage. In addition, NSR and CSXT pay CRC a fee for access to the Shared Assets Areas. "Purchased services and rents" and "Fuel" include expenses for amounts due to CRC for operation of the Shared Assets Areas totaling $34 million in the third quarter of 2008 and $30 million in the third quarter of 2007, and $98 million and $94 million, respectively, for the first nine months of 2008 and 2007. NS' equity in the earnings of Conrail, net of amortization, included in "Other income – net" was $8 million and $10 million in the third quarters of 2008 and 2007, respectively, and $23 million and $21 million for the first nine months of 2008 and 2007, respectively.

"Accounts payable" includes $76 million at Sept. 30, 2008, and $78 million at Dec. 31, 2007, due to Conrail for the operation of the Shared Assets Areas. In addition, "Other liabilities" includes $133 million at both Sept. 30, 2008 and Dec. 31, 2007, in long-term advances from Conrail, maturing 2035, that bear interest at an average rate of 4.4%.

7. Long-term Debt

In the second quarter of 2008, NS received $100 million under its accounts receivable securitization facility. At Sept. 30, 2008, and Dec. 31, 2007, the amounts outstanding under the facility were $100 million at an average variable interest rate of 2.87% and $250 million at an average variable interest rate of 5.57%, respectively. The amount of receivables included in "Accounts receivable – net" serving as collateral for these borrowings was $919 million and $778 million, respectively. In October 2008, NS renewed and amended its accounts receivable securitization facility, with a new 364-day term to run until October 2009.

During the second quarter of 2008, $200 million of commercial paper matured, and was refinanced as part of a private offering, under which NS issued and sold $600 million in debt securities at 5.75% due 2018. NS subsequently exchanged substantially all of these unregistered securities with essentially identical securities registered under the Securities Act of 1933.

8. Pensions and Other Postretirement Benefits

Norfolk Southern and certain subsidiaries have both funded and unfunded defined benefit pension plans covering principally salaried employees. Norfolk Southern and certain subsidiaries also provide specified health care and death benefits to eligible retired employees and their dependents. Under the present plans, which may be amended or terminated at NS' option, a defined percentage of health care expenses is covered, reduced by any deductibles, co-payments, Medicare payments and, in some cases, coverage provided under other group insurance policies.

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Pension and Other Postretirement Benefit Cost Components

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	Three months ended Sept. 30,			
	2008	**2007**	**2008**	**2007**
	Pension Benefits		**Other Benefits**	
	($ in millions)			
Service cost	$ 6	$ 6	$ 4	$ 5
Interest cost	25	23	13	11
Expected return on plan assets	(43)	(42)	(4)	(2)

Amortization of prior service cost (benefit)		1		1		(2)		(2)
Amortization of net losses		1		2		6		7
Net (benefit) cost	$	(10)	$	(10)	$	17	$	19

	Nine months ended Sept. 30,			
	2008	2007	2008	2007
	Pension Benefits		Other Benefits	
	($ in millions)			
Service cost	$ 18	$ 18	$ 12	$ 16
Interest cost	75	69	38	34
Expected return on plan assets	(129)	(126)	(11)	(8)
Amortization of prior service cost (benefit)	2	2	(7)	(6)
Amortization of net losses	5	7	19	21
Net (benefit) cost	$ (29)	$ (30)	$ 51	$ 57

The estimated amortization of certain items from accumulated comprehensive income (loss) into periodic net (benefit) cost is as follows:

	Nine Months Ended Sept. 30, 2008	Fourth Quarter of 2008	Year Ending Dec. 31, 2008
		($ in millions)	
Defined benefit pension plans:			
Prior service cost	$ 2	$ 1	$ 3
Estimated net losses	$ 5	$ 2	$ 7
Defined benefit post retirement plans:			
Prior service benefit	$ (7)	$ (1)	$ (8)
Estimated net losses	$ 19	$ 6	$ 25

9. Comprehensive Income

NS' total comprehensive income was as follows:

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2008	**2007**	**2008**	**2007**
	($ in millions)			
Net income	$ 520	$ 386	$ 1,264	$ 1,065
Other comprehensive income	3	4	10	16
Total comprehensive income	$ 523	$ 390	$ 1,274	$ 1,081

"Other comprehensive income" in 2008 and 2007 reflects primarily, net of tax, the amortization of the actuarial net losses and prior service costs (benefits) for the pension and other postretirement benefit plans and unrealized gains and losses on available-for-sale securities.

10. Commitments and Contingencies

Lawsuits

Norfolk Southern and/or certain subsidiaries are defendants in numerous lawsuits and other claims relating principally to railroad operations. When management concludes that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, it is accrued through a charge to earnings. While the ultimate amount of liability incurred in any of these lawsuits and claims is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payment of such liability and claims. However, the final outcome of any of these lawsuits and claims cannot be predicted with certainty, and unfavorable or unexpected outcomes could result in additional accruals that could be significant to results of operations in a particular year or quarter. Any adjustments to the recorded liability will be reflected in earnings in the periods in which such adjustments are known.

Casualty Claims

Casualty claims include employee personal injury and occupational claims as well as third-party claims, all exclusive of legal costs. To aid in valuing its personal injury liability and determining the amount to accrue with respect to such claims during the year, NS' management utilizes studies prepared by an independent consulting actuarial firm. Job-related accidental injury and occupational claims are subject to the Federal Employers' Liability Act (FELA), which is applicable only to railroads. FELA's fault-based system produces results that are unpredictable and inconsistent as compared with a no-fault workers' compensation system. The variability inherent in this system could result in actual costs being different from the liability recorded. While the ultimate amount of claims incurred is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payments of claims and is supported by the most recent actuarial study. In all cases, NS records a liability when the expected loss for the claim is both probable and estimable.

In April 2008, NS settled the lawsuit brought by Avondale Mills for claims associated with the Jan. 6, 2005, derailment in Graniteville, SC. The total liability related to the derailment represents NS' best estimate based on current facts and circumstances. The estimate includes amounts related to business property damage and other economic losses, personal injury and individual property damage claims as well as third-party response costs. NS' commercial insurance policies are expected to cover substantially all expenses related to this derailment above the unreimbursed portion and NS' self-insured retention, including NS' response costs and legal fees. The Consolidated Balance Sheets reflect current and long-term receivables for estimated recoveries from NS' insurance carriers. On July 1, 2008, NS filed a demand for arbitration against one of its insurance carriers that failed to respond to an insurance claim submitted by NS. Although the arbitral tribunal has been appointed, the carrier has not yet filed its grounds of defense. However, it is likely that all or part of the recorded recovery attributable to such carrier ($100 million) will be contested. NS believes these expenses are covered by the insurance policy and that recovery of any contested amount is probable, in that if the carrier contests payment an arbitrator would determine the settlement amounts to be reasonable and that the insurer's refusal to consent to and to fund the settlement was a breach of contract. In October 2008, another of NS' insurance carriers provided the preliminary findings of its review of NS' reimbursement request and reported that it may dispute a portion of that request. NS believes that all expenses contained in the reimbursement request are covered by the insurance policy and that recovery is probable.

Employee personal injury claims – The largest component of casualties and other claims expense is employee personal injury costs. The independent actuarial firm engaged by NS provides quarterly studies to aid in valuing its employee personal injury liability and estimating its employee personal injury expense. The actuarial firm studies NS' historical patterns of reserving for claims and subsequent settlements, taking into account relevant outside influences. The actuary uses the results of these analyses to estimate the ultimate amount of the liability, which includes amounts for incurred but unasserted claims. NS adjusts its liability quarterly based upon management's assessment and the results of the study. The estimate of loss liabilities is subject to inherent limitation given the difficulty of predicting future events such as jury decisions, court interpretations or legislative changes and as such the actual loss may differ from the estimated liability recorded.

Occupational claims – Occupational claims (including asbestosis and other respiratory diseases, as well as conditions allegedly related to repetitive motion) are often not caused by a specific accident or event but rather allegedly result from a claimed exposure over time. Many such claims are being asserted by former or retired employees, some of whom have not been employed in the rail industry for decades. The independent actuarial firm provides an estimate of the occupational claims liability based upon NS' history of claim filings, severity, payments and other pertinent facts. The liability is dependent upon management's judgments made as to the specific case reserves as well as judgments of the consulting independent actuarial firm in the periodic studies. The actuarial firm's estimate of ultimate loss includes a provision for those claims that have been incurred but not reported. This provision is derived by analyzing industry data and projecting NS' experience into the future as far as can be reasonably determined. NS adjusts its liability quarterly based upon management's assessment and the results of the study. However, it is possible that the recorded liability may not be adequate to cover the future payment of claims. Adjustments to the recorded liability are reflected in operating expenses in the periods in which such adjustments become known.

Third-party claims – NS records a liability for third-party claims including those for highway crossing accidents, trespasser and other injuries, automobile liability, property damage and lading damage. The independent actuarial firm assists with the calculation of potential liability for third-party claims, except lading damage, based upon NS' experience including number and timing of incidents, amount of payments, settlement rates, number of open claims and legal defenses. The actuarial estimate includes a provision for claims that have been incurred but have not yet been reported. Each quarter, NS adjusts its liability based upon management's assessment and the results of the study. Given the inherent uncertainty in regard to the ultimate outcome of third-party claims, it is possible that the actual loss may differ from the estimated liability recorded.

Environmental Matters

NS is subject to various jurisdictions' environmental laws and regulations. It is NS' policy to record a liability where such liability or loss is probable and its amount can be estimated reasonably. Claims, if any, against third parties for recovery of cleanup costs incurred by NS are reflected as receivables (when collection is probable) on the balance sheet and are not netted against the associated NS liability. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. NS also has an Environmental Policy Council, composed of senior managers, to oversee and interpret its environmental policy.

NS' Consolidated Balance Sheets include liabilities for environmental exposures in the amount of $39 million at Sept. 30, 2008, and $46 million at Dec. 31, 2007 (of which $12 million is classified as a current liability at the end of each period). At Sept. 30, 2008, the liability represents NS' estimate of the probable cleanup and remediation costs based on available information at 148 known locations. As of that date, 11 sites accounted for $19 million of the liability, and no individual site was considered to be material. NS anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 30 locations, one or more Norfolk Southern subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for cleanup costs.

With respect to known environmental sites (whether identified by NS or by the EPA or comparable state authorities), estimates of NS' ultimate potential financial exposure for a given site or in the aggregate for all such sites are necessarily imprecise because of the widely varying costs of currently available cleanup techniques, the likely development of new cleanup technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it), and evolving statutory and regulatory standards governing liability.

The risk of incurring environmental liability – for acts and omissions, past, present and future - is inherent in the railroad business. Some of the commodities in NS' traffic mix, particularly those classified as hazardous materials, pose special risks that NS and its subsidiaries work diligently to minimize. In addition, several NS subsidiaries own, or have owned, land used as operating property, or which is leased and operated by others, or held for sale. Because environmental problems may exist on these properties that are latent or undisclosed, there can be no assurance that NS will not incur environmental liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably at this time. Moreover, lawsuits and claims involving these and potentially other unidentified environmental sites and matters are likely to arise from time to time. The resulting liabilities could have a significant effect on financial position, results of operations or liquidity in a particular year or quarter.

On April 24, 2008, the United States Department of Justice (DOJ) brought an action against NS for alleged violations of federal environmental laws resulting from the discharge of chlorine and oil that occurred as a result of the Jan. 6, 2005 derailment in Graniteville, SC, including claims for civil penalties as well as injunctive relief. On June 24, 2008, NS filed a motion to dismiss DOJ’s claims, contending that insufficient facts have been alleged to support such claims. NS does not believe that the resolution of these claims will have a material adverse effect on its financial position, results of operations or liquidity.

Based on its assessment of the facts and circumstances now known, management believes that it has recorded the probable costs for dealing with those environmental matters of which NS is aware. Further, management believes that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on NS' financial position, results of operations or liquidity.

Insurance

Norfolk Southern obtains on behalf of itself and its subsidiaries insurance for potential losses for third-party liability and first-party property damages. NS is currently self-insured up to $25 million and above $1 billion per occurrence for bodily injury and property damage to third parties and up to $25 million and above $175 million per occurrence for property owned by NS or in NS’ care, custody or control.

Purchase Commitments

At Sept. 30, 2008, NSR had outstanding purchase commitments of approximately $169 million primarily for locomotives, RoadRailer® trailers, freight cars and track material in connection with its capital programs through 2009.

Report of Independent Registered Public Accounting Firm

The Stockholders and Board of Directors

Norfolk Southern Corporation:

We have reviewed the accompanying consolidated balance sheet of Norfolk Southern Corporation and subsidiaries as of September 30, 2008, the related consolidated statements of income for the three month and nine month periods ended September 30, 2008 and 2007 and the related consolidated statements of cash flows for the nine month periods ended September 30, 2008 and 2007. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Norfolk Southern Corporation and subsidiaries as of December 31, 2007, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated February 15, 2008, we expressed an unqualified opinion on those consolidated financial statements. Our report refers to Norfolk Southern Corporation's adoption of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, effective January 1, 2007. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Norfolk, Virginia
October 21, 2008

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

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Third-quarter 2008 net income was up $134 million, or 35%, compared with the same period last year. The improvement primarily resulted from a $213 million increase in income from railway operations, reflecting higher average revenue per unit (including fuel surcharges) that continued to more than offset the effects of lower traffic volume and increased operating expenses. The railway operating ratio (a measure of the amount of operating revenues consumed by operating expenses) decreased to 69.1% in the third quarter from 71.1% in the prior year.

Cash provided by operating activities for the first nine months was $2.1 billion which provided funding for capital expenditures, dividends, and, supplemented with proceeds from borrowings, share repurchases. In the third quarter of 2008, 6.2 million shares of Norfolk Southern Corporation common stock (Common Stock) were repurchased at a total cost of $405 million. Since inception of the share repurchase program in 2006, NS has repurchased and retired 60.5 million shares of Common Stock at a total cost of $3.1 billion. At Sept. 30, 2008, cash and short-term investment balances totaled $557 million.

SUMMARIZED RESULTS OF OPERATIONS

Third-quarter 2008 net income was $520 million, up $134 million, or 35%, compared with the same period last year. The improvement primarily resulted from a $213 million increase in income from railway operations that reflected a $541 million, or 23%, rise in railway operating revenues coupled with a $328 million, or 20%, increase in railway operating expenses. Third-quarter net income was reduced by an $83 million increase in income taxes, reflecting both higher pretax income and the absence of benefits associated with synthetic fuel tax credits that expired in 2007.

For the first nine months of 2008, net income was $1.3 billion, up $199 million, or 19%, compared with the same period last year. Increases of $372 million in income from railway operations and $33 million in other income were offset in part by a $207 million increase in income taxes. Railway operating revenues rose $1.2 billion, or 17%, while railway operating expenses were up $809 million, or 16%.

As a commodity, oil prices impact NS' results of operations in a variety of ways and can have an overall favorable or unfavorable impact in any particular quarter. In addition to the impact of oil prices on general economic conditions and traffic volume, oil prices directly affect NS' revenues through market-based fuel surcharges and contract escalators (see "Railway Operating Revenues") and expenses through fuel expense (see "Railway Operating Expenses"). For the third quarter and first nine months, oil prices had an overall favorable impact on income from railway operations. Future changes in oil prices may cause volatility in operating results that could be material to a particular quarter or year.

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Third-quarter 2008 railway operating revenues were $2.9 billion, up $541 million, or 23%, compared with the third quarter of 2007. As shown in the following table, the increases were the result of higher average revenue per unit, including increased fuel surcharges, which were offset in part by lower traffic volume. Fuel surcharges amounted to $535 million in the third quarter (up $339 million) and $1.3 billion for the first nine months (up $714 million).

Many of Norfolk Southern's negotiated fuel surcharges for coal and general merchandise traffic are based on the monthly average price of West Texas Intermediate Crude Oil (WTI Average Price). These surcharges are reset the first day of each calendar month based on the WTI Average Price for the second preceding calendar month. This two-month lag in computing WTI Average Price increased fuel surcharge revenue by approximately $55 million for the third quarter, but decreased fuel surcharge revenue by approximately $39 million for the first nine months.

	Third Quarter 2008 vs. 2007 Increase (Decrease)	First Nine Months 2008 vs. 2007 Increase (Decrease)
	($ in millions)	
Revenue per unit/mix	$558	$1,301
Traffic volume (units)	(17)	(120)
Total	$541	$1,181

Revenues, units and average revenue per unit for NS' market groups were as follows:

	Third Quarter					
	Revenues		Units		Revenue per Unit	
	2008	2007	2008	2007	2008	2007
	($ in millions)		*(in thousands)*		*($ per unit)*	
Coal	$ 876	$ 578	450.9	427.3	$ 1,941	$ 1,353
General merchandise:						
Chemicals	337	297	103.0	108.0	3,275	2,748
Metals/construction	357	287	203.7	200.3	1,752	1,433
Agr./consumer prod./govt.	338	264	158.6	151.4	2,136	