NORFOLK SOUTHERN CORP
Form 10-K
February 18, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended **DECEMBER 31, 2008**

( ) 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 **Norfolk, Virginia**	**23510-2191**
(Address of principal executive offices)	Zip Code
Registrant's telephone number, including area code	**(757) 629-2680**

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of each exchange on which registered
Norfolk Southern Corporation Common Stock (Par Value $1.00)	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes (X) No ( )

Indicate by check mark if the registrant is not required to file such reports pursuant to Section 13 or 15(d) of the Act.
Yes ( ) No (X)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or Section 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ( )

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer or smaller reporting company. See 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 ( ) Smaller reporting company ( )

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

The aggregate market value of the voting common equity held by non-affiliates as of June 30, 2008 was $23,454,318,004 (based on the closing price as quoted on the New York Stock Exchange on that date).

The number of shares outstanding of each of the registrant's classes of common stock, as of January 31, 2009: 366,460,780 (excluding 20,579,088 shares held by the registrant's consolidated subsidiaries).

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant’s definitive proxy statement to be filed electronically pursuant to Regulation 14A not later than 120 days after the end of the fiscal year, are incorporated by reference in Part III.

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PART I

Norfolk Southern Corporation and Subsidiaries (NS)

Item 1. Business and Item 2. Properties

GENERAL - Norfolk Southern Corporation (Norfolk Southern) is a Norfolk, Virginia based company that controls a major freight railroad, Norfolk Southern Railway Company. Norfolk Southern Railway Company is primarily engaged in the rail transportation of raw materials, intermediate products, and finished goods primarily in the Southeast, East, and Midwest and, via interchange with rail carriers, to and from the rest of the United States. Norfolk Southern also transports overseas freight through several Atlantic and Gulf Coast ports. Norfolk Southern provides comprehensive logistics services and offers the most extensive intermodal network in the eastern half of the United States. The common stock of Norfolk Southern is listed on the New York Stock Exchange (NYSE) under the symbol "NSC."

Norfolk Southern was incorporated on July 23, 1980, under the laws of the Commonwealth of Virginia. On June l, 1982, Norfolk Southern acquired control of two major operating railroads, Norfolk and Western Railway Company (NW) and Southern Railway Company (Southern) in accordance with an Agreement of Merger and Reorganization dated as of July 31, 1980, and with the approval of the transaction by the Interstate Commerce Commission (now the Surface Transportation Board [STB]). Effective December 31, 1990, Norfolk Southern transferred all the common stock of NW to Southern, and Southern's name was changed to Norfolk Southern Railway Company (Norfolk Southern Railway or NSR). Effective September 1, 1998, NW was merged with and into Norfolk Southern Railway. As of December 31, 2008, all the common stock of Norfolk Southern Railway was owned directly by Norfolk Southern.

Through a limited liability company, Norfolk Southern and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). Norfolk Southern has a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. CRC owns and operates certain properties (the Shared Assets Areas) for the joint and exclusive benefit of NSR and CSX Transportation Inc. (CSXT) (see Note 4 to the Consolidated Financial Statements).

Norfolk Southern makes available free of charge through its website, www.nscorp.com, its annual report on Form 10 K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). In addition, the following documents are available on the company's website and in print to any shareholder who requests them:

- Corporate Governance Guidelines
- Charters of the Committees of the Board of Directors
- The Thoroughbred Code of Ethics
- Code of Ethical Conduct for Senior Financial Officers
- Categorical Independence Standards for Directors

Unless otherwise indicated, Norfolk Southern and its subsidiaries are referred to collectively as NS.

RAILROAD OPERATIONS – As of December 31, 2008, NS' railroads operated approximately 21,000 miles of road in 22 eastern states and the District of Columbia.

The system's lines reach many individual industries, electric generating facilities, mines (in western Virginia, eastern Kentucky, southern and northern West Virginia, and western Pennsylvania), distribution centers, transload facilities, and other businesses located in smaller communities in its service area.

Corridors with heaviest freight volume:

New York City area to Chicago (via Allentown and Pittsburgh)

Chicago to Macon (via Cincinnati, Chattanooga, and Atlanta)

Appalachian coal fields of Virginia, West Virginia, and Kentucky to Norfolk and Sandusky, OH

Cleveland to Kansas City

Birmingham to Meridian

Memphis to Chattanooga

The miles operated, which include major leased lines between Cincinnati, Ohio, and Chattanooga, Tennessee, and trackage rights over property owned by North Carolina Railway Company, were as follows:

Mileage Operated as of December 31, 2008

	Miles of Road	Second and Other Main Track	Passing Track, Crossovers and Turnouts	Way and Yard Switching	Total
Owned	15,884	2,808	2,001	8,426	29,119
Operated under lease, contract or trackage rights	4,948	1,977	415	968	8,308
Total	20,832	4,785	2,416	9,394	37,427

Triple Crown Operations – Triple Crown Services Company (Triple Crown), NS' subsidiary, offers door-to-door intermodal service using RoadRailer® equipment and domestic containers. RoadRailer® units are enclosed vans that can be pulled over highways in tractor-trailer configuration and over the rails by locomotives. Triple Crown provides intermodal service in major traffic corridors, including those between the Midwest and the Northeast, the Midwest and the Southeast, and the Midwest and Texas.

The following table sets forth certain statistics relating to NS' railroads' operations for the past 5 years:

Rail Operating Statistics

	Years Ended December 31,				
	2008	2007	2006	2005	2004
Revenue ton miles (billions)	195	196	204	203	198

Freight train miles traveled (millions)	80.0	81.9	84.2	81.2	77.7
Revenue per ton mile	$0.0546	$0.0481	$0.0462	$0.0421	$0.0369
Revenue ton miles per					
man-hour worked	3,075	3,066	3,196	3,146	3,347
Percentage ratio of railway operating					
expenses to railway operating revenues	71.1%	72.6%	72.8%	75.2%	76.7%

RAILWAY OPERATING REVENUES – NS' total railway operating revenues were $10.7 billion in 2008. See the financial information by traffic segment in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

COAL TRAFFIC – Coal, coke, and iron ore – most of which is bituminous coal – is NS' railroads' largest commodity group as measured by revenues. The railroads handled a total of 194.2 million tons in 2008, most of which originated on NS' lines in West Virginia, Virginia, Pennsylvania, and Kentucky. Revenues from coal, coke, and iron ore accounted for about 29% of NS' total railway operating revenues in 2008.

Total coal handled through all system ports in 2008 was 41.8 million tons. Of this total, 18.9 million tons (including coastwise traffic) moved through Norfolk, Virginia, 5.7 million tons moved through the Baltimore Terminal, 11.3 million tons moved to various docks on the Ohio River, and 5.9 million tons moved to various Lake Erie ports. Other than coal for export, virtually all coal handled by NS' railroads was terminated in states east of the Mississippi River.

See the discussion of coal traffic, by type of coal, in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

GENERAL MERCHANDISE TRAFFIC - General merchandise traffic is composed of five major commodity groupings: automotive; chemicals; metals and construction; agriculture, consumer products and government; and paper, clay and forest products. The automotive group includes finished vehicles for BMW, Chrysler, Ford Motor Company, General Motors, Honda, Isuzu, Jaguar, Land Rover, Mazda, Mercedes-Benz, Mitsubishi, Nissan, Saab, Subaru, Suzuki, Toyota, and Volkswagen, and auto parts for Ford Motor Company, General Motors, Mercedes-Benz, and Toyota. The chemicals group includes sulfur and related chemicals, petroleum products, chlorine and bleaching compounds, plastics, rubber, industrial chemicals, chemical wastes, and municipal wastes. The metals and construction group includes steel, aluminum products, machinery, scrap metals, cement, aggregates, bricks, and minerals. The agriculture, consumer products, and government group includes soybeans, wheat, corn, fertilizer, animal and poultry feed, food oils, flour, beverages, canned goods, sweeteners, consumer products, ethanol, and items for the military. The paper, clay and forest products group includes lumber and wood products, pulp board and paper products, wood fibers, wood pulp, scrap paper, and clay.

In 2008, 135 million tons of general merchandise freight, or approximately 67% of total general merchandise tonnage handled by NS, originated online. The balance of general merchandise traffic was received from connecting carriers at interterritorial gateways. The principal interchange points for NS-received traffic included Chicago, Memphis, New Orleans, Cincinnati, Kansas City, Detroit, Hagerstown, St. Louis/East St. Louis, and Louisville. General merchandise carloads handled in 2008 were 2.6 million, the revenues from which accounted for 52% of NS' total railway operating revenues in 2008.

See the discussion of general merchandise rail traffic by commodity group in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

INTERMODAL TRAFFIC - The intermodal market consists of shipments moving in trailers, domestic and international containers, and Roadrailer® equipment. These shipments are handled on behalf of intermodal marketing companies, international steamship lines, truckers, and other shippers. Intermodal units handled in 2008 were 3 million, the revenues from which accounted for 19% of NS' total railway operating revenues for the year.

See the discussion of intermodal traffic in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

FREIGHT RATES - In 2008, NS' railroads continued their reliance on private contracts and exempt price quotes as their predominant pricing mechanisms. Thus, a major portion of NS' railroads' freight business is not currently economically regulated by the government. In general, market forces have been substituted for government regulation and now are the primary determinant of rail service prices.

In 2008, NS' railroads were found by the STB to be "revenue adequate" based on results for the year 2006. The STB has not made its revenue adequacy determination for the year 2007. A railroad is "revenue adequate" under the applicable law when its return on net investment exceeds the rail industry's composite cost of capital. This determination is made pursuant to a statutory requirement.

PASSENGER OPERATIONS

· Regularly scheduled passenger trains are operated by Amtrak on NS' lines between the following locations:

- Alexandria, Virginia, and New Orleans, Louisiana
- Raleigh and Charlotte, North Carolina
- Selma and Charlotte, North Carolina
- Chicago, Illinois, and Porter, Indiana
- Chicago, Illinois, and Battle Creek, Michigan
- Chicago, Illinois, and Pittsburgh, Pennsylvania
- Chicago, Illinois, and Detroit, Michigan
- Pittsburgh and Harrisburg, Pennsylvania

· Commuter trains are operated on the NS line between Manassas and Alexandria in accordance with contracts with two transportation commissions of the Commonwealth of Virginia

· NS leases the Chicago to Manhattan, Illinois, line to the Commuter Rail Division of the Regional Transportation Authority of Northeast Illinois

· NS operates freight service over lines with significant ongoing Amtrak and commuter passenger operations, and is conducting freight operations over trackage owned by:

- Amtrak
- New Jersey Transit
- Southeastern Pennsylvania Transportation Authority
- Metro-North Commuter Railroad Company
- Maryland Department of Transportation

· Passenger operations are conducted either by Amtrak or by the commuter agencies over trackage owned by Conrail in the Shared Assets Areas.

NONCARRIER OPERATIONS - NS' noncarrier subsidiaries engage principally in the acquisition, leasing, and management of coal, oil, gas and minerals; the development of commercial real estate; telecommunications; and the leasing or sale of rail property and equipment. In 2008, no such noncarrier subsidiary or industry segment grouping of noncarrier subsidiaries met the requirements for a reportable business segment set forth in the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information."

RAILWAY PROPERTY

The NS railroad system extends across 22 states and the District of Columbia. The railroad infrastructure makes the company capital intensive with total property of approximately $22 billion.

Capital Expenditures - Capital expenditures for road, equipment, and other property for the past five years were as follows (including capitalized leases):

	Capital Expenditures				
	2008	2007	2006	2005	2004
	($ in millions)				
Road and other property	$ 1,070	$ 894	$ 756	$ 741	$ 612
Equipment	488	447	422	284	429
Total	$ 1,558	$ 1,341	$ 1,178	$ 1,025	$ 1,041

Capital spending and maintenance programs are and have been designed to assure the ability to provide safe, efficient, and reliable rail transportation services. For 2009, NS has budgeted $1.41 billion of capital expenditures. On May 1, 2006, NS and Kansas City Southern (KCS) formed a joint venture, Meridian Speedway LLC (MSLLC), pursuant to which NS intends to contribute $300 million in cash, substantially all of which will be used for capital improvements over a period of approximately three years, in exchange for a 30% interest in the joint venture. Through December 31, 2008, NS has contributed $274 million. See the discussion following "Cash used for investing activities," in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Equipment - As of December 31, 2008, NS owned or leased the following units of equipment:

	Number of Units			Capacity
	Owned*	**Leased****	**Total**	**of Equipment**
Locomotives:				(Horsepower)
Multiple purpose	3,608	132	3,740	12,991,800
Switching	148	--	148	216,100
Auxiliary units	88	--	88	--
Total locomotives	3,844	132	3,976	13,207,900
Freight cars:				(Tons)
Hopper	18,343	805	19,148	2,081,957
Box	15,164	1,800	16,964	1,373,553
Covered hopper	8,593	2,759	11,352	1,248,050
Gondola	31,338	7,225	38,563	4,164,281
Flat	2,630	1,334	3,964	318,594
Caboose	174	--	174	--
Other	4,476	19	4,495	223,952
Total freight cars	80,718	13,942	94,660	9,410,387
Other:				
Work equipment	5,214	3	5,217	
Vehicles	4,073	--	4,073	
Highway trailers and				

containers	59	11,912	11,971
RoadRailer®	6,515	33	6,548
Miscellaneous	1,277	13,519	14,796
Total other	17,138	25,467	42,605

* Includes equipment leased to outside parties and equipment subject to equipment trusts, conditional sale agreements, and capitalized leases.

** Includes 4,651 freight cars leased from CRC.

The following table indicates the number and year built for locomotives and freight cars owned at December 31, 2008.

	Year Built								
	2008	2007	2006	2005	2004	1999-2003	1994-1998	1993 & Before	Total
Locomotives:									
No. of units	40	90	143	89	207	607	628	2,040	3,844
% of fleet	1%	2%	4%	2%	6%	16%	16%	53%	100%
Freight cars:									
No. of units	2,360	1,200	404	89	--	1,546	6,944	68,175	80,718
% of fleet	3%	1%	1%	--%	--%	2%	9%	84%	100%

The following table shows the average age of NS' locomotive and freight car fleets at December 31, 2008, and the number of retirements in 2008:

	Locomotives	Freight Cars
Average age – in service	18.9 years	29.9 years
Retirements	14 units	2,839 units
Average age – retired	34.4 years	39.6 years

Ongoing freight car and locomotive maintenance programs are intended to ensure the highest standards of safety, reliability, customer satisfaction, and equipment marketability. The locomotive bad order ratio includes units out of service for required inspections every 92 days and program work such as overhauls.

Annual Average Bad Order Ratio				
2008	2007	2006	2005	2004

Total

Freight cars	4.5%	4.9%	6.4%	6.3%	7.4%
Locomotives	5.8%	5.7%	5.7%	6.2%	6.3%

Encumbrances - Certain railroad equipment is subject to the prior lien of equipment financing obligations amounting to approximately $236 million as of December 31, 2008, and $389 million as of December 31, 2007.

Track Maintenance - Of the approximately 37,500 total miles of track operated, NS had responsibility for maintaining about 30,000 miles of track, with the remainder being operated under trackage rights from another party responsible for maintenance.

Over 75% of the main line trackage (including first, second, third, and branch main tracks, all excluding rail operated pursuant to trackage rights) has rail ranging from 131 to 155 pounds per yard with the standard installation currently at 136 pounds per yard. Approximately 44% of NS lines, excluding rail operated pursuant to trackage rights, carried 20 million or more gross tons per track mile during 2008.

The following table summarizes several measurements regarding NS' track roadway additions and replacements during the past five years:

	2008	2007	2006	2005	2004
Track miles of rail installed	459	401	327	302	246
Miles of track surfaced	5,209	5,014	4,871	4,663	5,055
New crossties installed (millions)	2.7	2.7	2.7	2.5	2.5

Microwave System - The NS microwave system, consisting of approximately 7,400 radio route miles, 426 core stations, 30 secondary stations, and 5 passive repeater stations, provides communications between most operating locations. The microwave system is used primarily for voice communications, VHF radio control circuits, data and facsimile transmissions, traffic control operations, and AEI data transmissions.

Traffic Control - Of the approximately 15,900 route miles owned by NS, about 11,000 miles are signalized, including 8,000 miles of centralized traffic control (CTC) and 3,000 miles of automatic block signals. Of the 8,000 miles of CTC, approximately 3,000 miles are controlled by data radio originating at 266 base station radio sites.

Computers - A computer network consisting of a centralized data center in Atlanta, Georgia, and various distributed computers throughout the company connects the yards, terminals, transportation offices, rolling stock repair points, sales offices, and other key system locations. Operating and traffic data are processed and stored to provide customers with information on their shipments throughout the system. Computer systems provide current information on the location of every train and each car on line, as well as related waybill and other train and car movement data. In addition, the computer systems are utilized to assist management in the performance of a variety of functions and services including payroll, car and revenue accounting, billing, material management activities and controls, and special studies.

ENVIRONMENTAL MATTERS - Compliance with federal, state, and local laws and regulations relating to the protection of the environment is a principal NS goal. To date, such compliance has not affected materially NS' capital additions, earnings, liquidity, or competitive position. See "Legal Proceedings," Part I, Item 3; "Personal Injury, Environmental, and Legal Liabilities" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations;" and Note 17 to the Consolidated Financial Statements.

EMPLOYEES – The following table shows the average number of employees and the average cost per employee for wages and benefits:

	2008	2007	2006	2005	2004
Average number of employees	30,709	30,806	30,541	30,294	28,475
Average wage cost per employee	$66,000	$62,000	$62,000	$61,000	$59,000
Average benefit cost per employee	$31,000	$30,000	$32,000	$29,000	$28,000

Approximately 85% of NS' railroad employees are covered by collective bargaining agreements with various labor unions. See the discussion of "Labor Agreements" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

GOVERNMENT REGULATION - In addition to environmental, safety, securities, and other regulations generally applicable to all businesses, NS' railroads are subject to regulation by the STB. The STB has jurisdiction over some rates, routes, fuel surcharges, conditions of service, and the extension or abandonment of rail lines. The STB also has jurisdiction over the consolidation, merger, or acquisition of control of and by rail common carriers. The Federal Railroad Administration regulates certain track and mechanical equipment standards.

The relaxation of economic regulation of railroads, begun over two decades ago under the Staggers Rail Act of 1980, includes exemptions of intermodal business (trailer-on-flat-car, container-on-flat-car), rail boxcar traffic, lumber, manufactured steel, automobiles, and certain bulk commodities such as sand, gravel, pulpwood, and wood chips for paper manufacturing. Transportation contracts on regulated shipments effectively remove those shipments from regulation as well for the duration of the contract. About 86% of NS' freight revenues come from either exempt traffic or traffic moving under transportation contracts.

Efforts were made in 2008 to re-subject the rail industry to increased federal economic regulation and such efforts are expected to continue in 2009. The Staggers Rail Act of 1980, which substantially balanced such regulation, encouraged and enabled rail carriers to innovate and to compete for business, thereby contributing to the economic health of the nation and to the revitalization of the industry. Accordingly, NS will continue to oppose efforts to reimpose increased economic regulation.

COMPETITION – There is continuing strong competition among rail, water, and highway carriers. Price is usually only one factor of importance as shippers and receivers choose a transport mode and specific hauling company.

Inventory carrying costs, service reliability, ease of handling, and the desire to avoid loss and damage during transit are also important considerations, especially for higher-valued finished goods, machinery, and consumer products. Even for raw materials, semifinished goods, and work-in-process, users are increasingly sensitive to transport arrangements that minimize problems at successive production stages.

NS' primary rail competitor is the CSX system; both operate throughout much of the same territory. Other railroads also operate in parts of the territory. NS also competes with motor carriers, water carriers, and with shippers who have the additional option of handling their own goods in private carriage.

Certain marketing strategies among railroads and between railroads and motor carriers enable carriers to compete more effectively in specific markets.

SECURITY OF OPERATIONS – NS has taken significant steps to provide enhanced security for the NS rail system. In particular, NS has developed and implemented a comprehensive security plan that is modeled on and was developed in conjunction with the security plan prepared by the Association of American Railroads (AAR) post September 11, 2001. The AAR Security Plan defines four Alert Levels and details the actions and countermeasures that are being applied across the railroad industry as the terrorist threat increases or decreases. The Alert Level actions include countermeasures that will be applied in three general areas: (1) operations (including transportation, engineering, and mechanical); (2) information technology and communications; and (3) railroad police. Although security concerns preclude public disclosure of its contents, the NS Departmental Security Plan outlines the protocol within NS for all concerned to be notified of AAR Alert Level changes. All NS Operations Division employees are advised by their supervisors or train dispatchers, as appropriate, of any change in Alert Level and any additional responsibilities they may incur due to such change.

The NS plan also effectively addresses and complies with Department of Transportation security regulations pertaining to training and security plans with respect to the transportation of hazardous materials. As part of the plan, security awareness training is given to all railroad employees who directly affect hazardous material transportation safety, and this training is integrated into recurring hazardous material training and re-certification programs. Toward that end, NS, working closely with the National Transit Institute at Rutgers University, has developed a four-module uniform national training program. NS also has worked with the Transportation Security Administration (TSA) in developing other industry training programs. More in-depth security training has been given to those select NS employees who have been given specific security responsibilities, and additional, location-specific security plans have been developed for certain metropolitan areas and each of six port facilities served by NS. With respect to the ports, each facility plan has been approved by the applicable Captain of the Port and subject to inspection by the U.S. Coast Guard.

Additionally, NS engages in close and regular coordination with numerous federal and state agencies, including the U.S. Department of Homeland Security (DHS), the TSA, the Federal Bureau of Investigation (FBI), the Federal Railroad Administration (FRA), the U.S. Coast Guard, U.S. Customs and Border Protection, and various state Homeland Security offices. As one notable example, an NS Police Special Agent, under the auspices of the AAR, has been assigned to the National Joint Terrorism Task Force (NJTTF) operating out of FBI Headquarters in

Washington, D.C. to represent and serve as liaison to the North American rail industry. This arrangement improves logistical flow of vital security and law enforcement information with respect to the rail industry as a whole, while having the post filled by an NS Special Agent has served to foster a strong working relationship between NS and the FBI. NS also has become a member of the Customs-Trade Partnership Against Terrorism (C-TPAT) program sponsored by U.S. Customs. C-TPAT allows NS to work closely with U.S. Customs and its customers to develop measures that will help ensure the integrity of freight shipments moving on NS, particularly those moving to or from a foreign country. Based on participation in C-TPAT, NS has ensured that its plan meets all current applicable security recommendations made by U.S. Customs.

Similarly, NS is guided in its operations by various supplemental security action items issued by DHS and U.S. Department of Transportation (DOT), U.S. Coast Guard Maritime Security requirements, as well as voluntary security action items developed in 2006 in collaboration with TSA, DOT, and the freight railroads. Many of the action items are based on lessons learned from DHS and DOT security assessments of rail corridors in High Threat Urban Areas (HTUA) begun in 2004. Particular attention is paid to: (1) the establishment of secure storage areas for rail cars carrying toxic-by-inhalation (TIH) materials; (2) the expedited movement of trains transporting rail cars carrying TIH materials; (3) the minimization of unattended loaded tank cars carrying TIH materials; and (4) cooperation with federal, state, local and tribal governments to identify, through risk assessments, those locations where security risks are the highest. These action items and NS' compliance initiatives are outlined in the various departmental sections of the NS Departmental Security Plan. NS is also taking the appropriate actions to ensure compliance with the 2008 TSA Final Rule addressing Rail Security Sensitive Materials, and the 2008 Pipeline and Hazardous Materials Safety Administration (PHMSA) rail-routing regulations outlined in Docket HM-232E.

In 2008, through participation in the Transportation Community Awareness and Emergency Response (TRANSCAER) Program, NS provided rail accident response training to approximately 4,300 emergency responders, such as local police and fire personnel, representing over 25,000 man-hours of emergency response training. NS also conducted railroad operations classes for FBI agents and the railroad liaison agents from Joint Terrorism Task Forces. NS' other training efforts throughout 2008 included participation in 15 drills including 2 major full-scale exercises with various local, state, and federal agencies conducted in accordance with the DHS Exercise and Evaluation Program. NS also has ongoing programs to sponsor local emergency responders at tank car emergency response training programs conducted at the AAR Transportation Technology Center in Pueblo, Colorado. Also, the NS annual TRANSCAER Whistle-Stop train makes stops in numerous cities, its special training cars serving as a resource to an audience of nearly 1,000 emergency responders annually.

Improvements in equipment design also are expected to play a role in enhancing rail security. The Pipeline and Hazardous Materials Safety Administration (PHMSA), in coordination with the FRA, is amending the Hazardous Materials Regulations to prescribe enhanced safety measures for rail transportation of TIH materials, including interim design standards for railroad tank cars. The rule mandates commodity-specific improvements in safety features and design standards for newly manufactured DOT specification tank cars and an improved top fittings performance standard. The interim standards established in this rule will enhance the accident survivability of TIH tank cars.

Item 1A. Risk Factors

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NS is subject to significant governmental legislation and regulation over commercial, environmental, and operating matters. Railroads are subject to the enactment of laws by Congress that could increase economic regulation of the industry. Railroads presently are subject to commercial regulation by the STB, which has jurisdiction over some routes, rates and fuel surcharges, conditions of service, and the extension or abandonment of rail lines. The STB also has jurisdiction over the consolidation, merger, or acquisition of control of and by rail common carriers. Additional economic regulation of the rail industry by Congress or the STB, whether under new or existing laws, could have a significant negative impact on NS' ability to determine prices for rail services and result in a material adverse effect in the future on NS' financial position, results of operations, or liquidity in a particular year or quarter. This potential material adverse effect could also result in reduced capital spending on NS' rail network.

Railroads are subject to safety and security regulation by the DOT and the DHS, which regulate most aspects of NS' operations. Compliance with the Rail Safety Improvement Act of 2008 will result in additional operating costs associated with the statutory mandate to implement positive train control by 2015. In addition, NS' failure to comply with applicable laws and regulations could have a material adverse effect on NS.

NS' operations are subject to extensive federal, state, and local environmental laws and regulations concerning, among other things, emissions to the air; discharges to waterways or ground water supplies; handling, storage, transportation, and disposal of waste and other materials; and the cleanup of hazardous material or petroleum releases. The risk of incurring environmental liability – for acts and omissions, past, present, and future – is inherent in the railroad business. Property owned by NS, whether currently or in the past, is and has been subject to a variety of uses, including NS railroad operations and other industrial activity by past owners or past and present tenants of NS. Environmental problems that are latent or undisclosed may exist on these properties, and NS could incur environmental liabilities or costs, the amount and materiality of which cannot be estimated reliably at this time, with respect to one or more of these properties. Moreover, lawsuits and claims involving other unidentified environmental sites and matters are likely to arise from time to time, and the resulting liabilities could have a significant effect on financial position, results of operations, or liquidity in a particular year or quarter.

NS, as a common carrier by rail, must offer to transport hazardous materials, regardless of risk. Transportation of certain hazardous materials could create catastrophic losses in terms of personal injury and property damage costs, and compromise critical parts of our rail network.

NS may be affected by terrorism or war. Any terrorist attack, or other similar event, any government response thereto, and war or risk of war could cause significant business interruption and may adversely affect NS' results of operations, financial position, and liquidity in a particular year or quarter. Because NS plays a critical role in the nation's transportation system, it could become the target of such an attack or have a significant role in the government's preemptive approach or response to an attack or war.

Although NS currently maintains insurance coverage for third-party liability arising out of war and acts of terrorism, it maintains only limited insurance coverage for first-party property damage and damage to property in NS' care, custody, or control caused by certain acts of terrorism. In addition, premiums for some or all of NS' current insurance programs covering these losses could increase dramatically, or insurance coverage for certain losses could be unavailable to NS in the future.

NS may be affected by general economic conditions. Prolonged negative changes in domestic and global economic conditions affecting the producers and consumers of the commodities NS carries may have an adverse effect on its operating results, financial position, and liquidity. Economic conditions resulting in bankruptcies of one or more large customers could have a significant impact on NS' financial position, results of operations, or liquidity in a particular year or quarter.

NS may be affected by the impact of environmental regulation on its utility coal customers and/or the value of certain NS assets. A number of evolving environmental issues could affect the U.S. utility coal market, including potential regional programs aimed at capping and reducing power plant CO_2 emissions and ongoing efforts at addressing climate change. Although certain utilities have begun adding or are planning to add emissions control technologies to their electric generating units, allowing them to utilize their existing coal-fired power plants, future regulatory developments in this area could have a negative effect on NS' utility coal customers and/or the value of coal reserves owned by NS and thus an adverse effect on NS' operating results, financial position, and liquidity.

NS faces competition from other transportation providers. NS is subject to competition from motor carriers, railroads, and to a lesser extent, ships, barges, and pipelines, on the basis of transit time, pricing, and the quality and reliability of service. While NS has used primarily internal resources to build or acquire and maintain its rail system, trucks and barges have been able to use public rights-of-way maintained by public entities. Any future improvements or expenditures materially increasing the quality or reducing the cost of alternative modes of transportation in the regions in which NS operates, or legislation granting materially greater latitude for motor carriers with respect to size or weight limitations, could have a material adverse effect on its financial position, results of operations, or liquidity in a particular year or quarter.

The operations of carriers with which NS interchanges may adversely affect its operations. NS' ability to provide rail service to customers in the U.S. and Canada depends in large part upon its ability to maintain cooperative relationships with connecting carriers with respect to, among other matters, freight rates, revenue divisions, car supply and locomotive availability, data exchange and communications, reciprocal switching, interchange, and trackage rights. Deterioration in the operations of, or service provided by connecting carriers, or in our relationship with those connecting carriers, could result in NS' inability to meet its customers' demands or require NS to use alternate train routes, which could result in significant additional costs and network inefficiencies.

NS relies on technology and technology improvements in its business operations. If NS experiences significant disruption or failure of one or more of its information technology systems, including computer hardware, software, and communications equipment, NS could experience a service interruption, security breach, or other operational difficulties, which could have a material adverse impact on its results of operations, financial condition, and liquidity in a particular year or quarter. Additionally, if NS does not have sufficient capital to acquire new technology or if it is unable to implement new technology, NS may suffer a competitive disadvantage within the rail industry and with companies providing other modes of transportation service, which could have a material adverse effect on its financial position, results of operations, or liquidity in a particular year or quarter.

The vast majority of NS employees belong to labor unions, and labor agreements, strikes, or work stoppages could adversely affect its operations. A pproximately 26,000, or about 85%, of NS railroad employees are covered by collective bargaining agreements with various labor unions. If unionized workers were to engage in a strike, work stoppage, or other slowdown, NS could experience a significant disruption of its operations. Additionally, future national labor agreements, or renegotiation of labor agreements or provisions of labor agreements, could significantly increase NS' costs for healthcare, wages, and other benefits. Any of these factors could have a material adverse impact on NS' financial position, results of operations, or liquidity in a particular year or quarter.

NS may be subject to various claims and lawsuits that could result in significant expenditures. The nature of NS' business exposes it to the potential for various claims and litigation related to labor and employment, personal injury, commercial disputes, freight loss and other property damage, and other matters. Job-related personal injury and occupational claims are subject to the Federal Employers' Liability Act (FELA), which is applicable only to railroads. FELA's fault-based tort system produces results that are unpredictable and inconsistent as compared with a no-fault worker's compensation system. The variability inherent in this system could result in actual costs being very different from the liability recorded.

Any material changes to current litigation trends or a catastrophic rail accident involving any or all of freight loss or property damage, personal injury, and environmental liability could have a material adverse effect on NS' operating results, financial condition, and liquidity to the extent not covered by insurance. NS has obtained insurance for potential losses for third-party liability and first-party property damages. Specified levels of risk are retained on a self-insurance basis (currently up to $25 million and above $1 billion per occurrence for bodily injury and property damage to third parties and $25 million and above $175 million per occurrence for property owned by NS or in its care, custody, or control). Insurance is available from a limited number of insurers and may not continue to be available or, if available, may not be obtainable on terms acceptable to NS.

Severe weather could result in significant business interruptions and expenditures. Severe weather conditions and other natural phenomena, including hurricanes, floods, fires, and earthquakes, may cause significant business interruptions and result in increased costs, increased liabilities, and decreased revenues, which could have an adverse effect on NS' financial position, results of operations, or liquidity in a particular year or quarter.

Unpredictability of demand for rail services resulting in the unavailability of qualified personnel could adversely affect NS' operational efficiency and ability to meet demand. Workforce demographics, training requirements, and the availability of qualified personnel, particularly engineers and trainmen, could each have a negative impact on NS' ability to meet demand for rail service. Unpredictable increases in demand for rail services may exacerbate such risks, which could have a negative impact on NS' operational efficiency and otherwise have a material adverse effect on its financial position, results of operations, or liquidity in a particular year or quarter.

NS may be affected by supply constraints resulting from disruptions in the fuel markets or the nature of some of its supplier markets. NS consumes about 500 million gallons of diesel fuel each year. Fuel availability could be affected by any limitation in the fuel supply or by any imposition of mandatory allocation or rationing regulations. If a severe fuel supply shortage arose from production curtailments, increased demand in existing or emerging foreign markets, disruption of oil imports, disruption of domestic refinery production, damage to refinery or pipeline infrastructure, political unrest, war or other factors, NS' financial position, results of operations, or liquidity in a particular year or quarter could be materially adversely affected. Also, such an event would impact NS as well as its customers and other transportation companies.

Due to the capital intensive nature and industry-specific requirements of the rail industry, there are high barriers of entry for potential new suppliers of core railroad items, such as locomotives and rolling stock equipment. Additionally, NS competes with other industries for available capacity and raw materials used in the production of certain track materials, such as rail and ties. Changes in the competitive landscapes of these limited-supplier markets could result in increased prices or material shortages that could materially affect NS' financial position, results of operations, or liquidity in a particular year or quarter.

The state of capital markets could adversely affect NS' liquidity. NS from time-to-time relies on the capital markets to provide some of its capital requirements, including the issuance of long-term debt instruments and commercial paper, as well as the sale of certain receivables. Significant instability or disruptions of the capital markets, including the credit markets, or deterioration of NS' financial condition due to internal or external factors could restrict or eliminate NS' access to, and/or significantly increase the cost of, various financing sources, including bank credit facilities and issuance of corporate bonds. Instability or disruptions of the capital markets and deterioration of NS' financial condition, alone or in combination, could also result in a reduction in NS' credit rating to below investment grade, which could prohibit or restrict NS from accessing external sources of short- and long-term debt financing and/or significantly increase the associated costs.

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Item 1B. Unresolved Staff Comments

None.

Item 3. Legal Proceedings

The Ohio Environmental Protection Agency has notified Norfolk Southern that it intends to seek penalties and require Norfolk Southern to take remedial actions in connection with alleged violations of the Clean Air and Water Acts stemming from the operation of our coal dock in Ashtabula, Ohio. The Pennsylvania Department of Environmental Protection has submitted to NS a proposed Consent Assessment of Civil Penalty with respect to several alleged environmental releases from September 2007 to the present. Although NS will contest liability and the imposition of any penalties, because these governmental proceedings with respect to environmental laws and regulations involve potential fines, penalties or other monetary sanctions in excess of $100,000, we describe them here consistent with SEC rules and requirements. NS does not believe that the outcome of these proceedings will have a material effect on its financial position, results of operations, or liquidity.

On November 6, 2007, various antitrust class actions filed against NS and other Class 1 railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. NS believes the allegations in the complaints are without merit and intends to vigorously defend the cases. NS does not believe that the outcome of these proceedings will have a material effect on its financial position, results of operations, or liquidity. A lawsuit containing similar allegations against NS and four other major railroads that was filed on March 25, 2008, in the U.S. District Court for the District of Minnesota was voluntarily dismissed by the plaintiff subject to a tolling agreement entered into in August 2008.

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 January 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.

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

There were no matters submitted to a vote of security holders during the fourth quarter of 2008.

Executive Officers of the Registrant.

Norfolk Southern's executive officers generally are elected and designated annually by the Board of Directors at its first meeting held after the annual meeting of stockholders, and they hold office until their successors are elected. Executive officers also may be elected and designated throughout the year as the Board of Directors considers appropriate. There are no family relationships among the officers, nor any arrangement or understanding between any officer and any other person pursuant to which the officer was selected. The following table sets forth certain information, as of February 1, 2009, relating to the executive officers.

Name, Age, Present Position	**Business Experience During Past Five Years**
Charles W. Moorman, 56, Chairman, President and Chief Executive Officer	Present position since February 1, 2006. Served as President and Chief Executive Officer from November 1, 2005 to February 1, 2006; as President from October 1, 2004 to November 1, 2005; as Senior Vice President – Corporate Planning and Services from December 1, 2003 to October 1, 2004; Senior Vice President – Corporate Services from February 1, 2003 to December 1, 2003 and prior thereto served as President – Thoroughbred Technology and Telecommunications, Inc.
Stephen C. Tobias, 64, Vice Chairman and Chief Operating Officer	Present position since August 1, 1998.
Deborah H. Butler, 54, Executive Vice President – Planning and Chief Information Officer	Present position since June 1, 2007. Prior thereto served as Vice President – Customer Service.
James A. Hixon, 55, Executive Vice President –	Present position since October 1, 2005. Served as Executive Vice President – Finance and Public Affairs

Law and Corporate Relations	From October 1, 2004, to October 1, 2005; Senior Vice President – Legal and Government Affairs from December 1, 2003 to October 1, 2004 and prior thereto served as Senior Vice President – Administration.
Mark D. Manion, 56, Executive Vice President – Operations	Present position since October 1, 2004. Served as Senior Vice President – Transportation Operations from December 1, 2003 to October 1, 2004 and prior thereto served as Vice President – Transportation Services and Mechanical.
John P. Rathbone, 56, Executive Vice President – Administration	Present position since October 1, 2004. Served as Senior Vice President – Administration from December 1, 2003 to October 1, 2004 and prior thereto served as Senior Vice President and Controller.
Donald W. Seale, 56, Executive Vice President and Chief Marketing Officer	Present position since April 1, 2006. Served as Executive Vice President – Sales and Marketing from October 1, 2004 to April 1, 2006; as Senior Vice President – Marketing Services from December 1, 2003 to October 1, 2004 and prior thereto was Senior Vice President – Merchandise Marketing.
James A. Squires, 47, Executive Vice President – Finance and Chief Financial Officer	Present position since July 1, 2007. Served as Executive Vice President – Finance from April 1, 2007 to July 1, 2007, Senior Vice President – Financial Planning from April 1, 2006 to April 1, 2007, Senior Vice President – Law from October 1, 2004 to April 1, 2006, as Vice President – Law from December 1, 2003 to October 1, 2004 and prior thereto was Senior General Counsel.
Daniel D. Smith, 56, Senior Vice President – Energy and Properties	Present position since December 1, 2003. Prior thereto served as President - NS Development.

Marta R. Stewart, 51,	Present position since December 1, 2003.
Vice President and Controller	Prior thereto was Assistant Vice President Corporate Accounting.

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PART II

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES (NS)

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

STOCK PRICE AND DIVIDEND INFORMATION

The Common Stock of Norfolk Southern Corporation, owned by 35,466 stockholders of record as of December 31, 2008, is traded on the New York Stock Exchange under the symbol NSC. The following table shows the high and low sales prices as reported by Bloomberg L.P. on its internet-based service and dividends per share, by quarter, for 2008 and 2007.

	Quarter							
2008		1st		2nd		3rd		4th
Market price								
High	$	56.89	$	67.38	$	73.64	$	65.04
Low		44.15		54.94		57.82		43.29
Dividends per share	$	0.29	$	0.29	$	0.32	$	0.32
2007		1st		2nd		3rd		4th
Market price								
High	$	53.84	$	59.19	$	59.77	$	54.58
Low		45.38		49.70		46.42		48.03
Dividends per share	$	0.22	$	0.22	$	0.26	$	0.26

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased (1)	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(2)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased Under the Plans or Programs(2)
October 1-31, 2008	4,202,600	54.43	4,202,600	10,312,150
November 1-30, 2008	--	--	--	10,312,150
December 1-31, 2008	2,125	47.05	--	10,312,150
Total	4,204,725		4,202,600	

(1) Of this amount 2,125 represent s hares tendered by employees in connection with the exercise of stock options under the Long-Term Incentive Plan.

(2) On November 22, 2005, the Board of Directors authorized a share repurchase program, pursuant to which up to 50 million shares of Common Stock could be purchased through December 31, 2015. On March 27, 2007, the Board of Directors amended the program and increased the number of shares that may be repurchased to 75 million, and shortened the repurchase term by five years to December 31, 2010.

Item 6. Selected Financial Data

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

FIVE-YEAR FINANCIAL REVIEW

	2008	2007	2006	2005[1]	2004[2]
			($ in millions, except per share amounts)		
RESULTS OF OPERATIONS					
Railway operating revenues	$ 10,661	$ 9,432	$ 9,407	$ 8,527	$ 7,312
Railway operating expenses	7,577	6,847	6,850	6,410	5,610
Income from railway operations	3,084	2,585	2,557	2,117	1,702
Other income – net	110	93	149	74	76
Interest expense on debt	444	441	476	494	489
Income before income taxes	2,750	2,237	2,230	1,697	1,289
Provision for income taxes	1,034	773	749	416	379
Net income	$ 1,716	$ 1,464	$ 1,481	$ 1,281	$ 910
PER SHARE DATA					
Net income – basic	$ 4.60	$ 3.74	$ 3.63	$ 3.17	$ 2.31
– diluted	$ 4.52	$ 3.68	$ 3.57	$ 3.11	$ 2.28
Dividends	$ 1.22	$ 0.96	$ 0.68	$ 0.48	$ 0.36
Stockholders’ equity at year end	$ 26.23	$ 25.64	$ 24.19	$ 22.63	$ 19.92
FINANCIAL POSITION					

Total assets	$	26,297	$	26,144	$	26,028	$	25,859	$	24,748
Total long-term debt, including										
current maturities	$	6,667	$	6,368	$	6,600	$	6,930	$	7,525
Stockholders' equity	$	9,607	$	9,727	$	9,615	$	9,276	$	7,977
OTHER										
Capital expenditures	$	1,558	$	1,341	$	1,178	$	1,025	$	1,041
Average number of shares										
outstanding (thousands)		372,276		389,626		405,988		404,170		394,201
Number of stockholders at year end		35,466		36,955		38,900		48,180		51,032
Average number of employees:										
Rail		30,241		30,336		30,079		29,851		28,057
Nonrail		468		470		462		443		418
Total		30,709		30,806		30,541		30,294		28,475

2005 provision for income taxes includes a $96 million benefit related to the reduction of NS' deferred income tax liabilities resulting from tax legislation enacted by Ohio. This benefit increased net income by $96 million, or 23 cents per diluted share.

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2004 other income – net includes a $40 million net gain from the Conrail Corporate Reorganization. This gain increased net income by $40 million or 10 cents per diluted share.

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See accompanying Consolidated Financial Statements and notes thereto.

Item 7 .. 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

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes and the Selected Financial Data.

OVERVIEW

NS' 2008 net income rose 17% largely on the strength of a 19% increase in income from railway operations. Operating results reflected higher average revenue per unit (including fuel surcharge revenue) that more than offset the effects of increased operating expenses and lower traffic volume. Operating revenues increased 13% and operating expenses rose 11% compared to 2007, resulting in a lower operating ratio (a measure of the amount of revenues consumed by expenses) of 71.1%, as compared with 72.6% in 2007.

Cash provided by operating activities was $2.7 billion, exceeding $2 billion for the fourth consecutive year. Coupled with net borrowings of $280 million, this provided funding for increased capital expenditures, share repurchases, and higher dividends.

During 2008, NS purchased and retired 19.4 million shares of NS common stock at a total cost of $1.1 billion under the share repurchase program which the Board of Directors approved in November 2005 and subsequently amended in March 2007 to authorize the repurchase of up to 75 million shares of NS common stock through December 31, 2010. In total, NS has purchased and retired 64.7 million shares under this program at a cost of $3.3 billion.

Looking ahead, NS expects revenues to decline in 2009, reflecting lower traffic volume due to the weak economy and decreased fuel surcharge revenue resulting from lower fuel prices. NS plans to continue to improve service, maintain a market-based approach to pricing, and reduce volume-related costs.

SUMMARIZED RESULTS OF OPERATIONS

2008 Compared with 2007

Net income in 2008 was $1.7 billion, up $252 million, or 17%, compared with 2007. Diluted earnings per share were $4.52, up 84¢, or 23%. The greater percentage increase in per share earnings was due to fewer shares outstanding as a result of NS' share repurchase program (see Note 13). The increase in net income was primarily due to higher income from railway operations that was offset in part by higher income taxes (see Note 3). Railway operating revenues increased $1.2 billion, as higher average revenue per unit (including fuel surcharges) outweighed lower traffic volumes. Railway operating expenses increased $730 million, principally due to higher fuel costs and increased compensation and benefits expenses.

Oil prices affect NS' results of operations in a variety of ways and can have an overall favorable or unfavorable impact in any particular quarter or year. 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 also affect fuel costs (see "Railway Operating Expenses"). For 2008, 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.

2007 Compared with 2006

Net income in 2007 was $1.5 billion, down $17 million, or 1%, compared with 2006. Diluted earnings per share were $3.68, up 11¢, or 3%, reflecting fewer shares outstanding as a result of NS' share repurchase program (see Note 13). The decrease in net income was primarily due to higher income taxes and lower non operating items that offset higher income from railway operations. Railway operating revenues increased $25 million, as higher average revenue per unit overshadowed lower traffic volumes. Railway operating expenses decreased $3 million, principally due to lower volume-related expenses that offset higher fuel expense.

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Railway operating revenues were $10.7 billion in 2008 and $9.4 billion in 2007 and 2006. The following table presents a three-year comparison of revenues, volume, and average revenue per unit by market group.

	Revenues			Units			Revenue per Unit		
	2008	**2007**	**2006**	**2008**	**2007**	**2006**	**2008**	**2007**	**2006**
	($ in millions)			*(in thousands)*			*($ per unit)*		
Coal	$ 3,111	$ 2,315	$ 2,330	1,765.7	1,699.4	1,760.0	$ 1,762	$ 1,363	$ 1,324
General merchandise:									
Agr./cons. prod./govt.	1,282	1,047	994	612.4	601.5	594.1	2,093	1,740	1,673
Metals/construction	1,251	1,149	1,168	742.4	783.6	835.3	1,686	1,467	1,398
Chemicals	1,238	1,166	1,079	393.7	426.7	426.4	3,144	2,732	2,530
Paper/clay/forest	898	860	891	394.1	428.1	466.7	2,280	2,010	1,909
Automotive	823	974	974	412.2	533.0	561.9	1,997	1,827	1,734
General merchandise	5,492	5,196	5,106	2,554.8	2,772.9	2,884.4	2,150	1,874	1,770
Intermodal	2,058	1,921	1,971	3,029.0	3,120.7	3,256.5	679	615	605
Total	$ 10,661	$ 9,432	$ 9,407	7,349.5	7,593.0	7,900.9	$ 1,451	$ 1,242	$ 1,191

Revenues increased $1.2 billion in 2008 and $25 million in 2007. As shown in the table below, both revenue improvements were the result of increased average revenue per unit, including fuel surcharge revenue, which more than offset decreased traffic volumes. Fuel surcharge revenue amounted to $1.6 billion in 2008 (up $830 million) compared to $792 million in 2007 and $1 billion in 2006. If fuel prices remain at or near year-end 2008 levels, fuel surcharge revenues in 2009 will be substantially lower, with a corresponding effect on revenue per unit.

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 coupled with the sharp drop in fuel prices late in the year increased fuel surcharge revenue by approximately $100 million for the year.

Revenue Variance Analysis

Increases (Decreases)

	2008 vs. 2007		2007 vs. 2006	
	($ in millions)			
Revenue per unit/mix	$	1,531	$	392
Traffic volume (units)		(302)		(367)
Total	$	1,229	$	25

Both comparisons reflect large increases in average revenue per unit, a result of higher rates and increased fuel surcharges. Traffic volumes in both years declined. For 2008, traffic volumes for all commodity groups except coal and agriculture/consumer products/government decreased. In 2007, traffic volumes for all commodity groups except agriculture/consumer products/government and chemicals decreased.

On January 26, 2007, the Surface Transportation Board (STB) issued a decision that the type of fuel surcharge imposed by NS and most other large railroads – a fuel surcharge based on a percentage of line haul revenue – would no longer be permitted for regulated traffic that moves under public (tariff) rates. The STB gave the railroads a 90 day transition period to adjust their fuel surcharge programs. During the second quarter of 2007, NS discontinued assessing fuel surcharges on its published (non-intermodal) public rates. Adjustments to public prices now reflect ongoing market conditions. The traffic moving under these tariffs and public quotes comprises about 10% of Norfolk Southern’s total revenue base.

COAL revenues increased $796 million, or 34%, compared with 2007, reflecting higher rates, including fuel surcharges, and a 4% increase in traffic volume. Coal average revenue per unit was up 29% compared with 2007, reflecting higher rates (which were comprised of pricing increases, contract escalators and the effect of increased longer-haul export coal traffic) and increased fuel surcharges. For 2009, average revenue per unit is expected to decline reflecting the effects of lower fuel surcharges and contract escalators.

Coal represented 29% of NS’ revenues in 2008 and 79% of shipments handled originated on NS’ lines. As shown in the following table, increased shipments of export, utility, and domestic metallurgical coal more than offset lower industrial shipments.

Total Coal, Coke, and Iron Ore Tonnage

	2008	2007	2006
		(Tons in thousands)	
Utility	144,451	142,734	148,078
Export	23,069	15,564	12,409
Domestic metallurgical	18,155	17,873	20,878
Industrial	8,553	9,794	9,202
Total	194,228	185,965	190,567

Coal r evenues in 2007 decreased $15 million, or 1%, compared with 2006, as a 2% reduction in tonnage handled more than offset a 3% increase in average revenue per unit. Carloads declined 3%, a higher percentage than the change in tonnage handled because of increased average tonnage per car. Coal represented 25% of NS' revenues in 2007, and 78% of shipments handled originated on NS' lines.

NS is currently involved in litigation with Virginia Electric and Power Company/Old Dominion Electric Cooperative (Virginia Power) regarding rate adjustment provisions in a transportation contract between them. In 2007, the Virginia Supreme Court issued a decision that remanded the case to the trial court on the grounds that neither of its prior decisions constituted a final order. In April 2008, the trial court entered a final order granting NS monetary damages, including interest, and prescribing the methodology for determining future rates. Virginia Power filed a notice of appeal and the Virginia Supreme Court has agreed to hear the appeal. Future developments and the ultimate resolution of this matter could result in NS recognizing additional revenues related to this dispute, which could have a favorable impact on results of operations in a particular year or quarter.

Utility coal tonnage increased 1%, compared with 2007, a result of modest stockpile growth in the Northeast.

In 2007, utility coal tonnage decreased 4% compared with 2006, reflecting high stockpile levels (particularly in the Southeast) that led to reduced shipments, despite fairly strong electric generation (up 4%) in the NS service region. In addition, the temporary closure of a major coal mine as well as the loss of business to barge transportation contributed to the decline.

For 2009, utility coal tonnage is expected to weaken, with lower electric demand as a result of a weak economy.

Export coal tonnage increased 48% compared to 2007, reflecting increased global demand coupled with weather-related supply constraints in Australia, reduced export volume from China, and the weak U.S. dollar. Norfolk volume increased about 51,000 carloads, or 39%, and Baltimore volume was up about 28,000 carloads, or 102%.

Export coal tonnage in 2007 increased 25% compared to 2006, primarily due to increased demand reflecting a lower valued U.S. dollar as well as loading delays at Australian ports. Norfolk volume increased by approximately 26,000 cars, or 25%, and Baltimore volume was up approximately 4,500 cars, or 19%.

For 2009, export coal tonnage is expected to decrease, reflecting a significant reduction in worldwide steel production, increasing competition into Europe due to changes in ocean freight rates, and the strengthening of the U.S. dollar against other currencies.

Domestic metallurgical coal, coke, and iron ore tonnage increased 2% compared with 2007, reflecting the start up of a new coke plant.

In 2007, domestic metallurgical coal, coke, and iron ore tonnage decreased 14% compared with 2006. The decrease was primarily due to coke furnace outages, mine production outages, and reduced spot iron ore traffic.

For 2009, domestic metallurgical coal, coke, and iron ore tonnage is expected to be down due to lower domestic steel demand.

Other coal tonnage (principally steam coal shipped to industrial plants) decreased 13% in 2008 compared to 2007 principally due to coal supply constraints. In 2007, other coal tonnage increased 6% versus 2006, primarily due to new business and stronger demand.

For 2009, other coal tonnage is expected to be flat compared to 2008.

GENERAL MERCHANDISE revenues in 2008 increased $296 million, or 6%, compared with 2007, as a 15% increase in average revenue per unit, reflecting continued market-based pricing and higher fuel surcharges, more than offset an 8% decline in traffic volume.

In 2007, general merchandise revenues increased $90 million, or 2%, compared with 2006, as a 6% increase in average revenue per unit, more than offset a 4% decline in traffic volume. Revenue in 2007 included $26 million related to a volume-related contract settlement with an automotive customer.

Agriculture, consumer products, and government revenue increased 22% in 2008 compared with 2007. The revenue improvement resulted from higher average revenue per unit, which reflected increased rates and higher fuel surcharge revenues. Traffic volume increased 2% as more ethanol, military, feed, soybeans, and food oils shipments offset declines in fertilizers, corn, beverages, and consumer products.

Agriculture, consumer products, and government revenue increased 5% in 2007 compared with 2006. The revenue improvement resulted from higher average revenue per unit, which reflected higher rates. Traffic volume rose modestly as more corn, fertilizer, and ethanol shipments were mitigated by less government and consumer product volume.

For 2009, agriculture revenue is expected to post modest growth, benefiting from increasing demand for biofuel products including ethanol, biodiesel, and feed ingredients from their production, and slightly higher average revenue per unit (including fuel surcharges). However, lower volumes in corn, soybeans, and fertilizer shipments due to softer demand along with declines in consumer products markets are expected to partially offset this growth.

Metals and construction revenue increased 9% in 2008 as a 15% increase in average revenue per unit that resulted from increased rates and higher fuel surcharge more than offset the effects of a 5% decrease in traffic volume. The decline in volume was due to reduced demand for construction materials and lower coil, iron, and steel shipments, reflecting the weak housing and automotive sectors.

Metals and construction revenue decreased 2% in 2007 as a 5% increase in average revenue per unit that resulted from higher rates was more than offset by the effects of a 6% decrease in traffic volume. The decline in volume was principally due to lower iron, steel, and coil shipments and reduced demand for construction materials, both reflecting the soft automotive and housing sectors.

For 2009, metals and construction revenues are expected to decline as a result of decreased traffic volumes due to lower steel production in North America coupled with continued weakness in the housing and automotive sectors and lower average revenue per unit (including fuel surcharges).

Chemicals revenue in 2008 increased 6%, compared with 2007, a result of increased rates and higher fuel surcharge revenue. Traffic volume declined 8%, reflecting continued weakness in both industrial intermediates and plastics (linked to housing construction declines) in addition to miscellaneous chemicals and petroleum-based products.

In 2007, chemicals revenue increased 8% compared with 2006, reflecting higher rates in all groups. Traffic volume rose modestly as more shipments of industrial intermediates offset fewer shipments in the petroleum, miscellaneous chemicals, and plastics markets, which continued to reflect weakness in housing-related demand.

For 2009, chemicals revenue is expected to decline as a result of reduced volumes, reflecting a weak economic outlook with fewer housing starts and construction-related weaknesses, and lower average revenue per unit (including fuel surcharges).

Paper, clay, and forest products revenue increased 4% in 2008 compared with 2007 due to a 13% increase in average revenue per unit which more than offset an 8% decrease in traffic volume. The volume decline reflected the continued housing slowdown and increased trucking capacity available to paper customers.

Paper, clay, and forest products revenue decreased 3% in 2007 compared with 2006 as the effects of higher average revenue per unit were more than offset by an 8% decrease in traffic volume reflecting the housing slowdown and decline in conventional paper markets.

For 2009, paper, clay, and forest products revenues are expected to decline due to economy-related volume declines, including the effects of increased trucking capacity, and lower average revenue per unit (including fuel surcharges).

Automotive revenues decreased 16% in 2008 compared to 2007 as lower traffic volumes offset higher average revenue per unit. Volumes decreased 23%, reflecting reduced North American sales and production. Automotive manufacturers, especially the domestic producers, continued to experience significant sales declines during the year. Three assembly plants closed during the year and six implemented shift reductions. In addition, one manufacturer temporarily closed an assembly plant to retool for a new product in 2010. As of year end, Ford, General Motors, and Chrysler combined operated 14 of 24 assembly plants served by NS. NS continues to monitor the state of the automotive industry and the collectability of the associated receivables.

Automotive revenues were flat in 2007 compared with 2006 as lower traffic volumes offset higher average revenue per unit. Revenue in 2007 included a $26 million volume-related contract settlement. Volume decreased 5%, reflecting softness in demand for vehicles as well as parts, and the closure in June 2007 of an NS-served plant.

For 2009, automotive revenues are expected to decrease reflecting continued production cutbacks and lower average revenue per unit (including fuel surcharges).

INTERMODAL revenues increased $137 million, or 7%, compared with 2007, as a 10% increase in average revenue per unit (including fuel surcharges) offset a 3% reduction in traffic volumes. Domestic volume (which includes truckload and intermodal marketing companies' [IMC] volumes) increased 8% compared with 2007, reflecting the relative fuel efficiency of intermodal versus over-the-road transportation and service improvements. International traffic volume declined 9%, primarily driven by the weak economy and less inland rail movement of West Coast port traffic that was partially offset by East Coast port volume growth. The Premium business, which includes parcel and less-than-truckload (LTL) carriers, decreased 6%, as reduced private empty movements and soft parcel business offset LTL conversions. Triple Crown Services Company (Triple Crown), a service with rail-to-highway trailers, experienced a 3% drop in volume primarily driven by reduced auto parts shipments.

Intermodal revenues in 2007 decreased $50 million, or 3%, compared with 2006, as a 4% reduction in traffic volumes offset a 2% increase in average revenue per unit. Truckload volume decreased 10% compared with 2006 and domestic IMC volume declined 4%. Traffic volume for Triple Crown dropped 3%. The declines for truckload, IMC, and Triple Crown were primarily due to lower national demand for dry van shipments resulting from continued weakness in the housing and automotive markets and increased over-the-road competition. International traffic volume decreased 4% reflecting reduced shipments of empty containers and less inland rail transportation of West Coast port traffic, which offset volume growth from East Coast port traffic. Premium business was up 2% reflecting gains in parcel shipments that offset modest declines in LTL shipper traffic.

For 2009, intermodal revenue is expected to decrease from 2008 primarily due to weak economic conditions, pressures from the drayage market and lower average revenue per unit (including fuel surcharges).

Railway Operating Expenses

Railway operating expenses in 2008 were $7.6 billion, up $730 million, or 11%, compared to 2007. Expenses in 2007 were about even with expenses in 2006. The increase in 2008 was primarily due to higher fuel costs and increased compensation and benefits expenses. The 2007 comparison reflected volume-related decreases offset by higher fuel expense.

The railway operating ratio, which measures the percentage of operating revenues consumed by operating expenses, improved to 71.1% in 2008, compared with 72.6% in 2007 and 72.8% in 2006.

The following table shows the changes in railway operating expenses summarized by major classifications.

Operating Expense Variances

Increases (Decreases)

	2008 vs. 2007		2007 vs. 2006	
	($ in millions)			
Compensation and benefits	$	132	$	(85)
Purchased services and rents		48		(27)
Fuel		469		74
Depreciation		29		37
Materials and other		52		(2)
Total	$	730	$	(3)

Compensation and benefits , which represents 35% of total railway operating expenses, increased $132 million, or 5%, compared with 2007, primarily due to higher incentive compensation (up $66 million); increased wage rates (up $54 million); costs associated with lump-sum payments due under a new Brotherhood of Locomotive Engineers and Trainmen (BLET) agreement ($31 million); higher payroll taxes (up $15 million); and, the absence of the 2007 employment tax refund ($9 million). These were partially offset by lower costs associated with trainees (down $19 million), lower health and welfare benefits resulting from higher employee contributions (down $19 million), and lower stock-based compensation (down $7 million). In 2008, compensation and benefits expense benefited from a net pension credit of $39 million; however, primarily due to the market decline in pension assets (see Note 10), NS does not expect a similar benefit in 2009.

In 2007, compensation and benefits decreased $85 million, or 3%, compared with 2006, primarily due to lower incentive compensation (down $48 million), lower volume-related payroll (down $37 million), the absence of the prior year retirement and waiver agreements with former executives as well as the cost of the regular stock-based grant to the former Chief Executive Officer ($24 million), lower stock-based compensation (down $13 million), and lower payroll taxes (down $12 million). These were partially offset by increased wage rates (up $27 million) and higher medical costs (up $27 million).

NS employment averaged 30,709 in 2008 compared with 30,806 in 2007 and 30,541 in 2006. The increase in 2007 in the number of employees was almost exclusively in operating department personnel to improve service needs, as well as to prepare for expected retirements. NS continues to monitor forecasted volumes in light of current economic conditions to ensure appropriate employment levels for service needs.

Purchased services and rents includes the costs of services purchased from outside contractors, including the net costs of operating joint (or leased) facilities with other railroads and the net cost of equipment rentals. This category of expenses increased $48 million, or 3%, in 2008 compared to 2007, but decreased $27 million, or 2%, in 2007 compared to 2006.

Purchased services costs were $1,242 million in 2008, $1,172 million in 2007 and $1,165 million in 2006. The increase in 2008 reflected higher intermodal operations costs, transportation operating costs, and professional and legal services. In 2007, higher expenses for maintenance activities were largely offset by volume-related declines.

Equipment rents, which includes the cost to NS of using equipment (mostly freight cars) owned by other railroads or private owners less the rent paid to NS for the use of its equipment, amounted to $357 million, $379 million and $413 million for 2008, 2007 and 2006, respectively. The decreases in 2008 and 2007 were principally due to lower shipment volumes and improved fleet utilization.

Fuel expense, which includes the cost of locomotive fuel as well as other fuel used in railway operations, increased $469 million, or 40%, in 2008 compared with 2007, and increased $74 million, or 7%, in 2007 compared with 2006. Fuel expense is recorded net of hedge benefits, although there have been no such benefits since May 2006 when the program wound down (see "Market Risks and Hedging Activities," below and Note 16). The increase in 2008 reflected a 45% increase in the price per gallon of locomotive fuel offset in part by a 3% decline in consumption. The increase in 2007 reflected a 9% increase in the price per gallon of locomotive fuel as well as the absence of hedge benefits offset in part by a 4% decline in consumption.

Legislation enacted in the first quarter of 2005 repealed the 4.3¢ per gallon excise tax on railroad diesel fuel for 2007, with the following phased reductions in 2005 and 2006: 1¢ per gallon from January 1, 2005 through June 30, 2005; 2¢ per gallon from July 1, 2005 through December 31, 2006; and by the full 4.3¢ thereafter. NS consumes about 500 million gallons of locomotive diesel fuel per year.

Depreciation expense increased $29 million, or 4%, in 2008 compared to 2007, and $37 million, or 5%, in 2007 compared to 2006. In both years, substantial capital investments and improvements resulted in higher depreciation expense.

Materials and other expenses (including the estimates of costs related to personal injury, property damage, and environmental matters) increased $52 million, or 7%, in 2008 compared with 2007, but decreased $2 million in 2007 compared with 2006, as shown in the following table.

	2008	2007	2006
		($ in millions)	
Materials	$ 380	$ 359	$ 346
Casualties and other claims	180	171	220
Other	292	270	236
	$ 852	$ 800	$ 802

The increase in 2008 was primarily due to costs associated with the Avondale Mills settlement related to the Graniteville accident (see below), as well as higher loss and damage claims and increased material costs for equipment and roadway repairs. These increases were partially offset by favorable personal injury claims development.

In April 2008, NS settled the lawsuit brought by Avondale Mills for claims associated with the January 6, 2005, derailment in Graniteville, SC. A portion of the settlement will not be reimbursed by insurance and was included in 2008 expenses. 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. NS is engaged in arbitration with one of its insurance carriers that failed to respond to an insurance claim submitted by NS. NS believes these expenses are covered by the insurance policy and that recovery of the contested amount is probable, in that NS expects the arbitrator will 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. Accordingly, NS has recorded the full recovery attributable to such carrier ($100 million). 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 has initiated arbitration against the carrier and believes that all expenses contained in the reimbursement request are covered by the insurance policy and that recovery is probable.

The decline in materials and other expense in 2007 was primarily due to lower derailment and personal injury costs, offset in part by higher property and other taxes, and increased materials costs for maintenance activities.

The largest component of casualties and other claims expense is personal injury costs. Cases involving occupational injuries comprised about 52% of total employee injury cases resolved and about 29% of total payments made. With its long-established commitment to safety, NS continues to work actively to eliminate all employee injuries and to reduce the associated costs. With respect to occupational injuries, which are not caused by a specific accident or event but allegedly result from a claimed exposure over time, the benefits of any existing safety initiatives may not be realized immediately. These types of claims are being asserted by former or retired employees, some of whom have not been actively employed in the rail industry for decades. The rail industry remains uniquely susceptible to litigation involving job-related accidental injury and occupational claims because of the Federal Employers' Liability Act (FELA), which is applicable only to railroads. FELA's fault-based system, which covers employee claims for job-related injuries, produces results that are unpredictable and inconsistent as compared with a no-fault workers' compensation system.

NS maintains substantial amounts of insurance for potential third-party liability and property damage claims. It also retains reasonable levels of risk through self-insurance (see Note 17). NS expects insurance costs to be slightly higher in 2009.

Other Income – Net

Other income – net was $110 million in 2008, $93 million in 2007, and $149 million in 2006 (see Note 2). The increase in 2008 reflected the absence of expenses related to synthetic fuel investments (see "Income Taxes" below), reduced other interest expense ($27 million) largely due to adjustments to reflect the outcome of certain tax examinations and higher coal royalties (up $12 million). These benefits were offset in part by lower returns and higher borrowing costs on corporate-owned life insurance (down $38 million), lower interest income (down $25 million), fewer gains on sales of property and investments (down $22 million), and lower equity in the earnings of Conrail (down $16 million), which reflects the absence of a tax audit settlement recorded by Conrail in 2007 ($18 million).

The decrease in 2007 reflected lower interest income ($31 million), higher expenses associated with synthetic fuel-related tax credit investments ($15 million), and lower returns from corporate-owned life insurance ($15 million) that combined to offset higher equity in earnings of Conrail ($20 million).

NS has membership interests representing ownership in companies that owned and operated facilities that produced synthetic fuel from coal. In addition, NS purchased two facilities that produced synthetic fuel from coal in 2007. The production of synthetic fuel resulted in tax credits as well as expenses related to the investments. The expenses are recorded as a component of "Other income – net," and the tax credits, as well as tax benefits related to the expenses, are reflected in "Provision for income taxes" (see further discussion below).

Income Taxes

Income tax expense in 2008 was $1 billion, for an effective rate of 38%, compared with effective rates of 35% in 2007 and 34% in 2006. The increase in the rate for 2008 was primarily due to the absence of synthetic fuel-related tax credits that expired at the end of 2007. The increase in the rate for 2007 largely resulted from Illinois tax legislation which increased deferred taxes by $19 million (see Note 3).

The tax credits generated by NS' synthetic fuel-related investments reduced the effective tax rate by 3% in 2007 and 2006. Net income in 2007 reflected $5 million less in net benefits from these credits, as compared with the same period of 2006, as shown below:

	2007		2006	
	($ in millions)			
Effect in "Other income – net:"				
Expenses on synthetic fuel-related investments	$	77	$	62
Effect in "Provision for income taxes:"				
Tax credits		60		56
Tax benefit of expenses on synthetic-fuel				
related investments		30		24
Total reduction of income tax expense		90		80
Effect in "Net income:"				
Net benefit from synthetic-fuel related investments	$	13	$	18

During 2008, NS resolved both the Internal Revenue Service (IRS) examination of its 2004 and 2005 consolidated federal income tax returns and its appeal of the 2002 and 2003 IRS examination without a material effect in income tax expense. NS' consolidated federal income tax returns for 2006 and 2007 are being audited by the IRS.

FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

Cash provided by operating activities, NS' principal source of liquidity, was $2.7 billion in 2008 compared with $2.3 billion in 2007 and $2.2 billion in 2006. The improvement in 2008 resulted from increased railway operating income and from bonus tax depreciation which reduced current tax payments. The improvement in 2007 resulted from favorable changes in working capital as well as a modest increase in income from railway operations. NS had working capital deficits of $106 million at December 31, 2008, and $273 million at December 31, 2007. The improvement was largely the result of increased cash and cash equivalents. NS expects that cash on hand combined with cash flow provided by operating activities will be sufficient to meet its ongoing obligations. NS' cash and cash equivalents balances totaled $618 million and $206 million at December 31, 2008 and 2007, respectively.

Contractual obligations at December 31, 2008, comprised of NS' long-term debt (including capital leases) (see Note 7), operating leases (see Note 8), agreements with CRC (see Note 4), unrecognized tax benefits (see Note 3), long-term advances from Conrail (see Note 4), and unconditional purchase obligations (see Note 17), were as follows:

	Payments Due By Period					
	Total	**2009**	**2010-2011**	**2012-2013**	**2014 and Subsequent**	**Other**
	($ in millions)					
Long-term debt and capital lease principal	$ 6,667	$ 484	$ 686	$ 79	$ 5,418	$ --
Operating leases	873	142	223	149	359	--
Agreements with CRC	450	29	58	58	305	--
Unrecognized tax benefits*	169	24	--	--	--	145
Long-term advances from Conrail	133	--	--	--	133	--
Unconditional purchase obligations	119	100	19	--	--	--
Total	$ 8,411	$ 779	$ 986	$ 286	$ 6,215	$ 145

* When the amount and timing of liabilities for unrecognized tax benefits can be reasonably estimated, the amount is shown in the table under the appropriate period. When the year of settlement cannot be reasonably estimated, the amount is shown in the Other column.

Off balance sheet arrangements consist of obligations related to operating leases, which are included in the table of contractual obligations above and disclosed in Note 8.

Cash used in investing activities was $1.2 billion in 2008, compared with $1 billion in 2007 and $684 million in 2006. The increase in 2008 primarily reflected increased property additions. The increase in 2007 primarily reflected lower net proceeds from short-term investment activities and increased property additions.

Property additions account for most of the recurring spending in this category. The following tables show capital spending (including capital leases) and track and equipment statistics for the past five years.

Capital Expenditures

	2008	2007	2006	2005	2004
			($ in millions)		
Road and other property	$ 1,070	$ 894	$ 756	$ 741	$ 612
Equipment	488	447	422	284	429
Total	$ 1,558	$ 1,341	$ 1,178	$ 1,025	$ 1,041

Track Structure Statistics (Capital and Maintenance)

	2008	2007	2006	2005	2004
Track miles of rail installed	459	401	327	302	246
Miles of track surfaced	5,209	5,014	4,871	4,663	5,055
New crossties installed (millions)	2.7	2.7	2.7	2.5	2.5

Average Age of Owned Railway Equipment

	2008	2007	2006	2005	2004
			(years)		
Freight cars	29.9	30.1	30.0	29.4	28.6
Locomotives	18.9	18.1	17.7	17.4	16.9
Retired locomotives	34.4	30.0	35.0	27.4	22.9

For 2009, NS has budgeted $1.41 billion for capital expenditures. The anticipated spending includes $698 million for roadway projects, including the normalized replacement of rail, ties and ballast and the improvement or replacement of bridges. Planned equipment spending of $124 million provides for the acquisition of over 500 super jumbo covered hoppers and continued spending on improvements to the locomotive fleet, including the rebuild and upgrade of existing units. Planned investments in facilities and terminals total $141 million, primarily for intermodal terminals and equipment to add capacity to the intermodal network and bulk transfer facilities to support the ethanol market. Infrastructure investments of $170 million are planned for network improvements to increase mainline capacity as well as various public/private partnership investments such as the Heartland Corridor and the Chicago CREATE project. Norfolk Southern also expects to spend $67 million related to computers, systems and information technology. All capital expenditures are expected to be made with internally generated funds.

The Heartland Corridor is a package of proposed clearance improvements and other facilities that will create a seamless high-capacity intermodal route across Virginia and West Virginia to Midwest markets. During 2006, NS and the states of Ohio, West Virginia and Virginia each entered into a Memorandum of Agreement with the Federal Highway Administration with respect to the tunnel clearance component of the Heartland Corridor that governs the release of up to $95 million in authorized federal funding. In 2006, NS also entered into agreements with two states governing the use of up to $11 million in state funding for the Heartland Corridor rail double-stack clearance project. NS began work on the Heartland Corridor tunnel clearances in October 2007 and the entire project is expected to be completed in 2010. NS expects to spend about $100 million over 2009 and 2010 in connection with this project.

The Chicago Region Environmental and Transportation Efficiency (CREATE) project is a public-private partnership to reduce rail and highway congestion and add freight and passenger capacity in the metropolitan Chicago area. NS and other railroads have agreed to participate in CREATE. A portion of the public funding has been approved and the parties have developed a list of projects to be included in Phase I of the project. A total of $100 million in public funding has been secured for Phase I and the railroads have contributed an additional $100 million. The railroads expect to complete Phase I by the end of 2010. As currently planned, the total project is estimated to cost $1.5 billion with city, state and federal support. If additional public funding is secured, the railroads are expected to contribute a total of $232 million towards the entire project. NS expects to spend approximately $15 million in 2009 related to CREATE projects.

The Meridian Speedway is a 320 mile rail line between Meridian, Mississippi and Shreveport, Louisiana. On May 1, 2006, NS and Kansas City Southern (KCS) formed a joint venture, Meridian Speedway LLC (MSLLC), pursuant to which NS would contribute $300 million in cash, substantially all of which will be used for capital improvements over a period of approximately three years, in exchange for a 30% interest in the joint venture. To date, NS has contributed $274 million. At the formation of MSLLC, KCS contributed the Meridian Speedway. NS is recognizing its pro rata share of the joint venture's earnings or loss as required under the equity method of accounting. NS' total investment in MSLLC is supported by the fair value of the rail line as well as intangible assets obtained through the transaction. The joint venture is expected to increase capacity and improve service over the Meridian Speedway into the Southeast.

Pan Am Southern LLC (PAS) will include the PAS Lines, which consist of a 155-mile main line track that runs between Mechanicville, New York and Ayer, Massachusetts, along with 281 miles of secondary and branch lines, including trackage rights in New York, Connecticut, Massachusetts, New Hampshire, and Vermont. PAS, when formed, will be a joint venture between NS and Pan Am Railways, Inc. (Pan Am) pursuant to which Pan Am expects to contribute the PAS Lines and NS expects to contribute cash and other property valued at $140 million, a significant portion of which will be used for capital improvements to the PAS Lines and the related construction of new intermodal and automotive terminals in the Albany, New York area. The joint venture is subject to regulatory approvals and other customary closing conditions.

The Crescent Corridor is a multistate network of infrastructure improvements and other facilities geared toward creating a seamless, high-capacity intermodal route spanning 11 states from New Jersey to Louisiana and offering truck-competitive service along several major interstate highway corridors, including I-81 and I-85, as well as I 20, I-40, I-59, and I-75. Based on the public benefits that stand to be derived in the form of highway congestion relief, NS plans to implement the Crescent Corridor through a series of public-private partnerships. Although there is not yet a single, integrated plan for the Crescent Corridor, preliminary work has begun and is slated to continue in 2009, including continued infrastructure improvements and other design and engineering work along the Virginia portion of the Corridor consistent with our matching obligation with respect to funds provided by the Commonwealth of Virginia .. NS expects to spend approximately $30 million related to Crescent Corridor projects in 2009.

The MidAmerica Corridor is a proposed cooperative arrangement between NS and Canadian National Railway (CN) to effectively share track between Chicago, St. Louis, Kentucky, and Mississippi in order to establish more efficient routes for traffic moving between the mid-western and southeastern U.S., including potential coal traffic moving to NS-served southeastern utility plants from CN-served Illinois Basin coal producers. To implement the MidAmerica Corridor, NS, at its option, would expend funds during the next five years to upgrade the rail line operated by West Tennessee Railway between Fulton, Kentucky, and Corinth, Mississippi, a line over which NS would operate pursuant to recently obtained trackage rights. The MidAmerica Corridor arrangement is subject to negotiation of definitive agreements between NS and CN, regulatory approvals, and other customary closing conditions.

Cash used in financing activities was $1.1 billion in 2008, compared with $1.6 billion in 2007 and $1.3 billion in 2006. The decrease in 2008 reflected a net increase in debt, compared with a net decline in 2007, which was offset in part by higher dividend payments. The increase in 2007 reflected higher share repurchases as a part of NS' share repurchase program (see Note 13), as well as higher debt repayments and increased dividend payments.

Share repurchases totaled $1.1 billion in 2008, $1.2 billion in 2007, and $964 million in 2006 for the purchase and retirement of 19.4 million, 23.6 million, and 21.7 million shares, respectively, of common stock as part of NS' share repurchase program. In March 2007, NS' Board of Directors amended NS' share repurchase program by increasing the authorized amount of share repurchases from 50 million to 75 million shares and shortening the authorized period from 2015 to 2010. To date, almost all of the purchases under the program have been made with internally generated cash. However, future funding sources could include proceeds from the issuance of debt, including the use of the receivable securitization program (see Note 7). The timing and volume of purchases is guided by management's assessment of market conditions and other pertinent facts. Due to economic and market conditions, NS reduced its share repurchases during the fourth quarter of 2008, and the amount of future purchases is uncertain due to the economic climate.

T hrough a private offering, NS issued and sold $600 million of unsecured notes in April 2008 (see Note 7), and subsequently exchanged substantially all of these unregistered securities with essentially identical securities registered under the Securities Act of 1933. In January 2009, through another private offering, NS issued $500 million of unsecured notes at 5.75% due 2016 (see Note 7). The net proceeds from the offering were $494 million after deducting the purchase discount and expenses. NS has agreed to exchange the unregistered securities with essentially identical securities registered under the Securities Act of 1933.

Subsequent to the January 2009 offering, NS has remaining authority from its board of directors to issue and sell up to $500 million of additional debt or equity securities through public or private sale. The Form S-3 shelf registration statements previously filed with the Securities and Exchange Commission (SEC) are no longer effective under SEC's Rule 415(a)(5), which provides for a three-year term. NS expects to file a new Form S-3 registration statement during the first quarter of 2009.

NS has in place and available a $1 billion, five-year credit agreement expiring in 2012, which provides for borrowings at prevailing rates and includes covenants. NS had no amounts outstanding under this facility at December 31, 2008, and NS is in compliance with all of the covenants. NS also has an accounts receivable securitization program which was renewed with a new 364-day term ending in October 2009. In addition, NS has the ability to directly access the debt markets.

Looking forward, NS' annual debt maturities are relatively modest and stable from year to year (see Note 7). NS expects to refinance maturing debt over the next several years and modestly increase current debt levels. Overall, NS' goal is to maintain a capital structure with appropriate leverage to support NS' business strategy and provide flexibility through business cycles.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions may require significant judgment about matters that are inherently uncertain, and future events are likely to occur that may require management to make changes to these estimates and assumptions. Accordingly, management regularly reviews these estimates and assumptions based on historical experience, changes in the business environment, and other factors that management believes to be reasonable under the circumstances. Management regularly discusses the development, selection, and disclosures concerning critical accounting estimates with the Audit Committee of its Board of Directors.

Pensions and Other Postretirement Benefits

Accounting for pensions and other postretirement benefit plans requires management to make several estimates and assumptions (see Note 10). These include the expected rate of return from investment of the plans' assets, projected increases in medical costs, and the expected retirement age of employees as well as their projected earnings and mortality. In addition, the amounts recorded are affected by changes in the interest rate environment because the associated liabilities are discounted to their present value. Management makes these estimates based on the company's historical experience and other information that it deems pertinent under the circumstances (for example, expectations of future stock market performance). Management utilizes an independent consulting actuarial firm's studies to assist it in selecting appropriate assumptions and valuing its related liabilities.

NS' net pension benefit, which is included in "Compensation and benefits" on its Consolidated Statements of Income, was $39 million for the year ended December 31, 2008. In recording this amount, NS assumed a long-term investment rate of return of 9%, which was supported by the long-term total rate of return on plan assets since inception. Given the uncertain economic outlook and the recent volatility in corporate bond indices, management reduced its long-term investment rate of return to 8.75% for 2009. A one percentage point change to this rate of return assumption would result in an $18 million change to the pension credit and, as a result, an equal change in "Compensation and benefits" expense. Changes that are reasonably likely to occur in assumptions concerning retirement age, projected earnings, and mortality would not be expected to have a material effect on NS' net pension benefit or net pension liability in the future. The net pension liability is recorded at its net present value using a discount rate that is based on the current interest rate environment in light of the timing of expected benefit payments. In 2008 and 2007, NS utilized an analysis in which the projected annual cash flows from the pension and postretirement benefit plans were matched with a yield curve based on an appropriate universe of high-quality corporate bonds. NS used the results of the yield curve to select the discount rate that matches the payment stream of the benefits in these plans. In 2006, NS referred to Moody's seasoned Aa corporate bond yields and the changes in such yields in establishing the discount rate.

NS' net cost for other postretirement benefits, which is also included in "Compensation and benefits," was $69 million for the year ended December 31, 2008. In recording this expense and valuing the net liability for other postretirement benefits, which is included in "Other postretirement benefits," management estimated future increases in health-care costs. These assumptions, along with the effect of a one percentage point change in them, are described in Note 10.

Properties and Depreciation

Most of NS' total assets are long-lived railway properties (see Note 5). As disclosed in Note 1, NS' properties are depreciated using group depreciation. Rail is depreciated primarily on the basis of use measured by gross-ton miles. Other properties are depreciated generally using the straight-line method over the lesser of estimated service or lease lives. NS reviews the carrying amount of properties whenever events or changes in circumstances indicate that such carrying amount may not be recoverable based on future undiscounted cash flows. Assets that are deemed impaired as a result of such review are recorded at the lesser of carrying amount or fair value.

NS' depreciation expense is based on management's assumptions concerning service lives of its properties as well as the expected net salvage that will be received upon their retirement. In developing these assumptions, NS' management utilizes periodic depreciation studies that are performed by an outside firm of consulting engineers. These studies analyze NS' historical patterns of asset use and retirement and take into account any expected change in operation or maintenance practices. NS' recent experience with these studies has been that while they do result in changes in the rates used to depreciate its properties, these changes have not caused a significant effect to its annual depreciation expense. The studies may also indicate that the recorded amount of accumulated depreciation is deficient (or in excess) of the amount indicated by the study. Any such deficiency (or excess) is amortized as a component of depreciation expense over the remaining service lives of the affected class of property. NS' depreciation expense for the year ended December 31, 2008, amounted to $804 million. NS' weighted-average depreciation rates for 2008 are disclosed in Note 5; a one-tenth percentage point increase (or decrease) in these rates would have resulted in a $28 million increase (or decrease) to depreciation expense.

Personal Injury, Environmental, and Legal Liabilities

NS' expense for casualties and other claims, included in "Materials and other," amounted to $180 million for the year ended December 31, 2008. Most of this expense was NS' accrual related to personal injury liabilities. Job-related personal injury and occupational claims are subject to FELA, which is applicable only to railroads. FELA's fault-based tort system produces results that are unpredictable and inconsistent as compared with a no-fault worker's compensation system. The variability inherent in this system could result in actual costs being very different from the liability recorded. In all cases, NS records a liability when the expected loss for the claim is both probable and estimable.

To aid in valuing its personal injury liability and determining the amount to accrue during the year, NS' management utilizes studies prepared by an independent consulting actuarial firm. For employee personal injury cases, the actuarial firm studies NS' historical patterns of reserving for claims and subsequent settlements, taking into account relevant outside influences. An estimate of the ultimate amount of the liability, which includes amounts for incurred but unasserted claims, is based on the results of this analysis. For occupational injury claims, the actuarial firm studies NS' history of claim filings, severity, payments and other relevant facts. Additionally, the estimate of the ultimate loss for occupational injuries includes a provision for those claims that have been incurred but not reported by projecting NS' experience into the future as far as can be reasonably determined. NS has recorded this actuarially determined liability. The liability is dependent upon many individual judgments made as to the specific case reserves as well as the judgments of the consulting actuary and management in the periodic studies. Accordingly, there could be significant changes in the liability, which NS would recognize when such a change became known. The most recent actuarial study, completed in the fourth quarter of 2008, resulted in a decrease to NS' personal injury liability during the fourth quarter. While the liability recorded is supported by the most recent study, it is reasonably possible that the ultimate liability could be higher or lower.

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 (see Note 17). Claims, if any, against third parties for recovery of cleanup costs incurred by NS, are reflected as receivables (when collection is probable) in the Consolidated Balance Sheets 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 established an Environmental Policy Council, composed of senior managers, to oversee and interpret its environmental policy.

Operating expenses for environmental matters totaled approximately $18 million in 2008, $16 million in 2007 and $19 million in 2006, and capital expenditures for environmental matters totaled approximately $7 million in both 2008 and 2007, and $6 million in 2006. Capital expenditures for environmental matters in 2009 are expected to be about $9 million.

NS' Consolidated Balance Sheets included liabilities for environmental exposures in the amount of $42 million at December 31, 2008, and $46 million at December 31, 2007 (of which $12 million is classified as a current liability at the end of each period). At December 31, 2008, the liability represented NS' estimate of the probable cleanup and remediation costs based on available information at 148 known locations. As of that date, 13 sites accounted for $22 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 NS 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. NS estimates its environmental remediation liability on a site-by-site basis, using assumptions and judgments that management deems appropriate for each site. As a result, it is not practical to quantitatively describe the effects of changes in these many assumptions and judgments. NS has consistently applied its methodology of estimating its environmental liabilities.

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 January 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 outcome of these proceedings will have a material effect on its financial position, results of operations, or liquidity.

Based on an assessment of known facts and circumstances, management believes that it is unlikely that any such known facts and circumstances, either individually or in the aggregate, will have a material adverse effect on NS’ financial position, results of operations, or liquidity.

Norfolk Southern and 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 expenses. 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, if any, 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 recorded liabilities will be reflected in expenses in the periods in which such adjustments are known.

Income Taxes

NS’ net long-term deferred tax liability totaled $6.4 billion at December 31, 2008 (see Note 3). This liability is estimated based on the expected future tax consequences of items recognized in the financial statements. After application of the federal statutory tax rate to book income, judgment is required with respect to the timing and deductibility of expenses in the corporate income tax returns. For state income and other taxes, judgment is also required with respect to the apportionment among the various jurisdictions. A valuation allowance is recorded if management expects that it is more likely than not that its deferred tax assets will not be realized. NS had an $11 million valuation allowance on $991 million of deferred tax assets as of December 31, 2008, reflecting the expectation that most of these assets will be realized.

In addition, NS has a recorded liability for its estimate of uncertain tax positions taken or expected to be taken in a tax return. Judgment is required in evaluating the application of federal and state tax laws and assessing whether it is more likely than not that a tax position will be sustained on examination and, if so, judgment is also required as to the measurement of the amount of tax benefit that will be realized upon settlement with the taxing authority. Management believes this liability for uncertain tax positions to be adequate. Income tax expense is adjusted in the period in which new information about a tax position becomes available or the final outcome differs from the amounts recorded. For every one half percent change in the 2008 effective tax rate net income would have changed by $14 million.

OTHER MATTERS

Labor Agreements

Approximately 26,000, or about 85%, of NS' railroad employees are covered by collective bargaining agreements with various labor unions. These agreements remain in effect until changed pursuant to the Railway Labor Act (RLA). NS largely bargains nationally, in concert with other major railroads. Moratorium provisions in the labor agreements govern when the railroads and the unions may propose changes.

The most recent national bargaining round began in late 2004. Since that time, the railroads have reached national agreements that extend through 2009 with all of the rail unions. Additionally, the current agreement with BLET extends through 2014. Because NS has reached separate agreements with the BLET and the American Train Dispatchers Association (ATDA), only the health and welfare provisions from the national agreements apply to NS' locomotive engineers and ATDA-represented dispatchers. A small number of longshoremen at Ashtabula (Ohio) Docks are represented by the International Longshoremen's Association (ILA) and do not participate in national bargaining. Negotiations are continuing with that organization.

Market Risks and Hedging Activities

NS has used derivative financial instruments to reduce the risk of volatility in its diesel fuel costs and to manage its overall exposure to fluctuations in interest rates.

In 2001, NS began a program to hedge a portion of its diesel fuel consumption. The intent of the program was to assist in the management of NS' aggregate risk exposure to fuel price fluctuations, which can significantly affect NS' operating margins and profitability, through the use of one or more types of derivative instruments. No new hedges have been entered into since May 2004, and the last remaining contracts were settled in the second quarter of 2006, bringing an end to the benefits from the program. Locomotive diesel fuel costs represented 14% of NS' operating expenses for 2006.

NS manages its overall exposure to fluctuations in interest rates by issuing both fixed- and floating-rate debt instruments and by entering into interest-rate hedging transactions to achieve an appropriate mix within its debt portfolio.

At December 31, 2008, NS' debt subject to interest rate fluctuations totaled $317 million. A 1% point increase in interest rates would increase NS' total annual interest expense related to all its variable debt by approximately $3 million. Management considers it unlikely that interest rate fluctuations applicable to these instruments will result in a material adverse effect on NS' financial position, results of operations, or liquidity.

Some of NS' capital leases, which carry an average fixed rate of 7%, were effectively converted to variable rate obligations using interest rate swap agreements. On December 31, 2008, the average pay rate under these agreements was 3%, and the average receive rate was 7%. During 2008 and 2007, the effect of the swaps was to reduce interest expense by approximately $1 million in both periods. A portion of the lease obligations is payable in Japanese yen. NS eliminated the associated exchange rate risk at the inception of each lease with a yen deposit sufficient to fund the yen-denominated obligation. Most of these deposits are held by foreign banks, primarily Japanese. As a result, NS is exposed to financial market risk relative to Japan. Counterparties to the interest rate swaps and Japanese banks holding yen deposits are major financial institutions believed by management to be creditworthy.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 157, “Fair Value Measurements.” This statement, effective for interim or annual reporting periods beginning after November 15, 2007, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. Effective January 1, 2008, NS adopted this standard related to financial instrument assets and liabilities with no effect on NS’ consolidated financial statements. NS will adopt the provisions of this standard relative to nonfinancial assets and nonfinancial liabilities that are not remeasured at fair value on a recurring basis in the first quarter of 2009. NS does not expect that it will have an effect on NS’ consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position (FSP) Emerging Issues Task Force (EITF) 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities.” This FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method as described in SFAS No. 128, “Earnings per Share.” NS will adopt the FSP, which affects the calculation of earnings per share, in the first quarter of 2009. The provisions of the FSP are to be applied retrospectively. NS expects that it will not have a material effect on NS’ consolidated financial statements.

FSP No. 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets,” was issued on December 30, 2008. This statement, effective for fiscal years ending after December 15, 2009, clarifies an employer’s disclosures about plan assets of a defined benefit pension or other postretirement plan. This statement prescribes expanded disclosures regarding investment allocation decisions, categories of plan assets, inputs, and valuation techniques used to measure fair value, the effect of Level 3 inputs on changes in plan assets and significant concentrations of risk. NS will adopt the FSP at the end of 2009 and expects it will not have a material effect on NS’ consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160 (SFAS 160), “Noncontrolling Interests in Consolidated Financial Statements,” which requires that noncontrolling (minority) interests be reported as a component of equity. NS will adopt the statement in the first quarter of 2009 and expects it will not have a material effect on NS’ consolidated financial statements.

Inflation

In preparing financial statements, U.S. generally accepted accounting principles require the use of historical cost that disregards the effects of inflation on the replacement cost of property. NS, a capital-intensive company, has most of its capital invested in such property. The replacement cost of these assets, as well as the related depreciation expense, would be substantially greater than the amounts reported on the basis of historical cost.

Proposed Legislation and Regulations on Safety and Transportation of Hazardous Materials

Federal regulations were adopted in late 2008 on safety and transportation of hazardous materials. NS is in compliance with those regulations currently effective and expects to be in compliance with those regulations to become effective at a later date.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that may be identified by the use of words like "believe," "expect," "anticipate" and "project." Forward-looking statements reflect management's good-faith evaluation of information currently available. However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which management has little or no control, including: domestic and international economic conditions; interest rates; the business environment in industries that produce and consume rail freight; competition and consolidation within the transportation industry; the operations of carriers with which NS interchanges; acts of terrorism or war; fluctuation in prices of key materials, in particular diesel fuel; labor difficulties, including strikes and work stoppages; legislative and regulatory developments; results of litigation; changes in securities and capital markets; disruptions to NS' technology infrastructure, including computer systems; and natural events such as severe weather, hurricanes, and floods. For a discussion of significant risk factors applicable to NS, see Part I, Item 1A "Risk Factors." Forward-looking statements are not, and should not be relied upon as, a guarantee of future performance or results, nor will they necessarily prove to be accurate indications of the times at or by which any such performance or results will be achieved. As a result, actual outcomes and results may differ materially from those expressed in forward-looking statements. NS undertakes no obligation to update or revise forward-looking statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The information required by this item is included in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Market Risks and Hedging Activities."

Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

Report of Management

February 18, 2009

To the Stockholders

Norfolk Southern Corporation

Management is responsible for establishing and maintaining adequate internal control over financial reporting. In order to ensure that the Corporation's internal control over financial reporting is effective, management regularly assesses such controls and did so most recently for its financial reporting as of December 31, 2008. This assessment was based on criteria for effective internal control over financial reporting described in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management has concluded that the Corporation maintained effective internal control over financial reporting as of December 31, 2008.

KPMG LLP, independent registered public accounting firm, has audited the Corporation's financial statements and issued an attestation report on the Corporation's internal control over financial reporting as of December 31, 2008.

/s/ Charles W. Moorman	/s/ James A. Squires	/s/ Marta R. Stewart
Charles W. Moorman	James A. Squires	Marta R. Stewart
Chairman, President and	Executive Vice President Finance and	Vice President and
Chief Executive Officer	Chief Financial Officer	Controller

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Norfolk Southern Corporation:

We have audited Norfolk Southern Corporation's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Norfolk Southern Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008, and our report dated February 18, 2009 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Norfolk, Virginia
February 18, 2009

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Norfolk Southern Corporation:

We have audited the accompanying consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2008. In connection with our audits of the consolidated financial statements, we also have audited financial statement schedule as listed in Item 15(A)2. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norfolk Southern Corporation and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in note 1 to the consolidated financial statements, Norfolk Southern Corporation adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* effective January 1, 2007 and Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* effective December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Norfolk Southern Corporation's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 18, 2009 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Norfolk, Virginia
February 18, 2009

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Income

	Years ended December 31,		
	2008	**2007**	**2006**
	($ in millions, except earnings per share)		
Railway operating revenues	$ 10,661	$ 9,432	$ 9,407
Railway operating expenses:			
Compensation and benefits	2,684	2,552	2,637
Purchased services and rents	1,599	1,551	1,578
Fuel	1,638	1,169	1,095
Depreciation	804	775	738
Materials and other	852	800	802
Total railway operating expenses	7,577	6,847	6,850
Income from railway operations	3,084	2,585	2,557
Other income – net	110	93	149
Interest expense on debt	444	441	476
Income before income taxes	2,750	2,237	2,230
Provision for income taxes	1,034	773	749
Net income	$ 1,716	$ 1,464	$ 1,481
Per share amounts:			
Net income			

Basic	$	4.60	$	3.74	$	3.63
Diluted	$	4.52	$	3.68	$	3.57

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Balance Sheets

	As of December 31,	
	2008	**2007**
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$ 618	$ 206
Accounts receivable – net	870	942
Materials and supplies	194	176
Deferred income taxes	149	190
Other current assets	168	161
Total current assets	1,999	1,675
Investments	1,779	1,974
Properties less accumulated depreciation	22,247	21,583
Other assets	272	912
Total assets	$ 26,297	$ 26,144
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 1,140	$ 1,139
Income and other taxes	261	203
Other current liabilities	220	237
Current maturities of long-term debt	484	369
Total current liabilities	2,105	1,948
Long-term debt	6,183	5,999
Other liabilities	2,030	2,039

Deferred income taxes		6,372		6,431
Total liabilities		16,690		16,417
Stockholders' equity:				
Common stock $1.00 per share par value, 1,350,000,000 shares				
authorized; outstanding 366,233,106 and 379,297,891 shares,				
respectively, net of treasury shares		368		380
Additional paid-in capital		1,680		1,466
Accumulated other comprehensive loss		(942)		(399)
Retained income		8,501		8,280
Total stockholders' equity		9,607		9,727
Total liabilities and stockholders' equity	$	26,297	$	26,144

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	Years Ended December 31,		
	2008	**2007**	**2006**
	($ in millions)		
Cash flows from operating activities			
Net income	$ 1,716	$ 1,464	$ 1,481
Reconciliation of net income to net cash provided by operating activities:			
Depreciation	815	786	750
Deferred income taxes	290	125	(8)
Gains and losses on properties and investments	(29)	(51)	(54)
Changes in assets and liabilities affecting operations:			
Accounts receivable	269	30	(60)
Materials and supplies	(18)	(25)	(19)
Other current assets	(8)	(17)	(11)
Current liabilities other than debt	(262)	38	38
Other – net	(58)	(17)	89
Net cash provided by operating activities	2,715	2,333	2,206
Cash flows from investing activities			
Property additions	(1,558)	(1,341)	(1,178)
Property sales and other transactions	109	124	119
Investments, including short-term	(86)	(635)	(1,804)
Investment sales and other transactions	307	827	2,179
Net cash used in investing activities	(1,228)	(1,025)	(684)
Cash flows from financing activities			

Dividends		(456)		(377)		(278)
Common stock issued – net		229		183		297
Purchase and retirement of common stock		(1,128)		(1,196)		(964)
Proceeds from borrowings		1,425		250		--
Debt repayments		(1,145)		(489)		(339)
Net cash used in financing activities		(1,075)		(1,629)		(1,284)
Net increase (decrease) in cash and cash equivalents		412		(321)		238
Cash and cash equivalents						
At beginning of year		206		527		289
At end of year	$	618	$	206	$	527
Supplemental disclosure of cash flow information						
Cash paid during the year for:						
Interest (net of amounts capitalized)	$	421	$	441	$	473
Income taxes (net of refunds)	$	615	$	603	$	692

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Unearned Restricted Stock	Accum. Other Compre-hensive Loss	Retained Income	Total
	($ in millions, except per share amounts)					
Balance December 31, 2005	$ 411	$ 992	$ (17)	$ (77)	$ 7,967	$ 9,276
Comprehensive income						
Net income					1,481	1,481
Other comprehensive						
income				2		2
Total comprehensive						
income						1,483
Adoption of SFAS 158,						
net of tax				(294)		(294)
Dividends on Common						
Stock, $0.68 per share					(278)	(278)
Share repurchases	(22)	(63)			(879)	(964)
Stock-based compensation,						
including tax benefit of $85	9	372	17		(8)	390

Other		2				2
Balance December 31, 2006	$ 398	$ 1,303	$ --	$ (369)	$ 8,283	$ 9,615
Comprehensive income						
Net income					1,464	1,464
Other comprehensive						
loss				(30)		(30)
Total comprehensive						
income						1,434
Adoption of FIN 48,						
net of tax					10	10
Dividends on Common						
Stock, $0.96 per share					(377)	(377)
Share repurchases	(24)	(81)			(1,091)	(1,196)
Stock-based compensation,						
including tax benefit of $57	6	238			(9)	235
Other		6				6
Balance December 31, 2007	$ 380	$ 1,466	$ --	$ (399)	$ 8,280	$ 9,727
Net income					1,716	1,716
Other comprehensive						
loss				(543)		(543)
Total comprehensive						
income						1,173

Dividends on Common Stock, $1.22 per share					(456)	(456)
Share repurchases	(19)	(79)			(1,030)	(1,128)
Stock-based compensation, including tax benefit of $76	6	287			(9)	284
Other	1	6				7
Balance December 31, 2008	$ 368	$ 1,680	$ --	$ (942)	$ 8,501	$ 9,607

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Notes to Consolidated Financial Statements

The following Notes are an integral part of the Consolidated Financial Statements.

1. Summary of Significant Accounting Policies

Description of Business

Norfolk Southern Corporation is a Virginia-based holding company engaged principally in the rail transportation business, operating approximately 21,000 route miles primarily in the East and Midwest. These consolidated financial statements include Norfolk Southern Corporation (Norfolk Southern) and its majority-owned and controlled subsidiaries (collectively, NS). Norfolk Southern's major subsidiary is Norfolk Southern Railway Company (NSR). All significant intercompany balances and transactions have been eliminated in consolidation.

NSR and its railroad subsidiaries transport raw materials, intermediate products and finished goods classified in the following market groups (percent of total railway operating revenues in 2008): coal (29%); intermodal (19%); agriculture/consumer products/government (12%); metals/construction (12%); chemicals (12%); paper/clay/forest products (8%); and automotive (8%). Although most of NS' customers are domestic, ultimate points of origination or destination for some of the products transported (particularly coal bound for export and some intermodal containers) may be outside the United States. Approximately 85% of NS' railroad employees are covered by collective bargaining agreements with various labor unions.

Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management periodically reviews its estimates, including those related to the recoverability and useful lives of assets, as well as liabilities for litigation, environmental remediation, casualty claims, income taxes, and pension and other postretirement benefits. Changes in facts and circumstances may result in revised estimates.

Revenue Recognition

Transportation revenue is recognized proportionally as a shipment moves from origin to destination and related expenses are recognized as incurred. Refunds (which are primarily volume-based incentives) are recorded as a reduction to revenues on the basis of management's best estimate of projected liability, which is based on historical activity, current traffic counts and the expectation of future activity. NS regularly monitors its contract refund liability, and historically, the estimates have not differed significantly from the amounts ultimately refunded. Switching, demurrage and other incidental service revenues are recognized when the services are performed.

Derivatives

NS does not engage in the trading of derivatives. NS has used derivative financial instruments to reduce the risk of volatility in its diesel fuel costs and in the management of its mix of fixed and floating-rate debt. Management has determined that these derivative instruments qualify as either fair-value or cash-flow hedges, having values that highly correlate with the underlying hedged exposures, and has designated such instruments as hedging transactions. Income and expense related to the derivative financial instruments are recorded in the same category as generated by the underlying asset or liability. Credit risk related to the derivative financial instruments is considered to be minimal and is managed by requiring high credit standards for counterparties and periodic settlements (see Note 16).

Cash Equivalents

"Cash equivalents" are highly liquid investments purchased three months or less from maturity.

Allowance for Doubtful Accounts

NS' allowance for doubtful accounts was $5 million at December 31, 2008, and December 31, 2007. To determine its allowance for doubtful accounts, NS evaluates historical loss experience (which has not been significant), the characteristics of current accounts, as well as general economic conditions and trends.

Materials and Supplies

"Materials and supplies," consisting mainly of fuel oil and items for maintenance of property and equipment, are stated at the lower of average cost or market. The cost of materials and supplies expected to be used in capital additions or improvements is included in "Properties."

Investments

Debt securities classified as "held-to-maturity" are reported at amortized cost and marketable equity and debt securities classified as "trading" or "available-for-sale" are recorded at fair value. Unrealized after-tax gains and losses for investments designated as "available-for-sale," are recognized in "Accumulated other comprehensive loss."

Investments where NS has the ability to exercise significant influence over but does not control the entity are accounted for using the equity method in accordance with APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock."

Properties

“Properties” are stated principally at cost and are depreciated using group depreciation. Rail is depreciated primarily on the basis of use measured by gross ton-miles. Other properties are depreciated generally using the straight-line method over the lesser of estimated service or lease lives. Depletion of natural resources (see Note 2) is based on units of production. Depreciation in the Consolidated Statements of Cash Flows includes depreciation and depletion. NS capitalizes interest on major capital projects during the period of their construction. Expenditures, including those on leased assets that extend an asset’s useful life or increase its utility, are capitalized. Expenditures capitalized include those that are directly related to a capital project and may include materials, labor, and equipment, in addition to an allocable portion of indirect costs that clearly relate to a particular project. Costs related to repairs and maintenance activities that do not extend an asset’s useful life or increase its utility are expensed when such repairs are performed. When properties other than land and nonrail assets are sold or retired in the ordinary course of business, the cost of the assets, net of sale proceeds or salvage, is charged to accumulated depreciation, and no gain or loss is recognized through income. Gains and losses on disposal of land and nonrail assets are included in “Other income - net” (see Note 2) since such income is not a product of NS’ railroad operations.

NS reviews the carrying amount of properties whenever events or changes in circumstances indicate that such carrying amount may not be recoverable based on future undiscounted cash flows. Assets that are deemed impaired as a result of such review are recorded at the lower of carrying amount or fair value.

Required Accounting Changes

Effective January 1, 2008, NS adopted the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 157, “Fair Value Measurements,” related to financial instrument assets and liabilities with no effect on NS’ consolidated financial statements. This statement, effective for interim or annual reporting periods beginning after November 15, 2007, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements.

Effective January 1, 2007, NS adopted Financial Accounting Standards Board Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes,” which clarifies accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109, “Accounting for Income Taxes.” FIN 48 prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. Under the guidelines of FIN 48, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination (see Note 3).

Effective December 31, 2006, NS adopted SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” (SFAS 158) (see Note 10).

Effective January 1, 2006, NS adopted SFAS No. 123(R), “Share-Based Payment,” [SFAS 123(R)]. This statement applies to awards granted, modified, repurchased or cancelled after the effective date as well as awards that are unvested at the effective date and includes, among other things, the requirement to expense the fair value of stock options. The standard also requires that awards to be settled in cash be measured at fair value at each reporting date until ultimate settlement. NS adopted SFAS 123(R) using the modified prospective method, which requires application of the standard to all awards granted, modified, repurchased or cancelled on or after January 1, 2006, and to all awards for which the requisite service has not been rendered as of such date. In accordance with the modified prospective approach, prior period financial statements have not been restated to reflect the impact of SFAS 123(R). Under SFAS 123(R), all new awards granted to retirement eligible employees must be expensed immediately. Under APB Opinion No. 25 and related interpretations, such awards were amortized over the stated service period.

In June 2008, the FASB issued FASB Staff Position (FSP) Emerging Issues Task Force (EITF) 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities.” This FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method as described in SFAS No. 128, “Earnings per Share.” NS will adopt the FSP, which affects the calculation of earnings per share, in the first quarter of 2009. The provisions of the FSP are to be applied retrospectively. NS expects that it will not have a material effect on NS’ consolidated financial statements.

2. Other Income - Net

	2008	2007	2006
		($ in millions)	
Income from natural resources:			
Royalties from coal	$ 64	$ 52	$ 55
Nonoperating depletion and depreciation	(11)	(11)	(12)
Subtotal	53	41	43
Rental income	47	46	45
Gains and losses from sale of properties and investments	29	51	54
Equity in earnings of Conrail (Note 4)	29	45	25
Interest income	20	45	76
Other interest expense – net	2	(25)	(15)
Expenses related to synthetic fuel investments	--	(77)	(62)
Corporate-owned life insurance – net	(31)	7	22
Taxes on nonoperating property	(10)	(10)	(9)
Other	(29)	(30)	(30)
Total	$ 110	$ 93	$ 149

"Other income – net" includes income and costs not part of rail operations and the income generated by the activities of NS' noncarrier subsidiaries as well as the costs incurred by those subsidiaries in their operations. NS had a 40.5% interest in a limited liability company that owned and operated facilities that produced synthetic fuel from coal. In addition, in 2007 NS purchased two facilities that produced synthetic fuel from coal. The production of synthetic fuel resulted in tax credits as well as expenses related to the investments. The expenses are included in "Expenses related to synthetic fuel investments" above. The tax credits related to the synthetic fuel investments expired at the end of 2007 and are no longer available.

3. Income Taxes

Provision for Income Taxes

	2008	2007	2006
		($ in millions)	
Current:			
Federal	$ 657	$ 570	$ 666
State	87	78	91
Total current taxes	744	648	757
Deferred:			
Federal	257	77	3
State	33	48	(11)
Total deferred taxes	290	125	(8)
Provision for income taxes	$ 1,034	$ 773	$ 749

Reconciliation of Statutory Rate to Effective Rate

The “Provision for income taxes” in the Consolidated Statements of Income differs from the amounts computed by applying the statutory federal corporate tax rate as follows:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
			($ in millions)			
Federal income tax at statutory rate	$ 963	35	$ 783	35	$ 780	35
State income taxes, net of Federal tax effect	77	3	63	3	52	2
Illinois tax law change, net of Federal tax effect	1	--	19	1	--	--
Tax credits	(2)	--	(65)	(3)	(62)	(3)
Other – net	(5)	--	(27)	(1)	(21)	--
Provision for income taxes	$ 1,034	38	$ 773	35	$ 749	34

Illinois enacted tax legislation in August 2007, revised in January 2008, that modified the way transportation companies apportion their taxable income to the state. The change resulted in an increase in NS’ deferred income tax liability in the third quarter of 2007, as required by SFAS No. 109, “Accounting for Income Taxes,” which increased deferred tax expense by $1 million in 2008 and $19 million in 2007.

Deferred Tax Assets and Liabilities

Certain items are reported in different periods for financial reporting and income tax purposes. Deferred tax assets and liabilities are recorded in recognition of these differences. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	December 31,	
	2008	**2007**
	($ in millions)	
Deferred tax assets:		
Compensation and benefits, including postretirement	$ 728	$ 417
Accruals, including casualty and other claims	218	219
Other	45	49
Total gross deferred tax assets	991	685
Less valuation allowance	(11)	(10)
Net deferred tax asset	980	675
Deferred tax liabilities:		
Property	(6,957)	(6,683)
Other	(246)	(233)
Total gross deferred tax liabilities	(7,203)	(6,916)
Net deferred tax liability	(6,223)	(6,241)
Net current deferred tax asset	149	190
Net long-term deferred tax liability	$ (6,372)	$ (6,431)

Except for amounts for which a valuation allowance has been provided, management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets. The valuation allowance at the end of each year relates to subsidiary state income tax net operating losses that may not be utilized prior to their expiration. The total valuation allowance increased $1 million in 2008 and 2007, and decreased $1 million in 2006.

Uncertain Tax Positions

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows ($ in millions):