NORFOLK SOUTHERN CORP
Form 10-Q
October 22, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended SEPTEMBER 30, 2014

( ) 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 (State or other jurisdiction of incorporation)	52-1188014 (IRS Employer Identification No.)
Three Commercial Place Norfolk, Virginia (Address of principal executive offices)	23510-2191 (Zip Code)

(757) 629-2680
(Registrant's telephone number, including area code)
No Change
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [X] No [ ]

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

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

Class	Outstanding at September 30, 2014
Common Stock ($1.00 par value per share)	309,441,867 (excluding 20,320,777 shares held by the registrant’s consolidated subsidiaries)

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NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES (NS)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Income
(Unaudited)

	Third Quarter		First Nine Months	
	2014	2013	2014	2013
	($ in millions, except per share amounts)			
Railway operating revenues	$3,023	$2,824	$8,754	$8,364
Railway operating expenses:				
Compensation and benefits	728	735	2,183	2,241
Purchased services and rents	429	420	1,235	1,223
Fuel	387	390	1,227	1,210
Depreciation	236	230	711	683
Materials and other	245	200	714	631
Total railway operating expenses	2,025	1,975	6,070	5,988
Income from railway operations	998	849	2,684	2,376
Other income – net	32	30	76	194
Interest expense on debt	138	131	416	388
Income before income taxes	892	748	2,344	2,182
Provision for income taxes	333	266	855	785
Net income	$559	$482	$1,489	$1,397
Per share amounts:				
Net income				
Basic	$1.80	$1.55	$4.80	$4.45
Diluted	1.79	1.53	4.75	4.40
Dividends	0.57	0.52	1.65	1.52

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
(Unaudited)

	Third Quarter		First Nine Months	
	2014	2013	2014	2013
	($ in millions)			
Net income	$559	$482	$1,489	$1,397
Other comprehensive income, before tax:				
Pension and other postretirement benefits	8	38	314	110
Other comprehensive income of equity investees	—	—	10	2
Other comprehensive income, before tax	8	38	324	112
Income tax expense related to items of other comprehensive income	(3)	(15)	(121)	(43)
Other comprehensive income, net of tax	5	23	203	69
Total comprehensive income	$564	$505	$1,692	$1,466

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Balance Sheets
(Unaudited)

	September 30, 2014	December 31, 2013
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$1,432	$1,443
Short-term investments	—	118
Accounts receivable – net	1,103	1,024
Materials and supplies	249	223
Deferred income taxes	178	180
Other current assets	50	87
Total current assets	3,012	3,075
Investments	2,610	2,439
Properties less accumulated depreciation of $10,740 and $10,387, respectively	27,230	26,645
Other assets	354	324
Total assets	$33,206	$32,483
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$1,387	$1,265
Short-term debt	—	100
Income and other taxes	301	225
Other current liabilities	392	270
Current maturities of long-term debt	2	445
Total current liabilities	2,082	2,305
Long-term debt	8,919	8,903
Other liabilities	1,084	1,444
Deferred income taxes	8,682	8,542
Total liabilities	20,767	21,194
Stockholders' equity:		
Common stock $1.00 per share par value, 1,350,000,000 shares authorized; outstanding 309,441,867 and 308,878,402 shares, respectively, net of treasury shares	311	310
Additional paid-in capital	2,150	2,021
Accumulated other comprehensive loss	(178)	(381)
Retained income	10,156	9,339

Total stockholders’ equity	12,439	11,289
Total liabilities and stockholders’ equity	$33,206	$32,483

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	First Nine Months	
	2014	2013
	($ in millions)	
Cash flows from operating activities:		
Net income	$1,489	$1,397
Reconciliation of net income to net cash provided by operating activities:		
Depreciation	715	687
Deferred income taxes	21	215
Gains and losses on properties and investments	(13)	(100)
Changes in assets and liabilities affecting operations:		
Accounts receivable	(79)	26
Materials and supplies	(26)	(8)
Other current assets	47	48
Current liabilities other than debt	258	121
Other – net	(66)	18
Net cash provided by operating activities	2,346	2,404
Cash flows from investing activities:		
Property additions	(1,379)	(1,470)
Property sales and other transactions	69	109
Investments, including short-term	(4)	(29)
Investment sales and other transactions	60	21
Net cash used in investing activities	(1,254)	(1,369)
Cash flows from financing activities:		
Dividends	(511)	(476)
Common stock issued – net	119	92
Purchase and retirement of common stock	(166)	(564)
Proceeds from borrowings – net	100	492
Debt repayments	(645)	(248)
Net cash used in financing activities	(1,103)	(704)
Net increase (decrease) in cash and cash equivalents	(11)	331
Cash and cash equivalents:		
At beginning of period	1,443	653
At end of period	$1,432	$984
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest (net of amounts capitalized)	$340	$305

Income taxes (net of refunds)	733	485

See accompanying notes to consolidated financial statements.

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Norfolk Southern Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly Norfolk Southern Corporation (Norfolk Southern) and subsidiaries' (collectively, NS, we, us, and our) financial condition at September 30, 2014, and December 31, 2013, our results of operations and comprehensive income for the third quarters and first nine months of 2014 and 2013, and our cash flows for the first nine months of 2014 and 2013 in conformity with U.S. generally accepted accounting principles (GAAP).

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our latest Annual Report on Form 10-K.

1. Stock-Based Compensation

During the first quarter of 2014, a committee of non-employee directors of our Board of Directors granted stock options, restricted stock units (RSUs) and performance share units (PSUs) pursuant to the Long-Term Incentive Plan (LTIP) and granted stock options pursuant to the Thoroughbred Stock Option Plan (TSOP) as discussed below. Stock-based compensation expense was $6 million and $4 million during the third quarters of 2014 and 2013, respectively. For the first nine months of 2014 and 2013, stock-based compensation expense was $48 million and $47 million, respectively. The total tax effects recognized in income in relation to stock-based compensation were net benefits of $2 million for the third quarters of both 2014 and 2013, and net benefits of $16 million for the first nine months of both 2014 and 2013, respectively.

Stock Options

In the first quarter of 2014, 515,240 options were granted under LTIP and 181,070 options were granted under TSOP. In each case, the grant price was $94.17, which was the greater of the average fair market value of Norfolk Southern common stock (Common Stock) or the closing price of Common Stock on the effective date of the grant, and the options have a term of 10 years. The options granted under LTIP and TSOP in 2014 may not be exercised prior to the fourth and third anniversaries of the date of grant, respectively. Holders of the 2014 options granted under LTIP who remain actively employed receive cash dividend equivalent payments for four years in an amount equal to the regular quarterly dividends paid on Common Stock. Dividend equivalent payments are not made on TSOP options.

The fair value of each option award in 2014 was measured on the date of grant using a lattice-based option valuation model. Expected volatilities are based on implied volatilities from traded options on, and historical volatility of, Common Stock. Historical data is used to estimate option exercises and employee terminations within the valuation model. The average expected option life is derived from the output of the valuation model and represents the period of time that all options granted are expected to be outstanding, including the branches of the model that result in options expiring unexercised. The average risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. For options granted that include dividend equivalent payments, a dividend yield of zero was used. A dividend yield of 2.29% was used for LTIP options for periods where no dividend equivalent payments are made as well as for TSOP options, which do not receive dividend equivalents.

The assumptions for the 2014 LTIP and TSOP grants are shown in the following table:

Expected volatility range	23% - 27%
Average expected volatility	25%
Average risk-free interest rate	2.79%
Average expected option term LTIP	8.9 years
Per-share grant-date fair value LTIP	$29.87
Average expected option term TSOP	8.8 years
Per-share grant-date fair value TSOP	$24.38

For the third quarter of 2014, options relating to 577,456 shares were exercised, yielding $28 million of cash proceeds and $9 million of tax benefit recognized as additional paid-in capital. For the third quarter of 2013, options relating to 207,233 shares were exercised, yielding $9 million of cash proceeds and $2 million of tax benefit recognized as additional paid-in capital.

For the first nine months of 2014, options relating to 1,811,527 shares were exercised, yielding $84 million of cash proceeds and $24 million of tax benefit recognized as additional paid-in capital. For the first nine months of 2013, options relating to 1,778,733 shares were exercised, yielding $62 million of cash proceeds and $22 million of tax benefit recognized as additional paid-in capital.

Restricted Stock Units

During the first quarter of 2014, there were 113,505 RSUs granted with a grant-date fair value of $94.17 and a five-year restriction period that will be settled through the issuance of shares of Common Stock. The RSU grants include cash dividend equivalent payments during the restriction period commensurate with regular quarterly dividends paid on Common Stock.

During the third quarter of 2014, 1,000 of the RSUs granted in 2009 vested, with 520 shares of Common Stock issued net of withholding taxes. No RSUs were earned or paid out in the third quarter of 2013. During the first nine months of 2014, 319,150 of the RSUs granted in 2009 vested, with 187,969 shares of Common Stock issued net of withholding taxes. For the first nine months of 2013, 298,400 of the RSUs granted in 2008 vested, with 178,250 shares of Common Stock issued net of withholding taxes. The total related tax benefits recognized as additional paid-in capital were less than $1 million and $1 million for the third quarters of 2014 and 2013, respectively, and $6 million and $3 million for the first nine months of 2014 and 2013, respectively.

Performance Share Units

PSUs provide for awards based on achievement of certain predetermined corporate performance goals at the end of a three-year cycle and are paid in the form of shares of Common Stock. During the first quarter of 2014, there were 399,530 PSUs granted. PSUs will earn out based on the achievement of a return on average invested capital target (a performance condition) and a total shareholder return target (a market condition). The grant-date fair values of the PSUs associated with the performance and market conditions were $94.17 and $50.31, respectively, with the market condition fair value measured on the date of grant using a Monte Carlo simulation model.

No PSUs were earned or paid out in the third quarters of 2014 and 2013. During the first nine months of 2014, 374,099 of the PSUs granted in 2011 were earned, with 223,253 shares of Common Stock issued net of withholding taxes. For the first nine months of 2013, 577,585 of the PSUs granted in 2010 were earned, with 348,189 shares of Common Stock issued net of withholding taxes. The total related tax benefits recognized as additional paid-in capital were $5 million for the first nine months of both 2014 and 2013.

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2. Income Taxes

There have been no material changes to the balance of unrecognized tax benefits reported at December 31, 2013. IRS examinations have been completed for all years prior to 2011. Our consolidated federal income tax returns for 2011 and 2012 are currently being audited by the IRS.

3. Earnings Per Share

	Basic		Diluted	
	Third Quarter			
	2014	2013	2014	2013
	($ in millions, except per share amounts, shares in millions)			
Net income	$559	$482	$559	$482
Dividend equivalent payments	(1)	(2)	(1)	(1)
Income available to common stockholders	$558	$480	$558	$481
Weighted-average shares outstanding	309.4	310.4	309.4	310.4
Dilutive effect of outstanding options and share-settled awards			3.2	3.5
Adjusted weighted-average shares outstanding			312.6	313.9
Earnings per share	$1.80	$1.55	$1.79	$1.53

	Basic		Diluted	
	First Nine Months			
	2014	2013	2014	2013
	($ in millions, except per share amounts, shares in millions)			
Net income	$1,489	$1,397	$1,489	$1,397
Dividend equivalent payments	(5)	(5)	(3)	(3)
Income available to common stockholders	$1,484	$1,392	$1,486	$1,394
Weighted-average shares outstanding	309.5	313.0	309.5	313.0
Dilutive effect of outstanding options and share-settled awards			3.2	3.6
Adjusted weighted-average shares outstanding			312.7	316.6
Earnings per share	$4.80	$4.45	$4.75	$4.40

During the third quarters and first nine months of 2014 and 2013, dividend equivalent payments were made to holders of stock options and RSUs. For purposes of computing basic earnings per share, dividend equivalent payments made to holders of stock options and RSUs were deducted from net income to determine income available to common stockholders. For purposes of computing diluted earnings per share, we evaluate on a grant-by-grant basis those stock options and RSUs receiving dividend equivalent payments under the two-class and treasury stock

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methods to determine which method is the more dilutive for each grant. For those grants for which the two-class method was more dilutive, net income was reduced by dividend equivalent payments to determine income available to common stockholders. The dilution calculations exclude options having exercise prices exceeding the average market price of Common Stock as follows: 0.7 million and 0.8 million in the first quarters of 2014 and 2013, respectively, and zero for the second and third quarters of both 2014 and 2013.

4. Stockholders' Equity

Common Stock

Common Stock is reported net of shares held by our consolidated subsidiaries (Treasury Shares). Treasury Shares at September 30, 2014, and December 31, 2013, amounted to 20,320,777 shares, with a cost of $19 million at both dates.

Accumulated Other Comprehensive Loss

Changes in the components of other comprehensive income reported in the Consolidated Statements of Comprehensive Income and the cumulative balances of "Accumulated other comprehensive loss" reported in the Consolidated Balance Sheets consisted of the following:

	Pensions and Other Postretirement Benefits	Accumulated Other Comprehensive Loss of Equity Investees	Accumulated Other Comprehensive Loss
	($ in millions)		
Third Quarter			
June 30, 2014	$(121)	$(62)	$(183)
Other comprehensive income:			
Amounts reclassified into net income	8 (1)	—	8
Tax expense	(3)	—	(3)
Other comprehensive income	5	—	5
September 30, 2014	$(116)	$(62)	$(178)

	Pensions and Other Postretirement Benefits	Accumulated Other Comprehensive Loss of Equity Investees	Accumulated Other Comprehensive Loss
	($ in millions)		
Third Quarter			
June 30, 2013	$(955)	$(108)	$(1,063)
Other comprehensive income:			
Amounts reclassified into net income	38 (1)	—	38
Tax expense	(15)	—	(15)
Other comprehensive income	23	—	23
September 30, 2013	$(932)	$(108)	$(1,040)

	Pensions and Other Postretirement Benefits		Accumulated Other Comprehensive Loss of Equity Investees	Accumulated Other Comprehensive Loss
	($ in millions)			
First Nine Months				
December 31, 2013	$(310)		$(71)	$(381)
Other comprehensive income:				
Prior service benefit	367		—	367
Amounts reclassified into net income	27	(1)	—	27
Net gain (loss)	(80)		10	(70)
Tax expense	(120)		(1)	(121)
Other comprehensive income	194		9	203
September 30, 2014	$(116)		$(62)	$(178)

	Pensions and Other Postretirement Benefits		Accumulated Other Comprehensive Loss of Equity Investees	Accumulated Other Comprehensive Loss
	($ in millions)			
First Nine Months				
December 31, 2012	$(999)		$(110)	$(1,109)
Other comprehensive income:				
Amounts reclassified into net income	110	(1)	—	110
Net gain	—		2	2
Tax expense	(43)		—	(43)
Other comprehensive income	67		2	69
September 30, 2013	$(932)		$(108)	$(1,040)

(1) These items are included in the computation of net periodic pension and postretirement benefit costs. See Note 7, "Pensions and Other Postretirement Benefits" for additional information.

5. Stock Repurchase Program

We repurchased and retired 1.7 million and 7.5 million shares of Common Stock in each of the first nine months of 2014 and 2013, respectively, at a cost of $166 million and $564 million, respectively. The timing and volume of purchases is guided by our assessment of market conditions and other pertinent factors. Any near-term share repurchases are expected to be made with internally generated cash, cash on hand, or proceeds from borrowings. Since the beginning of 2006, we have repurchased and retired 138.4 million shares at a total cost of $8.3 billion.

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6. Investment in Conrail

Through a limited liability company, we and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). We have a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. Our investment in Conrail was $1.1 billion at both September 30, 2014 and December 31, 2013.

CRC owns and operates certain properties (the Shared Assets Areas) for the joint and exclusive benefit of Norfolk Southern Railway Company (NSR) and CSX Transportation, Inc. (CSXT). The costs of operating the Shared Assets Areas are borne by NSR and CSXT based on usage. In addition, NSR and CSXT pay CRC a fee for access to the Shared Assets Areas. “Purchased services and rents” and “Fuel” include expenses for the use of the Shared Assets Areas totaling $38 million and $42 million for the third quarters of 2014 and 2013, respectively, and $106 million and $115 million for the first nine months of 2014 and 2013, respectively. Our equity in the earnings of Conrail, net of amortization, included in “Purchased services and rents” was $9 million and $25 million for the third quarter and the first nine months of 2014, respectively. For the third quarter and first nine months of 2013, this amounted to $9 million and $27 million, respectively, and was included in “Other income – net.”

“Accounts payable” includes $206 million at September 30, 2014, and $187 million at December 31, 2013, due to Conrail for the operation of the Shared Assets Areas. In addition, “Other liabilities” includes $133 million at both September 30, 2014, and December 31, 2013, for long-term advances from Conrail, maturing 2035, that bear interest at an average rate of 4.4%.

7. Pensions and Other Postretirement Benefits

We have both funded and unfunded defined benefit pension plans covering principally salaried employees. We also provide specific health care and life insurance benefits to eligible retired employees; these plans can be amended or terminated at our option. Under our self-insured retiree health care plan, a defined percentage of health care expenses is covered for retired employees and their dependents, reduced by any deductibles, coinsurance, and, in some cases, coverage provided under other group insurance policies.

	Pension Benefits		Other Postretirement Benefits	
	Third Quarter			
	2014	2013	2014	2013
	($ in millions)			
Service cost	$8	$11	$2	$4
Interest cost	23	20	6	12
Expected return on plan assets	(37)	(35)	(5)	(4)
Amortization of net losses	14	22	—	16
Amortization of prior service benefit	—	—	(6)	—
Net cost (benefit)	$8	$18	$(3)	$28

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	Pension Benefits		Other Postretirement Benefits	
	First Nine Months			
	2014	2013	2014	2013
	($ in millions)			
Service cost	$25	$31	$6	$12
Interest cost	70	61	19	37
Expected return on plan assets	(113)	(106)	(14)	(12)
Amortization of net losses	41	66	—	44
Amortization of prior service benefit	—	—	(14)	—
Net cost (benefit)	$23	$52	$(3)	$81

In the first quarter of 2014, we amended our retiree medical plan for participants who are Medicare eligible resulting in a remeasurement of our plan assets and obligations. Effective July 1, 2014, participants who are Medicare-eligible are not covered under the self-insured retiree health care plan but instead are provided with an employer-funded health reimbursement account which can be used for reimbursement of health insurance premiums or eligible out-of-pocket medical expenses. As required, the discount rate assumption was revised as a result of the remeasurement to 3.90% from 4.65% at December 31, 2013, and there were no significant changes to the expected return on plan assets, asset mix, mortality rates, or health care trend rates. The prior service benefit associated with the plan amendment was $367 million and the actuarial losses associated with the change in discount rate were $80 million, resulting in a decrease in the benefit obligation of $287 million. The estimated prior service benefit for the other postretirement benefit plans that will be amortized from accumulated other comprehensive loss into net periodic cost during the remainder of the year is $6 million.

For the remainder of 2014, we expect to contribute approximately $13 million to our other postretirement benefit plans for retiree health and life insurance benefits. Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

	Other Postretirement Benefits ($ in millions)
Remainder of 2014	$13
2015	47
2016	46
2017	45
2018	44
Years 2019 - 2023	201

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8. Fair Value

Fair Value Measurements

The Financial Accounting Standards Board (FASB) Accounting Standards Codifications (ASC) 820-10, “Fair Value Measurements,” established a framework for measuring fair value and a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as follows:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that we have the ability to access.

Level 2 Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset’s or liability’s fair value measurement level is based on the lowest level of any input that is significant to the fair value measurement. Other than those assets and liabilities described below that approximate fair value, there were no assets or liabilities measured at fair value on a recurring basis at September 30, 2014 or December 31, 2013.

Fair Values of Financial Instruments

We have evaluated the fair values of financial instruments and methods used to determine those fair values. The fair values of “Cash and cash equivalents,” “Short-term investments,” “Accounts receivable,” “Accounts payable,” and “Short-term debt” approximate carrying values because of the short maturity of these financial instruments. The carrying value of corporate-owned life insurance is recorded at cash surrender value and, accordingly, approximates fair value. The carrying amounts and estimated fair values for the remaining financial instruments, excluding investments accounted for under the equity method, consisted of the following:

	September 30, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	($ in millions)			
Long-term investments	$162	$193	$148	$177
Long-term debt, including current maturities	(8,921)	(10,718)	(9,348)	(10,673)

Underlying net assets were used to estimate the fair value of investments with the exception of notes receivable, which are based on future discounted cash flows. The fair values of long-term debt were estimated based on quoted market prices or discounted cash flows using current interest rates for debt with similar terms, company rating, and remaining maturity.

The following table sets forth the fair value of long-term investment and long-term debt balances disclosed above by valuation technique level, within the fair value hierarchy (there were no level 3 valued assets or liabilities).

	Level 1	Level 2	Total
	($ in millions)		
September 30, 2014			
Long-term investments	$50	$143	$193
Long-term debt, including current maturities	(10,507)	(211)	(10,718)
December 31, 2013			
Long-term investments	$47	$130	$177
Long-term debt, including current maturities	(10,449)	(224)	(10,673)

9. Commitments and Contingencies

Lawsuits

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

Two of our customers, DuPont and Sunbelt Chlor Alkai Partnership (Sunbelt), filed rate reasonableness complaints before the Surface Transportation Board (STB) alleging that our tariff rates for transportation of regulated movements are unreasonable. Since June 1, 2009, in the case of DuPont, and April 1, 2011, in the case of Sunbelt, we have been billing and collecting amounts based on the challenged tariff rates. On March 14, 2014, the STB resolved DuPont's rate reasonableness complaint in our favor, and on June 20, 2014, the STB resolved Sunbelt's rate case in our favor. The STB's findings in both cases remain subject to technical corrections, requests for reconsideration, and appeal. We believe the estimate of any reasonably possible loss will not have a material effect on our financial position, results of operations, or liquidity. With regard to rate cases, we record adjustments to revenues in the periods if and when such adjustments are probable and estimable.

On November 6, 2007, various antitrust class actions filed against us and other Class I railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. On June 21, 2012, the court certified the case as a class action. The defendant railroads appealed this certification, and the Court of Appeals for the District of Columbia vacated the District Court's decision and remanded the case for further consideration. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases. We do not believe the outcome of these proceedings will have a material effect on our financial position, results of operations, or liquidity. A lawsuit containing similar allegations against us 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, and most recently extended in August 2013.

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Casualty Claims

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

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

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

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

Environmental Matters

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

Our Consolidated Balance Sheets include liabilities for environmental exposures of $66 million at September 30, 2014, and $58 million at December 31, 2013 (of which $15 million is classified as a current liability at the end of each period). At September 30, 2014, the liability represents our estimate of the probable cleanup, investigation, and remediation costs based on available information at 147 known locations and projects compared with 142 locations and projects at December 31, 2013. At September 30, 2014, 14 sites accounted for $38 million of the liability, and no individual site was considered to be material. We anticipate that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 12 locations, one or more of our subsidiaries in conjunction with a number of other parties have been identified as potentially responsible parties under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes that impose joint and several liability for cleanup costs. We calculate our estimated liability for these sites based on facts and legal defenses applicable to each site and not solely on the basis of the potential for joint liability.

With respect to known environmental sites (whether identified by us or by the Environmental Protection Agency (EPA) or comparable state authorities), estimates of our ultimate potential financial exposure for a given site or in the aggregate for all such sites can change over time because of the widely varying costs of currently available cleanup techniques, unpredictable contaminant recovery and reduction rates associated with available cleanup technologies, the likely development of new cleanup technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it), and evolving statutory and regulatory standards governing liability.

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

Based on our assessment of the facts and circumstances now known, we believe we have recorded the probable and reasonably estimable costs for dealing with those environmental matters of which we are aware. Further, we believe that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on our financial position, results of operations, or liquidity.

Insurance

We obtain on behalf of ourself and our subsidiaries insurance for potential losses for third-party liability and first-party property damages. We are currently self-insured up to $50 million and above $1.0 billion per occurrence and/o

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r policy year for bodily injury and property damage to third parties and up to $25 million and above $200 million per occurrence and/or policy year for property owned by us or in our care, custody, or control.

Purchase Commitments

At September 30, 2014, we had outstanding purchase commitments totaling approximately $1.2 billion for locomotives, freight cars and containers, track material, and track and yard expansion projects in connection with our capital programs as well as long-term service contracts through 2018.

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
Norfolk Southern Corporation:

We have reviewed the accompanying consolidated balance sheet of Norfolk Southern Corporation and subsidiaries as of September 30, 2014, the related consolidated statements of income and comprehensive income for the three-month and nine-month periods ended September 30, 2014 and 2013 and the related consolidated statements of cash flows for the nine-month periods ended September 30, 2014 and 2013. These consolidated financial statements are the responsibility of the Company's management.

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

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

/s/ KPMG LLP
KPMG LLP
Norfolk, Virginia
October 22, 2014

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

Norfolk Southern Corporation and Subsidiaries

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

OVERVIEW

We are one of the nation's premier transportation companies. Our Norfolk Southern Railway Company subsidiary operates approximately 20,000 miles of road in 22 states and the District of Columbia, serves every major container port in the eastern United States, and provides efficient connections to other rail carriers. We operate the most extensive intermodal network in the East and are a major transporter of coal, automotive, and industrial products.

Our third quarter results reflect a continuation of trends seen in the second quarter as demand for rail service remained high. The higher-than-expected volumes led to a deterioration in our network fluidity. As we continue to bring additional employee and equipment resources on line we expect network performance to improve. Strength in our intermodal and chemical volumes drove revenue growth of 7% and our continued focus on cost control resulted in an increase of only 3% in operating expenses for the quarter. Our net income for the third quarter was $559 million, or $1.79 per diluted share (up $77 million, or $0.26 per diluted share), and our operating ratio improved 2.9 percentage points to 67.0%. All three of these metrics represent third quarter records for our company.

Cash provided by operating activities for the first nine months of 2014 totaled $2.3 billion, which along with cash on hand allowed for property additions, debt repayments, dividends, and share repurchases. In the first nine months of 2014, we repurchased 1.7 million shares of Norfolk Southern common stock (Common Stock) at a total cost of $166 million. Since inception of our stock repurchase program in 2006, we have repurchased and retired 138.4 million shares of Common Stock at a total cost of $8.3 billion. At September 30, 2014, cash and cash equivalents totaled $1.4 billion.

SUMMARIZED RESULTS OF OPERATIONS

Third quarter 2014 net income was $559 million, up 16% compared with the same period last year. The increase in net income for the quarter reflected higher income from railway operations, up $149 million, or 18%, primarily due to a $199 million, or 7%, improvement in railway operating revenues as a result of an 8% rise in volumes. The railway operating ratio (a measure of the amount of operating revenues consumed by operating expenses) improved to 67.0% for the third quarter of 2014, compared with 69.9% for the third quarter of 2013.

For the first nine months of 2014 net income was $1.5 billion, up $92 million, or 7%, compared with the same period last year. Prior year results included a gain from a land sale in Michigan, which benefited net income by $60 million and earnings per share by $0.19. Current year results were favorably impacted by higher income from railway operations (up $308 million, or 13%).

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Third-quarter railway operating revenues were $3.0 billion in 2014, up $199 million, or 7%, compared with the third quarter of 2013. For the first nine months of 2014, railway operating revenues were $8.8 billion, up $390 million, or 5%, compared with the same period last year. As shown in the following table, the increases resulted from higher volumes that were partially offset by lower average revenue per unit (which includes the effects of fuel surcharges). Fuel surcharge revenue for the third quarters of 2014 and 2013 totaled $368 million and $321 million, respectively, and $1.0 billion and $901 million for the first nine months of 2014 and 2013, respectively.

	Third Quarter 2014 vs. 2013	First Nine Months 2014 vs. 2013
	Increase (Decrease) ($ in millions)	
Volume (units)	$219	$409
Revenue per unit	(20)	(19)
Total	$199	$390

Many of our negotiated fuel surcharges for coal and industrial products shipments 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 applying WTI Average Price increased fuel surcharge revenue by approximately $34 million for the quarter and $6 million for the first nine months of 2014. This two-month lag decreased fuel surcharge revenue by approximately $41 million for the third quarter of 2013 and $68 million the first nine months of 2013.

Two of our customers, DuPont and Sunbelt Chlor Alkai Partnership (Sunbelt), filed rate reasonableness complaints before the Surface Transportation Board (STB) alleging that our tariff rates for transportation of regulated movements are unreasonable. Since June 1, 2009, in the case of DuPont, and April 1, 2011, in the case of Sunbelt, we have been billing and collecting amounts based on the challenged tariff rates. On March 14, 2014, the STB resolved DuPont's rate reasonableness complaint in our favor, and on June 20, 2014, the STB resolved Sunbelt's rate case in our favor. The STB's findings in both cases remain subject to technical corrections, requests for reconsideration, and appeal. We believe the estimate of any reasonably possible loss will not have a material effect on our financial position, results of operations, or liquidity. With regard to rate cases, we record adjustments to revenues in the periods if and when such adjustments are probable and estimable.

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

	Third Quarter Revenues		Units		Revenue per Unit	
	2014	2013	2014	2013	2014	2013
	($ in millions)		(in thousands)		($ per unit)	
Coal	$626	$641	332.1	339.9	$1,885	$1,885
General merchandise:						
Chemicals	488	429	132.0	113.1	3,697	3,787
Agriculture/consumer/gov't	364	346	146.1	138.0	2,491	2,504
Metals and construction	414	372	202.1	180.5	2,050	2,060
Automotive	254	227	104.6	93.3	2,429	2,441
Paper/clay/forest	210	204	79.4	79.4	2,636	2,575
General merchandise	1,730	1,578	664.2	604.3	2,604	2,611
Intermodal	667	605	1,004.7	912.9	664	663
Total	$3,023	$2,824	2,001.0	1,857.1	1,511	1,521

	First Nine Months Revenues		Units		Revenue per Unit	
	2014	2013	2014	2013	2014	2013
	($ in millions)		(in thousands)		($ per unit)	
Coal	$1,839	$1,902	982.3	1,024.5	$1,872	$1,856
General merchandise:						
Chemicals	1,386	1,238	369.9	333.1	3,746	3,716
Agriculture/consumer/gov't	1,111	1,073	448.8	433.8	2,476	2,473
Metals and construction	1,155	1,058	545.6	506.4	2,117	2,089
Automotive	751	732	306.4	298.4	2,451	2,455
Paper/clay/forest	599	595	227.8	232.4	2,628	2,561
General merchandise	5,002	4,696	1,898.5	1,804.1	2,635	2,603
Intermodal	1,913	1,766	2,865.9	2,650.3	668	666
Total	$8,754	$8,364	5,746.7	5,478.9	1,523	1,527

Coal

Coal revenues decreased $15 million, or 2%, in the third quarter and $63 million, or 3%, for the first nine months compared with the same periods last year. The decreases for the quarter and first nine months were driven by a 2% and 4% fall in carload volumes, respectively. Average revenue per unit was flat for the quarter and improved a modest 1% for the first nine months. Coal tonnage by market was as follows:

	Third Quarter		First Nine Months	
	2014	2013	2014	2013
	(tons in thousands)			
Utility	24,465	25,372	71,629	73,649
Export	5,491	6,512	18,437	22,311
Domestic metallurgical	4,542	4,357	11,849	13,007
Industrial	2,233	1,659	6,464	5,269
Total	36,731	37,900	108,379	114,236

Utility coal tonnage decreased 4% in the third quarter and 3% for the first nine months. Both periods were negatively impacted by the loss of business from a northern utility. Third quarter shipments of utility coal softened as mild summer weather reduced cooling demand and lower natural gas prices allowed stockpiles to rebuild. For the first nine months, these declines were offset in part by increased volumes in the second quarter as utilities rebuilt their stockpiles in response to higher electric demand as a result of the harsh winter. Export coal tonnage declined 16% in the third quarter and 17% for the first nine months, driven by strong competition that U.S. coal suppliers faced due to excess coal supply, depressed coal prices, and an Australian currency advantage. Domestic metallurgical coal tonnage was up 4% in the third quarter, but down 9% for the first nine months. Both periods experienced increased shipments of coke, which were offset in part for the quarter, but in whole for the year, by lower metallurgical coal shipments due to plant curtailments and customer sourcing shifts. Industrial coal tonnage increased 35% in the third quarter and 23% for the first nine months as a result of new business opportunities with existing customers.

Coal revenues for the remainder of the year are expected to be lower compared to last year due to lower average revenue per unit and lower volumes.

General Merchandise

General merchandise revenues increased $152 million, or 10%, in the third quarter, compared with the same period last year, reflecting a 10% rise in volume. For the first nine months, general merchandise revenues grew $306 million, or 7%, reflecting a 5% increase in carloads and a 1% rise in average revenue per unit.

Chemicals volume increased 17% in the third quarter and 11% for the first nine months, largely driven by higher shipments of crude oil originated from the Bakken and Canadian oil fields. Additionally, we handled higher volumes of liquefied petroleum gas.

Agriculture, consumer products, and government volume improved 6% in the third quarter and 3% for the first nine months, reflecting higher volumes of corn driven by increased demand for domestic ethanol production and more revenue shipments of empty railcars as part of a hopper re-body program. These improvements were partially offset for the first nine months by fewer shipments of fertilizer due to production curtailments, the late harvest, and the deferral of purchases by farmers.

Metals and construction volume rose 12% in the third quarter and 8% for the first nine months, reflecting higher shipments of fractionating sand for natural gas drilling, gains in our iron and steel business driven by higher import activity, and more coil shipments used to support growing demand in the automotive sector.

Automotive volume grew 12% in the third quarter, and 3% for the first nine months, primarily driven by increased production of North American light vehicles. Additionally, the third quarter of 2014 was positively impacted by the summer shutdown period for automakers, which enabled us to handle the finished vehicle backlog that resulted from the impacts of severe winter weather on our network during the first quarter.

Paper, clay, and forest products volume was flat for the third quarter, but declined 2% for the first nine months, reflecting reduced carloads of municipal solid waste by loss of business, fewer shipments of newsprint and paper due to the continued decline in demand, and lower pulp volumes due to production issues and reduced export demand. These decreases were partially offset by higher lumber shipments as demand for housing materials grew.

General merchandise revenues for the remainder of the year are expected to increase compared to last year due to higher volumes and improved average revenue per unit.

Intermodal

Intermodal revenues rose $62 million, or 10%, in the third quarter, compared with the same period last year, reflecting a 10% growth in volumes. For the first nine months, intermodal revenues increased $147 million, or 8%, reflecting an 8% improvement in volumes.

Domestic volume improved 8% in the third quarter and 7% for the first nine months, a result of growth in strategic corridors, continued highway conversions, and higher demand for rail service from existing customers.

International volume increased 15% in the third quarter and 10% for the first nine months due to growth with existing customers, as well as new service lanes. The first nine months also benefited from accelerated shipping in the first half of the year in anticipation of potential labor disruptions at West Coast ports.

Intermodal revenues for the remainder of the year are expected to be higher compared to last year due to volume increases and higher average revenue per unit.

Railway Operating Expenses

Third-quarter railway operating expenses were $2.0 billion in 2014, up $50 million, or 3%, compared with the same period last year. For the first nine months, expenses were $6.1 billion, up $82 million, or 1%.

Materials and other expenses increased $45 million, or 23%, in the third quarter and $83 million, or 13%, for the first nine months as follows:

	Third Quarter		First Nine Months	
	2014	2013	2014	2013
	($ in millions)			
Materials	$127	$100	$359	$317
Casualties and other claims	35	23	107	78
Other	83	77	248	236
Total	$245	$200	$714	$631

Both periods reflected increased locomotive maintenance and repair costs as a result of volume growth, in addition to higher loss and damage costs. Also, the impact of severe winter weather in the first quarter drove increases in maintenance activity which negatively impacted the comparison for the first nine months. Casualties and other claims expenses include the estimates of costs related to personal injury, property damage, and environmental matters. Both periods also reflected higher casualty and other claims expense as the prior year benefited from higher adjustments attributable to more favorable development in historical trend rates related to our personal injury liabilities.

Purchased services and rents includes the costs of services provided by outside contractors, the net costs of operating joint (or leased) facilities with other railroads and the net cost of equipment rentals. This category of expenses grew $9 million, or 2%, in the third quarter and $12 million, or 1%, for the first nine months, reflecting higher volume-related expenses (intermodal operations, equipment rents, and joint facilities), partially offset by the reduced expense associated with the shared asset areas (including equity in the earnings of Conrail, see Note 6). The first nine months also included higher weather-related expenses incurred during the first quarter.

The following table shows the components of purchased services and rents expenses:

	Third Quarter		First Nine Months	
	2014	2013	2014	2013
	($ in millions)			
Purchased services	$355	$349	$1,021	$1,013
Equipment rents	74	71	214	210
Total	$429	$420	$1,235	$1,223

Depreciation expense increased $6 million, or 3%, in the third quarter and $28 million, or 4%, for the first nine months due to the effects of a larger capital base.

Fuel expense, which includes the cost of locomotive fuel as well as other fuel used in railway operations, decreased $3 million, or 1%, in the quarter, primarily the result of a 6% drop in locomotive fuel prices, partially offset by a 4% increase in consumption. For the first nine months, fuel expense increased $17 million, or 1%, primarily the result of a 4% increase in consumption, partially offset by a 3% decline in locomotive fuel prices.

Compensation and benefits expense decreased $7 million, or 1%, in the third quarter and $58 million, or 3%, for the first nine months, reflecting changes in:

- postretirement and pension benefit costs (down $40 million for the quarter and $112 million for the first nine months) primarily due to the amortization of lower net actuarial losses and the effects of plan amendments to our retiree medical plan (see Note 7),
- health and welfare benefit costs (down $4 million for the quarter and $18 million for the first nine months),
- employee levels including increased overtime (up $4 million for the quarter but down $12 million for the first nine months),
- incentive and stock-based compensation (up $12 million for the quarter and $35 million for the first nine months), and
- pay rates (up $16 million for the quarter and $42 million for the first nine months).

Other Income – Net

Other income – net increased $2 million in the third quarter, but decreased $118 million for the first nine months of 2014. Higher gains from the sale of property, offset in part by lower returns from corporate-owned life insurance policies, drove the improvement in the third quarter. Additionally, both periods reflect decreased coal royalties, whereas the first nine months also reflected the absence of the prior year $97 million land sale gain in Michigan.

Provision for Income Taxes

The third-quarter and year-to-date effective income tax rates were 37.3% and 36.5%, compared with 35.6% and 36.0%, respectively, for the same periods last year. The higher third-quarter effective tax rate reflects the absence of a reduction in deferred tax expense for state law changes last year. Both periods reflect the absence of tax credits that became available in 2013 as a result of the American Taxpayer Relief Act of 2012 (Act), which was enacted January 2, 2013. The higher year-to-date effective tax rate also reflects the absence of $9 million in income tax benefits we recognized in the first quarter of 2013 for certain tax credits retroactively reinstated by the Act.

Fifty-percent bonus depreciation was allowed for federal income taxes in 2013 but has not been extended to 2014. While bonus depreciation does not affect our total provision for income taxes or effective rate, the absence of bonus depreciation increased current income tax expense and the related cash outflows for the payment of income taxes in 2014 as compared to 2013.
IRS examinations have been completed for all years prior to 2011. Our consolidated federal income tax returns for 2011 and 2012 are currently being audited by the IRS.

FINANCIAL CONDITION AND LIQUIDITY

Cash provided by operating activities, our principal source of liquidity, was $2.3 billion for the first nine months of 2014, compared with $2.4 billion for the same period of 2013, primarily reflecting higher tax payments, offset in part by improved operating results.

We had working capital of $930 million at September 30, 2014, compared with $770 million at December 31, 2013, reflecting a decline in the current portion of long-term debt. Cash and cash equivalents totaled $1.4 billion at September 30, 2014, and were invested in accordance with our corporate investment policy as approved by our Board of Directors. The portfolio contains securities that are subject to market risk. There are no limits or restrictions on our access to the assets. We expect cash on hand combined with cash provided by operating activities will be sufficient to meet our ongoing obligations. During the first nine months of 2014, we increased our purchase commitment obligations by $829 million ($315 million of which relates to 2016 and beyond), primarily for locomotives, coal and other freight cars, intermodal equipment, and track material. Other than these items, there have been no material changes to the information on our future obligations contained in our Form 10-K for the year ended December 31, 2013.

Cash used in investing activities was $1.3 billion for the first nine months of 2014, compared with $1.4 billion in the same period last year, primarily reflecting lower property additions.

Cash used in financing activities was $1.1 billion in the first nine months of 2014, compared with $704 million in the same period last year driven primarily by higher debt repayments and lower debt issuances, partially offset by lower share repurchase activity. We repurchased 1.7 million shares of Common Stock, totaling $166 million, in the first nine months of 2014, compared to 7.5 million shares, totaling $564 million, in the same period last year. The timing and volume of future share repurchases will be guided by our assessment of market conditions and other pertinent factors. Any near-term purchases under the program are expected to be made with internally generated cash, cash on hand, or proceeds from borrowings.

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Our total debt-to-total capitalization ratio was 41.8% at September 30, 2014, and 45.6% at December 31, 2013.

We have authority from our Board of Directors to issue an additional $800 million of debt or equity securities through public or private sale. We have on file with the Securities and Exchange Commission a Form S-3 automatic shelf registration statement for well-known seasoned issuers under which securities may be issued pursuant to this authority.

We also have in place and available a $750 million, five-year credit agreement expiring in 2016, which provides for borrowings at prevailing rates and includes covenants. We had no amounts outstanding under this facility at September 30, 2014, and are in compliance with all of our covenants. In October 2014, we renewed our $350 million accounts receivable securitization program with a two-year term to run until October 2016. There was $100 million and $200 million outstanding under this program at September 30, 2014 and December 31, 2013, respectively. Other than this, we have no other floating-rate debt instruments outstanding subject to market risk.

On June 4, 2014, we terminated our commercial paper dealer agreement.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP) requires us 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 revenue 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 us to make changes to these estimates and assumptions. Accordingly, we regularly review these estimates and assumptions based on historical experience, changes in the business environment, and other factors we believe to be reasonable under the circumstances. We regularly discuss the development, selection, and disclosures concerning critical accounting estimates with the Audit Committee of our Board of Directors. There have been no significant changes to the application of critical accounting estimates disclosure contained in our Form 10-K at December 31, 2013.

OTHER MATTERS

Labor Agreements

More than 80% of our 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. We largely bargain nationally in concert with other major railroads, represented by the National Carriers Conference Committee (NCCC). Moratorium provisions in the labor agreements govern when the railroads and the unions may propose change to the agreements. We and the NCCC have concluded the round of bargaining that began in November 2009 and reached agreements that extend through December 31, 2014 with all applicable labor unions.

Environmental Matters

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

Our Consolidated Balance Sheets include liabilities for environmental exposures of $66 million at September 30, 2014, and $58 million at December 31, 2013 (of which $15 million is classified as a current liability at the end of each period). At September 30, 2014, the liability represents our estimate of the probable cleanup, investigation, and remediation costs based on available information at 147 known locations and projects. At that date, 14 sites accounted for $38 million of the liability, and no individual site was considered to be material. We anticipate that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 12 locations, one or more of our subsidiaries in conjunction with a number of other parties, have been identified as potentially responsible parties under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes that impose joint and several liability for cleanup costs. We calculate our estimated liability for these sites based on facts and legal defenses applicable to each site and not solely on the basis of the potential joint liability.

With respect to known environmental sites (whether identified by us or the EPA, or comparable state authorities), estimates of our ultimate potential financial exposure for a given site or in the aggregate for all such sites can change over time because of the widely varying costs of currently available cleanup techniques, unpredictable contaminant recovery and reduction rates associated with available clean-up technologies, 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. We estimate our environmental remediation liability on a site-by-site basis, using assumptions and judgments we deem appropriate for each site. As a result, it is not practical to quantitatively describe the effects of changes in these many assumptions and judgments. We have consistently applied our methodology of estimating our environmental liabilities.

Based on our assessment of facts and circumstances now known, we believe we have recorded the probable and reasonably estimable costs for dealing with those environmental matters of which we are aware. Further, we believe that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on our financial position, results of operations, or liquidity.

New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, “Revenue from Contracts with Customers.” This update, effective for our annual and interim reporting periods beginning January 1, 2017, will replace most existing revenue recognition guidance in U.S. GAAP and requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Early application is not permitted, but once effective, permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures.

Inflation

In preparing financial statements, GAAP requires the use of historical cost that disregards the effects of inflation on the replacement cost of property. As a capital-intensive company, most of our capital is invested in long-lived assets. 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.

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," "estimate," "plan," "consider," "project," and similar references to the future. Forward-looking statements reflect our 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 we have little or no control, including: significant governmental legislation and regulation over commercial, operating and environmental matters; transportation of hazardous materials as a common carrier by rail; acts of terrorism or war; general economic conditions including, but not limited to, fluctuation and competition within the industries of our customers; climate change legislative and regulatory developments; competition and consolidation within the transportation industry; the operations of carriers with which we interchange; disruptions to our technology infrastructure, including computer systems; labor difficulties, including strikes and work stoppages; results of litigation; natural events such as severe weather, hurricanes, and floods; unpredictable demand for rail services; fluctuation in supplies and prices of key materials, in particular diesel fuel; and changes in securities and capital markets. For a discussion of significant risk factors applicable to our business, see Part II, 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. We undertake no obligation to update or revise forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The information required by this item is included in Part I, Item 2., "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Financial Condition and Liquidity."

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, with the assistance of management, evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) at September 30, 2014. Based on such evaluation, our officers have concluded that, at September 30, 2014, our disclosure controls and procedures are effective in alerting them on a timely basis to material information required to be included in our periodic filings under the Exchange Act.

Changes in Internal Control Over Financial Reporting

During the third quarter of 2014, we have not identified any changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

On November 6, 2007, various antitrust class actions filed against us and other Class I railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. On June 21, 2012, the court certified the case as a class action. The defendant railroads appealed this certification, and the Court of Appeals for the District of Columbia vacated the District Court's decision and remanded the case for further consideration. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases. We do not believe the outcome of these proceedings will have a material effect on our financial position, results of operations, or liquidity. A lawsuit containing similar allegations against us 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, and most recently extended in August 2013.

In 2012, we received a Notice of Violation (NOV) issued by the Tennessee Department of Environmental Conservation concerning soil runoff in connection with construction of the Memphis Regional Intermodal Facility in Rossville, Tennessee. Although we will contest liability and the imposition of any penalties, this matter is described here consistent with SEC rules and requirements concerning governmental proceedings with respect to environmental laws and regulations. We do not believe that the outcome of this proceeding will have a material effect on our financial position, results of operations, or liquidity.

In or around 2012, a building located on non-operating property formerly leased to various tenants in Williamson, West Virginia, was demolished and the related debris and waste disposed of at a local landfill. Upon further investigation in March 2014, it became uncertain as to whether asbestos abatement was properly conducted on the building prior to demolition. Although the matter is under further investigation, we have self-reported it to the West Virginia Department of Environmental Protection, and it is described here consistent with SEC rules and requirements concerning governmental proceedings with respect to environmental laws and regulations. We do not believe that the outcome of this proceeding will have a material effect on our financial position, results of operations, or liquidity.

Item 1A. Risk Factors.

The risk factors included in our 2013 Form 10-K remain unchanged and are incorporated herein by reference.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

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]
July 1-31, 2014	164,072	104.59	159,538	37,076,549
August 1-31, 2014	363,522	102.52	363,522	36,713,027
September 1-30, 2014	123,888	109.20	113,533	36,599,494
Total	651,482		636,593	

(1) Of this amount, 14,889 represent shares tendered by employees in connection with the exercise of options under the stockholder-approved Long-Term Incentive Plan.

(2) Our Board of Directors authorized a share repurchase program, pursuant to which up to 125 million shares of Common Stock could be purchased through December 31, 2014. On August 1, 2012, our Board of Directors authorized the repurchase of up to an additional 50 million shares of Common Stock through December 31, 2017.

Item 6. Exhibits.

See Exhibit Index beginning on page 33 for a description of the exhibits filed as part of this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NORFOLK SOUTHERN CORPORATION
Registrant

Date:	October 22, 2014	/s/ Thomas E. Hurlbut Thomas E. Hurlbut Vice President and Controller (Principal Accounting Officer) (Signature)
Date:	October 22, 2014	/s/ Denise W. Hutson Denise W. Hutson Corporate Secretary (Signature)

EXHIBIT INDEX

3(ii)	The Bylaws of Norfolk Southern Corporation, as amended July 22, 2014, are incorporated by reference to Exhibit 3(ii) to Norfolk Southern Corporation's Form 8-K filed on July 24, 2014.
10.1*	Directors' Deferred Fee Plan of Norfolk Southern Corporation, as amended effective October 3, 2014.
10.2	Amendment No. 11, dated as of October 16, 2014, to Transfer and Administration Agreement dated as of November 8, 2007, is incorporated herein by reference to Exhibit 10.1 to Norfolk Southern Corporation's Form 8-K filed on October 17, 2014.
15*	Letter regarding unaudited interim financial information.
31-A*	Rule 13a-14(a)/15d-014(a) CEO Certifications.
31-B*	Rule 13a-14(a)/15d-014(a) CFO Certifications.
32*	Section 1350 Certifications.
101*	The following financial information from Norfolk Southern Corporation's Quarterly Report on Form 10-Q for the third quarter of 2014, formatted in Extensible Business Reporting Language (XBRL) includes (i) the Consolidated Statements of Income for the third quarters and first nine months of 2014 and 2013; (ii) the Consolidated Statements of Comprehensive Income for the third quarters and first nine months of 2014 and 2013; (iii) the Consolidated Balance Sheets at September 30, 2014, and December 31, 2013; (iv) the Consolidated Statements of Cash Flows for the first nine months of 2014 and 2013; and (v) the Notes to Consolidated Financial Statements.

* Filed herewith.

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