

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 **DEC. 31, 2005**
- () 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

Registrant's telephone number, including area code

(757) 629-2680

No Change

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

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

<u>Title of each Class</u>	<u>Name of each exchange on which registered</u>
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 checkmark if the registrant is well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes (X) No ()

Indicate by checkmark 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 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 checkmark 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 nonaffiliates as of June 30, 2005 was \$12,524,405,303 (based on the closing price as quoted on the New York Stock Exchange on that date).

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

Large accelerated filer [X] Accelerated filer [] Non-accelerated filer []

The number of shares outstanding of each of the registrant's classes of common stock, as of Jan. 31, 2006 : 412,236,777 (excluding 20,833,125 shares held by 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) was incorporated on July 23, 1980 , under the laws of the Commonwealth of Virginia . On June 1, 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 Dec. 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 Sept. 1, 1998 , NW was merged with and into Norfolk Southern Railway. As of Dec. 31, 2005 , 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). On June 1, 1999 , NSR and CSXT, began operating separate portions of Conrail's rail routes and assets. On August 27, 2004, NS, CSX and Conrail completed a corporate reorganization of Conrail (Conrail Corporate Reorganization), which established direct ownership and control by NSR and CSX Transportation, Inc. (CSXT) of two former CRC subsidiaries, Pennsylvania Lines LLC (PRR) and New York Central Lines LLC (NYC), respectively (See Note 5 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). Additionally, Norfolk Southern's corporate governance guidelines, board committee charters, code of ethics and code of ethical conduct for senior financial officers are available on the company's website and in print to any shareholder who requests them.

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

RAILROAD OPERATIONS – As of Dec. 31, 2005 , NS' railroads operated approximately 21,200 miles of road in 22 eastern states, the District of Columbia and Ontario , Canada . The miles

operated, which includes 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 Dec. 31, 2005

	Miles of Road	Second and Other Main Track	Passing Track, Crossovers and Turnouts	Way and Yard Switching	Total
Owned	16,237	2,808	2,087	8,598	29,730
Operated under lease, contract or trackage rights	4,947	1,978	417	969	8,311
Total	<u>21,184</u>	<u>4,786</u>	<u>2,504</u>	<u>9,567</u>	<u>38,041</u>

NS' railroads carry raw materials, intermediate products and finished goods primarily in the Southeast, East and Midwest and, via interchange with other rail carriers, to and from the rest of the United States and parts of Canada. They also transport overseas freight through several Atlantic and Gulf Coast ports, which include:

The ports of New York/New Jersey	Philadelphia, PA	Camden, NJ
Baltimore, MD	Wilmington, DE	Norfolk, VA
Morehead City, NC	Charleston, SC	Savannah, GA
Brunswick, GA	Jacksonville, FL	Mobile, AL
New Orleans, LA		

The lines of NS' railroads reach most of the larger industrial and trading centers of the Southeast, Northeast, Mid-Atlantic region and Midwest. In addition, haulage arrangements with connecting carriers allow NS' railroads to provide single-line service to and from additional markets. Highlights of our service network are as follows:

Haulage, trackage rights and interline arrangements with:

Florida East Coast Railway Company	-	Service to Southern and Eastern Florida
The Kansas City Southern Railway Company	-	Transcontinental intermodal service via Dallas with the Burlington Northern Santa Fe Railway Company
Canadian Pacific Railway Company	-	Service to New England

Leading centers originating and terminating freight traffic:

Chicago	Norfolk	Detroit
Atlanta	New York City	Jacksonville
Kansas City , MO	Baltimore	Buffalo
Charleston	Cleveland	Columbus
Philadelphia	Pittsburgh	Toledo
Greensboro	Charlotte	Savannah

Major interterritorial gateways:

Chicago	Memphis	Sidney/Salem, IL
New Orleans	Kansas City	Buffalo
St. Louis	Meridian , MS	

Corridors with heaviest freight volume:

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

Chicago to Jacksonville (via Cincinnati , Chattanooga and Atlanta)

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

Cleveland to Kansas City

Knoxville to Chattanooga

The system's lines also 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 business located in smaller communities in its service area.

Triple Crown Operations – Triple Crown Services Company (TCSC), 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. TCSC 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 Dec. 31,				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Revenue ton miles (billions)	203	198	183	179	182
Freight train miles traveled (millions)	81.2	77.7	73.9	72.6	70.0
Revenue per ton mile	\$0.0421	\$0.0369	\$0.0353	\$0.0350	\$0.0339
Revenue ton miles per man-hour worked	3,146	3,347	3,111	3,067	3,023
Percentage ratio of railway operating					

expenses to railway operating revenues	75.2%	76.7%	83.5% ¹	81.5%	83.7%
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¹ Includes \$107 million of costs for a voluntary separation program, which added 1.6 percentage points to the ratio.

RAILWAY OPERATING REVENUES -- NS' total railway operating revenues were \$8.5 billion in 2005. 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 187 million tons in 2005, most of which originated on NS' lines in West Virginia, Virginia, Pennsylvania and Kentucky. Revenues from coal, coke and iron ore accounted for about 25% of NS' total railway operating revenues in 2005.

Total coal handled through all system ports in 2005 was 38 million tons. Of this total, 12 million tons (including coastwise traffic) moved through Norfolk, Virginia, 4 million tons moved through the Baltimore Terminal, 14 million tons moved to various docks on the Ohio River, and 8 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, DaimlerChrysler, 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 2005, 144 million tons of general merchandise freight, or approximately 66% 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 2005 were 2.9 million, the revenue from which accounted for 54% of NS' total railway operating revenues in 2005.

See the discussion of general merchandise rail traffic by commodity group in Part II, Item 7, "Management's Discussion and Analysis of Financial Conditions 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 2005 were 3.2 million, the revenues from which accounted for 21% 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 2005, 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 2005, coal movements that had been moving under common carrier (tariff) rates to Duke Energy and Carolina Power and Light power plants began moving under contract rates as part of the settlement agreements resolving the rail transportation rate cases brought by each of the utilities. In 2004 there were significant coal movements moving under common carrier (tariff) rates that had previously moved under rates contained in transportation contracts.

In 2005, NS' railroads were found by the STB to be "revenue adequate" based on results for the year 2004. 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 Alexandria and New Orleans, between Greensboro and Selma, North Carolina, between Chicago, Illinois, and Detroit, Michigan, and between Chicago 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 also leases the Chicago to Manhattan, Illinois, line to the Commuter Rail Division of the Regional Transportation Authority of Northeast Illinois. NS operates lines on which Amtrak conducts regularly scheduled passenger operations. In addition, NS provides freight service over lines with significant ongoing Amtrak and commuter passenger operations, and is conducting freight operations over some trackage owned by Amtrak or by New Jersey Transit, the Southeastern Pennsylvania Transportation Authority, Metro-North Commuter Railroad Company and Maryland DOT. Finally, 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 2005, no such noncarrier subsidiary or industry segment grouping of noncarrier subsidiaries met the requirements for a reportable business segment set forth in Statement of Financial Accounting Standards No. 131.

RAILWAY PROPERTY

The NS railroad system extends across 22 states, the District of Columbia and portions of Canada. The railroad infrastructure makes the company capital intensive with total property of approximately \$21 billion.

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

	Capital Expenditures								
	<u>2005</u>	-	<u>2004</u>	-	<u>2003</u>	-	<u>2002</u>	-	<u>2001</u>
	<i>(\$ in millions)</i>								
Road	\$ 739	\$	607	\$	495	\$	519	\$	505
Equipment	284		429		218		174		233
Other property	2		5		7		2		8
Total	<u>\$ 1,025</u>	\$	<u>1,041</u>	\$	<u>720</u>	\$	<u>695</u>	\$	<u>746</u>

Capital spending and maintenance programs are and have been designed to assure the ability to provide safe, efficient and reliable transportation services. For 2006, NS has budgeted \$1.15 billion of capital spending. On Dec. 2, 2005, NS announced an agreement to form a joint venture with Kansas City Southern pursuant to which NS intends to contribute \$300 million in cash in exchange for a 30% interest in the joint venture. 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 Dec. 31, 2005 , NS owned or leased the following units of equipment:

	Number of Units		Total	Capacity
	<u>Owned*</u>	<u>Leased**</u>		<u>of Equipment</u>
Locomotives:				(Horsepower)
Multiple purpose	3,360	150	3,510	12,077,200
Switching	207	--	207	303,700
Auxiliary units	<u>74</u>	<u>--</u>	<u>74</u>	<u>--</u>
Total locomotives	<u>3,641</u>	<u>150</u>	<u>3,791</u>	<u>12,380,900</u>
Freight cars:				(Tons)
Hopper	19,313	814	20,127	2,127,459
Box	18,615	2,257	20,872	1,652,499
Covered hopper	9,207	2,725	11,932	1,302,758
Gondola	30,118	8,031	38,149	4,090,723
Flat	2,785	1,339	4,124	321,218
Caboose	238	--	238	--
Other	<u>4,012</u>	<u>--</u>	<u>4,012</u>	<u>199,706</u>
Total freight cars	<u>84,288</u>	<u>15,166</u>	<u>99,454</u>	<u>9,694,363</u>
Other:				
Work equipment	5,422	3	5,425	
Vehicles	3,948	--	3,948	
Highway trailers and containers	450	10,253	10,703	
RoadRailer®	6,784	197	6,981	
Miscellaneous	<u>1,447</u>	<u>19,012</u>	<u>20,459</u>	
Total other	<u>18,051</u>	<u>29,465</u>	<u>47,516</u>	

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

** Includes 18 locomotives and 6,550 freight cars leased from CRC.

The following table indicates the number and year built for locomotives and freight cars owned at Dec. 31, 2005 .

	Year Built								Total
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>1994- 2000</u>	<u>1989- 1993</u>	<u>1988 & Before</u>	
Locomotives:									
No. of units	89	207	100	-- *	160	975	465	1,645	3,641
% of fleet	2%	6%	3%	--%	4%	27%	13%	45%	100%
Freight cars:									
No. of units	71	--	--	--	44	9,475	6,866	67,832	84,288
% of fleet	--%	--%	--%	--%	--%	11%	8%	81%	100%

* Fifty of the locomotives built in 2001 were purchased in 2002.

The following table shows the average age of NS' locomotive and freight car fleets at Dec. 31, 2005 , and the number of retirements in 2005:

	<u>Locomotives</u>	<u>Freight Cars</u>
Average age – in service	17.2 years	28.4 years
Retirements	52 units	1,499 units
Average age – retired	27.4 years	34.1 years

Between 1988 and 2000, about 29,000 coal cars were rebodied. As a result, the remaining serviceability of the freight car fleet is greater than may be inferred from the high percentage of freight cars built in earlier years.

	Annual Average Bad Order Ratio				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Freight cars	6.3%	7.4%	7.4%	8.1%	6.9%
Locomotives	6.2%	6.3%	6.2%	6.3%	5.8%

Ongoing freight car and locomotive maintenance programs are intended to ensure the highest standards of safety, reliability, customer satisfaction and equipment marketability. The freight car bad order ratio rose in 2001 and 2002 as a result of decreased maintenance activity.

The declines in 2005 and 2003 reflected an increase in maintenance activity as well as the retirement of unserviceable units. The locomotive bad order ratio includes units out of service for required inspections every 92 days and program work such as overhauls. The elevated ratio through 2005 reflected units out of service related to the resumption of maintenance and modification activities.

Encumbrances - Certain railroad equipment is subject to the prior lien of equipment financing obligations amounting to approximately \$650 million as of Dec. 31, 2005 , and \$930 million as of Dec. 31, 2004 .

Track Maintenance - Of the approximately 38,000 total miles of track operated, NS had responsibility for maintaining about 30,000 miles of track with the remainder being operated under trackage rights.

Over 75% of the main line trackage (including first, second, third and branch main tracks, all excluding 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 carried 20 million or more gross tons per track mile.

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Track miles of rail installed	302	246	233	235	254
Miles of track surfaced	4,663	5,055	5,105	5,270	3,836
New crossties installed (millions)	2.5	2.5	2.8	2.8	1.5

Microwave System - The NS microwave system, consisting of approximately 7,400 radio route miles, 424 core stations, 14 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 16,200 route miles owned by NS, 11,052 miles are signalized, including 8,030 miles of centralized traffic control (CTC) and 3,022 miles of automatic block signals. Of the 8,030 miles of CTC, 2,715 miles are controlled by data radio originating at 215 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 the discussion of "Personal Injury, Environmental and Legal Liabilities" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and in Note 18 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:

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Average number of employees	30,294	28,475	28,753	28,970	30,894
Average wage cost per employee	\$61,000	\$59,000	\$58,000	\$54,000	\$52,000
Average benefit cost per employee	\$29,000	\$28,000	\$28,000	\$24,000	\$21,000

Approximately 85% of NS' railroad employees are covered by collective bargaining agreements with 14 different 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, 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, has continued. Significant exemptions are TOFC/COFC (i.e., "piggyback") business, 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 80% of NS' freight revenues come from either exempt traffic or traffic moving under transportation contracts.

Efforts may be made in 2006 to re-subject the rail industry to unwarranted federal economic regulation. The Staggers Rail Act of 1980, which substantially reduced 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 oppose efforts to reimpose unwarranted 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.

Item 1A. Risk Factors.

NS is subject to significant governmental regulation and legislation over commercial, environmental and operating matters.

Railroads are subject to commercial regulation by the Surface Transportation Board, which has jurisdiction over some rates, routes, 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. Occasional efforts are made to re-subject the rail industry to unwarranted federal economic regulation. Economic re-regulation of the rail industry could negatively impact NS' ability to determine prices for rail services and reduce capital spending on its rail network, resulting in a material adverse effect on NS' results of operations, financial condition, and liquidity.

NS' operations are subject to extensive federal, state, and local environmental laws and regulations concerning, among other things, emissions to the air; discharges to water ways 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. Several of NS' subsidiaries own, or have owned, land used as operating property or held for sale, or which is leased or may have been leased and operated by others. 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 condition, results of operations or liquidity in a particular year or quarter.

The Federal Railroad Administration regulates a host of operations matters including track and mechanical equipment standards; signaling

systems; testing and inspection of grade crossing warning devices, hours of service of operating employees; drug and alcohol testing; locomotive engineer certification; and reporting of employee injuries, among other areas. NS' unintentional failure to comply with applicable laws and regulations could have a material adverse effect on NS, and changes in the legislative or regulatory frameworks within which NS operates could adversely affect its business.

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 condition, and liquidity. Economic conditions resulting in bankruptcies of one or more large customers could have a significant impact in a particular quarter.

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 results of operations, financial condition, and liquidity.

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. Legislation introduced in Congress in early 2005 would give federal regulators increased authority to conduct investigations and levy substantial fines and penalties in connection with railroad accidents. Federal regulators also would be required to prescribe new regulations governing railroads' transportation of hazardous materials. If enacted, such legislation and regulations could impose significant additional costs on railroads. Additionally, regulations adopted by the Department of Transportation and regulations contemplated by the Department of Homeland Security could significantly increase the costs associated with moving hazardous materials on NS' lines. Further, certain local governments have sought to enact ordinances banning hazardous materials moving by rail within their borders. Some legislators have contemplated pre-notification requirements for hazardous materials shipments. If promulgated such ordinances could require the re-routing of hazardous materials shipments, with the potential for significant additional costs and network inefficiencies.

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, reciprocal switching, interchange, trackage rights and locomotive availability. 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. 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 results of operations, financial position, and liquidity.

During 2006, NS will relocate its primary production data center to a newly renovated, state-of-the-art data center. Relocation of primary production applications will begin in April and continue through November. Multiple strategies are being utilized to minimize risk such as purchasing seed equipment for the new data center in support of all mission critical applications. This would include all network components, Mainframe, Teradata and server based critical infrastructure. For less critical applications, the equipment will be shutdown and transported to the new data center. In all cases disaster recovery readiness for mission critical applications will be maintained.

The vast majority of NS employees belong to labor unions, and labor agreements, strikes, or work stoppages could adversely affect its operations. Approximately 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' results of operations, financial condition, and liquidity.

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, 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 commercial 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 per occurrence for bodily injury and property

damage to third parties and \$12.5 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 and floods, may cause significant business interruptions and result in increased costs, increased liabilities, and decreased revenues, which could have an adverse effect on NS' operating results, financial condition, and liquidity.

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 results of operations, financial condition, and liquidity.

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 condition, and liquidity. 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, its current insurance coverage for first-party property damage and damage to property in NS' care, custody or control does not apply to damage caused by war and may not apply to 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 may not be available to NS in the future.

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 over 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, disruption of oil imports, disruption of domestic refinery production, damage to refinery or pipeline infrastructure, political unrest, war or otherwise, NS' operating results, financial condition, and liquidity could be 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' operating results, financial condition, and liquidity.

Item 1B. Unresolved Staff Comments.

None.

Item 3. Legal Proceedings .

None.

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 2005.

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 January 31, 2006, relating to the executive officers.

Name, Age, Present Position	Business Experience During Past Five Years
David R. Goode, 65, Chairman	Present position since November 1, 2005 . Served as Chairman and Chief Executive Officer from October 1, 2004 , to November 1, 2005 , and prior thereto was Chairman, President and Chief Executive Officer. Mr. Goode will retire from position as Chairman effective February 1, 2006 , and he will serve as special advisor to the Chief Executive Officer until his retirement effective March 1, 2006 .
Charles W. Moorman, 53, President and Chief Executive Officer	Present position since November 1, 2005 . Served 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 ; also served as President – Thoroughbred Technology and Telecommunications, Inc. since October 1999 and prior thereto was Vice President – Information Technology. Mr. Moorman will succeed Mr. Goode as Chairman effective February 1, 2006 .
L. I. Prillaman, 62, Vice Chairman and Chief Marketing Officer	Present position since August 1998.
Stephen C. Tobias, 61, Vice Chairman and Chief Operating Officer	Present position since August 1998.
Henry C. Wolf, 63, Vice Chairman and Chief Financial Officer	Present position since August 1998.
James A. Hixon, 52, Executive Vice President – Law and Corporate Relations	Present position since October 1, 2005 . Served as Executive Vice President – Finance and Public Affairs From October 1, 2004 , to October 1, 2005 ; Senior Vice President – Legal and Government Affairs from December

	1, 2003 to October 1, 2004 ; Senior Vice President – Administration from February 1, 2001 to December 1, 2003 ; Senior Vice President – Employee Relations from November 1, 1999 to February 1, 2001 ; and prior thereto was Vice President – Taxation.
Mark D. Manion, 53, 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 ; Vice President – Transportation Services and Mechanical from February 1, 2001 to December 1, 2003 ; and prior thereto was Vice President – Mechanical.
Kathryn B. McQuade, 49, Executive Vice President – Planning and Chief Information Officer	Present position since October 1, 2004 . Served as Senior Vice President – Finance from December 1, 2003 to October 1, 2004 ; Senior Vice President – Financial Planning from April 1, 2000 to December 1, 2003 ; and prior thereto was Vice President – Financial Planning.
John P. Rathbone, 53, Executive Vice President – Administration	Present position since October 1, 2004 . Served as Senior Vice President – Administration from December 1, 2003 to October 1, 2004 ; Senior Vice President and Controller from April 2000 to December 1, 2003 and prior thereto was Vice President and Controller.
Donald W. Seale, 53, Executive Vice President – Sales and Marketing	Present position since October 1, 2004 . Served as Senior Vice President – Marketing Services from December 1, 2003 to October 1, 2004 ; and prior thereto was Senior Vice President- Merchandise Marketing.
Daniel D. Smith, 53, Senior Vice President – Energy and Properties	Present position since December 1, 2003 . Served as President- NS Development from February 1, 2001 to December 1, 2003 ; and prior thereto was President of Pocahontas Land Corporation.

James A. Squires, 44,
Senior Vice President – Law

Present position since October 1, 2004 .
Served as Vice President – Law from December 1, 2003 to
October 1, 2004 ; Senior General Counsel from February
1, 2002
to December 1, 2003 and prior thereto was General
Counsel.

Marta R. Stewart , 48,
Vice President and Controller

Present position since December 1, 2003 .
Prior thereto was Assistant Vice President Corporate
Accounting.

PART II

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES (NS)

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters .

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

STOCK PRICE AND DIVIDEND INFORMATION

The Common Stock of Norfolk Southern Corporation, owned by 48,180 stockholders of record as of Dec. 31, 2005 , is traded on the New York Stock Exchange with 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 2005 and 2004.

	Quarter							
	2005				2004			
	-	<u>1st</u>	-	<u>2nd</u>	-	<u>3rd</u>	-	<u>4th</u>
Market price								
High	\$	38.99	\$	37.78	\$	40.93	\$	45.81
Low		33.21		29.60		30.70		38.01
Dividends per share	\$	0.11	\$	0.11	\$	0.13	\$	0.13
	2004							
Market price								
High	\$	24.06	\$	26.60	\$	29.79	\$	36.69
Low		20.38		21.54		24.77		29.88
Dividends per share	\$	0.08	\$	0.08	\$	0.10	\$	0.10

ISSUER REPURCHASES OF EQUITY SECURITIES

<u>Period</u>	<u>(a) Total Number of Shares (or Units) Purchased</u>	<u>(b) Average Price Paid per Share (or Unit)</u>	<u>(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs⁽²⁾</u>	<u>(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased Under the Plans or Programs⁽²⁾</u>
Oct. 1-31, 2005	2,524 ⁽¹⁾	\$39.61	--	--
Nov. 1-30, 2005	32,170 ⁽¹⁾	\$42.01	--	50,000,000
Dec. 1-31, 2005	<u>10,907⁽¹⁾</u>	\$44.28	--	50,000,000
Total	<u>45,601</u>	\$42.42		

(1) Shares tendered by employees in connection with the exercise of stock options under the Long-Term Incentive Plan.

(2) On Nov. 22, 2005, the Board of Directors authorized a share repurchase program, pursuant to which up to 50 million of the NS' common stock may be purchased by 2015.

Item 6. Selected Financial Data .

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

FIVE-YEAR FINANCIAL REVIEW 2001-2005

	<u>2005</u> ¹	<u>2004</u> ²	<u>2003</u> ³	<u>2002</u>	<u>2001</u>
	<i>(\$ in millions, except per share amounts)</i>				
RESULTS OF OPERATIONS					
Railway operating revenues	\$ 8,527	\$ 7,312	\$ 6,468	\$ 6,270	\$ 6,170
Railway operating expenses	<u>6,410</u>	<u>5,610</u>	<u>5,404</u>	<u>5,112</u>	<u>5,163</u>
Income from railway operations	2,117	1,702	1,064	1,158	1,007

Other income – net	74	89	19	66	99
Interest expense on debt	<u>494</u>	<u>489</u>	<u>497</u>	<u>518</u>	<u>553</u>
Income from continuing operations before income taxes and accounting changes	1,697	1,302	586	706	553
Provision for income taxes	<u>416</u>	<u>379</u>	<u>175</u>	<u>246</u>	<u>191</u>
Income from continuing operations before accounting changes	1,281	923	411	460	362
Discontinued operations ⁴	--	--	10	--	13
Cumulative effect of changes in accounting principles, net of taxes ⁵	<u>--</u>	<u>--</u>	<u>114</u>	<u>--</u>	<u>--</u>
Net income	\$ <u>1,281</u>	\$ <u>923</u>	\$ <u>535</u>	\$ <u>460</u>	\$ <u>375</u>

PER SHARE DATA

Income from continuing operations before accounting changes

operations before accounting changes – basic	\$ 3.17	\$ 2.34	\$ 1.05	\$ 1.18	\$ 0.94
– diluted	\$ 3.11	\$ 2.31	\$ 1.05	\$ 1.18	\$ 0.94
Net income – basic	\$ 3.17	\$ 2.34	\$ 1.37	\$ 1.18	\$ 0.97
– diluted	\$ 3.11	\$ 2.31	\$ 1.37	\$ 1.18	\$ 0.97
Dividends	\$ 0.48	\$ 0.36	\$ 0.30	\$ 0.26	\$ 0.24
Stockholders' equity at year end	\$ 22.66	\$ 19.95	\$ 17.83	\$ 16.71	\$ 15.78

FINANCIAL POSITION

Total assets	\$ 25,861	\$ 24,750	\$ 20,596	\$ 19,956	\$ 19,418
Total long-term debt, including current maturities ⁶	\$ 6,930	\$ 7,525	\$ 7,160	\$ 7,364	\$ 7,632
Stockholders' equity	\$ 9,289	\$ 7,990	\$ 6,976	\$ 6,500	\$ 6,090

OTHER

Capital expenditures	\$ 1,025	\$ 1,041	\$ 720	\$ 695	\$ 746
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Average number of
shares

outstanding (thousands)	404,170	394,201	389,788	388,213	385,158
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Number of stockholders
at year

end	48,180	51,032	52,091	51,418	53,042
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Average number of
employees:

Rail	29,851	28,057	28,363	28,587	30,510
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Nonrail	<u>443</u>	<u>418</u>	<u>390</u>	<u>383</u>	<u>384</u>
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Total	<u>30,294</u>	<u>28,475</u>	<u>28,753</u>	<u>28,970</u>	<u>30,894</u>
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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 \$53 million net gain from the Conrail Corporate Reorganization. This gain increased net income by \$53 million or 13 cents per diluted share.
- 2003 operating expenses include a \$107 million charge for a voluntary separation program. Other income – net includes an \$84 million charge to recognize the impaired value of certain telecommunications assets. These charges reduced net income by \$119 million, or 30 cents per diluted share.
- NS sold all the common stock of its motor carrier subsidiary, North American Van Lines, Inc. in 1998. Results in 2001 include an additional after-tax gain of \$13 million, or 3 cents per diluted share, that resulted from the expiration of certain indemnity obligations contained in the sales agreement. Results in 2003 include an additional after-tax gain of \$10 million, or 3 cents per diluted share, resulting from resolution of tax issues related to the transaction.
- Net income in 2003 reflects two accounting changes, the cumulative effect of which increased net income by \$114 million, or 29 cents per diluted share: a change in accounting for the cost to remove railroad crossties, which increased net income by \$110 million, and a change in accounting related to a special-purpose entity that leases certain locomotives to NS, which increased net income by \$4 million.
- Excludes notes payable to Conrail of \$716 million in 2003, \$513 million in 2002 and \$301 million in 2001.

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' results in 2005 reflect substantial increases in revenues resulting from higher pricing, fuel surcharges and increased traffic volume that kept pace with the growth of the U.S. economy. Revenues increased \$1.2 billion, or 17%, in 2005, as high demand for rail freight transportation, coupled with constrained capacity for other modes of transport and the fluidity of the NS network enabled NS to raise rates and handle additional volume. Approximately one-third of the revenue increase was due to higher fuel surcharge amounts. Carloadings were up 322,300 units, or 4%, largely because of a 9% increase in intermodal traffic. For the most part, increased operating expenses of \$800

million were reflective of the increased traffic volume as well as sharply higher fuel prices. In addition, casualties and other claims expenses were significantly higher in 2005 related to an accident in Graniteville, South Carolina in January, a large unfavorable jury award in July and two strong Gulf Coast hurricanes in August and September. Despite the 14% increase in expenses, the operating ratio, a measure of the amount of operating revenues consumed by operating expenses, improved to 75.2%, and income from railway operations rose 24%.

The strong operating results translated into significantly improved cash flows which were used to pay off debt and increase dividends while establishing an all-time high cash and short-term investment balance of \$1.3 billion at year end. Looking ahead, NS expects business levels to continue to grow in 2006 but at a more modest pace than seen in 2005. NS plans to continue its focus on improving service levels and maintaining an aggressive pricing strategy as business is renewed. Approximately one-half of NS' revenue base is subject to renegotiation or repricing in 2006.

SUMMARIZED RESULTS OF OPERATIONS

2005 Compared with 2004

Net income in 2005 was \$1.3 billion, or \$3.11 per diluted share, up \$358 million, or 39%, compared with \$923 million, or \$2.31 per diluted share, in 2004. The results in 2005 reflected a \$96 million second quarter increase to net income related to state tax law changes (see Note 3), while the results in 2004 reflected a \$53 million net gain related to the Conrail Corporate Reorganization (see Note 5). The remaining \$315 million increase in net income was primarily due to higher income from railway operations. Railway operating revenues increased \$1.2 billion, reflecting higher rates (including the favorable effects of the coal rate cases settled in the second quarter – see below), fuel surcharges and increased traffic volume. Railway operating expenses rose \$800 million, or 14%, principally due to higher diesel fuel prices, increased volume-related expenses and casualty claims costs.

2004 Compared with 2003

Net income in 2004 of \$923 million, or \$2.31 per diluted share, was up \$388 million, or 73%, compared with net income of \$535 million, or \$1.37 per diluted share, in 2003. Results in 2003 included a \$10 million, or 3 cents per share, gain from discontinued operations (see Note 17) and a \$114 million, or 29 cents per share, benefit related to the cumulative effect of changes in accounting principles (see Note 1). Income from continuing operations before accounting changes was \$923 million, or \$2.31 per diluted share, in 2004, compared with \$411 million, or \$1.05 per diluted share, in 2003. The increase in 2004 was the result of higher income from railway operations and also included a \$53 million net noncash gain from the Conrail Corporate Reorganization (see Note 5). In addition, the comparisons were affected by the costs of a voluntary separation program (see Note 11) and the impairment of certain telecommunications assets (see Note 6) in 2003, which combined to reduce net income in that year by \$119 million, or 30 cents per diluted share.

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Railway operating revenues were \$8.5 billion in 2005, \$7.3 billion in 2004 and \$6.5 billion in 2003. The following table presents a three-year comparison of revenues, volume and average revenue per unit by market group.

Revenues			Units			Revenue per Unit		
<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(\$ in millions)		(in thousands)			(\$ per unit)		

Coal	\$ 2,115	\$ 1,728	\$ 1,500	1,735.4	1,690.8	1,614.6	\$ 1,219	\$ 1,022	\$ 929
General merchandise:									
Automotive	997	954	936	615.9	634.6	645.1	1,620	1,503	1,450
Metals/construction	978	818	699	794.2	781.1	710.2	1,231	1,048	984
Chemicals	973	864	772	447.0	448.5	425.7	2,176	1,927	1,815
Agr./cons. prod./govt.	845	727	688	580.3	568.9	555.8	1,455	1,278	1,238
Paper/clay/forest	<u>793</u>	- <u>684</u>	- <u>634</u>	<u>458.8</u>	<u>448.8</u>	<u>443.2</u>	- 1,729	1,524	1,431
General merchandise	4,586	4,047	3,729	2,896.2	2,881.9	2,780.0	1,583	1,404	1,341
Intermodal	<u>1,826</u>	- <u>1,537</u>	- <u>1,239</u>	<u>3,154.9</u>	<u>2,891.5</u>	<u>2,466.6</u>	- 579	531	502
Total	\$ <u>8,527</u>	\$ <u>7,312</u>	\$ <u>6,468</u>	<u>7,786.5</u>	<u>7,464.2</u>	<u>6,861.2</u>	\$ 1,095	\$ 980	\$ 943

In 2005, revenues increased \$1.2 billion, or 17%, reflecting a \$539 million, or 13%, rise in general merchandise revenues; a \$387 million, or 22%, improvement in coal revenues; and a \$289 million, or 19%, increase in intermodal revenues. All market groups collected significant amounts of fuel surcharge, which accounted for approximately one-third of the increase in revenues. At year end 2005, fuel surcharge provisions covered approximately 85% of total revenues.

As shown in the following table, the 2005 revenue improvement was the result of increased average revenues and higher traffic volumes.

Revenue Variance Analysis

Increases

	<u>2005 vs. 2004</u>	<u>2004 vs. 2003</u>
	(\$ in millions)	
Revenue per unit/mix	\$ 899	\$ 275
Volume	<u>316</u>	<u>569</u>
Total	\$ <u>1,215</u>	\$ <u>844</u>

The favorable revenue per unit/mix variance accounted for 74% of the total variance and was driven by higher rates and increased fuel surcharges, offset in part by an unfavorable mix component reflecting a 9% rise in lower average priced intermodal traffic volume. Volume rose by 322,300 units, or 4%.

In 2004, revenues increased \$844 million, or 13%, reflecting a \$318 million, or 9%, rise in general merchandise revenues, a \$298 million, or 24%, increase in intermodal revenues and a \$228 million, or 15%, improvement in coal revenues. The revenue improvement was the result of 9% higher traffic volumes and increased average revenues. All general merchandise market groups except automotive posted volume increases over 2003. The favorable revenue per unit/mix variance was driven by higher average revenue per unit that reflected higher rates and increased fuel surcharges, offset in part by the effects of a 17% increase in lower-priced intermodal traffic volume.

Beginning March 1, 2004, NS modified its fuel surcharge program for its merchandise and coal traffic. The fuel surcharge program in effect until that time applied a 2% fuel surcharge to line haul freight charges when the West Texas Intermediate (WTI) crude oil price, as published in the Wall Street Journal, exceeded \$28.00 per barrel for 30 consecutive business days. For each \$5.00 per barrel increase, an additional 2% fuel surcharge applied. The revised fuel surcharge is based on the monthly average price of WTI crude oil. Line haul freight charges are adjusted by 0.4% for every dollar the average price exceeds \$23 per barrel in the second calendar month prior to the month in which the fuel surcharge is applied. The modification in the fuel surcharge program causes the amount charged to more closely reflect fuel price fluctuations. Higher average WTI crude oil prices resulted in an increase in fuel surcharges; however, this was offset by the effect of higher prices for diesel fuel and other oil products.

COAL revenues increased \$387 million, or 22%, compared with 2004, reflecting higher average revenue per carload and increased traffic volume. Coal average revenue per unit was up 19% compared with 2004, reflecting higher rates, the favorable effects of fuel surcharges, longer-haul business and the rate cases settled in the second quarter (see below). Coal represented 25% of NS' revenues in 2005, and 83% of shipments handled originated on NS' lines. Traffic volumes rose 3% primarily because of increased shipments of utility coal that offset lower export and domestic metallurgical coal, coke and iron ore shipments.

During the second quarter of 2005, NS entered into settlement agreements with two utility customers that resolved their rail transportation rate cases before the Surface Transportation Board (STB). In 2002, Duke Energy (Duke) and Carolina Power & Light (CP&L) each filed rate reasonableness complaints with the STB. In October 2004, the STB found NS' rates to be reasonable in both cases, and at the STB's invitation, Duke and CP&L each initiated proceedings to determine if phasing constraints should apply. As a result of the settlement of these cases, NS recognized \$55 million of additional coal revenue related to the period in dispute.

In 2004, coal revenues increased \$228 million, or 15%, versus 2003. Traffic volume increased 5% primarily due to higher export, utility and metallurgical coal volumes, which offset declines in coke and iron ore. Average revenue per unit increased 10%, reflecting higher rates, fuel surcharges, a favorable change in the mix of traffic (the rate of increase in longer haul traffic exceeded that of short haul traffic) and improved loading productivity (increased tons per car). Coal, coke and iron ore revenues represented 24% of total railway operating revenues in 2004, and 83% of NS' coal shipments originated on lines it operates.

Total Coal, Coke and Iron Ore Carloads

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(Cars in thousands)</i>		
Utility	1,292.0	1,222.4	1,188.5
Export	139.2	157.0	116.5
Domestic metallurgical	209.5	214.0	213.8
Industrial	<u>94.7</u>	<u>97.4</u>	<u>95.8</u>
Total	<u>1,735.4</u>	<u>1,690.8</u>	<u>1,614.6</u>

Utility coal volume increased 6%, compared to 2004, in response to increased coal-fired generation to meet the heavier electricity demand of a strong economy, limited nuclear power generation capacity, higher natural gas prices and utility coal stockpiles which were below target levels across NS' service area. Supply constraints dampened shipments while the increased demand for Eastern U.S. coal prompted some customers to shift to coal from non-traditional sources in Wyoming and Colorado and imported coal. Appalachian coal production increased modestly and western coal production was up 2% in 2005.

In 2004, utility coal volume increased 3%, compared to 2003, as electricity production was up almost 2% in NS' service region responding to higher demand driven by a rebounding U.S. economy. Utilities increased burn to meet the heavier electricity demand and a new rail unloading facility began operating in April 2004 at a northern utility. Utility coal stockpiles were below target levels across NS' service area due in part to the increased demand for coal-fired electric generation. Increased demand for Eastern U.S. coal prompted some customers to shift to coal from non-traditional sources in Wyoming and Colorado in addition to more imported coal. In response, Appalachian coal production increased slightly in 2004 following a decline in 2003.

The outlook for utility coal remains positive. The continued growth in demand for electricity and lower-than-targeted coal stockpiles at the utilities should support increased coal carloads in 2006. Domestic western origin and imported coals are expected to continue to be an important source of additional coal supply to overcome the supply imbalance created by increased utility demand and the supply constraints of Eastern U.S. coal sources. Natural gas prices are expected to remain higher and more volatile than coal energy prices. As always, demand for coal will be influenced by the weather.

A number of evolving environmental issues could affect the utility coal market, depending upon their outcome. These include a national energy policy, proposed multi-emissions legislation, mercury emissions standards, new source review, potential regional programs aimed at capping and reducing power plant CO₂ emissions, and ongoing efforts at addressing climate change. Certain utilities have chosen to add emissions control technologies to their electric generating units in advance of governmental requirements and are moving up their plans to more fully utilize their existing coal-fired power plants.

Export coal volume decreased 11% in 2005, compared to 2004, due to both coal supply constraints and a weak European steel market. Volume through Norfolk and Baltimore decreased. Norfolk was down approximately 16,000 carloads, or 14%, and Baltimore was down approximately 2,000 carloads, or 6%. U.S. exports in 2005 were constrained by several factors: (1) the tight coal supply from Eastern coal mines caused primarily by the sporadic closure of a major coal mine, (2) the idling of production by European steel manufacturers in order to manage finished goods inventory, and (3) the abundant supply of Chinese coke on the world market lowering the price and making it more economical to buy coke rather than import metallurgical coal from the U.S. and convert it.

In 2004, export coal volume increased 35%, compared to 2003, due to sustained strong global demand for high quality metallurgical coal and China's continued growing consumption of coal for steel production and electricity generation. The devaluation of the dollar resulted in lower U.S. coal prices relative to Australian and Canadian coal prices, which made U.S. coals more economical in traditional European markets. In addition, ocean vessel rates continued to favor U.S. coals. Volume through Baltimore and Norfolk increased dramatically. Baltimore was up approximately 24,000 carloads, or 159%, and Norfolk was up approximately 16,000 carloads, or 16%. However, U.S. exports in 2004 were constrained by the tight coal supply from Eastern coal mines.

Export coal volume for 2006 is expected to show improvement, subject to the availability of U.S. coal, as the European steel market recovers; and international demand for high-quality metallurgical coal is expected to remain high despite the impact of abundant Chinese coke on the world market.

Domestic metallurgical coal, coke and iron ore volume was down 2% in 2005, compared with 2004. Declines in domestic coke and iron ore volumes, principally due to the idling of a major steel blast furnace, were partially offset by an 8% increase in metallurgical coal.

For 2004, domestic metallurgical coal, coke and iron ore volume was flat compared with 2003. Metallurgical coal volume was up 12%. However, this was offset by declines in domestic coke and iron ore volumes, principally due to reduced production at an NS-served producer.

Demand for domestic metallurgical coal, coke and iron ore is expected to improve in 2006, as the idled blast furnace is expected to return to operation and metallurgical coal production is expected to grow.

Other coal volumes (principally steam coal shipped to industrial plants) decreased 3% versus 2004, primarily due to the diversion of coal to the utility market. In 2004, other coal volumes increased 2% versus 2003, primarily due to new business and the recovery of the U.S. economy.

GENERAL MERCHANDISE revenues increased 13% due to higher average rates and fuel surcharges. Traffic volume was up modestly compared with 2004 as decreases in automotive and chemicals traffic offset increases in other business groups. In 2004, general merchandise revenues increased 9% and traffic volume increased 4% compared to 2003, principally due to higher average revenues across all business groups, including increased fuel surcharges, and improved volumes in all but the automotive business group.

Automotive revenues rose 5% in 2005 compared with 2004, the result of an 8% increase in average revenue per unit that reflected pricing improvements and higher fuel surcharges. In contrast, traffic volume decreased 3% primarily due to reduced production at Ford and GM, with GM closing assembly plants in Michigan, Maryland and New Jersey. Ford and GM combined operate 17 of 31 assembly plants served by NS. These declines were partially offset by increased production at Honda, Mercedes-Benz and Toyota.

In 2004, automotive revenues increased 2%, reflecting pricing improvements and fuel surcharge increases. In contrast, traffic volume decreased 2% compared to 2003, primarily related to reduced automotive production at Ford and GM, partially offset by increased production at Toyota and Honda.

For 2006, automotive revenues are expected to increase modestly despite a continued decline in traffic volume. Production decreases by U.S. automotive manufacturers are expected to be partially offset by higher domestic production by foreign manufacturers. In addition to the GM plant closures that occurred in 2005, Ford announced that it will close five plants, of which NS serves the St. Louis and Atlanta assembly plants and the Batavia transmission plant.

Metals and construction revenue increased 20% and traffic volume increased 2% in 2005 compared with 2004. Revenue per unit rose 17% because of higher rates and fuel surcharges. The volume improvements were due primarily to continued strength at NS-served integrated and electric arc mills and higher aluminum product shipments, which were partially offset by lower scrap metal carloads. Construction traffic volume benefited from increased residential, commercial and highway construction.

For 2004, metals and construction revenue increased 17% and traffic volume increased 10% compared with 2003. The improvement was primarily due to increased production at NS-served integrated mills and mini-mills, the conversion of truck business to rail resulting from a shortage of flatbed trucks as well as higher scrap metal volumes resulting from expanded alliances with key scrap metal shippers and access to new scrap processors and steel mills. Construction traffic volume benefited from increased residential, commercial and highway construction.

Metals and construction volume is expected to be slightly higher in 2006, reflecting continued strength in metals and highway construction, coupled with reconstruction in the Gulf Coast region.

Chemicals revenues increased 13%, reflecting higher prices and fuel surcharges, while traffic volume was down slightly, as a result of production curtailment in the Gulf Coast region, compared with a strong 2004. Volume increases for plastic and petroleum products were offset by decreases in industrial and miscellaneous chemicals.

In 2004, chemicals revenues increased 12% and traffic volume increased 5% compared with 2003. Revenue per unit reflected higher prices in response to market conditions and fuel surcharges. The volume increase reflected manufacturers' increased demand across all chemical business groups. Feedstocks and plastic shipments were up as inventories were restocked in anticipation of higher product prices related to increased natural gas costs, and new propane and asphalt terminals in the Southeast added carloads.

Chemical volume is expected to grow modestly in 2006, supported by new and expanded propane and plastic plants in North Carolina and Virginia. However, volume could be adversely affected by the price of natural gas and crude oil, which accounts for more than 50% of the cost of most chemical products and presents a significant competitive challenge that could cause domestic chemical producers to move production overseas.

Agriculture, consumer products and government revenue increased 16% and traffic volume increased 2% in 2005 compared with 2004. Average revenue per unit rose 14%, a result of higher rates and fuel surcharges. Traffic volume growth resulted from sweeteners, government traffic and fertilizer. Government traffic growth was primarily due to the support of military operations in Iraq as well as shipments of temporary housing to hurricane-damaged areas. Ethanol traffic increased 38% due to higher shipments from current customers in addition to new business in Georgia and South Carolina.

In 2004, agriculture, consumer products and government revenue increased 6% and traffic volume increased 2% compared with 2003. Revenue per unit improved 3% as a result of changes in traffic mix such as increased ethanol traffic and more long haul feed shipments as well as higher prices. The volume increase was primarily driven by ethanol and fertilizer shipments. Ethanol traffic increased 59% primarily due to the opening of the Northeast market to ethanol as a gasoline additive. Fertilizer was up 7% year-over-year, reflecting higher domestic shipments to industrial customers and increased exports of phosphates, principally to China.

Agriculture, consumer products and government volume is expected to grow in 2006, benefiting from the expanding markets for ethanol and bio-diesel production and continued recovery efforts in the Gulf region.

Paper, clay and forest products revenue increased 16% and traffic volume increased 2% in 2005 compared with 2004. Average revenue per unit rose 13% due to higher rates and fuel surcharges. Pulp board, printing paper, newsprint and woodchip produced volume gains despite consolidations within the industry and mill shutdowns.

In 2004, paper, clay and forest products revenue increased 8% and traffic volume increased 1% compared with 2003, reflecting yield improvements in all segments except newsprint, together with higher printing paper, newsprint, pulp board and kaolin shipments as U.S. paper production and demand for paper products strengthened in 2004. Revenue per unit improved 6% principally as a result of price increases but also aided by higher fuel surcharges.

In 2006, paper, clay and forest product revenues are expected to benefit from paper volume, higher construction and demolition debris shipments and a new lumber distribution center that is expected to open in 2006.

INTERMODAL revenues increased \$289 million, or 19% compared with 2004, reflecting improved traffic volume, higher fuel surcharges, and increased rates. Despite moderated growth in domestic business, traffic volume increased 9% reflecting strength in the international, truckload and Triple Crown Services lines of business. International traffic volume grew by 16% reflecting strength in U.S. consumer markets and growth in the movement of import and export goods through NS-served east coast ports, as well as west coast ports. Truckload volume increased 10% compared with 2004, reflecting additional business with traditional truckload companies. Premium business, which includes parcel and LTL carriers, grew 6% due primarily to new business in the Northern region. Triple Crown Services volume grew 6% reflecting expanded geographic coverage and increased trailer fleet size to meet higher demand. Domestic volume decreased 3% compared with 2004, principally due to the continued reduction in transloading of west coast international freight into domestic containers. Intermodal revenue per unit increased 9%, a result of fuel surcharges and rate increases.

In 2004, intermodal revenue increased 24% and volume increased 17% compared with 2003. Strong demand was driven by an expanding economy led by higher consumer spending, industrial production and international trade, in addition to constraints in truck and other railroads' capacity. International steamship volume was up 15%, tied to the growth in U.S. trade volumes through east and west coast ports.

Truckload volume increased 28% as a result of new business with traditional truckload companies. Premium business, which includes parcel and LTL carriers, grew 15% principally due to new parcel service between Chicago and New Jersey. Triple Crown Services Company increased volume by 8% through an expanded trailer fleet and growth in its geographic coverage. Revenue per unit improved 6%, reflecting value-based pricing and fuel surcharges.

In 2006, intermodal revenues are expected to grow as NS plans to open new terminals in Kentucky and Pennsylvania in addition to expanding existing intermodal terminals in Georgia and Ohio. In addition, strong international trade is expected to create growth opportunities in NS' international business segment. Future growth may, however, be tempered by operating improvements at other railroads, as well as constraints in the drayage market.

Railway Operating Expenses

Railway operating expenses in 2005 were \$6.4 billion, up \$800 million, or 14%, compared to 2004, which were up 4% compared to 2003. The 2005 increase was principally due to a sharp rise in the price of diesel fuel, volume-related expense increases, more maintenance activities and higher casualty costs. Carloads rose 4% in 2005 compared to 2004 and 9% in 2004 compared to 2003. The increase in 2004 was largely the result of higher traffic volume, offset in part by the absence of the \$107 million cost of a voluntary separation program incurred in 2003.

The railway operating ratio, which measures the percentage of railway operating revenues consumed by railway operating expenses, was 75.2% in 2005, compared with 76.7% in 2004 and 83.5% in 2003.

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

Operating Expense Variances

Increases (Decreases)

	<u>2005 vs. 2004</u>	<u>2004 vs. 2003</u>
	(\$ in millions)	
Compensation and benefits*	\$ 221	\$ (3)
Materials, services and rents	208	174
Conrail rents and services	(190)	(100)
Depreciation	176	85
Diesel fuel	278	69
Casualties and other claims	73	(30)
Other	34	11
Total	<u>\$ 800</u>	<u>\$ 206</u>

* Includes \$107 million of voluntary separation costs in 2003.

Compensation and benefits, which represents about 40% of total railway operating expenses, increased \$221 million, or 10%, compared with 2004 and was flat in 2004 compared with 2003. The 2005 increase reflected increased hours for train operations, including trainees,

and equipment maintenance (up \$70 million); increased wage rates (up \$46 million); increased pension, postretirement and health and welfare benefit costs (up \$43 million); higher stock-based compensation (up \$22 million); and higher payroll taxes (up \$12 million).

NS employment averaged 30,294 in 2005 compared with 28,475 in 2004 and 28,753 in 2003. The increased employment has come almost exclusively in operating department personnel to meet the increased volume and service needs, as well as expected retirements. NS continues to hire and train additional workers in order to meet the requirements of forecasted volumes in light of the demographics of its work force.

In 2005 and prior years, NS accounted for its stock-based compensation under APB No. 25; however, NS will adopt SFAS 123(R) in the first quarter of 2006 (see discussion under "New Accounting Pronouncement" and Note 1) which will result in higher compensation expense. The expense increase will include the effect of accelerated recognition of costs related to grants to retirement-eligible employees. Most NS salaried employees are eligible to retire at age 55 with a reduced pension benefit. SFAS No. 123(R) requires immediate expense recognition for the cost of grants made to such retirement-eligible employees rather than accrual over the expected future service period. About three-quarters of the cost of stock-based compensation granted in January 2006 will be expensed in 2006 (with almost half of the cost in the first quarter) even though some of the components are earned over a three-year period.

In 2004, compensation expenses reflected higher volume-related train and engine payroll expenses, up \$39 million; higher wage rates, which added \$37 million; increased stock-based compensation, up \$24 million; and higher management and locomotive engineer performance-based incentive compensation, which was up \$20 million. These increases were offset by lower nonagreement workforce levels, saving \$24 million, as well as the absence of the \$107 million expense of the 2003 voluntary separation program.

The Railroad Retirement and Survivors' Improvement Act, which took effect Jan. 1, 2002, allows for investment of Tier II assets in a diversified portfolio through the National Railroad Retirement Investment Trust. The law also provides a mechanism for automatic adjustment of Tier II payroll taxes should the trust assets fall below a four-year reserve or exceed a six-year reserve. As a result, the employers' portion of Tier II retirement payroll taxes have been reduced from 14.2% in 2003 to 13.1% in 2004 and to 12.6% in 2005 and thereafter. However, these savings are expected to continue to be substantially offset by higher payroll taxes on increased wages and a higher wage base.

Materials, services and rents includes costs related to items used for the maintenance of railroad lines, structures and equipment; 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 \$208 million, or 13% in 2005 compared to 2004 and increased 12% in 2004 compared to 2003. The increase in 2005 reflected higher volume-related purchased services (up \$82 million) and higher maintenance expense (up \$74 million). Equipment rents rose \$28 million, reflecting higher traffic volume as well as leases from the Conrail Corporate Reorganization (see Note 5).

The 2004 increase was the result of higher purchased services, up \$100 million, including higher costs for volume-related intermodal services such as the lifting of containers and trailers and drayage. In addition, locomotive and freight car maintenance expenses rose \$23 million, and equipment rents increased \$33 million.

Locomotive repair costs increased in 2005 and 2004, due to more maintenance activity related to higher usage from increased traffic volumes coupled with the age of the fleet. This level of expense is expected to continue and may increase depending on traffic volumes.

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, rose 11% in 2005 and increased 9% in 2004. The increase in 2005 was principally due to additional lease expense for a full year from the Conrail Corporate Reorganization and increased volume-related intermodal shipments. The rise in 2004 was principally due to traffic volume (particularly intermodal shipments) and the absence of favorable settlements that benefited 2003.

Conrail rents and services decreased \$190 million, or 60%, in 2005 compared to 2004 and decreased 24% in 2004 compared to 2003. This item includes amounts due to CRC for operation of the Shared Assets Areas (see Note 5). The decline in both 2005 and 2004 was primarily driven by the Conrail Corporate Reorganization, which resulted in the consolidated reporting of individual components of Conrail equity earnings, principally depreciation, equipment rents and interest expense (see Note 5). NS' share of equity earnings after the Conrail Corporate Reorganization is a component of "Other income-net" (see Note 2).

Depreciation expense increased \$176 million, or 29%, in 2005 compared to 2004 and increased 17% in 2004 compared to 2003. The increases in 2005 and 2004 were primarily a result of the Conrail Corporate Reorganization (see Note 5). In addition, substantial capital investments and improvements affected all years, resulting in higher depreciation expense.

In 2004, NS received the results of a roadway depreciation study from an independent firm of engineers. The results of the study, which were implemented in September 2004, prospectively reduced depreciation expense by approximately \$17 million annually. In 2006, NS expects to complete an equipment depreciation study and an analysis of the assets received in the Conrail Corporate Reorganization. The results of these items are expected to reduce depreciation expense, making 2006 comparable with 2005.

Diesel fuel expenses increased 62% in 2005 compared with 2004 and increased 18% in 2004 compared with 2003. Diesel fuel expense is recorded net of hedge benefits (see "Market Risks and Hedging Activities," below and Note 16). The increase in 2005 reflects a 43% rise in the average price per gallon and a 2% increase in consumption. The increase in 2004 reflects a 13% rise in the average price per gallon and a 6% increase in consumption. Expenses in 2005 included hedge benefits of \$148 million compared with benefits of \$140 million in 2004 and \$59 million in 2003. NS has hedged approximately 4% of expected 2006 diesel fuel requirements as of Dec. 31, 2005, at an average price of 89 cents per gallon. No new hedges have been entered into since May 2004. Accordingly, if diesel fuel prices remain at their current levels, or increase further, diesel fuel expense will be higher in 2006.

Legislation enacted in the first quarter of 2005 repeals the 4.3 cents per gallon excise tax on railroad diesel fuel and inland waterway fuel by 2007, with the following phased reductions in 2005 and 2006: by 1 cent per gallon from Jan. 1, 2005 through June 30, 2005; 2 cents per gallon from July 1, 2005 through Dec. 31, 2006; and by the full 4.3 cents thereafter. NS consumes over 500 million gallons of diesel fuel per year.

Casualties and other claims expenses (including the estimates of costs related to personal injury, property damage and environmental matters) increased 48% in 2005 compared to 2004 and decreased 17% in 2004 compared to 2003. The increase in 2005 reflected costs associated with a derailment in Graniteville, South Carolina (see discussion below), \$16 million for an unfavorable jury verdict received in an FELA case, \$9 million of higher insurance costs, and \$4 million for the portion of the \$12.5 million self-insured retention related to Hurricane Katrina expenses. The decline in 2004 reflected favorable personal injury and freight claims development and higher insurance settlements, partially offset by increased derailment expenses.

On Jan. 6, 2005, a collision in Graniteville, South Carolina, between two NS trains caused the release of chlorine gas from a ruptured tank car. NS' liability in 2005 related to this accident includes a current and long-term portion which 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 NS' self-insured retention, including NS' response costs and legal fees. Accordingly, the Consolidated Balance Sheet reflects a current and long-term receivable for estimated recoveries from NS' insurance carriers. The \$41 million expense recorded in 2005 represents NS' retention under its insurance policies and other uninsured costs. While it is reasonable to expect that the liability for covered losses could differ from the amount recorded, such a change would be offset by a corresponding change in the insurance receivable. As a result, NS does not believe that it is reasonably likely that its net loss (the difference between the liability and future recoveries) will be materially different than the loss recorded in 2005. NS expects at this time that insurance coverage is adequate to cover potential claims and settlements above its self-insurance retention.

During the third quarter, NS' operations were adversely affected by Hurricane Katrina, and to a lesser extent, Hurricane Rita, both of which struck the Gulf Coast. NS sustained damage to its facilities in the region as a result of Hurricane Katrina but restored rail freight service into and around New Orleans in a relatively short period of time. The damage sustained to NS facilities as a result of Hurricane Katrina did not materially impact NS' financial condition or results of operations and is covered by insurance above the self-insurance retention limit.

The largest component of casualties and other claims expense is personal injury costs. Cases involving occupational injuries comprised about one-third of total employee injury cases resolved and about one-fourth 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 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 commercial insurance for potential third-party liability and property damage claims. It also retains reasonable levels of risk through self-insurance (see Note 18). NS expects insurance costs to be higher in 2006.

Other expenses increased 15% in 2005 compared to 2004 and 5% in 2004 compared to 2003. Both 2005 and 2004 reflected higher property and sales and use taxes.

Other income – net was \$74 million in 2005 and \$89 million in 2004, which included the \$53 million gain from the Conrail Corporate Reorganization (see Note 5). Results in 2005 reflected: (1) higher interest income (up \$28 million), (2) equity in earnings of Conrail subsequent to the Conrail Corporate Reorganization (up \$26 million), (3) additional coal royalties (up \$12 million), and (4) lower interest accruals related to tax liabilities (down \$9 million). These income improvements were partially offset by more expense associated with tax credit investments (up \$39 million).

In 2004, other income – net increased by \$70 million, reflecting the absence of the \$84 million telecommunications assets impairment charge that burdened 2003 (see Note 6) and the gain in 2004 on the Conrail Corporate Reorganization (see Note 5). These increases combined to more than offset expenses from an investment in a limited liability company that owns and operates facilities that produce synthetic fuel from coal (see Note 2). The production of synthetic fuel results 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 the provision for income taxes (see Note 3).

Income Taxes

Income tax expense in 2005 was \$416 million for an effective rate of 25%, compared with effective rates of 29% in 2004 and 30% in 2003. The large decline in 2005 resulted from the Ohio tax legislation changes, which lowered deferred taxes by \$96 million and the effective tax rate by six percentage points (see Note 3).

As shown in Note 3 to the Consolidated Financial Statements, which sets forth a reconciliation from the statutory rate to the effective rate for all three years, the effective rates in both 2005 and 2004 were reduced as a result of tax credits from synthetic fuel-related investments. In addition, 2004 benefited from the favorable resolution of an IRS audit of a synthetic fuel related investment. The effective rates in all three years benefited from favorable adjustments upon filing the prior year tax returns and favorable adjustments to state tax liabilities.

The consolidated federal income tax returns for 2002 through 2003 are being audited by the Internal Revenue Service (IRS). The IRS completed its examination of the 2000 and 2001 consolidated federal income tax returns and issued a Revenue Agent's Report in September 2005, which had a negligible effect on the effective tax rate.

For the 2001 through 2004 tax years, 30% and 50% bonus depreciation was allowed for federal income tax purposes. Except for certain areas affected by Hurricane Katrina, bonus depreciation was not available in 2005. In addition, the Conrail Corporate Reorganization resulted in NS receiving assets with less future tax depreciation than book depreciation. As a result, current taxes were higher in 2005 than in earlier years and are expected to remain higher in 2006.

NS' interests in synthetic fuel credits are subject to reduction if the Reference Price of a barrel of oil for the year falls within an inflation-adjusted phase-out range specified by the tax code. The Reference Price for a year is the annual average wellhead price per barrel of unregulated domestic crude oil as determined by the Secretary of the Treasury by April 1 of the following year. In 2004, the phase-out range was \$51.35 to \$64.47. The phase-out range for 2005 and later years will be adjusted for inflation. No phase out is considered likely in 2005; however, NS cannot predict with certainty the Reference Price of a barrel of oil for later years. If the Reference Price for a year falls within or exceeds the applicable phase-out range for that year, NS' synthetic fuel credits could be reduced or eliminated. However, indemnification

arrangements limit NS' exposure if tax credits are reduced due to oil prices.

Discontinued Operations

In 2003, income from discontinued operations consisted of a \$10 million after-tax gain related to the resolution of tax issues arising from the sale of NS' motor carrier subsidiary (see Note 17).

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities, NS' principal source of liquidity, was \$2.1 billion in 2005, compared with \$1.7 billion in 2004 and \$1.1 billion in 2003. The improvement in 2005 reflected the \$415 million increase in income from railway operations as well as the effects of the Conrail Corporate Reorganization (see below), offset in part by higher income tax payments, including a payment made upon settlement of a federal audit cycle. In 2004, the increase was primarily due to increased railway operating income.

Prior to the Conrail Corporate Reorganization (see Note 5), a significant portion of the payments made to PRR under the operating and lease agreements (which were included in "Conrail rents and services" and, therefore, were a use of cash in "Cash provided by operating activities"), was borrowed back from a subsidiary of PRR under a note due in 2032, and therefore, was a source of cash in "Proceeds from borrowings." NS' net cash flow from these borrowings amounted to \$118 million in 2004 and \$203 million in 2003. This note was effectively extinguished by the reorganization in 2004. Subsequent to the Conrail Corporate Reorganization, payments under "Conrail rents and services" have declined, depreciation charges have increased and the net borrowings have been terminated. Accordingly, NS' cash provided by operating activities after the Conrail Corporate Reorganization has increased.

NS had working capital of \$729 million at Dec. 31, 2005, compared with a working capital deficit of \$234 million at Dec. 31, 2004. The improvement reflected higher cash provided by operating activities, as well as a \$348 million reduction in current maturities of long-term debt. NS expects that cash on hand combined with cash flow from operations will be sufficient to meet its ongoing obligations. This expectation is based on a view that the economy will continue at a moderate growth rate through 2006.

Contractual obligations at Dec. 31, 2005, related to NS' long-term debt (including capital leases) (see Note 8), operating leases (see Note 9), agreements with CRC (see Note 5), unconditional purchase obligations (see Note 18) and other long-term obligations (see Note 18), are as follows:

	Payments Due By Period				
	<u>Total</u>	<u>2006</u>	<u>2007- 2008</u>	<u>2009- 2010</u>	<u>2011 and Subsequent</u>
	(\$ in millions)				
Long-term debt and capital lease principal	\$ 6,930	\$ 314	\$ 860	\$ 816	\$ 4,940
Operating leases	1,067	144	255	185	483
Agreements with CRC	456	25	50	50	331
Unconditional purchase obligations	341	240	101	--	--
Long-term advances from Conrail	133	--	--	--	133
Other long-term obligations	17	11	6	--	--
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Total	\$	<u>8,944</u>	\$	<u>734</u>	\$	<u>1,272</u>	\$	<u>1,051</u>	\$	<u>5,887</u>
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Off balance sheet arrangements consist of operating lease obligations, which are included in the table of contractual obligations above and disclosed in Note 9. NS did not renew its accounts receivable securitization program which expired in May 2005.

Cash used for investing activities was \$1.8 billion in 2005, compared with \$1.2 billion in 2004 and \$640 million in 2003. The increase in 2005 was principally the result of larger purchases of short-term investments, while the rise in 2004 resulted from higher property additions and the investment in a membership interest in a limited liability company that owns and operates facilities that produce synthetic fuel from coal. 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

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
	<i>(\$ in millions)</i>				
Road	\$ 739	\$ 607	\$ 495	\$ 519	\$ 505
Equipment	284	429	218	174	233
Other property	<u>2</u>	<u>5</u>	<u>7</u>	<u>2</u>	<u>8</u>
Total	\$ <u>1,025</u>	\$ <u>1,041</u>	\$ <u>720</u>	\$ <u>695</u>	\$ <u>746</u>

Capital expenditures in 2005 were \$16 million, or 2%, lower than 2004 principally due to decreases in equipment purchases that were partially offset by increased investment in roadway projects. In 2004, higher capital expenditures were primarily due to increased locomotive purchases as well as investment in roadway projects, Triple Crown Services equipment and freight cars.

Track Structure Statistics (Capital and Maintenance)

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Track miles of rail installed	302	246	233	235	254
Miles of track surfaced	4,663	5,055	5,105	5,270	3,836
New crossties installed (millions)	2.5	2.5	2.8	2.8	1.5

Average Age of Owned Railway Equipment

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
			(years)		
Freight cars	28.4	27.6	26.6	25.9	25.4
Locomotives	17.2	16.8	15.3	16.1	15.7
Retired locomotives	27.4	22.9	28.7	28.2	22.4

Through its coal car rebody program, which was suspended in 2000, NS converted about 29,000 hopper cars into high-capacity steel gondolas or hoppers. As a result, the remaining service life of the freight-car fleet is greater than may be inferred from the increasing average age shown in the table above.

For 2006, NS has budgeted \$1.15 billion for capital expenditures. The anticipated spending includes \$735 million for roadway projects, of which \$484 million is for track and bridge program work. Also included are projects for communications, signal and electrical systems, as well as projects for environmental and public improvements such as grade crossing separations and signal upgrades. Other roadway projects include marketing and industrial development initiatives, including increasing track capacity and access to coal receivers and vehicle production and distribution facilities, and continuing investments in intermodal infrastructure. Equipment spending of \$358 million includes the purchase of 133 locomotives and upgrades to existing units, improvements to multilevel automobile racks, and projects related to computers and information technology, including additional security and backup systems. NS expects to make all of its capital expenditures with internally generated funds.

On Dec. 2, 2005, NS announced an agreement to form a joint venture with Kansas City Southern 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 four years, in exchange for a 30% interest in the joint venture. Kansas City Southern will contribute a 320 mile rail line between Meridian, Mississippi and Shreveport, Louisiana (the "Meridian Speedway"). Closing of the transaction is conditioned on the receipt of the necessary authority from the Surface Transportation Board. Accordingly, if the transaction is authorized and consummated, NS expects to recognize its pro rata share of the joint venture's earnings or loss as required under the equity method of accounting. The transaction is expected to be modestly dilutive in the early years of the venture due to lost interest income on the cash contributed to the joint venture. However, NS expects that the dilution from the lost interest income will be offset from additional traffic as the investment is made and improvements are completed. The joint venture is expected to increase capacity and improve service on the Meridian Speedway.

NS expects to spend \$50 million, in the near future, connected with Heartland Corridor-related projects. 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. Completion of the related projects is contingent on securing public or third-party funding commitments.

NS and other railroads have agreed to participate in the Chicago Region Environmental and Transportation Efficiency (CREATE) project in Chicago. The intent of the proposed public-private partnership is to reduce rail and highway congestion and add freight and passenger capacity in the metropolitan Chicago area. A portion of the public funding has been approved and the parties are working to develop a list of projects to be included in Phase I of the project. Funding requirements will be determined by the selection of Phase I projects. The railroads expect to complete Phase I over the next four years.

Cash used for financing activities was \$456 million in 2005, compared with \$233 million in 2004 and \$314 million in 2003. Financing activity in 2005 included: (1) the issuance of \$300 million aggregate principal amount of 6% unsecured notes due March 2105, and (2) the issuance of \$717 million of unsecured notes (\$350 million at 5.64% due 2029 and \$367 million at 5.59% due 2025) and payment of \$218 million of premium in exchange for \$717 million of previously issued unsecured notes (\$350 million at 7.8% due 2027, \$200 million at 7.25% due 2031, and \$167 million at 9.0% due 2021) (see Note 8). The \$218 million cash premium payment is reflected as a reduction of debt in the Consolidated Balance Sheets and Statement of Cash Flows and will be amortized as additional interest expense over the terms of the new debt. Investing activities in 2005 and 2004 also included substantial proceeds from employee exercise of stock options. NS' debt-to-total capitalization ratio was 42.7% at Dec. 31, 2005, and 48.5% at Dec. 31, 2004.

In November 2005, NS' Board of Directors authorized the repurchase of up to 50 million shares of NS Common Stock through the end of 2015. The timing and volume of any purchases will be guided by management's assessment of market conditions and other pertinent factors. Near-term purchases under the program are expected to be made with internally generated cash; however, future funding sources could include proceeds from the sale of commercial paper notes or the issuance of long-term debt.

NS currently has in place and available a \$1 billion, five-year credit agreement, which provides for borrowings at prevailing rates and includes financial covenants. There were no amounts outstanding under this facility at Dec. 31, 2005, and NS is in compliance with all of the financial covenants. NS also has in place a shelf registration statement on Form S-3 filed with the SEC in September 2004 with \$700 million of available capacity (see Note 8). On July 18, 2005, Standard & Poor's (S&P) upgraded its ratings on NS' unsecured debt from BBB to BBB+. Moody's rating remains at Baa1, comparable to S&P's.

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 change them. 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 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 11). 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 engages an independent consulting actuarial firm 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 Income Statement, was \$23 million for the year ended Dec. 31, 2005. In recording this amount, NS assumed a long-term investment rate of return of 9%. Investment experience of the pension fund over the past 10-, 15- and 20-year periods has been a rate of return in excess of 10%. 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 asset in the future. The net pension asset 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. Specifically, NS refers to Moody's seasoned Aa corporate bond yields and the changes in such yields; therefore, management has little discretion in this assumption.

NS' net cost for other postretirement benefits, which is also included in "Compensation and benefits," was \$62 million for the year ended Dec. 31, 2005. In recording this expense and valuing the net liability for other postretirement benefits, which is included in "Other benefits" as disclosed in Note 11, 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 11.

Properties and Depreciation

Most of NS' total assets are comprised of long-lived railway properties (see Note 6). 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. These assumptions are the product of periodic depreciation studies that are performed by a 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 Dec. 31, 2005, amounted to \$774 million. NS' weighted-average depreciation rates for 2005 are disclosed in Note 6; a one-tenth percentage point increase (or decrease) in these rates would have resulted in a \$25 million increase (or decrease) to NS' depreciation expense.

Personal Injury, Environmental and Legal Liabilities

NS' expense for "Casualties and other claims" amounted to \$224 million for the year ended Dec. 31, 2005. Most of this expense was composed of NS' accrual related to personal injury liabilities (see discussion of FELA in the discussion captioned "Casualties and other claims" above). 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.

NS engages an independent consulting actuarial firm to aid in valuing its personal injury liability and determining the amount to accrue during the year. 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 2005, resulted in a slight 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 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 18). 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 \$16 million in 2005, \$11 million in 2004 and \$9 million in 2003, and capital expenditures totaled approximately \$9 million in each of 2005, 2004 and 2003. Capital expenditures in 2006 are expected to be comparable to those in 2005.

NS' balance sheets included liabilities for environmental exposures in the amount of \$58 million at Dec. 31, 2005, and \$64 million at Dec. 31, 2004 (of which \$12 million was accounted for as a current liability at Dec. 31, 2005, and 2004). At Dec. 31, 2005, the liability represented NS' estimate of the probable cleanup and remediation costs based on available information at 189 identified locations. On that date, 16 sites accounted for \$30 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 some of the 189 locations, certain 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.

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

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 \$6,620 million at Dec. 31, 2005 (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 a \$16 million valuation allowance on \$775 million of deferred tax assets as of Dec. 31, 2005, reflecting the expectation that most of these assets will be realized. In addition, NS has a recorded liability for its estimate of potential income tax exposures. Management believes this liability for potential exposure to be adequate. Income tax expense is adjusted to the extent the final outcome of these matters differs from the amounts recorded. For every one half percent change in the 2005 effective rate net income would have changed by \$8 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 in concert with other major railroads. Moratorium provisions in the labor agreements govern when the railroads and the unions may propose labor agreement changes. The previous moratorium provisions expired in the latter part of 2004 and the railroads and the rail labor unions thereafter served new proposals to begin the next bargaining round. Industry issues include train crew staffing and employee contributions for health care benefits.

Seven rail unions (Brotherhood of Locomotive Engineers and Trainmen, Brotherhood of Maintenance of Way Employees, American Train Dispatchers Association, Brotherhood of Railroad Signalmen, International Brotherhood of Blacksmiths and Boilermakers, National Conference of Firemen and Oilers, and Sheet Metal Workers International Association) are bargaining together under the auspices of the Rail Labor Bargaining Coalition (RLBC). The railroads filed for mediation with the United Transportation Union (UTU) and with the RLBC unions. The status quo is preserved during mediation while a federal mediator assists the parties in their efforts to reach agreement. If the NMB were to terminate mediation, it would, at that time, propose that the parties arbitrate their differences. A strike could occur 30 days thereafter if the parties did not accept arbitration. However, the President of the United States of America could then appoint an Emergency Board which would delay any strike for a further 60 days while the Board made recommendations and the parties and engaged in further negotiations. The outcome of the negotiations cannot be determined at this point.

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 is 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.

Diesel fuel costs represented 11% of NS' operating expenses for 2005. The program provides that NS will not enter into any fuel hedges with a duration of more than 36 months, and that no more than 80% of NS' average monthly fuel consumption will be hedged for any month within any 36-month period.

As of Dec. 31, 2005, through swap transactions, NS has hedged approximately 4% of expected 2006 diesel fuel requirements. The effect of these hedges is to yield an average cost of 89 cents per hedged gallon, including federal taxes and transportation. A 10% decrease in diesel fuel prices would reduce NS' asset related to the swaps by approximately \$4 million as of Dec. 31, 2005.

However, with fuel prices near historic highs and fuel surcharges being collected under certain tariffs and contracts, NS has not entered into additional hedges since May 2004. Consequently, the past pattern of entering into regular monthly swaps may not be indicative of future hedging activity. If diesel fuel prices remain at their current levels, or increase further, diesel fuel expense will be higher going forward.

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 Dec. 31, 2005, NS' debt subject to interest rate fluctuations totaled \$285 million. A 1% 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 Dec. 31, 2005, the average pay rate under these agreements was 7%, and the average receive rate was 5%. During 2005, the effect of the swaps was to reduce interest expense by \$2 million. 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 Pronouncement

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123(R), "Share-Based Payments". This statement establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services, such as stock-based compensation plans. NS will adopt this standard in the first quarter of 2006, which will result in higher compensation expense (see Note 1). The statement applies to all awards granted after the effective date and to awards modified, repurchased, or cancelled after that date, as well as awards that are unvested at the effective date.

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 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" 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: legislative and regulatory developments; competition and consolidation within the transportation industry; domestic and international economic conditions; the business environment in industries that produce and consume rail freight; the operations of carriers with which we interchange; labor difficulties, including strikes and work stoppages; disruptions to our technology infrastructure including our computer systems; natural events such as severe weather, floods and hurricanes; acts of terrorism or war; fluctuation in prices of key materials, in particular diesel fuel; and changes in securities and capital markets. Forward-looking statements are not, and should not be relied upon as, a guaranty 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."

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Item 8. Financial Statements and Supplementary Data.

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Report of Management

February 21, 2006

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, 2005. 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, 2005 .

KPMG LLP, independent registered public accounting firm, has audited the Corporation's financial statements and has reported on management's assessment of the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2005 .

/s/ Charles W. Moorman

/s/ Henry C. Wolf

/s/ Marta R. Stewart

Charles W. Moorman
Chairman, President and
Chief Executive Officer

Henry C. Wolf
Vice Chairman and
Chief Financial Officer

Marta R. Stewart
Vice President and
Controller

Report of Independent Registered Public Accounting Firm

The Stockholders and Board of Directors

Norfolk Southern Corporation:

We have audited management's assessment, included in the accompanying Report of Management, that Norfolk Southern Corporation maintained effective internal control over financial reporting as of December 31, 2005, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Norfolk Southern Corporation'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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. 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 U.S. 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, management's assessment that Norfolk Southern Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Norfolk Southern Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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, 2005 and 2004, 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, 2005. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in Item 15(A)2. Our report dated February 21, 2006, expressed an unqualified opinion on the consolidated financial statements and financial statement schedule.

/s/ KPMG LLP

Norfolk, Virginia

February 21, 2006

Report of Independent Registered Public Accounting Firm

The Stockholders and Board of Directors

Norfolk Southern Corporation:

We have audited the accompanying consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2005 and 2004, 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, 2005. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in Item 15(A)2. These consolidated financial statements and financial statement schedule are the responsibility of Norfolk Southern Corporation'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, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, 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, effective January 1, 2003, Norfolk Southern Corporation adopted Financial Accounting Standards Board Statement No. 143, *Accounting for Asset Retirement Obligations*, and Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Norfolk Southern Corporation's internal control over financial reporting as of December 31, 2005, 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 21, 2006, expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Norfolk , Virginia

February 21, 2006

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Income

	Years ended Dec. 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions, except earnings per share)</i>		
Railway operating revenues	\$ 8,527	\$ 7,312	\$ 6,468
Railway operating expenses			
Compensation and benefits (Note 11)	2,493	2,272	2,275
Materials, services and rents	1,809	1,601	1,427
Conrail rents and services (Note 5)	129	319	419
Depreciation (Note 5)	774	598	513
Diesel fuel	727	449	380
Casualties and other claims (Note 18)	224	151	181
Other	<u>254</u>	<u>220</u>	<u>209</u>
Total railway operating expenses	<u>6,410</u>	<u>5,610</u>	<u>5,404</u>
Income from railway operations	2,117	1,702	1,064
Other income – net (Note 2)	74	89	19
Interest expense on debt (Note 6)	<u>494</u>	<u>489</u>	<u>497</u>
Income from continuing operations before income taxes and accounting changes	1,697	1,302	586

Provision for income taxes (Note 3)	<u>416</u>	<u>379</u>	<u>175</u>
Income from continuing operations before accounting changes	1,281	923	411
Discontinued operations – gain on sale of motor carrier, net of taxes (Note 17)	--	--	10
Cumulative effect of changes in accounting principles, net of taxes (Note 1)	<u>--</u>	<u>--</u>	<u>114</u>
Net income	\$ <u>1,281</u>	\$ <u>923</u>	\$ <u>535</u>
Per share amounts (Note 14):			
Income from continuing operations before accounting changes			
Basic	\$ 3.17	\$ 2.34	\$ 1.05
Diluted	\$ 3.11	\$ 2.31	\$ 1.05
Net income			
Basic	\$ 3.17	\$ 2.34	\$ 1.37
Diluted	\$ 3.11	\$ 2.31	\$ 1.37

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Balance Sheets

	As of Dec. 31,	
	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 289	\$ 467
Short-term investments (Note 5)	968	202
Accounts receivable – net (Notes 4 and 18)	931	767
Materials and supplies	132	104
Deferred income taxes (Note 3)	167	187
Other current assets	<u>163</u>	<u>240</u>
Total current assets	2,650	1,967
Investments (Note 5)	1,590	1,499
Properties less accumulated depreciation (Note 6)	20,705	20,526
Other assets (Note 18)	<u>916</u>	<u>758</u>
Total assets	\$ <u>25,861</u>	\$ <u>24,750</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable (Notes 7 and 18)	\$ 1,163	\$ 1,090

Income and other taxes	231	210
Other current liabilities (Note 7)	213	239
Current maturities of long-term debt (Note 8)	<u>314</u>	<u>662</u>
Total current liabilities	1,921	2,201
Long-term debt (Note 8)	6,616	6,863
Other liabilities (Notes 10 and 18)	1,415	1,146
Deferred income taxes (Note 3)	<u>6,620</u>	<u>6,550</u>
Total liabilities	16,572	16,760
Stockholders' equity:		
Common stock \$1.00 per share par value, 1,350,000,000 shares		
authorized; issued 430,718,913 and 421,346,107 shares,		
respectively	431	421
Additional paid-in capital	992	728
Unearned restricted stock (Note 12)	(17)	(8)
Accumulated other comprehensive loss (Note 13)	(77)	(24)
Retained income	7,980	6,893
Less treasury stock at cost, 20,833,125 and 20,907,125 shares,		
respectively	<u>(20)</u>	<u>(20)</u>
Total stockholders' equity	<u>9,289</u>	<u>7,990</u>
Total liabilities and stockholders' equity	\$ <u>25,861</u>	\$ <u>24,750</u>

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	Years Ended Dec. 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(\$ in millions)		
Cash flows from operating activities			
Net income	\$ 1,281	\$ 923	\$ 535
Reconciliation of net income to net cash provided by operating activities:			
Net cumulative effects of changes in accounting principles	--	--	(114)
Depreciation	787	609	528
Deferred income taxes	80	200	132
Equity in earnings of Conrail (Note 5)	(37)	(54)	(58)
Gain on Conrail Corporate Reorganization (Note 5)	--	(53)	--

Gains and losses on properties and investments	(51)	(46)	(45)
Income from discontinued operations	--	--	(10)
Changes in assets and liabilities affecting operations:			
Accounts receivable (Note 4)	(94)	(71)	(12)
Materials and supplies	(28)	(12)	5
Other current assets	20	(18)	(4)
Current liabilities other than debt	55	126	(25)
Other – net (Notes 6 and 11)	<u>92</u>	<u>57</u>	<u>122</u>
Net cash provided by operating activities	2,105	1,661	1,054
Cash flows from investing activities			
Property additions	(1,025)	(1,041)	(720)
Property sales and other transactions	110	75	78
Investments, including short-term	(1,822)	(396)	(106)
Investment sales and other transactions	<u>910</u>	<u>117</u>	<u>108</u>
Net cash used for investing activities	(1,827)	(1,245)	(640)
Cash flows from financing activities			
Dividends	(194)	(142)	(117)
Common stock issued – net	194	162	13
Redemption of minority interest	--	--	(43)
Proceeds from borrowings	433	202	261
Debt repayments	<u>(889)</u>	<u>(455)</u>	<u>(428)</u>
Net cash used for financing activities	<u>(456)</u>	<u>(233)</u>	<u>(314)</u>
Net increase (decrease) in cash and cash equivalents	(178)	183	100
Cash and cash equivalents			
At beginning of year	<u>467</u>	<u>284</u>	<u>184</u>
At end of year	\$ <u>289</u>	\$ <u>467</u>	\$ <u>284</u>
Supplemental disclosure of cash flow information			
Cash paid during the year for:			
Interest (net of amounts capitalized)	\$ 485	\$ 483	\$ 510
Income taxes (net of refunds)	\$ 271	\$ 146	\$ 93

See accompanying notes to consolidated financial statements.

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Unearned Restricted Stock</u>	<u>Other Compre- hensive Income (Loss)</u>	<u>Retained Income</u>	<u>Treasury Stock</u>	<u>Total</u>
<i>(\$ in millions, except per share amounts)</i>							
Balance Dec. 31, 2002	\$ 410	\$ 481	\$ --	\$ (65)	\$ 5,694	\$ (20)	\$ 6,500
Comprehensive income							
Net income					535		535
Other comprehensive income (Note 13)				21			21
Total comprehensive income							556
Dividends on Common Stock, \$0.30 per share					(117)		(117)
Other (Notes 11 and 12)	2	40	(5)				37
Balance Dec. 31, 2003	412	521	(5)	(44)	6,112	(20)	6,976
Comprehensive income							
Net income					923		923
Other comprehensive income (Note 13)				20			20
Total comprehensive income							943
Dividends on Common Stock, \$0.36 per share					(142)		(142)
Other (Notes 11 and 12)	9	207	(3)				213
Balance Dec. 31, 2004	421	728	(8)	(24)	6,893	(20)	7,990

Comprehensive

income								
Net income							1,281	1,281
Other comprehensive loss (Note 13)				(53)				(53)
Total comprehensive income								<u>1,228</u>
Dividends on Common Stock, \$0.48 per share							(194)	(194)
Other (Notes 11 and 12)	10	264	(9)					<u>265</u>
Balance Dec. 31, 2005	<u>\$ 431</u>	<u>\$ 992</u>	<u>\$ (17)</u>	<u>\$ (77)</u>	<u>\$ 7,980</u>	<u>\$ (20)</u>	<u>\$ 9,289</u>	

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 21,200 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.

The railroad transports raw materials, intermediate products and finished goods classified in the following market groups (percent of total railway operating revenues in 2005): coal (25%); intermodal (21%); automotive (12%); metals/construction (12%); chemicals (11%); agriculture/consumer products/ government (10%); and paper/clay/forest products (9%). 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 14 different 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 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 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 uses 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 have

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).

Stock-Based Compensation

NS has stock-based employee compensation plans, which are more fully described in Note 12. Through Dec. 31, 2005, NS applied the intrinsic value recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25), and related interpretations in accounting for these plans (See "Required Accounting Change in 2006," below).

The following table illustrates the effect on net income and earnings per share if NS had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), to stock-based employee compensation:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions except per share)</i>		
Net income, as reported	\$ 1,281	\$ 923	\$ 535
Add: Stock-based employee compensation expense			
included in reported net income, net of related tax effects	46	32	18
Deduct: Stock-based employee compensation expense determined under fair value method, net of related tax effects	<u>(45)</u>	<u>(44)</u>	<u>(35)</u>
Pro forma net income	\$ <u>1,282</u>	\$ <u>911</u>	\$ <u>518</u>
Earnings per share:			
As reported			
Basic	\$ 3.17	\$ 2.34	\$ 1.37
Diluted	\$ 3.11	\$ 2.31	\$ 1.37
Pro forma			
Basic	\$ 3.17	\$ 2.31	\$ 1.33
Diluted	\$ 3.10	\$ 2.28	\$ 1.33

Required Accounting Change in 2006

Effective January 1, 2006, NS adopted Statement of Financial Accounting Standards, No. 123(R), "Share Based Payments," [SFAS No. 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. In November 2005, the Board of Directors of NS changed the vesting period on options granted in January 2005 from three years to one year in order to reduce future compensation expense. At the time, these options had an intrinsic value of approximately \$9 each and the modification resulted in less than \$1 million of compensation expense. Future compensation expense will be reduced by \$10 million as a result of this modification.

Under SFAS No. 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. Such awards were treated similarly under SFAS No. 123 in the pro forma amounts disclosed in the preceding table. As a result of SFAS No. 123(R), expense recognition is accelerated on grants to retirement eligible employees and the effect of this acceleration will be approximately \$20 million of additional compensation expense in 2006.

Cash Equivalents

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

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."

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."

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. 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 (see Note 6).

Required Accounting Changes in 2003

NS adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," (SFAS No. 143) effective Jan. 1, 2003, and recorded a \$110 million net adjustment (\$182 million before taxes) for the cumulative effect of this change in accounting on years prior to 2003. Pursuant to SFAS No. 143, the cost to remove crossties must be recorded as an expense when incurred; previously these removal costs were accrued as a component of depreciation. This change in accounting lowered depreciation expense (because the

depreciation rate for crossties no longer reflects cost to remove) and increased compensation and benefits and other expenses (for the costs to remove retired assets). The net effect to total railway operating expenses and net income was not material.

NS also adopted Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities," (FIN No. 46) effective Jan. 1, 2003, and recorded a \$4 million net adjustment (\$6 million before taxes) for the cumulative effect of this change in accounting on years prior to 2003. Pursuant to FIN No. 46, NS consolidated a special-purpose entity that leased certain locomotives to NS. This entity's assets and liabilities at Jan. 1, 2003, included \$169 million of locomotives and \$157 million of debt related to their purchase as well as a \$6 million minority interest liability. This change in accounting increased depreciation and interest expense (to reflect the locomotives as owned assets) and lowered lease expense. The net effect to total railway operating expenses and net income was not material.

The cumulative effect of these changes amounted to \$114 million, or 29 cents per share, in 2003.

Reclassifications

Certain amounts have been reclassified to conform to current presentation. Specifically, \$112 million of auction rate securities held at Dec. 31, 2004, previously classified as cash equivalents, have been reclassified as short-term investments. These securities were sold in the first quarter of 2005 at market value, which was equal to their carrying cost, and accordingly are included in "Investment sales and other transactions" in the Consolidated Statements of Cash Flows. In addition, the following items shown in the Consolidated Balance Sheet as of Dec. 31, 2004, have been reclassified to conform to the current presentation: (1) "Investment in Conrail" and the amount of investments included in "Other assets" have been reclassified and comprise "Investments" and (2) "Due to Conrail" has been reclassified and is included in the amount shown for "Accounts Payable."

2. Other Income - Net

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions)</i>		
Income from natural resources:			
Royalties from coal	\$ 54	\$ 42	\$ 39
Nonoperating depletion and depreciation	<u>(13)</u>	<u>(11)</u>	<u>(15)</u>
Subtotal	41	31	24
Gains from sale of properties and investments	49	46	45
Rental income	42	40	38
Interest income	41	13	10
Equity in earnings of Conrail (Note 5)	37	11	--
Corporate-owned life insurance – net	4	8	21
Gain from Conrail Corporate Reorganization (Note 5)	--	53	--
Equity in losses of partnerships	(108)	(61)	--
Taxes on nonoperating property	(9)	(8)	(8)
Other interest expense	(6)	(17)	(4)
Charitable contributions	(4)	(4)	(4)
Impairment of telecommunications assets (Note 6)	--	--	(84)
Other	<u>(13)</u>	<u>(23)</u>	<u>(19)</u>
Total	\$ <u>74</u>	\$ <u>89</u>	\$ <u>19</u>

"Other income - net" includes the income generated by the activities of NS' noncarrier subsidiaries as well as the costs incurred by those subsidiaries in their operations. NS has a 40.5% interest in a limited liability company that owns and operates facilities that produce synthetic fuel from coal. The production of synthetic fuel results in tax credits as well as expenses related to the investments. The expenses are classified in "Equity in losses of partnerships" above.

"Other current assets" in the Consolidated Balance Sheets includes prepaid interest of \$47 million at Dec. 31, 2005, and \$48 million at Dec. 31, 2004, arising from corporate-owned life insurance borrowings.

3. Income Taxes

Provision for Income Taxes

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions)</i>		
Current:			
Federal	\$ 283	\$ 133	\$ 32
State	<u>53</u>	<u>46</u>	<u>11</u>
Total current taxes	336	179	43
Deferred:			
Federal	220	181	97
State	<u>(140)</u>	<u>19</u>	<u>35</u>
Total deferred taxes	<u>80</u>	<u>200</u>	<u>132</u>
Provision for income taxes	\$ <u>416</u>	\$ <u>379</u>	\$ <u>175</u>

Reconciliation of Statutory Rate to Effective Rate

The "Provision for income taxes" in the Consolidated Statements of Income reflects taxes from continuing operations before accounting changes and differs from the amounts computed by applying the statutory federal corporate tax rate as follows:

	<u>2005</u>		<u>2004</u>		<u>2003</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
	<i>(\$ in millions)</i>					
Federal income tax at statutory rate	\$ 594	35	\$ 456	35	\$ 205	35
State income taxes, net of federal tax effect	40	2	42	3	30	5
Tax credits	(104)	(6)	(80)	(7)	--	--
Ohio rate change, net of federal tax effect	(96)	(6)	--	--	--	--
Equity in earnings of Conrail	(10)	--	(18)	(1)	(20)	(3)
Gain from Conrail Corporate						

Reorganization	--	--	(19)	(1)	--	--
Other – net	<u>(8)</u>	<u>--</u>	<u>(2)</u>	<u>--</u>	<u>(40)</u>	<u>(7)</u>
Provision for income taxes	\$ <u>416</u>	<u>25</u>	\$ <u>379</u>	<u>29</u>	\$ <u>175</u>	<u>30</u>

In June 2005, Ohio enacted tax legislation that phases out its Corporate Franchise Tax, which was generally based on federal taxable income, and phases in a new gross receipts tax called the Commercial Activity Tax, which is based on current year sales and rentals. The phased elimination of the Corporate Franchise Tax resulted in a reduction in NS' deferred income tax liability, as required by Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," which, as noted above, decreased deferred tax expense by \$96 million.

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:

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>	
Deferred tax assets:		
Reserves, including casualty and other claims	\$ 162	\$ 200
Retiree health and death benefit obligations	190	180
Taxes, including state and property	390	449
Other	<u>33</u>	<u>44</u>
Total gross deferred tax assets	775	873
Less valuation allowance	<u>(16)</u>	<u>(21)</u>
Net deferred tax asset	<u>759</u>	<u>852</u>
Deferred tax liabilities:		
Property	(6,957)	(7,022)
Other	<u>(255)</u>	<u>(193)</u>
Total gross deferred tax liabilities	<u>(7,212)</u>	<u>(7,215)</u>
Net deferred tax liability	(6,453)	(6,363)
Net current deferred tax asset	<u>167</u>	<u>187</u>
Net long-term deferred tax liability	\$ <u>(6,620)</u>	\$ <u>(6,550)</u>

Net deferred income tax liabilities increased by \$3,113 million in 2004 as a result of the Conrail Corporate Reorganization (see Note 5). Except for amounts for which a valuation allowance has been provided, management believes that it is more likely than not that future taxable income will be sufficient 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 decreased \$5 million in 2005, \$1 million in 2004 and \$2 million in 2003.

Internal Revenue Service (IRS) Reviews

Consolidated federal income tax returns have been examined and Revenue Agent Reports have been received for all years up to and including 2001. In 2004, the favorable resolution of the IRS audit of a synthetic fuel-related investment is reflected in the "Tax credits" line of the reconciliation of statutory rate to the effective rate. In 2003, the favorable resolution of prior years' audits is reflected in the "Other – net" line of the reconciliation of statutory rate to the effective rate, as shown above, and comprised most of that line item. The consolidated federal income tax returns for 2002 and 2003 are being audited by the IRS. The IRS examination for 2002 and 2003 is expected to be completed by the end of 2006. Management believes that adequate provision has been made for any additional taxes and interest thereon that might arise as a result of IRS examinations.

4. Accounts Receivable

Until May 2005, NS had in place an accounts receivable sales program. Under this program a bankruptcy-remote special purpose subsidiary of NS sold without recourse undivided ownership interests in a pool of accounts receivable. While there were some sales during 2004 and 2003, there were no accounts receivable sold under this arrangement as of Dec. 31, 2004. The change in "Accounts receivable" included on the Consolidated Statements of Cash Flows related to receivable sales was zero for 2005 and 2004 and a decrease of \$30 million in 2003. The fees associated with sales, which are based on the buyers' financing costs, are included in "Other income – net" (see Note 2).

NS' allowance for doubtful accounts was \$6 million at Dec. 31, 2005, and \$9 million at Dec. 31, 2004. 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.

5. Investments

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>	
Short-term investments with average maturities at		
Dec. 31, 2005 :		
Federal government notes, 6 months	\$ 348	\$ --
Corporate notes, 10 months	290	40
Commercial paper, 4 months	251	--
Municipal debt, 5 months	43	96
Other short-term investments, 6 months	36	66
Total short-term investments	<u>\$ 968</u>	<u>\$ 202</u>
Long-term investments:		
Investment in Conrail Inc.	\$ 844	\$ 805
Other equity method investments	331	313
Company-owned life insurance at net cash surrender value	276	254
Other investments	139	127
Total long-term investments	<u>\$ 1,590</u>	<u>\$ 1,499</u>

The \$968 million in "Short-term investments" is classified as available-for-sale, of which approximately two-thirds mature within 6 months. Unrealized gains from short-term investments were less than \$1 million at Dec. 31, 2005 and \$1 million at Dec. 31, 2004 .

Investment in Conrail and Operations Over Its Lines

Overview

Through a limited liability company, Norfolk Southern and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). NS has a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. 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.

Conrail Corporate Reorganization

On August 27, 2004 , NS, CSX and Conrail completed a reorganization of Conrail (Conrail Corporate Reorganization), which established direct ownership and control by NSR and CSXT of two former CRC subsidiaries, Pennsylvania Lines LLC (PRR) and New York Central Lines LLC (NYC), respectively. Prior to the Conrail Corporate Reorganization, NSR operated the routes and assets of PRR and CSXT operated the routes and assets of NYC, each in accordance with operating and lease agreements. Pursuant to the Conrail Corporate Reorganization, the operating and lease agreements were terminated and PRR and NYC were merged into NSR and CSXT, respectively.

The reorganization did not involve the Shared Assets Areas and did not affect the competitive rail service provided in the Shared Assets Areas. Conrail continues to own, manage and operate the Shared Assets Areas as previously approved by the Surface Transportation Board (STB).

As a part of the Conrail Corporate Reorganization, Conrail restructured its existing unsecured and secured public indebtedness, with the consent of Conrail's debtholders. Prior to the restructuring, there were two series of unsecured public debentures with an outstanding principal amount of approximately \$800 million and 13 series of secured debt with an outstanding principal amount of approximately \$300 million. Guaranteed debt securities were offered in an approximate 58%/42% ratio in exchange for Conrail's unsecured debentures. Of the \$800 million unsecured public debentures, \$779 million were tendered and accepted for exchange, and NSR issued unsecured public debentures with a total principal of \$452 million and an issue-date fair value of \$595 million. Conrail's secured debt and lease obligations remain obligations of Conrail and are supported by leases and subleases which are the direct lease and sublease obligations of NSR or CSXT. Substantially all of these NSR obligations are capital leases and, accordingly, are a component of NS' capital lease obligations (see Note 8).

NS accounted for the transaction at fair value, which resulted in the recognition of a \$53 million net gain (reported in "Other income – net") from the tax-free distribution to NS of a portion of its investment in Conrail. NS concluded that fair value was the appropriate measurement for 42% of PRR because the transaction resulted in the complete ownership and control of PRR. The remaining 58% of PRR was recorded at NS' carryover basis. As a result of the transaction, NS' investment in Conrail no longer includes amounts related to PRR and NYC. Instead the assets and liabilities of PRR are reflected in their respective line items in NS' Consolidated Balance Sheet and amounts due to PRR were extinguished.

The following summarizes the effect of the transaction on NS' Consolidated Balance Sheet (\$ in millions):

Properties	\$	8,368
Extinguishment of amounts due to PRR		870
Other assets and liabilities, net		177
Deferred income taxes		(3,113)
Long-term debt, including current maturities		<u>(734)</u>
Net assets received		5,568
Investment in Conrail		<u>(5,515)</u>
Gain from Conrail Corporate Reorganization	\$	<u>53</u>

The amounts shown above for the net assets received reflect the fair value of such assets. Properties have been valued based on information received from an independent valuation consultant. The assets of PRR included the note due from NSR discussed below under the heading "Related Party Transactions," which resulted in its effectively being extinguished. Debt has been recorded at fair value based on interest rates at the time of the reorganization. The reduction to NS' investment in Conrail represents the removal of amounts related to NS' equity interests in PRR and NYC as well as amounts related to the Conrail debt that was exchanged or effectively assumed by the leases and subleases entered into to support those obligations.

On the Consolidated Statements of Income, "Conrail rents and services" is reduced as a result of the transaction. After the Conrail Corporate Reorganization, "Conrail rents and services" reflects only the expenses associated with the Shared Assets Areas, and other expenses (primarily the depreciation related to the PRR assets) are reflected in their respective line items in the Consolidated Statements of Income. The transaction's impact on net income was the \$53 million gain discussed above. Prospectively, the transaction will have no effect on revenues and will not have a significant ongoing effect on net income. Had the transaction been consummated before the periods presented, there would have been no change in revenues and no significant change to net income.

NS is continuing to apply the equity method of accounting to its remaining investment in Conrail in accordance with APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." NS is amortizing the excess of the purchase price over Conrail's net equity using the principles of purchase accounting, based primarily on the estimated remaining useful lives of Conrail's depreciable property and equipment, including the related deferred tax effect of the differences in tax and accounting bases for certain assets, as all of the purchase price at acquisition was allocable to Conrail's tangible assets and liabilities. At Dec. 31, 2005, the difference between NS' investment in Conrail and its share of Conrail's underlying net equity was \$593 million.

Related-Party Transactions

CRC owns and operates certain properties (the Shared Assets Areas) for the joint and exclusive benefit of NSR and CSXT. NSR and CSXT pay CRC a fee for joint and exclusive access to the Shared Assets Areas. In addition, NSR and CSXT pay, based on usage, the costs incurred by CRC to operate the Shared Assets Areas. Future minimum lease payments due to CRC under the Shared Assets Areas agreements are as follows: \$25 million in each of 2006 through 2010 and \$331 million thereafter.

The components of "Conrail rents and services" are as follows:

	Years Ended Dec. 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions)</i>		
Amounts due to PRR for use by NSR of operating properties and equipment (prior to the Conrail Corporate Reorganization)	\$ --	\$ 233	\$ 348
NS' equity in the earnings of Conrail, net of amortization (prior to the Conrail Corporate Reorganization)*	--	(43)	(58)
Expenses for amounts due to CRC for operation of the Shared Assets Areas	<u>129</u>	<u>129</u>	<u>129</u>
Conrail rents and services	\$ <u>129</u>	\$ <u>319</u>	\$ <u>419</u>

*After the reorganization, NS' equity in the earnings of Conrail, net of amortization, is included in "Other income – net," (see Note 2).

Prior to the Conrail Corporate Reorganization, a significant portion of the payments made to PRR was borrowed back from a subsidiary of PRR under a note due in 2032. Amounts outstanding under this note comprised the long-term balance of "Due to Conrail," and this note was effectively extinguished by the reorganization. "Due to Conrail" included in "Accounts payable" (see Note 7) is composed principally of amounts related to expenses included in "Conrail rents and services," as discussed above. "Long-term advances from Conrail," included in "Other liabilities" (see Note 10), bear interest at an average rate of 4.4% and are due in 2035.

NS provides certain general and administrative support functions to Conrail, the fees for which are billed in accordance with several service-provider arrangements and amount to approximately \$7 million annually.

Summary Financial Information – Conrail

As a result of the Conrail Corporate Reorganization discussed above, two CRC subsidiaries, PRR and NYC, were distributed to NS and CSX, respectively, and CRC's public indebtedness was restructured. The results of the operations of these subsidiaries and their net assets are presented in the following financial information as "Discontinued Operations." The 2005 and 2004 summarized information was derived from unaudited financial statements. The 2003 summarized information was derived from audited financial statements.

Summarized Income Statement Information - Conrail

	Years Ended Dec. 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions)</i>		

Operating revenues	\$	378	\$	352	\$	316
Operating income (loss)	\$	32	\$	(18)	\$	(36)
Income from continuing operations	\$	85	\$	22	\$	10
Discontinued operations (PRR and NYC)	\$	--	\$	119	\$	191
Net income	\$	85	\$	140	\$	203

Note: Conrail adopted FIN No. 46 "Consolidation of Variable Interest Entities," effective Jan. 1, 2004, and recorded a \$1 million net adjustment for the cumulative effect of this change in accounting on years prior to 2004. Conrail adopted SFAS No. 143, effective Jan. 1, 2003, and recorded a \$40 million net adjustment for the cumulative effect of this change in accounting on years prior to 2003 (including \$38 million related to discontinued operations). NS excluded this amount from its determination of equity in earnings of Conrail because an amount related to Conrail is included in NS' cumulative effect adjustment for SFAS No. 143.

Summarized Balance Sheet Information - Conrail

	As of Dec. 31,	
	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>	
Assets:		
Current assets	\$ 233	\$ 334
Noncurrent assets	1,242	1,080
Total assets	\$ <u>1,475</u>	\$ <u>1,414</u>
Liabilities and stockholders' equity:		
Current liabilities	\$ 233	\$ 242
Noncurrent liabilities	807	811
Stockholders' equity	<u>435</u>	<u>361</u>
Total liabilities and stockholders' equity	\$ <u>1,475</u>	\$ <u>1,414</u>

Note: Current assets include amounts due from NS and CSX totaling \$134 million at Dec. 31, 2005, and \$165 million at Dec. 31, 2004. Noncurrent assets include amounts due from NS and CSX totaling \$413 million at Dec. 31, 2005, and \$225 million at Dec. 31, 2004. Current liabilities include amounts payable to NS and CSX totaling \$6 million at Dec. 31, 2005, and \$4 million at Dec. 31, 2004.

6. Properties

	Dec. 31,		<u>Depreciation</u>
	<u>2005</u>	<u>2004</u>	
	<i>(\$ in millions)</i>		<u>Rate for 2005</u>
Land	\$ 2,088	\$ 2,083	
Railway property:			
Road	18,131	17,552	2.8%
Equipment	6,838	6,661	4.4%
Other property	<u>469</u>	<u>469</u>	2.8%

	27,526	26,765
Less accumulated depreciation	<u>(6,821)</u>	<u>(6,239)</u>
Net properties	\$ <u>20,705</u>	\$ <u>20,526</u>

Railway property includes \$602 million at Dec. 31, 2005 , and \$618 million at Dec. 31, 2004 , of assets recorded pursuant to capital leases with accumulated amortization of \$170 million and \$149 million at Dec. 31, 2005 and 2004, respectively. Other property includes the costs of obtaining rights to natural resources of \$337 million at Dec. 31, 2005 , and \$341 million at Dec. 31, 2004 . Properties increased \$8,368 million in 2004 as a result of the Conrail Corporate Reorganization (see Note 5).

Impairment of Telecommunications Assets in 2003

In 2003, NS recorded an \$84 million non-cash reduction in the carrying value of certain telecommunications assets to recognize their impaired value in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." NS' subsidiary, Thoroughbred Technology and Telecommunications (T-Cubed), developed fiber optic infrastructure with companies in the telecommunications industry. This industry experienced a severe downturn in 2003; accordingly, T-Cubed monitored the carrying amount of these assets through independent fair market value appraisals. As a result of a deterioration in the long-term prospects for these assets, an updated appraisal obtained in the fourth quarter of 2003 indicated a significant decline in their value. T-Cubed continues to monitor the carrying value of these assets.

Capitalized Interest

Total interest cost incurred on debt in 2005, 2004 and 2003 was \$505 million, \$499 million and \$509 million, respectively, of which \$11 million, \$10 million and \$12 million was capitalized.

7. Current Liabilities

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Accounts payable:		
Accounts and wages payable	\$ 571	\$ 544
Casualty and other claims (Note 18)	291	222
Vacation liability	119	115
Equipment rents payable – net	101	106
Due to Conrail	56	78
Other	<u>25</u>	<u>25</u>
Total	\$ <u>1,163</u>	\$ <u>1,090</u>
Other current liabilities:		
Interest payable	\$ 100	\$ 117
Liabilities for forwarded traffic	47	46
Retiree health and death benefit obligations (Note 11)	45	45
Other	<u>21</u>	<u>31</u>
Total	\$ <u>213</u>	\$ <u>239</u>

8. Long-term Debt

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>	
Notes and debentures at average rates and maturities as follows:		
7.10%, maturing to 2010	\$ 1,440	\$ 1,840
5.89%, maturing 2011 and 2014	741	741
8.02%, maturing 2017 to 2025	1,314	1,114
7.13%, maturing 2027 to 2031	1,300	1,500
7.21%, maturing 2037 and 2043	855	855
7.02%, maturing 2097 and 2105	650	350
Equipment obligations at an average rate of 5.54%, maturing to 2014	363	563
Capitalized leases at an average rate of 4.49%, maturing to 2024	290	370
Other debt at an average rate of 7.04%, maturing to 2019	113	113
Discounts and premiums, net	(136)	79
Total long-term debt	<u>6,930</u>	<u>7,525</u>
Less current maturities	<u>(314)</u>	<u>(662)</u>
Long-term debt excluding current maturities	\$ <u>6,616</u>	\$ <u>6,863</u>
Long-term debt maturities subsequent to 2006 are as follows:		
2007	\$ 492	
2008	368	
2009	476	
2010	340	
2011 and subsequent years	<u>4,940</u>	
Total	\$ <u>6,616</u>	

In May 2005, NS issued \$717 million of unsecured notes (\$350 million at 5.64% due 2029 and \$367 million at 5.59% due 2025) and paid \$218 million of premium in exchange for \$717 million of its previously issued unsecured notes (\$350 million at 7.8% due 2027, \$200 million at 7.25% due 2031, and \$167 million at 9.0% due 2021). The \$218 million cash premium payment is reflected as a reduction of debt in the Consolidated Balance Sheet and Statement of Cash Flows and is included in "Discounts and premiums, net." The premium is being amortized as additional interest expense over the terms of the new debt, resulting in effective interest rates of 8.7% for the 2029 notes and 9.0% for the 2025 notes.

In August 2004, pursuant to the Conrail Corporate Reorganization (see Note 5), NSR issued unsecured public debentures with a total principal of \$452 million (\$314 million at 9.75% due 2020 and \$138 million at 7.875% due 2043) and fair value of \$595 million. This difference is included in "Discounts and premiums, net" and is being amortized as a reduction of interest expense over the terms of the notes, resulting in effective interest rates of 6.0% for the 2020 notes and 6.2% for the 2043 notes.

The railroad equipment obligations and the capitalized leases are secured by liens on the underlying equipment. Certain lease obligations require the maintenance of yen-denominated deposits, which are pledged to the lessor to satisfy yen-denominated lease payments. These deposits are included in "Other assets" on the balance sheet and totaled \$87 million at Dec. 31, 2005, and \$100 million at Dec. 31, 2004.

Shelf Registration

NS has on file with the Securities and Exchange Commission a Form S-3 shelf registration statement covering the issuance of up to \$1 billion of registered debt or equity securities. In 2005, NS issued \$300 million of 6% senior notes due March 2105 under this shelf registration statement.

Credit Agreement, Debt Covenants and Commercial Paper

In August 2004, NS renewed its \$1 billion credit facility under substantially the same terms and conditions as the previous facility for a five-year term expiring in 2009. Any borrowings under the credit agreement are contingent on the continuing effectiveness of the representations and warranties made at the inception of the agreement. NS is subject to various financial covenants with respect to its debt and under its credit agreement, including a minimum net worth requirement, a maximum leverage ratio restriction, certain restrictions on the issuance of further debt by NS or its subsidiaries and the consolidation, merger or sale of substantially all of NS' assets. At Dec. 31, 2005, NS was in compliance with all financial covenants.

NS has the ability to issue commercial paper supported by its \$1 billion credit agreement. At Dec. 31, 2005, and Dec. 31, 2004, NS had no outstanding commercial paper or borrowings under the credit agreement.

9. Lease Commitments

NS is committed under long-term lease agreements, which expire on various dates through 2067, for equipment, lines of road and other property. The following amounts do not include payments to CRC under the Shared Assets Areas agreements (see Note 5). Future minimum lease payments and operating lease expense are as follows:

	Operating	Capital
	<u>Leases</u>	<u>Leases</u>
	<i>(\$ in millions)</i>	
2006	\$ 144	\$ 67
2007	141	78
2008	114	46
2009	100	59
2010	85	24
2011 and subsequent years	<u>483</u>	<u>44</u>
Total	\$ <u>1,067</u>	\$ 318
Less imputed interest on capital leases at an average rate of 5.4%		<u>(28)</u>
Present value of minimum lease payments included in debt		\$ <u>290</u>

Operating Lease Expense

2005

2004

2003

(\$ in millions)

Minimum rents	\$ 190	\$ 151	\$ 130
Contingent rents	<u>75</u>	<u>65</u>	<u>63</u>
Total	\$ <u>265</u>	\$ <u>216</u>	\$ <u>193</u>

10. Other Liabilities

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Casualty and other claims (Note 18)	\$ 421	\$ 315
Retiree health and death benefit obligations (Note 11)	364	354
Deferred compensation	143	143
Long-term advances from Conrail	133	--
Net pension obligations (Note 11)	106	94
Other	<u>248</u>	<u>240</u>
Total	\$ <u>1,415</u>	\$ <u>1,146</u>

11. Pensions and Other Postretirement Benefits

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

Asset Management

Eleven investment firms manage the Company's defined benefit pension plan's assets under investment guidelines approved by the Board of Directors. Investments are restricted to domestic fixed income securities, international fixed income securities, domestic and international equity investments and unleveraged exchange-traded options and financial futures. Limitations restrict investment concentration and use of certain derivative instruments. The target asset allocation for equity is 75% of the pension plan's assets. Fixed income investments must have an average rating of "AA" or better and all fixed income securities must be rated "A" or better except bond index funds. Equity investments must be in liquid securities listed on national exchanges. No investment is permitted in the securities of Norfolk Southern Corporation or its subsidiaries (except through commingled pension trust funds). Investment managers' returns are expected to exceed selected market indices by prescribed margins.

NS' pension plan weighted-average asset allocations at Dec. 31, 2005 and 2004, by asset category, are as follows:

<u>Asset Category</u>	Percentage of	
	<u>2005</u>	<u>2004</u>
	-	

Equity securities	76%	76%
Debt securities	24%	24%
Total	<u>100%</u>	<u>100%</u>
International equity securities included in equity securities above	11%	10%

The postretirement benefit plan assets consist primarily of trust-owned variable life insurance policies with an asset allocation at Dec. 31, 2005, of 66% in equity securities and 34% in debt securities compared with 67% in equity securities and 33% in debt securities at Dec. 31, 2004. The target asset allocation for equity is between 50% and 75% of the plan's assets.

The plans' assumed future returns are based principally on the asset allocation and on the historic returns for the plans' asset classes determined from both actual plan returns and, over longer time periods, market returns for those asset classes.

Voluntary Separation Program in 2003

Compensation and benefits expense in 2003 includes \$107 million of costs related to a voluntary separation program undertaken in the fourth quarter. Through the program, 553 nonagreement employees were separated from service, of which 314 retired under Norfolk Southern's retirement plan. The costs include \$66 million for separation payments and other benefits of the program and \$41 million of costs related to the pension and other benefit plans.

Medicare Changes

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) was signed into law in December 2003. The Act introduced a new prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The actuary for Norfolk Southern's medical plan has determined that Norfolk Southern's medical plan's prescription drug benefit for 2006 is actuarially equivalent to the new prescription drug benefit under Medicare Part D. In accordance with Financial Accounting Standards Board Staff Position No. 106-1, NS elected to take into account these legislative changes in the measurement of its postretirement benefit obligations, which resulted in a reduction of \$15 million in the net benefit cost in 2005, \$9 million in 2004 and no effect on the net benefit cost in 2003.

Pension and Other Postretirement Benefit Obligations and Plan Assets

	Pension Benefits		Other Benefits	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>			
Change in benefit obligations				
Benefit obligation at beginning of year	\$ 1,574	\$ 1,488	\$ 701	\$ 608
Service cost	23	18	17	15
Interest cost	87	89	40	39
Settlement	--	--	(12)	--
Actuarial losses	72	96	60	83
Benefits paid	<u>(114)</u>	<u>(117)</u>	<u>(52)</u>	<u>(44)</u>
Benefit obligation at end of year	<u>1,642</u>	<u>1,574</u>	<u>754</u>	<u>701</u>

Change in plan assets

Fair value of plan assets at beginning of year	1,806	1,720	105	130
Actual return on plan assets	126	197	3	10
Employer contribution	6	6	52	9
Benefits paid	<u>(114)</u>	<u>(117)</u>	<u>(52)</u>	<u>(44)</u>
Fair value of plan assets at end of year	<u>1,824</u>	<u>1,806</u>	<u>108</u>	<u>105</u>

Funded status

	182	232	(646)	(596)
Unrecognized actuarial loss	336	253	264	232
Unrecognized prior service cost (benefit)	<u>14</u>	<u>18</u>	<u>(27)</u>	<u>(35)</u>
Net amount recognized	\$ <u>532</u>	\$ <u>503</u>	\$ <u>(409)</u>	\$ <u>(399)</u>

Amounts recognized in the Consolidated

Balance Sheets consist of:

Prepaid benefit cost	\$ 612	\$ 577	\$ --	\$ --
Accrued benefit liability	(106)	(94)	(409)	(399)
Accumulated other comprehensive income	<u>26</u>	<u>20</u>	<u>--</u>	<u>--</u>
Net amount recognized	\$ <u>532</u>	\$ <u>503</u>	\$ <u>(409)</u>	\$ <u>(399)</u>

During 2005, NS distributed split dollar life insurance policies to eligible retired employees, which resulted in a \$12 million reduction of the postretirement benefit obligation.

Following is information for NS' unfunded pension plans which in all cases have no assets and therefore have an accumulated benefit obligation in excess of plan assets:

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Projected benefit obligation	\$ 134	\$ 120
Accumulated benefit obligation	\$ 106	\$ 94

Pension and Other Postretirement Benefit Costs Components

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(\$ in millions)		
Pension benefits			
Service cost	\$ 23	\$ 18	\$ 20
Interest cost	87	89	89
Curtailment loss	--	--	17

Expected return on plan assets	(149)	(149)	(158)
Amortization of prior service cost	2	3	5
Recognized net actuarial losses	14	3	2
Net benefit	\$ <u>(23)</u>	\$ <u>(36)</u>	\$ <u>(25)</u>

Other postretirement benefits

Service cost	\$ 17	\$ 15	\$ 18
Interest cost	40	39	40
Curtailement loss	--	--	10
Special termination benefits	--	--	17
Expected return on plan assets	(9)	(12)	(12)
Amortization of prior service cost (benefit)	(8)	(9)	(7)
Amortization of unrecognized losses	22	16	14
Net cost	\$ <u>62</u>	\$ <u>49</u>	\$ <u>80</u>

Pension Assumptions

Pension and other postretirement benefit costs are determined based on actuarial valuations that reflect appropriate assumptions as of the measurement date, ordinarily the beginning of each year. The funded status of the plans is determined using appropriate assumptions as of each year end. A summary of the major assumptions follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Funded status:			
Discount rate	5.50%	5.75%	6.25%
Future salary increases	4.5%	4.5%	4.5%
Pension cost:			
Discount rate	5.75%	6.25%	6.75%
Return on assets in plans	9%	9%	9%
Future salary increases	4.5%	4.5%	4.5%

Health Care Cost Trend Assumptions

For measurement purposes at Dec. 31, 2005, increases in the per capita cost of covered health care benefits were assumed to be 9% for 2005 and 8% for 2006. It is assumed the rate will decrease gradually to an ultimate rate of 5% for 2009 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported in the financial statements. To illustrate, a one-percentage-point change in the assumed health care cost trend would have the following effects:

One percentage point

	<u>Increase</u>	<u>Decrease</u>
	<i>(\$ in millions)</i>	
Increase (decrease) in:		
Total service and interest cost components	\$ 7	\$ (6)
Postretirement benefit obligation	\$ 81	\$ (69)

Contributions and Estimated Future Benefit Payments

In 2006, NS expects to contribute approximately \$8 million to its unfunded pension plans for payments to pensioners and \$44 million to its other postretirement benefit plans for retiree health benefits.

Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

	<u>Pension</u> <u>Benefits</u>	<u>Other</u> <u>Benefits</u>
	<i>(\$ in millions)</i>	
2006	\$ 116	\$ 44
2007	113	45
2008	111	46
2009	110	47
2010	111	49
Years 2011-2015	587	262

Beginning in 2006, the other benefit payments include an estimated annual \$4 million reduction due to the Medicare Part D Subsidy.

Other Postretirement Coverage

Under collective bargaining agreements, NS and certain subsidiaries participate in a multi-employer benefit plan, which provides certain postretirement health care and life insurance benefits to eligible union employees. Premiums under this plan are expensed as incurred and amounted to \$26 million in 2005, \$20 million in 2004 and \$18 million in 2003.

Section 401(k) Plans

Norfolk Southern and certain subsidiaries provide Section 401(k) savings plans for employees. Under the plans, NS matches a portion of employee contributions, subject to applicable limitations. NS' expenses under these plans were \$13 million in 2005, and \$12 million in

each of 2004 and 2003.

12. Stock-Based Compensation

Under the stockholder-approved Long-Term Incentive Plan (LTIP), a committee of nonemployee directors of the Board or the chief executive officer (if delegated such authority by the committee) may grant stock options, stock appreciation rights (SARs), restricted shares, restricted stock units and performance share units (PSUs), up to a maximum of 88,025,000 shares of Norfolk Southern Common Stock (Common Stock). Of these shares, 5,000,000 were approved by the Board for issuance to non-officer participants; as a broad-based issuance, stockholder approval was not required. In May 2005, the stockholders approved an amended LTIP which provided that 8,500,000 shares of stock previously approved for issuance under LTIP could be granted as restricted shares, restricted stock unit shares or performance shares. Under the Board-approved Thoroughbred Stock Option Plan (TSOP), the committee may grant stock options up to a maximum of 6,000,000 shares of Common Stock. Options may be granted for a term not to exceed 10 years, but may not be exercised prior to the first anniversary of the date of grant. Options are exercisable at the fair market value of Common Stock on the date of grant.

The LTIP also permits the payment – on a current or a deferred basis and in cash or in stock – of dividend equivalents on shares of Common Stock covered by options, PSUs or restricted stock units in an amount commensurate with dividends paid on Common Stock. Tax absorption payments also are authorized for any awards under LTIP in amounts estimated to equal the federal and state income taxes applicable to shares of Common Stock issued subject to a share retention agreement.

Accounting Method

As disclosed in Note 1, through Dec. 31, 2005, NS applied APB Opinion 25 and related interpretations in accounting for awards made under the plans. Accordingly, grants of PSUs, restricted shares, restricted share units, dividend equivalents, tax absorption payments and SARs resulted in charges to net income, while grants of stock options had no effect on net income. Related compensation costs were \$75 million in 2005, \$53 million in 2004 and \$29 million in 2003. NS recognized additional paid-in capital of \$47 million in 2005, \$30 million in 2004 and \$2 million in 2003 related to the tax benefit generated by stock option exercises.

Note 1 includes a table that illustrates the effect on net income and earnings per share had NS applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation. The pro forma amounts include compensation costs calculated using the Black-Scholes option-pricing model, with the following assumptions and no dividend yield:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Average expected option life	5 years	5 years	5 years
Average risk-free interest rate	3.7%	3.2%	2.8%
Average stock-price volatility	33%	35%	33%
Per-share grant-date fair value	\$ 12.19	\$ 7.95	\$ 6.60

Stock Option Activity

	Weighted
	Average
	<u>Exercise Price</u>
Option Shares	

Balance Dec. 31, 2002	37,658,644	\$	23.47
Granted	5,700,000		19.63
Exercised	(781,610)		16.13
Expired	<u>(863,219)</u>		24.37
Balance Dec. 31, 2003	41,713,815	\$	23.07
Granted	4,580,500		22.02
Exercised	(8,203,589)		19.60
Expired	<u>(1,233,859)</u>		24.53
Balance Dec. 31, 2004	36,856,867	\$	23.66
Granted	1,353,600		34.10
Exercised	(8,651,237)		22.93
Expired	<u>(13,550)</u>		30.00
Balance Dec. 31, 2005	<u>29,545,680</u>	\$	24.35

Of the total options outstanding at Dec. 31, 2005, 28 million were vested and had a weighted-average exercise price of \$23.88.

Stock Options Outstanding

<u>Range</u>	<u>Weighted Average Exercise Price</u>	<u>Number Outstanding at Dec. 31, 2005</u>	<u>Weighted Average Remaining Contractual Life</u>
\$ 15.48 - \$ 16.94	16.12	4,587,502	4.6 years
19.63 - 22.49	21.53	13,550,929	7.0 years
24.41 - 27.69	27.65	3,632,042	3.0 years
<u>29.46 - 34.10</u>	<u>32.58</u>	<u>7,775,207</u>	2.7 years
\$ 15.48 - \$ 34.10	24.35	29,545,680	5.0 years

Performance Share Units

PSUs provide for awards based on achievement of certain predetermined corporate performance goals at the end of a three-year cycle. PSU grants and average grant-date fair values were 1,344,400 and \$34.10 in 2005; 831,000 and \$22.02 in 2004; and 946,000 and \$19.63 in 2003. PSUs may be paid in the form of shares of Common Stock, cash or any combination thereof. Shares earned and issued may be subject to share retention agreements and held by NS for up to five years.

Restricted Shares and Restricted Stock Units

Restricted share and restricted stock unit grants were 576,240 and 384,160, respectively, in 2005, with a grant-date fair value of \$34.10 and a five-year restriction period (that may be accelerated to a three-year restriction period upon achievement of specified performance measures), and were 359,040 and 239,360, respectively, in 2004, with a grant date fair value of \$22.02 and a three-year restriction period. At Dec. 31, 2005 and 2004, the balance of unearned compensation was \$17 million and \$8 million, relating to 1,262,776 and 726,540 restricted

shares, respectively. Restricted stock units are payable in cash.

Shares Available and Issued

Shares of stock available for future grants and issued in connection with all features of the LTIP and TSOP are as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Available for future grants as of Dec. 31:			
LTIP	11,321,573	14,033,053	17,994,726
TSOP	2,771,400	2,773,300	2,737,200
Shares of Common Stock issued:			
LTIP	9,078,717	8,764,021	1,412,749
TSOP	410,750	8,700	--

13. Stockholders' Equity

Accumulated Other Comprehensive Loss

"Accumulated other comprehensive income (loss)" reported in the Consolidated Statements of Changes in Stockholders' Equity consisted of the following:

	Balance	Net		Balance
	at Beginning	Gain	Reclassification	at End
	of Year	(Loss)	Adjustments	of Year
	<i>(\$ in millions)</i>			
Dec. 31, 2005				
Unrealized gains (losses) on securities	\$ 1	\$ (1)	\$ --	\$ --
Cash flow hedges	47	55	(90)	12
Minimum pension liability	(72)	(17)	--	(89)
Accumulated other comprehensive loss	<u>\$ (24)</u>	<u>\$ 37</u>	<u>\$ (90)</u>	<u>\$ (77)</u>
Dec. 31, 2004				
Unrealized gains on securities	\$ --	\$ 1	\$ --	\$ 1
Cash flow hedges	28	104	(85)	47
Minimum pension liability	(72)	--	--	(72)
Accumulated other				

comprehensive loss

\$ (44) \$ 105 \$ (85) \$ (24)

“Other comprehensive income (loss)” reported in the Consolidated Statements of Changes in Stockholders' Equity consisted of the following:

	<u>Pretax Amount</u>	<u>Tax (Expense) Benefit</u> (\$ in millions)	<u>Net-of-Tax Amount</u>
Year ended Dec. 31, 2005			
Net gain (loss) arising during the year:			
Cash flow hedges	\$ 92	\$ (37)	\$ 55
Reclassification adjustments for gains included in net income	<u>(148)</u>	<u>58</u>	<u>(90)</u>
Subtotal	(56)	21	(35)
Unrealized losses on securities	(1)	--	(1)
Minimum pension liability	<u>(19)</u>	<u>2</u>	<u>(17)</u>
Other comprehensive income (loss)	\$ <u>(76)</u>	\$ <u>23</u>	\$ <u>(53)</u>
Year ended Dec. 31, 2004			
Net gain (loss) arising during the year:			
Cash flow hedges	\$ 171	\$ (67)	\$ 104
Reclassification adjustments for gains included in net income	<u>(140)</u>	<u>55</u>	<u>(85)</u>
Subtotal	31	(12)	19
Unrealized gains on securities	<u>1</u>	<u>--</u>	<u>1</u>
Other comprehensive income (loss)	\$ <u>32</u>	\$ <u>(12)</u>	\$ <u>20</u>
Year ended Dec. 31, 2003			
Net gain (loss) arising during the year:			
Cash flow hedges	\$ 75	\$ (29)	\$ 46
Reclassification adjustments for gains included in net income	<u>(59)</u>	<u>23</u>	<u>(36)</u>
Subtotal	16	(6)	10
Unrealized losses on securities	(1)	--	(1)
Minimum pension liability	<u>11</u>	<u>1</u>	<u>12</u>
Other comprehensive income (loss)	\$ <u>26</u>	\$ <u>(5)</u>	\$ <u>21</u>

In 2005, 2004 and 2003, Conrail recorded a \$22 million loss, a \$3 million gain and a \$25 million gain, respectively, in other comprehensive income (loss) related to its minimum pension liability. NS' "Other comprehensive income (loss)" includes a \$13 million loss for 2005, a \$2 million gain for 2004 and a \$14 million gain for 2003, arising from the Conrail adjustments.

14. Earnings Per Share

The following table sets forth the calculation of basic and diluted earnings per share:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions except per share, shares in millions)</i>		
Income available to common stockholders for basic and diluted computations	\$ <u>1,281</u>	\$ <u>923</u>	\$ <u>535</u>
Basic earnings per share:			
Weighted-average shares outstanding	<u>404.2</u>	<u>394.2</u>	<u>389.8</u>
Basic earnings per share	\$ <u>3.17</u>	\$ <u>2.34</u>	\$ <u>1.37</u>
Diluted earnings per share:			
Weighted-average shares outstanding per above	404.2	394.2	389.8
Dilutive effect of outstanding options, PSUs and restricted shares (as determined by the application of the treasury stock method)	<u>8.1</u>	<u>5.1</u>	<u>1.9</u>
Adjusted weighted-average shares outstanding	<u>412.3</u>	<u>399.3</u>	<u>391.7</u>
Diluted earnings per share	\$ <u>3.11</u>	\$ <u>2.31</u>	\$ <u>1.37</u>

These calculations exclude options whose exercise price exceeded the average market price of Common Stock as follows: 1 million in 2005, 13 million in 2004 and 28 million in 2003.

As disclosed in Note 1, the cumulative effect of changes in accounting principles in 2003 amounted to \$114 million, or 29 cents per share (basic and diluted). As disclosed in Note 17, the results in 2003 included discontinued operations of \$10 million, or 3 cents per share (basic and diluted).

There are no adjustments to "Net income" or "Income from continuing operations" for the diluted earnings per share computations.

15. Fair Values of Financial Instruments

The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable" and "Accounts payable" approximate carrying values because of the short maturity of these financial instruments. The fair value of corporate-owned life insurance approximates carrying value. The carrying amounts and estimated fair values for the remaining financial instruments, excluding derivatives (see

Note 16) and investments accounted for under the equity method in accordance with APB Opinion No. 18, consisted of the following at Dec. 31:

<u>2005</u>		<u>2004</u>	
<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
<i>(\$ in millions)</i>			

Investments	\$ 139	\$ 160	\$ 125	\$ 134
Long-term debt	(6,930)	(7,934)	(7,525)	(8,577)

Quoted market prices were used to determine the fair value of marketable securities; underlying net assets were used to estimate the fair value of other investments. The fair values of notes receivable are based on future discounted cash flows. The fair values of 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.

Carrying amounts of marketable securities reflect unrealized holding gains of less than \$1 million on Dec. 31, 2005, and \$1 million on Dec. 31, 2004. Sales of "available-for-sale" securities were immaterial for the years ended Dec. 31, 2005, 2004 and 2003; most short-term investments were redeemed at maturity.

16. Derivative Financial Instruments

On Jan. 1, 2001, NS adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as amended by Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (SFAS No. 138). The Statements establish accounting and reporting standards for derivative instruments and hedging activities, requiring that all derivatives be recognized in the financial statements as either assets or liabilities and that they be measured at fair value. Changes in fair value are recorded as adjustments to the assets or liabilities being hedged in "Other comprehensive income," or in current earnings, depending on whether the derivative is designated and qualifies for hedge accounting, the type of hedge transaction represented and the effectiveness of the hedge. The settlements of the hedges will result in the reclassification into diesel fuel expense of the related gains or losses recorded as a component of "Other comprehensive income."

NS uses 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. NS does not engage in the trading of derivatives. Management has determined that its derivative financial 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. 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.

Diesel Fuel Hedging

NS has hedged a portion of its diesel fuel consumption. The intent of the hedges is to assist in the management of NS' aggregate risk exposure to fuel price fluctuations, which can significantly affect NS' operating margins and profitability. In order to minimize this risk, NS has entered into a series of swaps in order to lock in the purchase prices of some of its diesel fuel. Management has designated these derivative instruments as cash-flow hedges of the exposure to variability in expected future cash flows attributable to fluctuations in diesel fuel prices.

Following is a summary of NS' diesel fuel swaps:

	<u>2005</u>	<u>2004</u>
Number of swaps entered into during the year	--	120
Approximate number of gallons hedged (millions)	--	157
Approximate average price per gallon of Nymex No. 2 heating oil	n/a	\$0.86

NS has 4% of estimated 2006 future diesel fuel consumption covered as of Dec. 31, 2005.

Hedges are entered into periodically by competitive bid among selected counterparties; however, no hedges have been placed since May 2004. The goal of this hedging strategy is to reduce the variability of fuel costs over an extended period of time while minimizing the incremental cost of hedging. The program provides that NS will not enter into any fuel hedges with a duration of more than 36 months, and that no more than 80% of NS' average monthly fuel consumption will be hedged for each month within any 36-month period. After taking into account the effect of the hedging, diesel fuel costs represented 11% of NS' operating expenses for the year ended Dec. 31, 2005, 8% for the year ended Dec. 31, 2004, and 7% for the year ended Dec. 31, 2003.

NS' fuel hedging activity resulted in decreases in diesel fuel expenses of \$148 million, \$140 million and \$59 million for 2005, 2004 and 2003, respectively. Ineffectiveness, or the extent to which changes in the fair value of the heating oil contracts do not offset changes in the fair values of the expected diesel fuel transactions, was a \$5 million expense in 2005, a \$5 million benefit in 2004 and less than a \$1 million benefit in 2003.

Interest Rate Hedging

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. NS had \$116 million, or 1.7%, and \$151 million, or 2.2%, of its fixed rate debt portfolio hedged as of Dec. 31, 2005, and Dec. 31, 2004, respectively, using interest rate swaps that qualify for and are designated as fair-value hedge transactions. NS' interest rate hedging activity resulted in decreases in interest expenses of \$2 million, \$6 million and \$10 million for 2005, 2004 and 2003, respectively. These swaps have been effective in hedging the changes in fair value of the related debt arising from changes in interest rates and there has been no impact on earnings resulting from ineffectiveness associated with these derivative transactions.

Fair Values

The fair values of NS' diesel fuel derivative instruments as of Dec. 31, 2005 and 2004 were determined based upon current market values as quoted by an independent third party. Fair values of interest rate swaps were determined based upon the present value of expected future cash flows discounted at the appropriate implied spot rate from the spot rate yield curve. Fair value adjustments are noncash transactions and, accordingly, are excluded from the Consolidated Statement of Cash Flows. "Accumulated other comprehensive loss," a component of "Stockholders' equity," included unrealized gains of \$20 million (pretax) as of Dec. 31, 2005, and \$75 million (pretax) as of Dec. 31, 2004, related to the fair value of derivative fuel hedging transactions that will terminate within twelve months of the respective dates. Any future gain or loss actually realized will be based on the fair value of the derivative fuel hedges at the time of termination.

The asset and liability positions of NS' outstanding derivative financial instruments were as follows:

	Dec. 31,	
	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>	
<i>Interest rate hedges:</i>		
Gross fair value asset position	\$ 3	\$ 9
Gross fair value (liability) position	--	--
<i>Fuel hedges:</i>		
Gross fair value asset position	20	81
Gross fair value (liability) position	--	--
Total net asset (liability) position	<u>\$ 23</u>	<u>\$ 90</u>

17. Discontinued Operations - Motor Carrier

On March 28, 1998, NS sold all the common stock of North American Van Lines, Inc. (NAVL), its motor carrier subsidiary. Results in 2003 include an additional after-tax gain of \$10 million, or 3 cents per share (basic and diluted), that resulted from resolution of tax issues related to the transaction.

18. Commitments and Contingencies

Lawsuits

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 earnings. While the ultimate amount of liability incurred in any of these lawsuits and claims is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payment of such liability and claims. However, the final outcome of any of these lawsuits and claims cannot be predicted with certainty, and unfavorable or unexpected outcomes could result in additional accruals that could be significant to results of operations in a particular year or quarter. Any adjustments to the recorded liability will be reflected in earnings in the periods in which such adjustments are known.

NS has been involved in mass tort litigation proceedings arising out of historic flooding events that occurred in West Virginia in 2001. During the third quarter, one of NS' subsidiaries was identified as the target defendant for claims related to a specific sub-watershed. The final outcome of these proceedings is inestimable at this time. Although NS has good defenses to the litigation, an unexpected adverse resolution could have a material adverse effect on the results of operations in a particular quarter or fiscal year.

Casualty Claims

Casualty claims include employee personal injury and occupational claims as well as third-party claims, all exclusive of legal costs. NS engages an independent consulting actuarial firm to aid in valuing its liability for these claims. 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 very different from the liability recorded. While the ultimate amount of claims incurred is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payments of claims and is supported by the most recent actuarial study. In all cases, NS records a liability when the expected loss for the claim is both probable and estimable.

In 2005, NS recorded a liability related to the Jan. 6, 2005 derailment in Graniteville, SC. The liability, which includes a current and long-term portion, 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 NS' self-insured retention, including NS' response costs and legal fees. Accordingly, the Consolidated Balance Sheet reflects a current and long-term receivable for estimated recoveries from NS' insurance carriers. The \$41 million expense recorded in 2005 related to this incident represents NS' retention under its insurance policies and other uninsured costs. While it is reasonable to expect that the liability for covered losses could differ from the amount recorded, such a change would be offset by a corresponding change in the insurance receivable. As a result, NS does not believe that it is reasonably likely that its net loss (the difference between the liability and future recoveries) will be materially different than the loss recorded in 2005. NS expects at this time that insurance coverage is adequate to cover potential claims and settlements above its self-insurance retention.

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

Occupational claims – Occupational claims (including asbestosis and other respiratory diseases, as well as repetitive motion) are often not caused by a specific accident or event but rather 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 actuarial firm provides an estimate of the occupational claims liability based upon NS' history of claim filings, severity, payments and other pertinent facts. The liability is dependent upon management's judgments made as to the specific case reserves as well as judgments of the consulting actuarial firm in the periodic studies. The actuarial firm's estimate of ultimate loss includes a provision for those claims that have been incurred but not reported. This provision is derived by analyzing industry data and projecting NS' experience into the future as far as can be reasonably determined. NS adjusts its liability to the actuarially determined amount on a quarterly basis. However, it is possible that the recorded liability may not be adequate to cover the future payment of claims. Adjustments to the recorded liability are reflected in operating expenses in the periods in which such adjustments become known.

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

Environmental Matters

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

NS' Consolidated Balance Sheets included liabilities for environmental exposures in the amount of \$58 million at Dec. 31, 2005, and \$64 million at Dec. 31, 2004 (of which \$12 million was accounted for as a current liability at Dec. 31, 2005 and 2004). At Dec. 31, 2005, the liability represented NS' estimate of the probable cleanup and remediation costs based on available information at 189 known locations. On that date, 16 sites accounted for \$30 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 some of the 189 locations, certain 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.

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

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

Insurance

NS obtains on behalf of itself and its subsidiaries commercial insurance for potential losses for third-party liability and first-party property damages. Specified levels of risk are retained on a self-insurance basis (up to \$25 million per occurrence for bodily injury and property damage to third parties and \$12.5 million per occurrence for property owned by NS or in NS' care, custody or control).

Purchase Commitments

NSR had outstanding purchase commitments of approximately \$341 million in connection with its 2006 and 2007 capital programs, including 133 locomotives in 2006 and 63 locomotives in 2007. In addition, Norfolk Southern has committed to purchase telecommunications services totaling \$17 million through 2007.

Change-In-Control Arrangements

Norfolk Southern has compensation agreements with officers and certain key employees that become operative only upon a change in control of the Corporation, as defined in those agreements. The agreements provide generally for payments based on compensation at the time of a covered individual's involuntary or other specified termination and for certain other benefits.

Guarantees

In a number of instances, NS and its subsidiaries have agreed to indemnify lenders for additional costs they may bear as a result of certain changes in laws or regulations applicable to their loans. Such changes may include impositions or modifications with respect to taxes, duties, reserves, liquidity, capital adequacy, special deposits, and similar requirements relating to extensions of credit by, deposits with, or the assets or liabilities of such lenders. Similar provisions exist in NS' accounts receivable sales program. The nature and timing of changes in laws or regulations applicable to NS' financings are inherently unpredictable, and therefore NS' exposure in connection with the foregoing indemnifications cannot be quantified. No liability has been recorded related to these indemnifications. In the case of one type of equipment financing, NSR's Japanese leveraged leases, NSR may terminate the leases and ancillary agreements if such a change-in-law indemnity is triggered. Such a termination would require NSR to make early termination payments that would not be expected to have a material adverse effect on NS' financial condition, results of operations or liquidity.

NS has indemnified parties in a number of transactions for U.S. income tax withholding imposed as a result of changes in U.S. tax law. In all cases, NS has the right to unwind the related transaction if the withholding cannot be avoided in the future. Because these indemnities would be triggered and are dependent upon a change in the tax law, the maximum exposure is not quantifiable. Management does not believe that it is likely that it will be required to make any payments under these indemnities.

NS has outstanding warranty liabilities primarily related to work performed at its locomotive facilities. NS has recorded a reserve of less than \$1 million as of Dec. 31, 2005, and 2004, for these warranties.

As of Dec. 31, 2005, certain Norfolk Southern subsidiaries are contingently liable as guarantors with respect to \$8 million of indebtedness of an entity in which they have an ownership interest, the Terminal Railroad Association of St. Louis, due in 2019. Six other railroads are also jointly and severally liable as guarantors for this indebtedness. No liability has been recorded related to this guaranty.

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

QUARTERLY FINANCIAL DATA

(Unaudited)

Three Months Ended

	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
	<i>(In millions of dollars, except per share amounts)</i>			
2005				
Railway operating revenues	\$ 1,961	\$ 2,154	\$ 2,155	\$ 2,257
Income from railway operations	403	592	528	594
Net income	194	424 ¹	301	362
Earnings per share:				
Basic	\$ 0.48	\$ 1.05 ¹	\$ 0.74	\$ 0.89
Diluted	\$ 0.47	\$ 1.04 ¹	\$ 0.73	\$ 0.87
2004				
Railway operating revenues	\$ 1,693	\$ 1,813	\$ 1,857	\$ 1,949
Income from railway operations	346	425	469	462
Net income	158	213	288 ²	264
Earnings per share:				
Basic	\$ 0.40	\$ 0.55	\$ 0.73 ²	\$ 0.66
Diluted	\$ 0.40	\$ 0.54	\$ 0.72 ²	\$ 0.65

¹ Includes a \$96 million, or 23 cents per diluted share, benefit related to a reduction of deferred income tax liabilities resulting from tax legislation enacted by Ohio .

² Includes a \$53 million or 13 cents per diluted share net gain from the Conrail Corporate Reorganization (see Note 5 to the Consolidated Financial Statements).

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure .

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Norfolk Southern's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of NS' 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 (the "Exchange Act")) as of December 31, 2005. Based on such evaluation, such officers have concluded that, as of Dec. 31, 2005, NS' disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to NS (including its consolidated subsidiaries) required to be included in NS' periodic filings under the Exchange Act.

Internal Control over Financial Reporting

The management of Norfolk Southern is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control over financial reporting includes those policies and procedures that pertain to the Corporation's ability to record, process, summarize and report reliable financial data. Management recognizes that there are inherent limitations in the effectiveness of any internal control over financial reporting, including the possibility of human error and the circumvention or overriding of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

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 Dec. 31, 2005. This assessment was based on criteria for effective internal control over financial reporting set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on our assessment, management has concluded that the Corporation maintained effective internal control over financial reporting as of Dec. 31, 2005.

The Board of Directors, acting through its Audit Committee, is responsible for the oversight of the Corporation's accounting policies, financial reporting and internal control. The Audit Committee of the Board of Directors is comprised entirely of outside directors who are independent of management. The independent registered public accounting firm and the internal auditors have full and unlimited access to the Audit Committee, with or without management, to discuss the adequacy of internal control over financial reporting, and any other matters which they believe should be brought to the attention of the Audit Committee.

Norfolk Southern's management has issued a report of its assessment of internal control over financial reporting, and Norfolk Southern's independent registered public accounting firm has issued a report on this assessment. These reports appear in Part II, Item 8 of this report on Form 10-K.

During the fourth quarter of 2005, management has not identified any changes in NS' internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, NS' internal control over financial reporting.

PART III

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES (NS)

Item 10. Directors and Executive Officers of the Registrant .

In accordance with General Instruction G(3), information called for by Item 10, Part III, is incorporated herein by reference from the

information appearing under the caption "Election of Directors," under the caption "Board of Directors;" and under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in Norfolk Southern's definitive Proxy Statement for the Norfolk Southern Annual Meeting of Stockholders to be held on May 11, 2006, which definitive Proxy Statement will be filed electronically with the Commission pursuant to Regulation 14A no later than May 1, 2006. The information regarding executive officers called for by Item 401 of Regulation S-K is included in Part I hereof beginning under "Executive Officers of the Registrant."

Item 11. Executive Compensation .

In accordance with General Instruction G(3), information called for by Item 11, Part III, is incorporated herein by reference from the information appearing under the subcaption "Compensation" under the caption "Board of Directors" for directors and under the caption "Executive Compensation" for executives, including the information appearing in the "Summary Compensation Table" and under the subcaptions "Long-Term Incentive Plan" (including the three tables therein), "Pension Plans" (including the table therein), and "Change in Control Arrangements" in Norfolk Southern's definitive Proxy Statement for the Norfolk Southern Annual Meeting of Stockholders to be held on May 11, 2006, which definitive Proxy Statement will be filed electronically with the Commission pursuant to Regulation 14A no later than May 1, 2006.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters .

In accordance with General Instruction G(3), information on security ownership of certain beneficial owners and management called for by Item 12, Part III, Item 403 of Regulation S-K, is incorporated herein by reference from the information appearing under the caption "Beneficial Ownership of Stock" and the caption "Executive Compensation" in Norfolk Southern's definitive Proxy Statement for the Norfolk Southern Annual Meeting of Stockholders to be held on May 11, 2006, which definitive Proxy Statement will be filed electronically with the Commission pursuant to Regulation 14A no later than May 1, 2006.

Equity Compensation Plan Information (as of Dec. 31, 2005)

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted- average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity Compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation Plans approved by security holders ¹	28,456,663	23.78 ⁽⁴⁾	11,321,573 ⁽⁵⁾
Equity			

compensation Plans not approved by security holders ²	<u>4,210,417</u> ⁽³⁾	27.79 ⁽³⁾	<u>2,810,400</u> ⁽⁶⁾
Total	<u>32,667,080</u>	24.35	<u>14,131,973</u>

¹ The Long-Term Incentive Plan, excluding five million shares for broad-based issuance to non-officers.

² The Long-Term Incentive Plan's five million shares for broad-based issuance to non-officers, the Thoroughbred Stock Option Plan and the Directors' Restricted Stock Plan.

³ Includes options and performance share units granted under the Long-Term Incentive Plan on 1,401,267 shares for non-officers and options granted under the Thoroughbred Stock Option Plan.

⁴ Calculated without regard to 3,121,400 outstanding performance share units at Dec. 31, 2005 .

⁵ Of the shares remaining available for grant under plans approved by stockholders, 8,500,000 are available for grant as restricted shares, performance shares or restricted stock unit shares under the Long-Term Incentive Plan.

⁶ Of the shares remaining available for grant under plans not approved by stockholders, 39,000 are available for grant as restricted stock under the Directors' Restricted Stock Plan.

Norfolk Southern Corporation Long-Term Incentive Plan ("LTIP")

Established on June 28, 1983 , and approved by stockholders at their Annual Meeting held on May 10, 1984 , LTIP was adopted to promote the success of Norfolk Southern by providing an opportunity for non-employee directors, officers and other key employees to acquire a proprietary interest in the Corporation. On Jan. 23, 2001 , the Board of Directors further amended the plan and approved the issuance of an additional 5,000,000 shares of authorized but unissued Common Stock under LTIP to participants who are not officers of Norfolk Southern. The issuance of these shares was broadly-based, and stockholder approval of these shares was not required. Accordingly, this portion of LTIP is included in the number of securities available for future issuance for plans not approved by stockholders. Also on Jan. 23, 2001 , the Board adopted an amended plan, which was approved by shareholders on May 10, 2001 , that included the reservation for issuance of an additional 30,000,000 shares of authorized but unissued Norfolk Southern Common Stock.

Pursuant to another amendment approved by stockholders on May 12, 2005 , not more than 8.5 million of the shares remaining available for issuance under the plan may be awarded as restricted shares, performance shares or restricted stock unit shares. Cash payments of restricted stock units, stock appreciation rights and performance share units will not be applied against the maximum number of

shares issuable under the plan. Any shares of Common Stock subject to options, performance share units or restricted stock units which are not issued as Common Stock will again be available for award under the plan after the expiration or forfeiture of an award.

Non-employee directors, officers and other key employees residing in the United States or Canada are eligible for selection to receive LTIP awards. Under LTIP, the Compensation Committee (Committee) may grant incentive stock options, nonqualified stock options, stock appreciation rights, restricted shares, restricted stock units and performance share units (in addition, dividend equivalents may be awarded for options, restricted stock units and performance share units). The Committee may establish such terms and conditions for the awards as provided in the plan.

For options, the option price per share will not be less than 100% of the fair market value of Norfolk Southern's Common Stock on the effective date the option is granted. All options are subject to a vesting period of at least one year, and the term of the option will not exceed ten years. LTIP specifically prohibits option repricing without stockholder approval, except for capital adjustments.

Performance share units entitle a recipient to receive performance-based compensation at the end of a three-year performance cycle based on Norfolk Southern's performance during that three-year period. For the 2005 performance share unit awards, corporate performance will be measured using three equally weighted standards established by the committee: (1) three-year average return on average capital invested, (2) three-year average operating ratio and (3) three-year total return to stockholders. Performance share units may be payable in either shares of Norfolk Southern Common Stock or cash.

Restricted stock units are payable in cash or in shares of Norfolk Southern Common Stock at the end of a restriction period of not less than 36 months and not more than 60 months. During the restriction period, the holder of the restricted stock units has no beneficial ownership interest in the Norfolk Southern Common Stock represented by the restricted stock units and has no right to vote the shares represented by the units or to receive dividends (except for dividend equivalent rights that may be awarded with respect to the restricted stock units). Restricted stock units will be forfeited immediately if the holder leaves the continuous employment of Norfolk Southern before the end of the restriction period, unless such employment is terminated by reason of retirement, disability or death or unless the restrictions are waived by Norfolk Southern.

Norfolk Southern Corporation Thoroughbred Stock Option Plan

The Board adopted the Norfolk Southern Corporation Thoroughbred Stock Option Plan ("TSOP") on Jan. 26, 1999, to promote the success of Norfolk Southern by providing an opportunity for nonagreement employees to acquire a proprietary interest in Norfolk Southern and thereby to provide an additional incentive to nonagreement employees to devote their maximum efforts and skills to the advancement, betterment, and prosperity of Norfolk Southern and its stockholders. The plan has not been and is not required to have been approved by stockholders. Six million shares of authorized but unissued Common Stock were reserved for issuance under TSOP.

Active full-time nonagreement employees residing in the United States or Canada are eligible for selection to receive TSOP awards. Under TSOP, the Compensation Committee of the Board of Directors may grant nonqualified stock options subject to such terms and conditions as provided in the plan.

The option price will not be less than 100% of the fair market value of Norfolk Southern's Common Stock on the effective date the options are granted. All options are subject to a vesting period of at least one year, and the term of the option will not exceed ten years. TSOP specifically prohibits option repricing without stockholder approval, except for capital adjustments.

Norfolk Southern Corporation Directors' Restricted Stock Plan

The Norfolk Southern Corporation Directors' Restricted Stock Plan ("Plan") was adopted on Jan. 1, 1994, and is designed to increase ownership of Norfolk Southern Common Stock by its non-employee directors so as to further align their ownership interest in Norfolk Southern with that of stockholders. The Plan has not been and is not required to have been approved by stockholders. Currently, a maximum of 66,000 shares of Corporation Common Stock may be granted under the Plan. To make grants to eligible directors, Norfolk

Southern purchases, through one or more subsidiary companies, the number of shares required in open-market transactions at prevailing market prices, or makes such grants from Norfolk Southern Common Stock already owned by one or more of Norfolk Southern's subsidiary companies.

Only non-employee directors who are not and never have been employees of Norfolk Southern are eligible to participate in the Plan. Upon becoming a director, each eligible director receives a one-time grant of 3,000 restricted shares of Norfolk Southern Common Stock. No individual member of the Board exercises discretion concerning the eligibility of any director or the number of shares granted.

The restriction period applicable to restricted shares granted under the plan begins on the date of the grant and ends on the earlier of the recipient's death or six months after the recipient ceases to be a director by reason of disability or retirement. During the restriction period shares may not be sold, pledged or otherwise encumbered. Directors will forfeit the restricted shares if they cease to serve as a director of Norfolk Southern for reasons other than their disability, retirement or death.

Item 13. Certain Relationships and Related Transactions .

In accordance with General Instruction G(3), information called for by Item 13, Part III, is incorporated herein by reference from the information appearing under the caption "Certain Relationships and Related Transactions" in Norfolk Southern's definitive Proxy Statement for the Norfolk Southern Annual Meeting of Stockholders to be held on May 11, 2006, which definitive Proxy Statement will be filed electronically with the Commission pursuant to Regulation 14A no later than May 1, 2006.

Item 14. Principal Accountant Fees and Services.

In accordance with General Instruction G(3), information called for by Item 14, Part III is incorporated herein by reference from the information appearing under the caption "Ratification of Appointment of Independent Registered Public Accounting Firm" in Norfolk Southern's definitive Proxy Statement for the Norfolk Southern Annual Meeting of Stockholders to be held on May 11, 2006, which definitive proxy statement will be filed electronically with the Commission pursuant to Regulation 14A no later than May 1, 2006.

PART IV

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES (NS)

Item 15. Exhibits and Financial Statement Schedules .

(A) The following documents are filed as part of this report:

1. Index to Consolidated Financial Statements

Report of Management	K43
Reports of Independent Registered Public Accounting Firm	K44
Consolidated Statements of Income, Years ended Dec. 31, 2005, 2004 and 2003	K47
Consolidated Balance Sheets As of Dec. 31, 2005 and 2004	K48
Consolidated Statements of Cash Flows, Years ended Dec. 31, 2005, 2004 and 2003	K49
Consolidated Statements of Changes in Stockholders' Equity, Years ended Dec. 31, 2005, 2004 and 2003	K50
Notes to Consolidated Financial Statements	K51

2. Financial Statement Schedule:

The following consolidated financial statement schedule should be read in connection with the consolidated financial statements:

<u>Index to Consolidated Financial Statement Schedule</u>	<u>Page</u>
Schedule II - Valuation and Qualifying Accounts	K97

Schedules other than the one listed above are omitted either because they are not required or are inapplicable, or because the information is included in the consolidated financial statements or related notes.

3. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
3	Articles of Incorporation and Bylaws -
3(i)	The Restated Articles of Incorporation of Norfolk Southern Corporation are incorporated By reference to Exhibit 3(i) to Norfolk Southern Corporation's 10-K filed on March 5, 2001 .
3(ii)	The Bylaws of Norfolk Southern Corporation, as amended Jan. 23, 2006 , are incorporated by reference to Exhibit 3(ii) to Norfolk Southern Corporation's Form 8-K filed on Jan. 27, 2006 .

Instruments Defining the Rights of Security Holders, Including Indentures:

4

- (a) Indenture, dated as of Jan. 15, 1991 , from Norfolk Southern Corporation to First Trust of New York, National Association, as Trustee, is incorporated by reference to Exhibit 4.1 to Norfolk Southern Corporation's Registration Statement on Form S-3 (No. 33-38595).
- (b) First Supplemental Indenture, dated May 19, 1997 , between Norfolk Southern Corporation and First Trust of New York, National Association, as Trustee, related to the issuance of notes in the principal amount of \$4.3 billion, is incorporated herein by reference to Exhibit 1.1(d) to Norfolk Southern Corporation's Form 8-K filed on May 21, 1997 .
- (c) Second Supplemental Indenture, dated April 26, 1999 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, related to the issuance of notes in the principal amount of \$400 million, is incorporated herein by reference to Exhibit 1.1(c) to Norfolk Southern Corporation's Form 8-K filed on April 30, 1999 .
- (d) Third Supplemental Indenture, dated May 23, 2000 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, related to the issuance of notes in the principal amount of \$600 million, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on May 25, 2000 .
- (e) Fourth Supplemental Indenture, dated as of Feb. 6, 2001 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, related to the issuance of notes in the principal amount of \$1 billion, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on Feb. 7, 2001 .
- (f) Fifth Supplemental Indenture, dated as of July 5, 2001 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, related to the issuance of notes in the principal amount of \$250 million, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on July 5, 2001 .
- (g) Sixth Supplemental Indenture, dated as of April 30, 2002 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, relating to the issuance of notes in the principal amount of \$200 million, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on May 1, 2002 .
- (h) Seventh Supplemental Indenture, dated as of April 30, 2002 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, relating to the issuance of notes in the principal amount of \$100 million, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on May 1, 2002 .
- (i) Eighth Supplemental Indenture, dated as of Sept. 17, 2004, between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, relating to the issuance of 5.257% Notes due 2014 ("Securities") in the aggregate principal amount of \$441.5 million in connection with Norfolk Southern

Corporation's offer to exchange the Securities and cash for up to \$400 million of its outstanding 7.350% Notes due 2007, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on Sept. 23, 2004.

- (j) Indenture, dated Aug. 27, 2004 , among PRR Newco, Inc., as Issuer, and Norfolk Southern Railway Company, as Guarantor, and The Bank of New York, as Trustee, is incorporated herein by reference to Exhibit 4(l) to Norfolk Southern Corporation's Form 10-Q filed on Oct. 28, 2004 .
- (k) First Supplemental Indenture, dated Aug. 27, 2004, among PRR Newco, Inc., as Issuer, and Norfolk Southern Railway Company, as Guarantor, and The Bank of New York, as Trustee, related to the issuance of notes in the principal amount of approximately \$451.8 million, is incorporated herein by reference to Exhibit 4(m) to Norfolk Southern Corporation's Form 10-Q filed on Oct. 28, 2004.
- (l) Ninth Supplemental Indenture, dated as of March 11, 2005 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, relating to the issuance of notes in the principal amount of \$300 million, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on March 15, 2005 .
- (m) Tenth Supplemental Indenture, dated as of May 17, 2005 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, relating to the issuance of notes in the principal amount of \$366.6 million, is incorporated herein by reference to Exhibit 99.1 to Norfolk Southern Corporation's Form 8-K filed on May 18, 2005 .
- (n) Eleventh Supplemental Indenture, dated as of May 17, 2005 , between Norfolk Southern Corporation and U.S. Bank Trust National Association, as Trustee, relating to the issuance of notes in the principal amount of \$350 million, is incorporated herein by reference to Exhibit 99.2 to Norfolk Southern Corporation's Form 8-K filed on May 18, 2005 .

In accordance with Item 601(b)(4)(iii) of Regulation S-K, copies of other instruments of Norfolk Southern Corporation and its subsidiaries with respect to the rights of holders of long-term debt are not filed herewith, or incorporated by reference, but will be furnished to the Commission upon request.

10 Material Contracts -

- (a) The Transaction Agreement, dated as of June 10, 1997, by and among CSX, CSX Transportation, Inc., Registrant, Norfolk Southern Railway Company, Conrail Inc., Consolidated Rail Corporation and CRR Holdings LLC, with certain schedules thereto, previously filed, is incorporated herein by reference to Exhibit 10(a) to Norfolk Southern Corporation's Form 10-K filed on Feb. 24, 2003.
- (b) Amendment No. 1, dated as of Aug. 22, 1998, to the Transaction Agreement, dated as of June 10, 1997, by and among CSX Corporation, CSX Transportation, Inc., Norfolk Southern Corporation, Norfolk Southern Railway Company, Conrail Inc., Consolidated Rail Corporation and CRR Holdings LLC, is incorporated herein by reference from Exhibit 10.1 to Norfolk Southern Corporation's Form 10-Q filed on Aug. 11, 1999.
- (c) Amendment No. 2, dated as of June 1, 1999, to the Transaction Agreement, dated June 10, 1997, by and among CSX Corporation, CSX Transportation, Inc.,

Norfolk Southern Corporation, Norfolk Southern Railway Company, Conrail Inc., Consolidated Rail Corporation and CRR Holdings LLC, is incorporated herein by reference from Exhibit 10.2 to Norfolk Southern Corporation's Form 10-Q filed on Aug. 11, 1999.

- (d) Shared Assets Area Operating Agreement for North Jersey , dated as of June 1, 1999 , by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibit thereto, is incorporated herein by reference from Exhibit 10.4 to Norfolk Southern Corporation's Form 10-Q filed on Aug. 11, 1999 .
- (e) Shared Assets Area Operating Agreement for South Jersey / Philadelphia , dated as of June 1, 1999 , by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibit thereto, is incorporated herein by reference from Exhibit 10.5 to Norfolk Southern Corporation's Form 10-Q filed on Aug. 11, 1999 .
- (f) Shared Assets Area Operating Agreement for Detroit , dated as of June 1, 1999 , by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibit thereto, is incorporated herein by reference from Exhibit 10.6 to Norfolk Southern Corporation's Form 10-Q filed on Aug. 11, 1999 .
- (g) Amendment No. 1, dated as of June 1, 2000 , to the Shared Assets Areas Operating Agreement for North Jersey , South Jersey/Philadelphia and Detroit , dated as of June 1, 1999 , by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibit thereto, is incorporated herein by reference to Exhibit 10(h) to Norfolk Southern Corporation's 10-K filed on March 5, 2001 .
- (h) Amendment No. 2, dated as Jan. 1, 2001 , to the Shared Assets Area Operating Agreements for North Jersey , South Jersey/Philadelphia and Detroit , dated as of June 1, 1999 , by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibit thereto, is incorporated herein by reference to Exhibit 10(j) to Norfolk Southern Corporation's Form 10-K filed on Feb. 21, 2002.
- (i) Amendment No. 3, dated as of June 1, 2001, and executed in May of 2002, to the Shared Assets Area Operating Agreement for North Jersey, South Jersey/Philadelphia and Detroit, dated as of June 1, 1999, by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibit thereto, is incorporated herein by reference to Exhibit 10(k) to Norfolk Southern Corporation's Form 10-K filed on Feb. 24, 2003.
- (j) Monongahela Usage Agreement, dated as of June 1, 1999 , by and among CSX Transportation, Inc., Norfolk Southern Railway Company, Pennsylvania Lines LLC and New York Central Lines LLC, with exhibit thereto, is incorporated herein by reference from Exhibit 10.7 to Norfolk Southern Corporation's Form 10-Q filed on Aug. 11, 1999 .
- (k) The Agreement, entered into as of July 27, 1999 , between North Carolina Railroad Company and Norfolk Southern Railway Company, is incorporated herein by reference from Exhibit 10(i) to Norfolk Southern Corporation's Form 10-K filed on March 6, 2000 .

- (l) The Supplementary Agreement, entered into as of Jan. 1, 1987, between the Trustees of the Cincinnati Southern Railway and The Cincinnati, New Orleans and Texas Pacific Railway Company (the latter a wholly owned subsidiary of Norfolk Southern Railway Company) - extending and amending a Lease, dated as of Oct. 11, 1881 - is incorporated by reference to Exhibit 10(k) to Norfolk Southern Corporation's Form 10-K filed on March 5, 2001.
- * (m) The Norfolk Southern Corporation Executive Management Incentive Plan, effective Jan. 25, 2005, is incorporated by reference herein from Exhibit 99 to Norfolk Southern Corporation's Form 8-K filed on May 13, 2005.
- * (n) The Norfolk Southern Corporation Long-Term Incentive Plan, as amended effective Jan. 25, 2005, is incorporated herein by reference to Exhibit 99 to Norfolk Southern Corporation's Form 8-K filed on May 13, 2005.
- * (o) The Norfolk Southern Corporation Officers' Deferred Compensation Plan, as amended effective September 26, 2000, is incorporated herein by reference to Exhibit 10(n) to Norfolk Southern Corporation's Form 10-K filed on March 5, 2001.
- * (p) The Norfolk Southern Corporation Executives' Deferred Compensation Plan, as amended effective Jan. 20, 2001, is incorporated herein by reference to Exhibit 10(o) to Norfolk Southern Corporation's Form 10-K filed on March 5, 2001.
- * (q) The Directors' Deferred Fee Plan of Norfolk Southern Corporation, as amended effective Jan. 23, 2001, is incorporated herein by reference to Exhibit 10(p) to Norfolk Southern Corporation's Form 10-K filed on March 5, 2001.
- * (r) The Norfolk Southern Corporation Directors' Restricted Stock Plan, effective Jan. 1, 1994, as restated Nov. 24, 1998, is incorporated herein by reference from Exhibit 10(h) to Norfolk Southern Corporation's Form 10-K filed on March 24, 1999.
- * (s) Form of Severance Agreement, dated as of June 1, 1996, between Norfolk Southern Corporation and certain executive officers (including those defined as "named executive officers" and identified in the Corporation's Proxy Statement for the 1997 through 2001 Annual Meetings of Stockholders), is incorporated herein by reference to Exhibit 10(t) to Norfolk Southern Corporation's Form 10-K filed on Feb. 21, 2002.
- * (t) Norfolk Southern Corporation Supplemental (formerly, Excess) Benefit Plan, effective as of Aug. 22, 1999, is incorporated herein by reference to Exhibit 10(r) to Norfolk Southern Corporation's Form 10-K filed on March 6, 2000.
- * (u) The Norfolk Southern Corporation Directors' Charitable Award Program, effective Feb. 1, 1996, is incorporated herein by reference to Exhibit 10(v) to Norfolk Southern Corporation's Form 10-K filed on Feb. 21, 2002.
- * (v) The Norfolk Southern Corporation Outside Directors' Deferred Stock Unit Program, as amended effective Jan. 28, 2003, is incorporated herein by reference to Exhibit 10(x) to Norfolk Southern Corporation's Form 10-K filed on

Feb. 24, 2003 .

- * (w) Form of Agreement, dated as of Oct. 1, 2001 , providing enhanced pension benefits to three officers in exchange for their continued employment with Norfolk Southern Corporation for two years, is incorporated herein by reference to Exhibit 10(w) to Norfolk Southern Corporation's Form 10-Q filed on Nov. 9, 2001 . The agreement was entered into with L. Ike Prillaman, Vice Chairman and Chief Marketing Officer; Stephen C. Tobias, Vice Chairman and Chief Operating Officer; and Henry C. Wolf, Vice Chairman and Chief Financial Officer.

- (x) The Norfolk Southern Corporation Thoroughbred Stock Option Plan, as amended effective Jan. 28, 2003 , is incorporated herein by reference to Exhibit 10(z) to Norfolk Southern Corporation's Form 10-K filed on Feb. 24, 2003 .

- * (y) The Norfolk Southern Corporation Restricted Stock Unit Plan, effective Jan. 28, 2003 , is incorporated herein by reference to Exhibit 10(bb) to Norfolk Southern Corporation's Form 10-K filed on Feb. 24, 2003 .

- * (z) The Norfolk Southern Corporation Executive Life Insurance Plan, as amended, effective Oct. 1, 2003 , is incorporated herein by reference to Exhibit 10 to Norfolk Southern Corporation's Form 10-Q filed on Oct. 31, 2003 .

- (aa) Amendment No. 3, dated as of June 1, 1999, and executed in April 2004, to the Transaction Agreement, dated June 10, 1997, by and among CSX Corporation, CSX Transportation, Inc., Norfolk Southern Corporation, Norfolk Southern Railway Company, Conrail Inc., Consolidated Rail Corporation and CRR Holdings LLC, is incorporated herein by reference to Exhibit 10(dd) to Norfolk Southern Corporation's Form 10-Q filed on July 30, 2004.

- (bb) Distribution Agreement, dated as of July 26, 2004, by and among CSX Corporation, CSX Transportation, Inc., CSX Rail Holding Corporation, CSX Northeast Holdings Corporation, Norfolk Southern Corporation, Norfolk Southern Railway Company, CRR Holdings LLC, Green Acquisition Corp., Conrail Inc., Consolidated Rail Corporation, New York Central Lines LLC, Pennsylvania Lines LLC, NYC Newco, Inc. and PRR Newco, Inc., is incorporated herein by reference to Exhibit 2.1 to Norfolk Southern Corporation's Form 8-K filed on Sept. 2, 2004.

- (cc) Amendment No. 5 to the Transaction Agreement, dated as of Aug. 27, 2004, by and among CSX Corporation, CSX Transportation, Inc., Norfolk Southern Corporation, Norfolk Southern Railway Company, Conrail Inc., Consolidated Rail Corporation and CRR Holdings LLC, is incorporated herein by reference to Exhibit 10.1 to Norfolk Southern Corporation's Form 8-K filed on Sept. 2, 2004.

- (dd) Tax Allocation Agreement, dated as of Aug. 27, 2004 , by and among Green Acquisition Corp., Conrail Inc., Consolidated Rail Corporation, New York Central Lines LLC and Pennsylvania Lines LLC, is incorporated herein by reference to Exhibit 10.2 to Norfolk Southern Corporation's Form 8-K filed on Sept. 2, 2004 .

- (ee) Credit Agreement dated as of Aug. 31, 2004 , between Norfolk Southern Corporation and various lenders, is incorporated herein by reference to Exhibit 99 to Norfolk Southern Corporation's Form 8-K/A filed on Sept. 7, 2004 .

- (ff) Amendment No. 4, dated as of June 1, 2005, and executed in late June 2005, to the

Shared Assets Area Operating Agreement for North Jersey, South Jersey/Philadelphia and Detroit, dated as of June 1, 1999, by and among Consolidated Rail Corporation, CSX Transportation, Inc. and Norfolk Southern Railway Company, with exhibits thereto, is incorporated herein by reference to Exhibit 99 to Norfolk Southern Corporation's Form 8-K filed on July 1, 2005.

- * (gg) The description of Norfolk Southern Corporation's executive physical reimbursement for non-employee directors and certain executives is incorporated herein by reference to Norfolk Southern Corporation's Form 8-K filed on July 28, 2005 .
- * (hh) Form of 2006 Incentive Stock Option and Non-Qualified Stock Option Agreement under the Norfolk Southern Long-Term Incentive Plan, is incorporated herein by reference to Exhibit 99 to Norfolk Southern Corporation's Form 8-K/A filed on Dec. 7, 2005 .
- * (ii) Form of 2006 Restricted Share and Restricted Stock Unit Agreement under the Norfolk Southern Corporation Long-Term Incentive Plan, is incorporated herein by reference to Exhibit 99 to Norfolk Southern Corporation's Form 8-K/A filed on Dec. 7, 2005 .
- * (jj) Form of 2005 Performance Share Unit Award under the Norfolk Southern Corporation Long-Term Incentive Plan, is incorporated herein by reference to Exhibit 99 to Norfolk Southern Corporation's Form 8-K/A filed on Dec. 7, 2005 .
- * (kk) Revised annual salaries for certain named executive officers are incorporated herein by reference to Norfolk Southern Corporation's Form 8-K/A filed on Dec. 7, 2005 .
- ** (ll) The Transaction Agreement, dated as of Dec. 1, 2005 , by and among Norfolk Southern Corporation, The Alabama Great Southern Railroad Company, Kansas City Southern and The Kansas City Southern Railway Company (Exhibits, annexes and schedules omitted. The Registrant will furnish supplementary copies of such materials to the SEC upon request).
- ** (mm) Amendment No. 1, dated as of Jan. 17, 2006 , by and among Norfolk Southern Corporation, The Alabama Great Southern Railroad Company, Kansas City Southern and the Kansas City Southern Railroad.
- * (nn) The retirement agreement, dated Jan. 27, 2006 , between Norfolk Southern Corporation and David R. Goode, is incorporated herein by reference to Exhibit 10.1 to Norfolk Southern Corporation's Form 8-K filed on Jan. 27, 2006 .
- * (oo) The waiver agreement, dated Jan. 27, 2006 , between Norfolk Southern Corporation and David R. Goode, providing for the waiver of forfeiture provisions otherwise applicable to certain restricted shares and restricted stock units upon retirement, is incorporated herein by reference to Exhibit 10.2 to Norfolk Southern Corporation's Form 8-K filed on Jan. 27, 2006 .
- * (pp) Revised fees for outside directors are incorporated herein by reference to Norfolk Southern Corporation's Form 8-K filed on Jan. 27, 2006 .

- **12 Statement re: Computation of Ratio of Earnings to Fixed Charges.
- **21 Subsidiaries of the Registrant.
- **23.1 Consent of Independent Registered Public Accounting Firm.
- **23.2 Consent of Independent Registered Public Accounting Firms.
- **31 Rule 13a-14(a)/15d-14(a) Certifications.
- **32 Section 1350 Certifications.
- **99.1 Annual CEO Certification pursuant to NYSE Rule 303A.12(a).
- **99.2 Unaudited Financial Statements of Conrail Inc.

* *Management contract or compensatory arrangement.*

** *Filed herewith.*

(B) Exhibits.

The Exhibits required by Item 601 of Regulation S-K as listed in Item 15(A)3 are filed herewith or incorporated herein by references.

(C) Financial Statement Schedules.

Financial statement schedules and separate financial statements specified by this Item are included in Item 15(A)2 or are otherwise not required or are not applicable.

Exhibits 23.1, 31, 32 and 99.1 are included; remaining exhibits are not included in copies assembled for public dissemination. These exhibits are included in the 2005 Form 10-K posted on our website at www.nscorp.com under "Investors" and "SEC Filings" or you may request copies by writing to:

Office of Corporate Secretary

Norfolk Southern Corporation

Three Commercial Place

Norfolk , Virginia 23510-9219

Each person whose signature appears below under "SIGNATURES" hereby authorizes Henry C. Wolf, James A. Hixon and James A. Squires or any one of them, to execute in the name of each such person, and to file, any amendment to this report and hereby appoints Henry C. Wolf, James A. Hixon and James A. Squires or any one of them, as attorneys-in-fact to sign on his or her behalf, individually and in each capacity stated below, and to file, any and all amendments to this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Norfolk Southern Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 21st day of February, 2006.

NORFOLK SOUTHERN CORPORATION

By: /s/ Charles W. Moorman

Charles W. Moorman

(Chairman, President and Chief Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on this 21st day of February 2006, by the following persons on behalf of Norfolk Southern Corporation and in the capacities indicated.

Signature

Title

/s/ Charles W. Moorman

Chairman, President and Chief Executive Officer and
Director

(Charles W. Moorman)

(Principal Executive Officer)

/s/ Henry C. Wolf

Vice Chairman and Chief Financial Officer

(Henry C. Wolf)

(Principal Financial Officer)

/s/ Marta R. Stewart

Vice President and Controller

(Marta R. Stewart)

(Principal Accounting Officer)

/s/ Gerald L. Baliles

Director

(Gerald L. Baliles)

/s/ Daniel A. Carp Director
(Daniel A. Carp)

-

/s/ Gene R. Carter Director
(Gene R. Carter)

/s/ Alston D. Correll Director
(Alston D. Correll)

/s/ David R. Goode Director
(David R. Goode)

-

/s/ Landon Hilliard Director
(Landon Hilliard)

/s/ Burton M. Joyce Director
(Burton M. Joyce)

/s/ Steven F. Leer Director
(Steven F. Leer)

/s/ Jane Margaret O'Brien Director
(Jane Margaret O'Brien)

/s/ Harold W. Pote Director
(Harold W. Pote)

/s/ J. Paul Reason Director
(J. Paul Reason)

Norfolk Southern Corporation and Subsidiaries
Valuation and Qualifying Accounts
Years Ended December 31, 2003 , 2004 and 2005
(In millions of dollars)

	<u>Beginning Balance</u>	<u>Additions charged to:</u>			<u>Deductions</u>	<u>Ending Balance</u>
		<u>Expenses</u>	<u>Other Accounts</u>			
<i>Year ended December 31, 2003</i>						
Valuation allowance (included net in deferred tax liability) for deferred tax assets	\$ 24	\$ --	\$ --	\$ 2 ²	\$ 22	
Casualty and other claims included in other liabilities	\$ 254	\$ 134	\$ 6 ¹	\$ 124 ³	\$ 270	
Current portion of casualty and other claims included in accounts payable	\$ 207	\$ 34	\$ 125 ¹	\$ 148 ⁴	\$ 218	
<i>Year ended December 31, 2004</i>						
Valuation allowance (included net in deferred tax liability) for deferred tax assets	\$ 22	\$ --	\$ --	\$ 1 ²	\$ 21	
Casualty and other claims included in other liabilities	\$ 270	\$ 112	\$ 48 ¹	\$ 115 ³	\$ 315	
Current portion of casualty and other claims included in accounts payable	\$ 218	\$ 23	\$ 124 ¹	\$ 143 ⁴	\$ 222	
<i>Year ended December 31, 2005</i>						
Valuation allowance (included net in deferred tax liability) for deferred tax assets	\$ 21	\$ --	\$ --	\$ 5 ²	\$ 16	
Casualty and other claims included in other liabilities	\$ 315	\$ 311	\$ --	\$ 205 ³	\$ 421	
Current portion of casualty and other claims included in accounts payable	\$ 222	\$ 92	\$ 114 ¹	\$ 137 ⁴	\$ 291	

¹ Includes revenue refunds and overcharges provided through deductions from operating revenues and transfers from other accounts.

² Reclassifications to/from other assets.

³ Payments and reclassifications to/from accounts payable.

⁴ Payments and reclassifications to/from other liabilities.

TRANSACTION AGREEMENT

BY AND AMONG

**KANSAS CITY SOUTHERN,
THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
NORFOLK SOUTHERN CORPORATION,**

AND

THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY

DATED AS OF

DECEMBER 1, 2005

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TRANSACTION AGREEMENT

THIS TRANSACTION AGREEMENT (this "Agreement") is made and entered into as of December 1, 2005, by and among KANSAS CITY SOUTHERN, a Delaware corporation ("KCS"), THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Missouri corporation and Subsidiary of KCS ("KCSR"), NORFOLK SOUTHERN CORPORATION, a Virginia corporation ("NS"), and THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY, an Alabama corporation and Subsidiary of NS ("AGS"), with reference to the following facts:

- A. KCS, through KCSR, currently owns or operates certain properties, trackage rights, signals, equipment, and other rights, Permits, claims, contracts and assets related thereto, in each case, as set forth on Annex A hereto (collectively, the "Assets"), constituting the rail line between Meridian, Mississippi and Shreveport, Louisiana identified on Annex B (the "Line").
- B. KCS and NS have determined that it is advisable to form a joint venture which will own such Assets, and, at the Closing, KCS and NS, through AGS, will form a limited liability company (the "Company") for the purpose of effecting the joint venture contemplated hereby and enter into a Limited Liability Company Agreement substantially in the form attached hereto as Exhibit A (the "Company Agreement") setting forth their rights and obligations as members of the Company.
- C. On the terms and subject to the conditions contained herein, KCS desires to, and desires to cause KCSR to, contribute the Assets to the Company in exchange for a 70% membership interest in the Company, (as contemplated by the Company Agreement), and NS desires to cause AGS to contribute the amounts contemplated by Schedule 2.1(a) to the Company in exchange for a 30% membership interest in the Company.
- D. In connection with the transactions contemplated by this Agreement and the Company Agreement, at the Closing, the parties will enter into, or will cause the Company or their respective Affiliates to enter into, as applicable: (i) an Operating Agreement substantially in the form attached hereto as Exhibit B (the "Operating Agreement"), (ii) an NSR Joint Use Agreement substantially in the form attached hereto as Exhibit C (the "NSR Joint Use Agreement"), (iii) a KCSR Joint Use Agreement substantially in the form attached hereto as Exhibit D (the "KCSR Joint Use Agreement"), (iv) a Western Haulage Agreement substantially in the form attached hereto as Exhibit E, (v) a KCSR Master Interchange Agreement substantially in the form attached hereto as Exhibit F, (vi) a Unified Assignment and Assumption Agreement substantially in the form attached hereto as Exhibit G, (vii) the Vicksburg Assignment Agreement (as defined in Section 3.1(b)), (viii) the Jackson Assignment Agreement (as defined in Section 3.1(c)), (ix) one or more Notes (as defined in Section 4), (x) the Omnibus Bill of Sale attached hereto as Exhibit H, (xi) the Unified Liability Agreement attached hereto as Exhibit I, (xii) the Dallas Terminal Marketing Agreement attached hereto as Exhibit J, (xiii) the NSR - KCSR Haulage Agreement (as defined in Section 3.1(c)) and (xiv) the Access Agreement (as defined in Section 10.2(c)) (collectively, the "Ancillary Agreements").

NOW, THEREFORE, with reference to the foregoing facts and in consideration of the mutual agreements and understandings set forth herein, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Definitions .

1.1 Certain Definitions

. All terms defined in this Agreement shall have the defined meanings when used in this Agreement or in any agreement, note, certificate, report or other document made or delivered pursuant to this Agreement, unless otherwise defined or the context otherwise requires. The following terms shall have the following meanings:

"AAA" shall have the meaning given to that term in Section 14.13.

"Access Agreement" shall have the meaning given to that term in Section 10.2(c).

"Action" means any litigation, action, suit, proceeding, investigation, arbitration, claim or other dispute by or before any court or other Governmental Authority, or any other alternative dispute resolution proceedings, such as arbitration or mediation.

"Affiliate" shall mean, with respect to any specified Person, (i) any other Person who, directly or indirectly, controls, is under common control with, or is controlled by, such specified Person, (ii) any other Person who is a director, officer, manager, member, partner or trustee of the specified Person or a Person described in clause (i) of this definition or any spouse of the specified Person or any such other Person or (iii) any Person of which the specified Person and/or any one or more of the Persons specified in clause (i) or (ii) of this definition, individually or in the aggregate, beneficially own 10% or more of any class of voting securities.

"Aggregate NS Consideration" shall have the meaning given to that term in Schedule 2.1(a).

"Agreement" shall have the meaning given to that term in the Recitals.

"AGS" shall have the meaning given to that term in the Recitals.

"Alternative Proposal" shall have the meaning given to that term in Section 10.3.

"Ancillary Agreements" shall have the meaning given to that term in the Recitals.

"Anniversary Date" shall have the meaning given to that term in Section 2.1(b).

"Appraiser" shall have the meaning given to that term in Section 10.10(d).

"Appraisal Report" shall have the meaning given to that term in Section 10.10(e).

"Assets" shall have the meaning given to that term in the Recitals.

"Assumed Liabilities" shall have the meaning given to that term in Section 3.2(a).

"Business Combination" shall have the meaning given to that term in Section 10.8.

"Business Day" shall mean any day other than a Saturday or Sunday or any day banks in the State of New York are authorized or required to be closed.

"Canadian National" shall mean the Canadian National Railway Company .

"Capital Contribution Amount" shall mean, on any given date, the total of the KCSR Borrowing Capacity and the Company Capital Amount.

"Capital Proceeds" shall have the meaning given to that term in Section 2.2.

"Charter Documents" shall mean the certificate of incorporation or articles of incorporation and the by-laws, with respect to a corporation; the partnership agreement, with respect to a general partnership; or the certificate of formation and operating or company agreement, with respect to a limited liability company.

"Cleanup" shall mean all actions, including investigations, required by Law to: (1) cleanup, remove, treat or remediate Hazardous Materials in the environment; (2) prevent the Release of Hazardous Materials so that they do not migrate, endanger or threaten to endanger public health or welfare or the environment; (3) perform pre-remedial studies and investigations and post-remedial monitoring and care; or (4) respond to any government requests for information or documents in any way relating to cleanup, removal, treatment or remediation or potential cleanup, removal, treatment or remediation of Hazardous Materials in the environment.

"Closing" shall mean the closing of the purchase and sale of the NS Interest on the Closing Date as contemplated by Section 2.1(a) and the contribution of the Assets in exchange for the KCS Interest.

"Closing Date" shall have the meaning given to that term in Section 6.1.

"Company" shall have the meaning given to that term in the Recitals.

"Company Agreement" shall have the meaning given to that term in the Recitals.

"Company Capital Amount" shall mean, as of any determination date, the total amount that the Company will be able to expend for capital improvements on the Line within one-hundred eighty (180) days of such date in accordance with Section 4.06(iii) of the Indentures which improvements were not the subject of any prior calculation of the Company Capital Amount.

"Company Indemnified Parties" shall have the meaning given to that term in Section 12.2(a).

"Company Line Assets" shall have the meaning given to that term in Section 10.10(a)(ii).

"Confidentiality Agreement" shall have the meaning given to that term in Section 10.2(a).

"Contract" shall mean any note, bond, debenture, mortgage, license, agreement, commitment, contract, obligation, promise or understanding.

"Conveying Party" shall have the meaning given to that term in Section 3.1(c).

"Damages" shall have the meaning given to that term in Section 12.2(a).

"Delaware Courts" shall have the meaning given to that term in Section 14.5(b).

"Dispute" shall have the meaning given to that term in Section 14.13.

"Dispute Notice" shall have the meaning given to that term in Section 14.13.

"Disclosure Schedule" shall have the meaning given to that term in Article 8.

"Environmental Claim" means any fine, claim, action, lien, cause of action, investigation or notice by any Person alleging potential liability (including potential liability for Cleanup costs, governmental response costs, natural resources damages, property damages, personal injuries, or penalties) arising out of, based on or resulting from (a) the presence, Release or threatened Release of any Hazardous Materials, or (b) circumstances forming the basis of any violation of any Environmental Law.

"Environmental Laws" means all Laws relating to pollution or protection of human health or the environment, including all Laws relating to Releases or threatened Releases of Hazardous Materials or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, Release, disposal, transport or handling of Hazardous Materials, all Laws relating to record keeping, notification, disclosure and reporting requirements respecting Hazardous Materials and all Laws relating to endangered or threatened species of fish, wildlife and plants and natural resources.

"Environmental Reports" shall have the meaning given to that term in Section 8.7(d).

"Excess Capital" shall have the meaning given to that term in Section 2.2.

"Excess Proceeds" shall have the meaning given to that term in Section 2.2.

"Excluded Assets" shall have the meaning given to that term in Section 8.3.

"Governmental Authority" shall mean any nation or government, any state or other political subdivision thereof, and any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government or any mediation body or arbitral tribunal, including the STB.

SEQ CHAPTER 14.1 **"Hazardous Materials"** shall mean all substances defined as Hazardous Substances, Oils, Pollutants or Contaminants in the National Oil and Hazardous Substances Pollution Contingency Plan, 40 C.F.R. § 300.5, or defined as such by, or regulated as such under, any Environmental Law.

"Indebtedness" means, with respect to any Person, (i) any liability, contingent or otherwise, (a) for borrowed money, capitalized lease obligations, purchase money obligations or other obligations relating to the deferred purchase price of assets or property or (b) evidenced by a note, bond, debenture, letter of credit or similar instrument given in connection with the acquisition, other than in the ordinary course of business consistent with past practice, of any property, assets, securities or otherwise, including indebtedness created or arising under conditional sale or other title retention agreements (even though the rights and remedies of the seller or lender under the agreements in the event of default are limited to repossession or sale of the property), (ii) any liability of others described in the preceding clause (i) which such Person has guaranteed or which otherwise is its legal liability, (iii) all indebtedness referred to above secured by (or for which the holder of the indebtedness has an existing right, contingent or otherwise, to be secured by), any Lien upon the property of such Person, whether or not the obligations secured thereby have been assumed, and (iv) any amendment, renewal, extension or refunding of any liability referred to in clauses (i), (ii) and (iii) above; provided, however, that Indebtedness does not include any trade payables of any Person incurred in the ordinary course of business consistent with past practice. The amount of Indebtedness of any Person at any date shall be the outstanding balance at the date of all unconditional obligations as described above and the maximum amount of any contingent obligations at the date.

"Indemnified Party" shall have the meaning given to that term in Section 12.4.

"Indemnifying Party" shall have the meaning given to that term in Section 12.4.

"Indentures" shall mean, collectively, the Indenture, dated as of September 27, 2000, among KCSR, KCS, certain Subsidiaries of KCS and The Bank of New York, as trustee, governing the terms of KCS' 9½% Senior Notes due 2008 and the Indenture, dated as of June 12,

2002, among KCSR, KCS, certain Subsidiaries of KCS and U.S. Bank National Association, as trustee, governing the terms of KCS' 7½% Senior Notes due 2009, as they may be amended from time to time.

"Issuance Date" shall have the meaning given to that term in Schedule 2.1(a).

"Jackson Assignment Agreement " shall have the meaning given to that term in Section 3.1(c).

"Jackson Flyover" shall mean a bridge to carry the Company's tracks over the real property and tracks of Canadian National Railway Company (or its Subsidiaries) located at Jackson, Mississippi which establishes a continuous line of rail between Meridian, Mississippi and Shreveport, Louisiana.

"KCS" shall have the meaning given to that term in the Recitals.

"KCSR Borrowing Capacity" shall mean, as of any determination date, the total amount of previously unborrowed funds that KCSR (or any other Subsidiary of KCS which is on such date a party to the Company Agreement) is permitted to borrow from the Company pursuant to a Note on such date without violating in any respect the KCS Credit Agreement, the Indentures or any other Contract evidencing more than \$100,000 of Indebtedness to which it is a party on such date; it being understood that, in no event shall the KCSR Borrowing Capacity, together with all funds previously borrowed pursuant to any Note (including any Note evidencing the borrowing of the Excess Proceeds contemplated by Section 4), exceed \$300,000,000.

"KCS Credit Agreement" shall mean the Credit Agreement dated as of March 30, 2004 among KCSR, KCS, certain subsidiaries of KCS and Lenders (as defined therein), as amended through the date hereof.

"KCS Credit Agreement Amendment No. 2" shall mean Amendment No. 2 to the Credit Agreement, dated as of September 30, 2005, among KCSR, KCS, the subsidiary guarantors listed on the signature page thereto, the Lender Parties (as defined therein) thereto and The Bank of Nova Scotia.

"KCS Interest" shall have the meaning given to that term in Section 3.1.

"KCSR Joint Use Agreement" shall have the meaning given to that term in the Recitals.

"KCS Line Assets" shall have the meaning given to that term in Section 10.10(a).

"KCS Membership Interests" shall have the meaning given to that term in Section 10.10(a)(i).

"KCSR" shall have the meaning given to that term in the Recitals.

"Knowledge" with respect to KCS shall mean the actual knowledge, after due inquiry into the matter in question, of any of the Persons listed on Schedule 1.1(a) hereto.

"Law" shall mean any U.S. federal, state or local or foreign statute, law, rule, regulation, ordinance, order, code, policy or rule of common law, now or hereafter in effect and, in each case, as amended, any binding judicial or administrative interpretation thereof by a Governmental Authority or otherwise, including any judicial or administrative order, consent, decree or judgment; provided that, each reference to " Law " in Sections 8 and 9 of this Agreement shall mean only a Law in effect as of the date of this Agreement.

"Lease" shall have the meaning given to that term in Section 8.4(b)(viii).

"Leased Personal Property" shall mean all personal property leased by KCS and its Affiliates which is included in the Assets.

"Leased Property" shall have the meaning given to that term in Section 8.14(b).

"Lien" shall mean any mortgage, deed of trust, pledge, security interest, hypothecation, assignment, deposit arrangement, encumbrance, lien (statutory or other), or preference, purchase option, right of first offer, right of first refusal, priority or other security agreement (including any conditional sale or other title retention agreement, any financing lease having substantially the same economic effect as any of the foregoing, and the filing of any financing statement under the Uniform Commercial Code or comparable Law of any jurisdiction to evidence any of the foregoing).

"Line" shall have the meaning given to that term in the Recitals.

"Line Assets" shall have the meaning given to that term in Section 10.10(a).

"Line FMV" shall have the meaning given to that term in Section 10.10(d)(i).

"Line Option" shall have the meaning given to that term in Section 10.10(a).

"Line Option Exercise Notice" shall have the meaning given to that term in Section 10.10(g).

"Line Option Notice" shall have the meaning given to that term in Section 10.10(a).

"Line Option Valuation Notice" shall have the meaning given to that term in Section 10.10(d).

"Material Adverse Effect" shall mean, with respect to any party, any change, circumstance, event or effect which, individually or when

considered in conjunction with other changes, circumstances or effects, has had or would reasonably be likely to have a material adverse effect on (a) with respect to a Material Adverse Effect on KCS and KCSR, the Assets, taken as a whole, or the financial condition or results of operations of the business of the Company to be conducted with the Assets after the Closing, taken as a whole, or (b) any party, the ability of such party to consummate the transactions contemplated by this Agreement, the Ancillary Agreements or the Company Agreement or to perform its obligations hereunder or thereunder; provided, that none of the following shall be deemed to constitute, and none of the following shall be taken into account in determining whether there has been, a Material Adverse Effect: (x) any adverse change, event, development, or effect arising from or relating to (1) general business or economic conditions, including conditions related to the prospective business of the party and including changes in energy prices or availability, except to the extent that such conditions disproportionately affect such party's business relative to the effect of such factors on other Persons operating in such party's industry, (2) national or international political or social conditions, including the engagement by the United States in hostilities, whether or not pursuant to the declaration of a national emergency or war, or the occurrence of any military or terrorist attack upon the United States, or any of its territories, possessions, or diplomatic or consular offices or upon any military installation, equipment or personnel of the United States, except to the extent that such conditions disproportionately affect such party's business relative to the effect of such factors on other Persons operating in such party's industry, (3) financial, banking, or securities markets (including any disruption thereof and any decline in the price of any security or any market index), (4) changes in United States generally accepted accounting principles, (5) changes in Law or (6) the taking of any action contemplated by this Agreement and the other agreements contemplated hereby, (y) any of the events, occurrences, or circumstances set forth in Schedule 1.1(b) and (z) any change, occurrence, event or effect, which shall have been cured without a Material Adverse Effect (excluding this clause (z)), on the Assets, before the earlier of the Closing Date or the date on which this Agreement is terminated pursuant to Section 13.

"Material Contracts" shall have the meaning given to that term in Section 8.4(b).

"Membership Interest FMV" shall have the meaning given to that term in Section 10.10(d)(ii).

"MSR Jackson Trackage Rights" shall mean that certain trackage rights agreement, as supplemented and amended from time to time, dated March 26, 1986, between Midsouth Rail Corporation and Illinois Central Gulf Railroad Corporation, and the underlying right of movement, pursuant to which KCSR (as successor to Midsouth Rail Corporation) operates over an approximately four-tenths (0.4) of a mile section of track in Jackson, Mississippi that is controlled by Canadian National (as successor to Illinois Central Gulf Railroad Corporation).

"Notes" shall have the meaning given to that term in Section 4.

"Notices" shall have the meaning given to that term in Section 14.1.

"NS" shall have the meaning given to that term in the Recitals.

"NS Closing Cash Purchase Price" shall mean the NS Consideration payable by NS on the Closing Date as determined in accordance with Schedule 2.1(a).

"NS Consideration" shall have the meaning given to that term in Schedule 2.1(a).

"NS Indemnified Parties" shall have the meaning given to that term in Section 12.2(a).

"NS Interest" shall have the meaning given to that term in Section 2.1(a).

"NSR" shall mean Norfolk Southern Railway Company, a Virginia corporation and Subsidiary of NS.

"NSR Joint Use Agreement" shall have the meaning given to that term in the Recitals.

"Officer's Certificate" shall have the meaning given to that term in Section 2.1(b).

"Operating Agreement" shall have the meaning given to that term in the Recitals.

"Owned Property" shall have the meaning given to that term in Section 8.14(a).

"Partner Financing" shall have the meaning given to that term in Article 4.

"Permitted Liens" shall mean collectively, (i) Liens for Taxes not yet due and payable or which are being contested in good faith by appropriate proceedings and for which adequate reserves have been made; (ii) such imperfections of title, easements and other similar encumbrances, if any, as do not, individually or in the aggregate, interfere in any material respect with the use of any Owned Property as such Owned Property is used on the date of this Agreement; (iii) mechanics', materialmen's, workmen's, repairmen's, warehousemen's, carrier's and other similar Liens arising in the ordinary course of business consistent with past practice, all of which shall be released at or prior to the Closing; (iv) Liens arising under the Indentures; or (v) those Liens set forth on Schedule 1.1(c) hereto.

"Permits" shall have the meaning given to that term in Section 8.8(b).

"Person" shall mean an individual or a partnership, corporation, trust, association, limited liability company, Governmental Authority or other entity.

"Preferred Return" shall have the meaning given to that term in the Company Agreement.

"Preferred Return Amount" shall have the meaning given to that term in the Company Agreement.

"Property" shall have the meaning given to that term in Section 8.14(c).

SEQ CHAPTER 1111 **"Release"** means any release, spill, emission, discharge, leaking, pumping, injection, deposit, disposal, or leaching into the environment (including ambient air, surface water, groundwater and surface or subsurface strata) or into or out of any property, including the movement of Hazardous Materials through or in the air, soil, surface water, groundwater or property.

"Required Governmental Consents" shall have the meaning given to that term in Section 10.5.

"Restricted Subsidiary" shall have the meaning given to that term in the Indentures.

"Retained Interests" shall have the meaning given to that term in Section 3.1(d).

"Rules" shall have the meaning given to that term in Section 14.13.

"Standstill Period" shall have the meaning given to that term in Section 10.8.

"STB" shall mean the Surface Transportation Board or any successor entity thereto.

"Subsidiary" of any Person shall mean any entity of which such Person owns, directly or indirectly, securities or other ownership interests having the power to elect a majority of the board of directors or other persons performing similar functions, or otherwise having the power to direct, manage or control the conduct of business of such entity.

"Tax Return" shall mean any report, return, document, declaration or other information or filing (including any amendment thereto) with respect to Taxes required by Law to be supplied to any Governmental Authority (foreign or domestic) or to be collected or maintained, including information returns, any documents accompanying payments of estimated Taxes, or requests for the extension of time in which to file any such report, return, document, declaration or other information or filing.

"Taxes" shall mean all federal, state, local, foreign and other taxes, customs, duties, fees, levies, assessments or charges of any kind whatsoever, including all net income, gross income, gross receipts, sales, use, ad valorem, transfer, franchise, profits, license, withholding, payroll, employment, excise, estimated, severance, stamp, occupation, real or personal property, business, documentary, registration, filing, recordation, unemployment, worker's compensation, commercial rent, premium, windfall profits, deemed profits, lease, capital, production, corporation, value added, bulk sale or other taxes, customs, duties, fees, levies, assessments or charges of any kind whatsoever, together with any interest and any penalties, additions to tax or additional amounts imposed by any Governmental Authority (domestic or foreign) regardless of whether disputed or whether related to the filing of a Tax Return (or the failure to file a Tax Return).

"Terminal" shall have the meaning given to that term in Section 8.14(a).

"Third Party Claim" shall have the meaning given to that term in Section 12.5(a).

"Third Party Leases" shall have the meaning given to that term in Section 8.4(b)(ix).

"Title Company" shall have the meaning given to that term in Section 10.6(b).

"Transfer" shall mean sell, assign, transfer, pledge, grant a security interest in, or otherwise dispose of, with or without consideration, and "Transferred" shall have a correlative meaning.

"Vicksburg Assignment Agreement " shall have the meaning given to that term in Section 3.1(b).

"Vicksburg Bridge Lease " shall mean that certain lease, as supplemented, amended and/or replaced from time to time, dated February 11, 1928 between Vicksburg Bridge and Terminal Company and The Yazoo and Mississippi Valley Railroad Company, pursuant to which KCSR leases that certain railroad bridge over the Mississippi River at Vicksburg, MS.

1.2 Construction of Certain Terms and Phrases

Unless the context otherwise requires, (a) words of any gender include each other gender; (b) words using the singular or plural number also include the plural or singular number, respectively; (c) the terms "hereof," "herein," "hereby" and derivative or similar words refer to this entire Agreement; (d) the terms "Article" or "Section" refers to the specified Article or Section of this Agreement; (e) the terms "and" and "or" include the term "and/or" when the context is appropriate; (f) the terms "include" or "including" also include the words "without limitation" when the context is appropriate; and (g) the phrases "ordinary course of business" and "ordinary course of business consistent with past practice" refer to the business and practice of the Person specified or, in the case of the operation of the Line, the business and practice of KCS, KCSR and their respective Subsidiaries with respect to the Assets. Whenever this Agreement refers to a number of days, such number shall refer to calendar days unless Business Days are specified. All accounting terms used herein and not expressly defined herein shall have the meanings given to them under generally accepted accounting principles, as in effect in the United States of America. Whenever this Agreement refers to an Exhibit or Schedule attached hereto, the Exhibit or Schedule shall be deemed to be incorporated by reference.

2. Purchase and Sale of Membership Interest .

2.1 Purchase and Sale of Membership Interest .

(a) KCS shall prepare and deliver to NS at least ten (10) Business Days prior to the Closing Date a certificate duly executed by the

chief financial officer of KCS certifying as of such date the Capital Contribution Amount (each such certificate, an "Officer's Certificate"). Subject to the terms and conditions of this Agreement, at the Closing, KCS and NS shall cause the Company to issue and sell to AGS, and NS shall cause AGS to purchase from the Company, up to a 30% membership interest in the Company (as adjusted pursuant to Section 2.1(b), the "NS Interest") in exchange for cash consideration, in each case, as determined in accordance with Schedule 2.1(a).

(b) Within ten (10) Business Days prior to each six-month anniversary of the Closing Date (each, an "Anniversary Date") until the NS Interest represents a 30% membership interest in the Company, KCS shall prepare and deliver to NS an Officer's Certificate. Subject to the terms and conditions of this Agreement, on each Anniversary Date, KCS and NS shall cause the Company to issue and sell to AGS, and NS shall cause AGS to purchase from the Company, in exchange for cash consideration determined in accordance with Schedule 2.1(a), an additional membership interest in the Company such that, upon the issuance thereof, AGS and KCS will hold the respective percentage membership interests in the Company, in each case, determined in accordance with Schedule 2.1(a).

2.2 Use of Proceeds

KCS and NS shall cause the Company to use \$260,000,000 of the proceeds from the sale of the NS Interest plus any interest earned thereon from time to time (the "Capital Proceeds") for the capital expenditures anticipated to be made in accordance with the Company Agreement and the Budgets (including any Rollover Budgets) and Business Plans (as each such term is defined in the Company Agreement) for the Company contemplated thereby. KCS and NS shall cause at Closing up to \$40,000,000 of the proceeds from the sale of the NS Interest to be paid to reimburse KCS for capital expenditures made by KCS on the Line within the two-year period ending on the Closing Date (none of which shall have been made in anticipation of this Agreement) as presented on a schedule delivered to NS prior to the Closing Date, which schedule shall be final and binding on NS if it accurately sets forth expenditures made in accordance with the principles expressed in this sentence (the difference between \$40,000,000 and such reimbursement shall be the "Excess Proceeds"), and (b) the Excess Proceeds and any portion of the Capital Proceeds not allocated at such time for capital expenditures in accordance with the then current Budget or any Rollover Budget, as the case may be, and Business Plan (in the aggregate, the "Excess Capital") to be made available by the Company to provide the Partner Financing pursuant to Article 4 below. KCS and NS shall cause the Company to pay KCS a Preferred Return Amount on and, at KCS' election, a Preferred Return of, the Excess Proceeds, as contemplated in the Company Agreement.

3. Contribution of Assets and Assumption of Liabilities .

3.1 Contribution of Assets .

(a) Subject to the terms and conditions of this Agreement, at the Closing, KCS and KCSR shall, and shall cause their respective Subsidiaries, as applicable, to, transfer, convey, assign and deliver to the Company, all of their respective right, title and interest in the Assets, free and clear of all Liens other than Permitted Liens, and in exchange for the Assets, KCS and NS shall cause the Company to issue to KCS a 71.4286% membership interest in the Company (as adjusted pursuant to Section 2.1(b) and together with the Preferred Return, the "KCS Interest"). The parties acknowledge that KCS' initial capital account in the Company will be as set forth in Exhibit 2.2 to the Company Agreement and that the Company shall be a Restricted Subsidiary prior to the transfer of the Assets to the Company and shall remain a Restricted Subsidiary so long as the Indentures remain in effect.

(b) Prior to the Closing, KCSR shall use its commercially reasonable efforts to obtain the consent of the Warren County Bridge Commission to an assignment of the Vicksburg Bridge Lease to the Company. Should KCSR obtain said consent prior to the Closing, at the Closing, KCSR shall assign the Vicksburg Bridge Lease to the Company pursuant to an assignment agreement substantially in the form attached hereto as Exhibit K (the "Vicksburg Assignment Agreement"). Should KCSR fail to obtain said consent prior to the Closing, at the Closing, KCSR shall sublease, at the same rate as paid by KCSR, the Vicksburg Bridge Lease to the Company pursuant to a customary sublease agreement, and thereafter shall continue to use its commercially reasonable efforts to obtain the consent of the Warren County Bridge Commission to an assignment of the Vicksburg Bridge Lease to the Company and, upon receipt of such consent, shall assign the Vicksburg Bridge Lease to the Company pursuant to an assignment agreement substantially in the form of the Vicksburg Assignment Agreement. Notwithstanding anything herein to the contrary, for purposes of this Agreement, the Vicksburg Assignment Agreement shall only be considered an Ancillary Agreement if the consent of the Warren County Bridge Commission to an assignment of the Vicksburg Bridge Lease to the Company is obtained by KCSR prior to Closing. Any material amendment, and any termination or renewal, of the Vicksburg Bridge Lease prior to any assignment pursuant to the Vicksburg Assignment Agreement shall be made only with the written consent of NS, provided that the consent of NS shall not be required for KCS to resolve the current dispute with the Warren County Bridge Commission regarding the Vicksburg Bridge Lease described in Section 8.4(a)(i) of the Disclosure Schedule if such resolution does not prevent or materially impair the assignment to the Company of such lease as contemplated by this Section 3.1(b) or materially, adversely affect the access to or enjoyment of the Vicksburg Bridge as contemplated by the NSR Joint Use Agreement.

(c) Prior to the Closing, KCSR shall use its commercially reasonable efforts to obtain the consent of Canadian National to an assignment of the MSR Jackson Trackage Rights to the Company. KCS and NS shall seek an order of the STB permitting said assignment, should such consent be obtained, or overriding any provision of said MSR Jackson Trackage Rights preventing such assignment without the consent of Canadian National, should such consent not be obtained. Any assignment by KCSR of the MSR Jackson Trackage Rights to the Company shall be pursuant to an assignment agreement substantially in the form attached hereto as Exhibit L (the "Jackson Assignment Agreement"). Following the Closing Date and until the earlier of assignment to the Company of the MSR Jackson Trackage Rights or commencement of railroad operations over the Jackson Flyover, as provided in Section 5.13 of the Company Agreement, KCSR shall provide the Company and NSR with haulage rights over the portion of the Line subject to the MSR Jackson Trackage Rights pursuant to an NSR - KCSR Haulage Agreement substantially in the form attached as Exhibit M hereto (the "NSR - KCSR Haulage Agreement").

(d) Schedule 3.1(d) sets forth certain interests of KCS and its Subsidiaries (the "Retained Interests") in the Assets to be conveyed to

the Company pursuant to Section 3.1(a) which interests shall be retained following the Closing by the party conveying the relevant Assets to the Company (the "Conveying Party"). The Retained Interests may be exercised only at the sole risk and expense of the Conveying Party, in a manner that shall not unreasonably interfere with the operation of the Assets as contemplated by the Operating Agreement, the NSR Joint Use Agreement and the KCSR Joint Use Agreement, and shall be subject to execution of a reasonable access agreement between the relevant Conveying Party and the Company. KCS shall cause any Conveying Party seeking to exercise Retained Interests to provide reasonable advance notice to the Company before said party may enter any relevant Assets consisting of Property for purposes of exercising a Retained Interest, and said party's actions on such Property shall at all times be subject to the reasonable direction and control of the operating officer in charge of the Property and to applicable provisions of the Company's safety and operating rules.

(e) The parties hereto acknowledge that some of the Owned Properties include adjoining land, buildings, structures and other improvements that are not included in the Assets and that, accordingly, must be subdivided into separate lots. Accordingly, as to each such Owned Property, KCS shall promptly, and at KCS' sole expense, take all steps necessary (including, without limitation, recording all required deeds, performing all required surveys and obtaining all necessary planning and zoning approvals) to subdivide and obtain a separate tax lot/parcel for the portion of each such Owned Property that is included in the Assets, distinct from any adjoining land, buildings, structures or other improvements that are not included in the Assets.

3.2 Transfer of Liabilities .

(a) Subject to the terms and conditions of this Agreement, at the Closing, KCS and NS shall cause the Company to assume the liabilities and obligations of KCS, KCSR and their respective Affiliates relating to the operation of the Assets set forth on Schedule 3.2 hereto (the "Assumed Liabilities"). Except as and to the extent otherwise expressly provided in this Agreement, the Company has not agreed to pay, shall not be required to assume and shall not have any obligation in respect of, any liability or obligation, direct or indirect, absolute or contingent, of KCS, KCSR, NS or any other Person, the assumption of which by the Company is not expressly provided for in this Agreement.

(b) Notwithstanding anything in Section 3.2(a) to the contrary, any assignment agreement or sublease entered into pursuant to Section 3.1(b) shall provide that all liabilities and obligations under the Vicksburg Bridge Lease relating to or arising from events or omissions occurring prior to the Closing shall be the liabilities and obligations of KCSR, and any liabilities and obligations under the Vicksburg Bridge Lease relating to or arising from events or omissions occurring after the Closing shall be the liabilities and obligations of the Company, except to the extent that any such liabilities or obligations arise from the exercise by the Conveying Parties of the Retained Interests.

4. Partner Financing

. Promptly following the Closing, KCS and NS shall cause the Company to loan to KCS an amount not to exceed the Excess Proceeds and thereafter to KCS and NS from time to time upon such party's request up to an amount equal to the Excess Capital less the aggregate amount of any outstanding loans made pursuant to this Section 4 (such loans, the "Partner Financing") to be evidenced by one or more notes substantially in the form attached hereto as Exhibit N (collectively, the "Notes"). All such Partner Financing shall first be made available to KCS and, if KCS elects not to borrow such amounts, subsequently to NS and shall in each case be structured so as to not violate, in the reasonable opinion of counsel to KCS, any provision of the Indentures.

5. Intentionally Omitted

6. The Closing .

6.1 The Closing

. The Closing shall take place at the offices of Sonnenschein Nath & Rosenthal LLP, 1221 Avenue of the Americas, 25th Floor, New York, New York 10020 at 10:00 A.M., local time on a date to be agreed to by NS and KCS, which date shall be no later than three Business Days following the date on which all of the conditions set forth in Article 11 shall have been satisfied or waived (other than those conditions that by their nature are to be satisfied at the Closing, but subject to the fulfillment or waiver of those conditions), or at such other time and place as KCS and NS mutually agree upon in writing. The date of the Closing is referred to in this Agreement as the "Closing Date."

7. Deliveries at the Closing .

7.1 Deliveries at the Closing

. At the Closing:

(a) NS shall, or shall cause AGS and its other Subsidiaries to, deliver (i) the NS Closing Cash Purchase Price by wire transfer of immediately available funds to the account(s) designated by KCS and NS on behalf of the Company in writing at least one Business Day prior to the Closing Date; (ii) duly executed counterpart originals of each Ancillary Agreement to which NS, AGS or any of their respective Subsidiaries is a party to KCS or the Company, as applicable; (iii) a duly executed counterpart original of the Company Agreement to KCS; (iv) the certificate required to be delivered to KCS pursuant to Section 11.3(c) of this Agreement; (v) the opinions required pursuant to Section 11.3(e) of the Agreement to KCS; and (vi) such documents and instruments as KCS may reasonably request to evidence the satisfaction of all conditions precedent set forth in Article 11 of this Agreement or which are required to be delivered by NS at or prior to the Closing Date pursuant to this Agreement.

(b) KCS and KCSR shall, or shall cause their respective Subsidiaries to, deliver: (i) a duly executed counterpart original of the Company Agreement to NS; (ii) duly executed counterpart originals of each Ancillary Agreement to which KCS, KCSR or their respective Subsidiaries is a party to NS or the Company, as applicable; (iii) the certificate required to be delivered to NS pursuant to Section 11.2(c) of

this Agreement; (iv) the consents required, if any, pursuant to Section 11.2(d) of this Agreement to NS; (v) quitclaim deeds with respect to each of the Owned Properties to the Company; (vi) the consent to assignment or sublease, as the case may be, provided for in Section 3.1(b) of this Agreement to the Company; (vii) all such other deeds, endorsements, assignments and other instruments as are necessary to transfer to the Company KCS' and its Subsidiaries' interest in the Assets in accordance with the terms hereof; (viii) the opinions required pursuant to Section 11.2(f) of the Agreement to NS; and (ix) such documents and instruments to NS as NS may reasonably request to evidence the satisfaction of all conditions precedent set forth in Article 11 of this Agreement or which are required to be delivered by KCS at or prior to the Closing Date pursuant to this Agreement.

(c) KCS and NS shall cause the Company to deliver (i) duly executed counterpart originals of each Ancillary Agreement to which the Company is a party to NS or KCS, as applicable and (ii) certificates representing the NS Initial Interest and the KCS Interest to AGS and KCS, respectively.

7.2 Further Assurances

. At and following the Closing, each party to this Agreement shall deliver or cause to be delivered, as appropriate, such further certificates, consents and other documents as may be necessary to carry out the terms of this Agreement.

8. Representations and Warranties of KCS and KCSR

. Except as set forth in the disclosure schedule (the "Disclosure Schedule") prepared by KCS and delivered to NS concurrently with the execution of this Agreement (in each case making reference to the particular subsection of this Agreement to which the relevant disclosure or exception is being made), KCS and KCSR jointly represent and warrant to NS as of the date hereof and, to the extent provided in Section 11.2(a), as of the Closing, as follows:

8.1 Organization, Standing and Power

. Each of KCS and KCSR is a corporation duly organized, validly existing and in good standing under the Laws of the jurisdiction of its incorporation and has all requisite power and authority to own, lease and operate its properties and assets and to carry on its business as now being conducted. Each of KCS and KCSR is duly qualified or licensed as a foreign entity and is in good standing in each jurisdiction where the nature of its properties owned or held under lease or the nature of the business conducted by it make such qualification necessary, except for any failure to be so qualified, licensed and in good standing as would not, individually or in the aggregate, have a Material Adverse Effect on KCS or KCSR.

8.2 Authority; Enforceability; Noncontravention

(a) Each of KCS, KCSR and their respective Subsidiaries, as the case may be, has full power and authority to enter into, execute and deliver this Agreement, each of the Ancillary Agreements and the Company Agreement to which it is a party and perform its obligations hereunder and thereunder. This Agreement has been, and each of the Ancillary Agreements and the Company Agreement will be, duly authorized by all necessary action of each of KCS, KCSR and their respective Subsidiaries, as the case may be. This Agreement has been, and each of the Ancillary Agreements and the Company Agreement will be, duly executed and delivered by each of KCS, KCSR and their respective Subsidiaries, as the case may be, and, assuming their due execution and delivery by the other party or parties hereto or thereto, constitutes or will constitute a valid and legally binding obligation of each of KCS, KCSR and their respective Subsidiaries, as the case may be, respectively, enforceable against them in accordance with its terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar Laws relating to or affecting creditors' rights generally, and to the availability of equitable remedies.

(b) The execution and delivery of this Agreement, each of the Ancillary Agreements and the Company Agreement by each of KCS, KCSR and their respective Subsidiaries, as the case may be, does not and will not, and compliance by KCS and KCSR, as applicable, with the provisions of this Agreement, each of the Ancillary Agreements and the Company Agreement will not, (i) conflict with or result in a breach or default under the Charter Documents of KCS, KCSR or their respective Subsidiaries; (ii) constitute or result in a material breach or violation of, or a material default under, or the acceleration of (with or without the giving of notice, the lapse of time or both) any obligation pursuant to, any provision of any Material Contract to which KCS, KCSR or their respective Subsidiaries is a party or otherwise bound, or to which any property or asset of KCS, KCSR or their respective Subsidiaries is subject; (iii) subject to the filings with Governmental Authorities and other matters referred to in Section 8.2(c) below, violate any Law applicable to KCS, KCSR or their respective Subsidiaries; (iv) result in the creation or imposition of any material Lien on the Assets; or (v) constitute or result in any material change in the rights or obligations of any party under any of the Material Contracts.

(c) Except (i) for the applicable requirements of the STB and (ii) as set forth on Section 8.2(c) of the Disclosure Schedule, there are no approvals, authorizations, consents, orders or other actions of, or filings with, any Person, including any Governmental Authority, that are required to be obtained or made by KCS, KCSR, or their respective Subsidiaries or the Company in connection with the execution of, and the consummation of the transactions contemplated under, this Agreement, the Ancillary Agreements or the Company Agreement, except in each case as will not, individually or in the aggregate, impair in any material respect the performance by KCS, KCSR or their respective Subsidiaries of their respective obligations hereunder.

8.3 Assets

. The Assets constitute all properties, assets and rights (real, personal and mixed, tangible and intangible) currently utilized in the operation of the Line, other than operating equipment such as locomotives, rail cars and maintenance vehicles, and other than maintenance of way

machinery and tools (the "Excluded Assets") and, except for the Excluded Assets, the Assets are sufficient to operate the Line (i) in substantially the same manner as operated by KCS and its Affiliates prior to the Closing and (ii) as contemplated by the NSR Joint Use Agreement, the KCSR Joint Use Agreement, and the Operating Agreement. KCS or one of its wholly owned Subsidiaries has, and upon consummation of the transactions contemplated hereby the Company will acquire, good and marketable title to all of the non-real estate owned Assets free and clear of all Liens except for Permitted Liens.

8.4 Material Contracts .

(a) (i) True and correct copies of each Material Contract, including all amendments and modifications thereof and waivers thereunder, have been made available to NS and its counsel; (ii) except as set forth in Section 8.4(a)(ii) of the Disclosure Schedule, each Material Contract is in full force and effect, and is the valid and binding obligation of KCS, KCSR or their respective Subsidiaries and, to the Knowledge of KCS, each other party to the Material Contract, and upon consummation of the transactions contemplated hereby each Material Contract will remain in full force and effect, and will be the valid and binding obligation of the Company and, to the Knowledge of KCS, each other party to the Material Contract; (iii) except as set forth in Section 8.4(a)(iii) of the Disclosure Schedule, KCS, KCSR or their respective Subsidiaries has performed all of its respective material obligations required to be performed by it to date under each Material Contract, and is not in material breach of or material default under any Material Contract, and no event has occurred or circumstance exists which, with notice or lapse of time or both, would constitute a material breach of or material default by KCS, KCSR or their respective Subsidiaries under any Material Contract; (iv) except as set forth in Section 8.4(a)(iv) of the Disclosure Schedule, to the Knowledge of KCS, each party to each Material Contract other than KCS, KCSR or their respective Subsidiaries has performed all of the material obligations required to be performed by it to date under the Material Contract, and is not in material breach of or in material default under the Material Contract, and no event has occurred or circumstance exists which, with notice or lapse of time or both, would constitute a material breach of or material default by such other party under any Material Contract; and (v) no Material Contract will be affected adversely in any material way by the execution, delivery or performance of this Agreement, the Ancillary Agreements or the Company Agreement, each in accordance with its terms, and no Material Contract contains any change in control provision, restriction on assignment or other terms that will become applicable or inapplicable as a result of the consummation of the transactions contemplated by this Agreement, the Ancillary Agreements or the Company Agreement.

(b) For purposes of this Agreement, "Material Contracts" shall mean the following Contracts of KCS, KCSR or their respective Subsidiaries, each of which contracts is listed in Section 8.4(b) of the Disclosure Schedule, (X) relating to or affecting in any material way the Assets or the Assumed Liabilities or (Y) to be assigned to the Company pursuant to the terms hereof which are in effect on the date hereof:

(i) Each Contract which is to be performed in whole or in part at or after the date of this Agreement and which (1) cannot be canceled upon 60 days' notice without payment or penalty and involves aggregate annual payments of more than \$100,000; (2) involves material nonmonetary obligations to be performed later than one year from the date hereof; (3) otherwise materially affects the Assets or the operation of the Line; or (4) was not entered into in the ordinary course of business consistent with past practice;

(ii) Each Contract providing for the indemnification of any third party;

(iii) Each Contract providing for any future payments that are conditioned, in whole or in part, on any Transfer or assignment of any of the Assets;

(iv) Each Contract for the Transfer of any of the Assets or for the grant of any preferential right to purchase any of the Assets or which requires the consent of any third party to the Transfer of any of the Assets;

(v) Each Contract evidencing more than \$100,000 of Indebtedness of KCS or its Subsidiaries (including the Indentures);

(vi) Each Contract involving aggregate consideration in excess of \$100,000 (1) under which the benefits cannot be retained or there will be a default as a result of the consummation of the transactions contemplated by this Agreement without the written consent or approval of other parties or (2) which would require the making of any material payment, other than payments as contemplated by this Agreement, to any employee of KCS or to any other Person as a result of the consummation of the transactions contemplated herein;

(vii) Each Contract pursuant to which any material Leased Personal Property is used or leased in the operation of the Line;

(viii) Each lease, sublease or other occupancy agreement pursuant to which KCS or any of its Subsidiaries leases, subleases or otherwise occupies any real property included or related to the Line (such leases, subleases and other occupancy agreements, together with any amendments, modifications and other supplements thereto, each a "Lease" and collectively, the "Leases");

(ix) Each lease, sublease or other occupancy agreement pursuant to which KCS or any of its Subsidiaries leases or subleases any Property to a third party or one of its Affiliates (each such lease, sublease and other occupancy agreement, together with any amendments, modifications and other supplements thereto, a "Third Party Lease" and collectively, the "Third Party Leases");

(x) Each Contract involving a guarantee of any Indebtedness or imposing a Lien on any of the Assets which serve as collateral for Indebtedness; and

(xi) Each Contract granting haulage, trackage or other access or operating rights with respect to the Line.

8.5 Absence of Certain Changes and Events

. Except as set forth in Section 8.5 of the Disclosure Schedule, since December 31, 2004 and prior to the date hereof, except for this Agreement and changes contemplated by this Agreement, (i) neither KCS nor any of its Subsidiaries has taken any action which would be in violation of Section 10.1 had such action been taken after the date hereof and (ii) there has not been any change or development or combination of changes or developments which, individually or in the aggregate, has resulted in, or is reasonably likely to result in, a Material Adverse Effect on KCS or KCSR.

8.6 Litigation and Proceedings

. Except as set forth in Section 8.6 of the Disclosure Schedule, there is no pending or, to the Knowledge of KCS, threatened Action to which KCS, KCSR or any of their respective Subsidiaries is a party involving the Assets or the operation of the Line in any material way, and neither KCS nor any of its Subsidiaries is subject to any material judgment, order, writ, injunction, decree or regulatory directive or agreement with respect to the Assets or the operation of the Line. None of the Assets is subject to any judgment, order or decree entered in any Action which would be reasonably likely to have a Material Adverse Effect on KCS or KCSR.

8.7 Environmental Matters

(a) KCS, KCSR and their respective Subsidiaries, with respect to the Properties and the operation of the Line, are in compliance in all material respects with all applicable Environmental Laws (which compliance includes, but is not limited to, the possession by KCS, KCSR and their respective Subsidiaries of all material permits and other governmental authorizations required under applicable Environmental Laws, and compliance with the terms and conditions thereof). None of KCS, KCSR or any of their respective Subsidiaries has received in writing any notice, action, inquiry, investigation or claim alleging that KCS, KCSR or any of their respective Subsidiaries, with respect to the Properties or the operation of the Line, are not in such compliance.

(b) There is no Environmental Claim relating to the Properties or the operation of the Line pending or, to the Knowledge of KCS, threatened against KCS, KCSR or any of their respective Subsidiaries or, to the Knowledge of KCS, against any Person whose liability for any such Environmental Claim KCS, KCSR or any of their respective Subsidiaries has retained or assumed either contractually or by operation of Law which would, individually or in the aggregate, be material.

(c) To the Knowledge of KCS, no event has occurred and no condition exists including, without limitation, the Release, threatened Release or presence of any Hazardous Material, which could reasonably be expected to form the basis of any Environmental Claim relating to the Properties or the operation of the Line which would, individually or in the aggregate, be material.

(d) KCS has delivered or otherwise made available for inspection to NS true and correct copies and results of any reports, studies, analyses, tests or other monitoring reports or related substantive correspondence with any Governmental Authority possessed or initiated by or on behalf of KCS, KCSR or any of their respective Subsidiaries pertaining to Hazardous Materials in, on, beneath or adjacent to the Properties, or regarding KCS' and its Subsidiaries' compliance with applicable Environmental Laws with respect to the Properties and the operation of the Line (any of the foregoing, "Environmental Reports").

8.8 Compliance With Laws and Other Matters

. KCS, KCSR and each of their respective Subsidiaries:

(a) is, and since January 1, 2003 has been, in compliance in all material respects, in the operation of the Line, with all applicable Laws (it being understood that, solely for purposes of this Section 8.8, the term "Laws" shall not include any Environmental Laws) and the regulations, ordinances, rules, judgments, orders or decrees of any Governmental Authority applicable thereto or to the employees involved in the operation of the Line;

(b) has, and upon the consummation of the transactions contemplated hereby the Company will have, all material permits, licenses, franchises, certificates of authority, orders, and approvals of, and has made all material filings, applications, and registrations with, Governmental Authorities that are required in order to permit it to operate the Line (the "Permits"); and since January 1, 2003 has been, in compliance in all material respects with the terms of the Permits; and all the Permits are, and will be, in full force and effect and a complete and accurate list of the Permits is set forth in Section 8.8(b) of the Disclosure Schedule;

(c) has, since January 1, 2003, received no notification or communication from any Governmental Authority (i) asserting that it is not in compliance with any Laws (or indicating, in the absence of any such assertion, a possible investigation or inquiry with respect to any of the foregoing) with respect to the operation of the Line or (ii) threatening to suspend, materially modify or revoke any Permit; and

(d) is not a party to or subject to any material order, decree, agreement, memorandum of understanding or similar arrangement with, or a commitment letter, supervisory letter or similar submission to, any Governmental Authority with respect to the Assets or the operation of the Line, and none of KCS, KCSR or any of their respective Subsidiaries has been advised by any such Governmental Authority that such Governmental Authority is contemplating issuing or requesting (or is considering the appropriateness of issuing or requesting) any such material order, decree, agreement, memorandum of understanding, commitment letter, supervisory letter or similar submission.

8.9 Labor Relations

. Except as set forth in Section 8.9 of the Disclosure Schedule:

- (a) There is no strike, lockout, slowdown or stoppage pending or, to the Knowledge of KCS, threatened against or directly affecting the operation of the Line.
- (b) Neither KCS nor any of its Subsidiaries is delinquent in payments in any material respect: (i) to any of its employees involved in the operation of the Line for any wages, salaries, commissions, bonuses or other direct compensation for any services performed by them, (ii) to any of its employees involved in the operation of the Line for amounts required to be reimbursed to such employees or (iii) to any benefit plans with respect to amounts owed on behalf of any of its employees involved in the operation of the Line.
- (c) There is no unfair labor practice, charge or complaint against KCS, KCSR or their respective Subsidiaries with respect to the operation of the Line, pending or, to the knowledge of KCS, threatened, before any Governmental Authority; and there is no grievance that would be reasonably likely to have a Material Adverse Effect on KCS or KCSR nor any arbitration proceeding arising out of or under any collective bargaining agreement pending against KCS, KCSR or their respective Subsidiaries with respect to the operation of the Line.
- (d) Each of KCS and any of its Subsidiaries who are or have been (i) required to comply with Executive Order 11246 or any other requirements applicable to a "contractor" or "subcontractor" (as defined by Executive Order 11246) or (ii) required to maintain an affirmative action plan have complied with such requirements in all material respects.

8.10 Taxes

. (a) All Tax Returns required to be filed by KCS, KCSR or any of their respective Subsidiaries with respect to the Assets and the operation of the Line have been filed on a timely basis and all such returns are true, complete, and correct in all material respects, (b) all Taxes (whether or not shown on any Tax Return) that are due or claimed to be due from KCS, KCSR or any of their respective Subsidiaries with respect to the Assets and the operation of the Line have been paid, (c) no notice has been received of any deficiencies for Taxes claimed, proposed or assessed by any Government Authority with respect to the Assets or the operation of the Line for which KCS, KCSR or any of their respective Subsidiaries may be liable, (d) there are no pending, current or proposed audits, examinations, suits, proceedings, investigations, claims or administrative proceedings for or relating to any liability in respect of any Taxes with respect to the Assets or the operation of the Line for which KCS, KCSR or any of their respective Subsidiaries may be liable, (e) each of KCS, KCSR and their respective Subsidiaries has withheld and paid to the relevant Governmental Authority all Taxes required to have been withheld and paid in accordance with applicable Law with respect to the Assets and the operation of the Line, including in connection with any amounts paid or owing to any employee, independent contractor, creditor, equity holder or other Person, (f) there is, to the Knowledge of KCS, no outstanding material claim by any Governmental Authority in a jurisdiction where KCS, KCSR or any of their respective Subsidiaries does not file Tax Returns that KCS, KCSR or any of such Subsidiaries may be subject to Tax in such jurisdiction with respect to the Assets or and the operation of the Line, (g) there are no Liens on any of the Assets that arose in connection with any failure (or alleged failure) to pay any Tax, and (h) none of KCS, KCSR or any of their respective Subsidiaries with respect to the Assets or the operation of the Line will be required to include any item of income in, or exclude any item of deduction from, income for any Tax period (or portion thereof) ending after the Closing Date as a result of any (1) change in method of accounting for a Tax period ending on or prior to the Closing Date, (2) agreement with a Governmental Authority executed on or prior to the Closing Date, (3) deferred gains, (4) installment sale or open transaction disposition made on or prior to the Closing Date, or (5) prepaid amount received on or prior to the Closing Date, in each case under this Section 8.10(h), to the extent that the Tax liability of the Company or any Member (as defined in the Company Agreement) could be materially affected.

8.11 Insurance

. The Assets are insured with reputable insurers and Section 8.11 of the Disclosure Schedule contains a true and correct list of such insurance policies maintained by KCS, copies of which have been made available to NS. With respect to all insurance policies that are individually or in the aggregate material to the Assets and the operation of the Line: (i) such policies are in full force and effect on the date hereof and KCS, KCSR and their respective Subsidiaries shall use their commercially reasonable efforts to continue such policies in full force and effect through the Closing Date, (ii) all premiums currently payable or previously due and payable with respect to all periods up to and including the Closing Date have been paid to the extent such premiums are due and payable on or prior to the date hereof and, with respect to premiums not due or payable at or prior to the date hereof, all premiums due and payable prior to the Closing Date, will have been paid prior to the Closing Date and (iii) no notice of cancellation or termination has been received with respect to any such policy.

8.12 Books and Records

. The books and records of KCS, KCSR and their respective Subsidiaries relating to the Assets and the operation of the Line have been fully, properly and accurately maintained in all material respects.

8.13 Transactions with Affiliates

. With respect to the Assets and the operation of the Line, there are no outstanding amounts payable to or receivable from, or advances by KCS, KCSR or any of their respective Subsidiaries to, and none of KCS, KCSR or any of their respective Subsidiaries is otherwise a creditor or debtor to, any member or stockholder, director, employee or Affiliate of KCS, KCSR or any of their respective Subsidiaries. With respect to the Assets and the operation of the Line, neither KCS, KCSR nor any Subsidiary of KCS nor KCSR is a party to any transaction or agreement with any Affiliate, member or stockholder, director or executive officer of KCS, KCSR or any of their respective Subsidiaries or any material transaction or agreement with any employee other than executive officers.

8.14 Real Property .

- (a) Section 8.14(a) of the Disclosure Schedule sets forth a true, correct and complete list of each parcel of real property owned by

KCS, KCSR or their respective Subsidiaries included in the Assets (each such parcel and, for solely the purposes of this Section 8.14, the Dallas Intermodal Terminal described on Annex C hereto (the "Terminal"), individually, an "Owned Property" and collectively, the "Owned Properties") showing the common address, or other means of identification, and record title holder thereof and, to the Knowledge of KCS, all Liens thereon. Each of KCS, KCSR and their respective Subsidiaries, as applicable, owns, and upon the consummation of the transactions contemplated hereby will transfer to the Company all of their respective rights, titles and interests in and to the Owned Properties and to all buildings, structures and other improvements thereon, free and clear of all Liens, except for Permitted Liens, and subject to the Retained Interests, sufficient for the operation of the Line in the ordinary course of business (i) in substantially the same manner as operated by KCS and its Affiliates prior to the Closing and (ii) as contemplated by the NSR Joint Use Agreement, the KCSR Joint Use Agreement, and the Operating Agreement.

(b) Section 8.14(b) of the Disclosure Schedule sets forth the common address of each parcel of real property leased or subleased by KCS, KCSR or their applicable Subsidiary pursuant to each Lease (each a "Leased Property" and collectively, the "Leased Properties"). True, correct and complete copies of all work letters, side agreements, consents, subordination agreements, guarantees and other similar arrangements or agreements with respect to each Lease and to which KCS or any of its Subsidiaries is a party (or that are otherwise in the possession of KCS, KCSR or their respective Subsidiaries) has heretofore been made available to NS and its counsel. KCS (either directly or through KCSR or another Subsidiary) holds, and after the consummation of the transactions contemplated hereby the Company will hold, a valid and existing leasehold or subleasehold interest, as applicable, in each Leased Property pursuant to the applicable Lease, free and clear of all Liens, other than Permitted Liens, and subject to the Retained Interests. There are no oral agreements in effect as to any Lease to which KCS or any of its Subsidiaries is a party. The terms of the Leases have not been modified in any respect, except to the extent that such modifications are set forth in the documents previously delivered or made available to NS and its counsel, and none of KCS, KCSR or any of their respective Subsidiaries is in negotiations with any landlord to cancel or terminate any Lease prior to the stated maturity date of such Lease. Except for Permitted Liens, none of KCS, KCSR or their applicable Subsidiaries has assigned, transferred, conveyed, mortgaged, deeded in trust or encumbered its leasehold interest in any Lease. Neither KCS nor any Subsidiary has received a notice of default or termination with respect to any Lease. No material damage or destruction (i.e., damage or destruction that would permit either party to the applicable Lease to terminate such Lease or cause the abatement of rent thereunder) has occurred with respect to any of the Leased Properties which has not been repaired prior to the date hereof.

(c) The Owned Properties and the Leased Properties (each a "Property" and collectively, the "Properties") constitute all of the real estate, other than rail yards and similar facilities, within which KCS and its Subsidiaries operate the Line. The Properties are in compliance with all requirements of applicable Law in all material respects, and none of KCS, KCSR or any of their respective Subsidiaries has received notice of, and KCS has no Knowledge of, any condemnation, eminent domain, zoning, land use proceedings or other claims, causes of action, lawsuits or legal proceedings pending, threatened or contemplated regarding the ownership, use or possession of the Properties or any part thereof or of any sale or other disposition of the Owned Properties or any part thereof in lieu of condemnation, except for those matters that are set forth in Section 8.14(c) of the Disclosure Schedule.

(d) Section 8.14(d) of the Disclosure Schedule sets forth the common address of, or other means of identifying, each parcel of real property leased or subleased by KCS, KCSR or their applicable Subsidiary pursuant to each Third Party Lease and the property (or portion thereof) subject to such Third Party Lease. True, correct and complete copies of all work letters, side agreements, consents, subordination agreements, guarantees and other similar arrangements or agreements with respect to the Third Party Leases and to which KCS, KCSR or any of their respective Subsidiaries is a party (or that are otherwise in the possession of KCS, KCSR or any of their respective Subsidiaries) has heretofore been made available to NS. There are no oral agreements in effect as to any Third Party Lease to which KCS or any Subsidiary of KCS is a party. The terms of the Third Party Leases have not been modified in any respect, except to the extent that such modifications are set forth in the documents previously delivered or made available to NS and its counsel, and neither KCS, KCSR or any of their respective Subsidiaries is in negotiations with any tenant or subtenant to cancel or terminate any Third Party Lease prior to the stated maturity date of such Third Party Lease.

8.15 Brokers

Neither KCS nor any of its Affiliates has retained or otherwise engaged or employed, or paid or agreed to pay any fee or commission, to any agent, broker, finder or other Person, for or on account of acting as a finder or broker in connection with this Agreement, the Ancillary Agreements or the Company Agreement or the transactions contemplated hereby and thereby.

9. Representations and Warranties of NS

NS hereby represents and warrants as of the date hereof and, to the extent provided in Section 11.3(a), as of the Closing, as follows:

9.1 Organization, Standing and Power

NS is a corporation duly organized, validly existing and in good standing under the Laws of the jurisdiction of its incorporation and has all requisite power and authority to own, lease and operate its properties and assets and to carry on its business as now being conducted.

9.2 Authority; Enforceability; Noncontravention

(a) Each of NS, AGS and their respective Subsidiaries, as the case may be, has full power and authority to enter into, execute and deliver this Agreement, each of the Ancillary Agreements and the Company Agreement to which it is a party and perform its obligations hereunder and thereunder. This Agreement has been, and each of the Ancillary Agreements and the Company Agreement will be, duly authorized by all necessary action of each of NS, AGS and their respective Subsidiaries, as the case may be. This Agreement has been and each of the Ancillary Agreements and the Company Agreement will be, duly executed and delivered by each of NS, NSR and AGS, as the case may be, and, assuming it is duly executed and delivered by KCS and the Company, as applicable, constitutes or will constitute a valid and legally binding obligation of each of NS, AGS and their respective Subsidiaries, as the case may be, enforceable against them in

accordance with its terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar Laws relating to or affecting creditors' rights generally, and to the availability of equitable remedies.

(b) The execution and delivery by each of NS, NSR and AGS, as the case may be, of this Agreement, each of the Ancillary Agreements and the Company Agreement do not and will not, and compliance by each of NS, NSR or AGS, as the case may be, with the provisions of this Agreement, each of the Ancillary Agreements and the Company Agreement will not, (i) conflict with or result in a breach or default under the Charter Documents of NS, NSR or AGS or any of the terms, conditions or provisions of any Contract to which NS is a party or otherwise bound, or to which any property or asset of NS, NSR or AGS is subject; (ii) subject to the filings with Governmental Authorities and other matters referred to in Section 9.2(c) below, violate any Law applicable to NS, NSR or AGS; or (iii) result in the creation or imposition of any Lien on any asset of NS, NSR or AGS, except in each case as will not, individually or in the aggregate, impair in any material respect NS' performance of its obligations hereunder.

(c) Except (i) for the applicable requirements of the STB and (ii) as set forth on Schedule 9.2(c), there are no approvals, authorizations, consents, orders or other actions of, or filings with, any Person that are required to be obtained or made by NS, NSR, AGS or the Company in connection with the execution of, and the consummation of the transactions contemplated under, this Agreement, the Ancillary Agreements or the Company Agreement, except for any matters as will not, individually or in the aggregate, impair in any material respect NS' performance of its obligations hereunder.

9.3 Brokers

. Neither NS nor any of its Affiliates has retained or otherwise engaged or employed, or paid or agreed to pay any fee or commission, to any agent, broker, finder or other Person, for or on account of acting as a finder or broker in connection with this Agreement, the Ancillary Agreements or the Company Agreement or the transactions contemplated hereby and thereby.

9.4 Sufficient Funds

. NS has, and will have as of the Closing, sufficient funds available to pay the NS Closing Cash Purchase Price.

10. Covenants .

10.1 Operation of the Line by KCS and KCSR

. Between the date of this Agreement and the earlier of the Closing or termination pursuant to Section 13, except (a) as contemplated by this Agreement, (b) as may be required by applicable Law, (c) as set forth in Schedule 10.1 or (d) with the prior written consent of NS, KCS and KCSR will, and will cause their respective Subsidiaries to (X) operate the Line according to the ordinary course of business consistent with past practice, (Y) use all commercially reasonable efforts to preserve intact the Assets and maintain the rights, franchises and existing relations with suppliers and employees relating thereto and (Z) without limiting the generality of the clauses (X) and (Y) above:

(i) not transfer any of the Assets or any interest of KCS, KCSR or any of their respective Subsidiaries therein other than in the ordinary course of business consistent with past practice or to KCS or any Restricted Subsidiary;

(ii) not change the general nature of operation of the Assets or conduct any new line of business with the rail operating Assets not consistent with past practice;

(iii) not mortgage, encumber or pledge any of the Assets or permit or allow any of the Assets to be subjected to any Lien other than Permitted Liens;

(iv) not terminate prior to the scheduled expiration of, make any material modifications to, transfer or materially amend any Material Contract;

(v) not dispose of any books, records and accounts relating to the Assets, and to maintain such books records or accounts in the usual, regular and ordinary manner, on a basis consistent with prior periods;

(vi) not enter into any lease for real property with respect to any portion of the Assets;

(vii) not enter into any Contract of any kind or nature with any Affiliate (other than KCS or any Restricted Subsidiary), or make any payment or other asset Transfer to or for the benefit of any Affiliate (other than KCS or any Restricted Subsidiary), in each case, relating to the Assets or the operation of the Line;

(viii) not permit any waste of any of the Assets;

(ix) not pay, discharge or satisfy any material claim, liability or obligation (absolute, accrued, contingent or otherwise) related to the Assets other than in the ordinary course of business consistent with past practice;

(x) not cancel or compromise any material debt or material claim or waive or release any material rights relating to the Assets or the operation of the Line;

(xi) not grant any haulage, trackage or other access or operating rights with respect to the Line, except as required by Law;

(xii) not take any action that would cause a breach of any representation or warranty set forth in Article 8 hereof; or

(xiii) not authorize or enter into any agreement to otherwise take any of the foregoing actions.

10.2 Inspection of Records; Environmental Audits .

(a) Between the date of this Agreement and the Closing, KCS and KCSR shall, and shall cause their respective Subsidiaries to, allow, to the extent not prohibited by applicable Law, the officers, attorneys, accountants and other duly authorized representatives of NS reasonable access during regular business hours to the records and files, correspondence, audits, properties and personnel, as well as to all information, in each case, relating to the Assets. Any information regarding the Assets so obtained, and any information obtained by either party pursuant to the provisions of this Agreement, the Company Agreement and the Ancillary Agreements, shall be subject to the Agreement Regarding Confidentiality and Related Matters between KCS and NS, dated as of April 11, 2005, as extended to date (the "Confidentiality Agreement"), and such information shall be held by the recipient in accordance with the terms of the Confidentiality Agreement; it being understood that, for purposes of this provision, the term of the Confidentiality Agreement shall be deemed to have been extended for a period of one (1) year immediately following the Closing Date. No investigation by NS or its representatives shall affect the representations and warranties of KCS and KCSR set forth herein or preclude reliance thereon.

(b) Between the date of this Agreement and the Closing, KCS shall continue to make available for inspection by NS true, correct and complete copies of the Environmental Reports, and shall promptly deliver to NS true, correct and complete copies of any Environmental Reports that are prepared after the date hereof or that have not been previously disclosed to NS.

(c) If reasonably necessary (as determined solely by NS), NS and/or its appointed agents shall be entitled to perform at the expense of NS Phase I and Phase II environmental audits of the Properties in a manner which shall not unreasonably interfere with the operation of the Line in the ordinary course of business consistent with past practice. With respect to any Property for which NS determines a Phase I and/or Phase II audit is warranted, KCS, KCSR and their respective Subsidiaries shall provide NS and its appointed agents reasonable access to any such Property to conduct the Phase I and/or Phase II audit. Additionally, KCS, KCSR and their respective Subsidiaries shall fully cooperate with all reasonable requests made by NS and its appointed agents in connection with the Phase I and Phase II audits in accordance with the terms of the access agreement set forth in Exhibit O (the "Access Agreement") and shall cooperate in good faith with reasonable requests made by NS and its appointed agents in connection with the Phase I and Phase II audits.

10.3 Alternative Proposals

. During the period from the date of this Agreement and extending through the earlier of the termination of this Agreement in accordance with its terms or the Closing, KCS agrees that (a) it shall not, and shall use its commercially reasonable efforts to direct and cause its officers, directors, employees, agents and representatives (including any investment banker, attorney or accountant), as applicable, not to, directly or indirectly, (i) initiate, solicit or encourage, directly or indirectly, or accept the submission of any proposal or offer by any third party with respect to any joint venture, merger, acquisition, sale, consolidation or similar transaction involving the Line or any haulage, trackage or marketing arrangement involving the Line, in each case, other than the transactions contemplated by this Agreement (any such proposal or offer being hereinafter referred to as an "Alternative Proposal") or initiate or participate in any negotiations or discussions concerning an Alternative Proposal, (ii) enter into any agreement, agreement in principle, letter of intent or similar arrangement (whether or not legally binding) with any third party relating to an Alternative Proposal or (iii) provide any confidential information or data to any third party relating to an Alternative Proposal, and (b) it shall notify NS promptly if any Alternative Proposal is received by it or any negotiations or discussions relating to a potential Alternative Proposal are sought to be initiated or continued with KCS, including the material terms of such Alternative Proposal and the identity of the Person making such Alternative Proposal or seeking such negotiations or discussions; provided, that nothing in this Section 10.3 shall prevent KCS from taking any action with respect to any proposal or offer not initiated, solicited or encouraged in violation of this Section 10.3 or participating in negotiations or discussions with respect to such a proposal or offer if it is advised by outside legal counsel that it is required to take such action to satisfy the fiduciary duties of the Board of Directors of KCS under Delaware law; provided, however, that KCS shall not be permitted to terminate this Agreement other than as provided in Article 13 hereof.

10.4 Confer with NS

. Prior to the Closing, to the extent practicable and not prohibited by applicable Law, KCS shall confer with NS on all operational matters that might reasonably be expected to materially affect the Assets or, after the Closing Date, the operation of the Line, including, but not limited to material transactions and material expenditures.

10.5 Commercially Reasonable Efforts

. Between the date of this Agreement and the Closing, each of the parties to this Agreement will use its commercially reasonable efforts to cause the conditions to the obligations of the other parties set forth in Article 11 of this Agreement, as the case may be, to be satisfied; provided, that, except as agreed in writing by the parties hereto, in no event shall any of the parties hereto be obligated to accept, or cause the Company to accept, in connection with obtaining any Required Governmental Consents required by Section 11.1(c) or any consent, approval or agreement required by Section 11.2(d), any condition or requirement that is not acceptable to such party in its reasonable judgment. In addition, the parties hereto shall (i) cooperate and use their commercially reasonable efforts to obtain all consents, approvals, authorizations and agreements (or exemptions therefrom) of all Governmental Authorities necessary to authorize, approve or permit the consummation of the transactions contemplated by this Agreement, the Company Agreement and the Ancillary Agreements (the "Required Governmental Consents") at the earliest possible time hereafter, (ii) as promptly as practicable hereafter, file or submit, or cause to be filed or submitted, to all Governmental Authorities all notices, applications, documents and other materials necessary in connection with obtaining the Required

Governmental Consents and (iii) use their respective commercially reasonable efforts to respond as promptly as practicable to all inquiries received from all Governmental Authorities for additional information or documentation in connection with obtaining such Required Governmental Consents. Each of the parties hereto shall promptly advise each other party hereto upon receiving any communication (written or oral) from any Governmental Authority whose consent, approval or authorization is required, or to whom notice must be submitted, for consummation of the transactions contemplated by this Agreement, the Company Agreement and the Ancillary Agreements which constitutes a reasonable likelihood that any requisite regulatory consent, approval or authorization will not be obtained or that receipt of any such consent, approval or authorization will be materially delayed. Each of the parties hereto shall furnish to the other party hereto such necessary information and reasonable assistance as the other may reasonably request in connection with its preparation of any filings or submissions to any Governmental Authority necessary to obtain any of the Required Governmental Consents. Each of the parties hereto shall provide the other party hereto with draft copies and as-filed copies of all filings and submissions with Governmental Authorities in respect of the Required Governmental Consents and shall provide the other with a reasonable opportunity to comment upon all such draft copies. Each of the parties hereto and its respective representatives shall promptly inform the other party hereto regarding the substance of all communications and contacts received from any Governmental Authority with respect to this Agreement, the Company Agreement, the Ancillary Agreements or the transactions contemplated hereby and thereby, and neither of the parties hereto shall initiate any contact or communications with any Governmental Authority regarding this Agreement, the Ancillary Agreements or the transactions contemplated hereby and thereby without giving reasonable prior notice to the other party hereto and offering the other party hereto the opportunity to have a representative of such party participate in the contact or communication. For the avoidance of doubt, either party hereto shall be free to discuss regulatory matters with any Governmental Authority without the participation of the other party hereto to the extent such discussions do not directly relate to the transaction contemplated by this Agreement, the Company Agreement and the Ancillary Agreements.

10.6 Real Estate Matters .

(a) KCS and KCSR shall use their commercially reasonable efforts to obtain an estoppel certificate from each landlord under the Leases certifying that each lease is in full force and effect and that there are no defaults thereunder or any conditions that with the passage of time would constitute a default thereunder, or an estoppel certificate in the form so provided for under any such Lease or Third Party Lease. In the event that KCS is unable to deliver an estoppel certificate for any of the Leases or Third Party Leases to NS at the Closing, KCS shall indemnify NS against any loss, cost, liability or expense which NS may incur as a result of the failure of KCS to deliver such estoppel certificate.

(b) KCS and KCSR shall cause (i) title to the Owned Properties, at Closing, to be free and clear of all Liens and without exceptions, disclaimers of liability or objections except for Permitted Liens and any matters which the Title Company has committed to insure over or omit, and (ii) the First American Title Insurance Company of New York or another reputable title insurance company selected by NS (the "Title Company") to insure the Owned Properties under the terms described above.

(c) Between the date of this Agreement and the Closing, KCS shall disclose to NS any newly identified Liens on the Owned Properties that have not been previously disclosed to NS.

10.7 Publicity

. The initial public disclosure relating hereto, if any, will be a joint press release and thereafter, except as otherwise required by Law, the applicable rules of the stock exchanges on which KCS' and NS' shares are listed or any other self-regulatory organization, the parties shall coordinate with each other, including the provision of drafts and the opportunity to comment thereon, prior to issuing any press releases or otherwise making public statements with respect to the transactions contemplated hereby.

10.8 Standstill

. For a ten (10) year period commencing on the date hereof (such period, the "Standstill Period"), neither KCS nor NS shall, jointly with any third Person, directly or indirectly, (i) purchase or offer or agree to purchase any material assets or any voting securities of the other party (other than purchases of up to 1% of the other party's common stock) other than in the ordinary course of business consistent with past practice or (ii) propose any merger or other business combination involving the other party (any such purchase, offer to purchase or proposal, a "Business Combination"), except, in each case, if specifically invited in writing to do so by the other party. In addition, during the Standstill Period, neither KCS nor NS nor any of their respective Subsidiaries shall, jointly with any third Person, without the prior written consent of the other party: (i) make, or in any way participate, directly or indirectly, in any solicitation of proxies to vote or seek to advise or influence any Person with respect to the voting of any voting securities of the other party; (ii) form, join, or in any way participate in a "group" within the meaning of Section 13(d)(3) of the Securities Exchange Act of 1934 with respect to any voting securities of the other party; or (iii) otherwise act, alone or in concert with others, to seek to control the management, Board of Directors, or policies of the other party. Notwithstanding the foregoing, the provisions of this Section 10.8 shall not apply to either party if during such Standstill Period (i) the other party publicly proposes to enter into a Business Combination with another Person, (ii) either NS or KCS (or their respective Affiliates) ceases to be a member of the Company or (iii) this Agreement is terminated pursuant to Article 13 hereof.

10.9 Encumbrance and Transfer of Assets; Indentures .

(a) From and after the date hereof, KCS shall not, and shall cause its Subsidiaries not to, without the prior written consent of NS: (i) enter into, amend or extend any Contract (including the Indentures or the notes governed thereby) in any manner which would encumber any of the assets or properties of the Company or prohibit, limit or defer in any way any of NS' management rights set forth in the Company Agreement (including any rights in respect of Major Decisions (as such term is defined in the Company Agreement) that become or may become with the passage of time effective and/or that are modified after the Closing Date); or (ii) with respect to any assets transferred from the Company to KCS or its Restricted Subsidiaries as permitted by the Company Agreement, except as contemplated by Section 10.10, enter into any Contract with respect to or consummate any (x) acquisition, divestiture, spin-off, merger, consolidation, business combination or

similar transaction in which such assets would cease to be held by KCS or a Restricted Subsidiary or their respective successors, (y) sale, transfer, lease, sublease, license or other disposition of such assets (except by a Restricted Subsidiary to another Restricted Subsidiary or KCS) or (z) formation of or other participation in, any joint venture or partnership with respect to such assets.

(b) From and after the date hereof, KCS shall, and from and after the Closing Date NS shall, cause the Company to comply with the provisions of the Indentures and shall not, and shall cause the Company not to, incur any additional Indebtedness other than as and to the extent permitted by the Company Agreement and the Indentures and, in any event, subject to Section 10.9(a).

10.10 Option to Acquire the Line .

(a) In the event of a Permitted Asset Transfer (as such term is defined in the Company Agreement) to which NS has not previously consented in writing, KCS shall, at least twenty (20) Business Days before such transfer, provide Notice thereof (each such Notice, a "Line Option Notice") to NS in accordance with the provisions of Section 14.1 and NS shall have the option (the "Line Option") to acquire, or cause one or more of its Subsidiaries to acquire, in accordance with the procedures set forth in this Section 10.10, (1) from the relevant transferee or transferees, all right, title and interest in the Line, as it then exists, but subject to Permitted Liens, that is owned by such transferee(s) together with, at the option of NS in its sole discretion, all right, title and interest of such transferee(s) or KCS and its Subsidiaries (other than the Company) in and to the rail yards at or near Monroe, Louisiana, Bossier City, Louisiana and Pearson, Mississippi (the Line and such rail yards collectively, the "Line Assets") that are owned by such transferee or KCS or any of its Subsidiaries (other than the Company) at the time of such Permitted Asset Transfer (the "KCS Line Assets") and (2) either:

(i) from KCS and its Subsidiaries, the Membership Interests of the KCS Member (as such terms are defined in the Company Agreement) (the "KCS Membership Interests"); or

(ii) from the Company, the remaining Line Assets (if any) owned by the Company following such Permitted Asset Transfer (the "Company Line Assets").

(b) Notwithstanding anything to the contrary herein, in the case of a Permitted Asset Transfer involving one or more assets of the Company that are not material, individually or in the aggregate, to the operation of the Line, the Line Option will not be available to NS if, within twenty (20) days after such transfer, the asset(s) subject to such Permitted Asset Transfer are transferred back to the Company on terms which have the same effect as if such Permitted Asset Transfer had not occurred.

(c) From and after the date of a Line Option Notice, KCS shall allow, to the extent not prohibited by applicable Law, the officers, attorneys, accountants and other duly authorized representatives of NS access during regular business hours to any books, records, files, correspondence, audits, properties, personnel and other information of KCS or its Subsidiaries relating to the Line Assets owned by KCS or its Subsidiaries (other than the Company) that is reasonably requested by NS or its representatives.

(d) At any time during the thirty (30) day period commencing on receipt of a Line Option Notice, NS may give Notice to KCS in accordance with the provisions of Section 14.1 (each such Notice, a "Line Option Valuation Notice") of its desire to commence the valuation of the Line Assets and the KCS Membership Interests in accordance with the procedures set forth in this Section 10.10(d). Upon the delivery of a Line Option Valuation Notice, NS and KCS shall each select and engage a reputable, independent M.A.I. designated appraiser with at least ten (10) years of experience in valuing real property and rail improvements for rail line and yard property or, at their respective option, an independent investment banking firm of national reputation and such appraisers or investment banking firms shall be instructed to meet within thirty (30) days following their selection and at such meeting to mutually agree upon the selection of an appraiser, appropriately qualified in their judgment (the "Appraiser") to determine:

(i) the fair market value of the Line Assets on a stand-alone rail operation basis (the "Line FMV"), as well as the portion of the Line FMV attributable to the KCS Line Assets, in the aggregate, and the Company Line Assets, in the aggregate; and

(ii) the fair market value of the KCS Membership Interests (with the Line FMV determined as provided in Section 10.10(d)(i)) (the "Membership Interest FMV").

For purposes of this Section 10.10(d), "fair market value" shall mean, with respect to any asset or property, the price that could be negotiated in an arm's-length, free market transaction, for cash, between a willing seller and a willing and able buyer, neither of whom is under undue pressure or compulsion to complete the transaction.

(e) Within ninety (90) days of the date of its appointment, the Appraiser shall provide to both NS and KCS a report (the "Appraisal Report"), which report shall include the Appraiser's determination of the Line FMV, as well as the portion of the Line FMV attributable to the KCS Line Assets, in the aggregate, and the Company Line Assets, in the aggregate, and the Appraiser's determination of the Membership Interest FMV.

(f) Each of NS and KCS shall, and shall cause the Company and their respective Subsidiaries to, cooperate with the Appraiser and promptly provide all documents and other information and access during regular business hours to the Line Assets reasonably requested by the Appraiser in connection with its appraisal. The determination of the Line FMV and the Membership Interest FMV set forth in the Appraisal Report shall be final and binding on NS and KCS for purposes of this Section 10.10. KCS and NS shall bear equally all expenses of the Appraiser.

(g) Within sixty (60) days after the determination of the Line FMV and the Membership Interest FMV, either by mutual agreement of the parties (without any obligation to negotiate toward or reach such agreement) or by the issuance of the Appraisal Report, NS shall give Notice to KCS of whether it wishes to exercise the Line Option (the "Line Option Exercise Notice") at the Line FMV or the portion thereof

attributable to the KCS Line Assets and Membership Interest FMV, as the case may be, as finally determined pursuant to subsections (e) and (f) above, which Notice shall indicate whether NS wishes to acquire the KCS Membership Interests pursuant to Section 10.10(a)(i) or the Company Line Assets pursuant to Section 10.10(a)(ii). In the event that NS has elected to acquire the KCS Membership Interests pursuant to the Line Option, the transfer of such interests shall be governed by the procedure set forth in Article 10 of the Company Agreement. If NS delivers a Line Option Exercise Notice to KCS, NS (or its designated Subsidiar(ies)), KCS and its Subsidiaries shall effect the transfer of the KCS Line Assets, and (in the case that NS has elected to acquire the Company Line Assets pursuant to the Line Option) cause the Company to effect the transfer of the Company Line Assets, to NS (or its designated Subsidiar(ies)) pursuant to customary documentation reasonably acceptable to the parties, including any agreements, documents and other instruments necessary or reasonably requested by NS (or its designated Subsidiar(ies)) to effect such transfer. Such documentation shall call for KCS and its Subsidiaries and, if NS elects to acquire the Company Line Assets pursuant to Section 10.10(a)(ii), the Company to provide representations, warranties, covenants and indemnities with respect to the KCS Line Assets and Company Line Assets, respectively, with terms at least as favorable to NS and its Subsidiaries as are set forth in this Agreement with respect to the Line and the Assets. Notwithstanding anything to the contrary contained herein, the completion of the sale of the KCS Line Assets and/or Company Line Assets, as the case may be, pursuant to the Line Option and in accordance with the terms of such documentation shall each occur, and the NS Member shall pay the portion of the Line FMV attributable to the assets so acquired to the transferring party, on a date to be mutually agreed by KCS and NS, but in no event later than the later of (i) ninety (90) days after the delivery date of the Line Option Exercise Notice and (ii) five Business Days after the date on which the last of any required regulatory approvals in connection with such transaction is received. The KCS Line Assets and, if applicable, Company Line Assets, shall be conveyed to NS (or its designated Subsidiar(ies)) subject only to Permitted Liens and KCS shall be responsible for the payment of all transfer, filing and recording taxes in connection with the exercise of the Line Option with respect to such assets and the conveyance of the KCS Line Assets and, if applicable, Company Line Assets. All payments of the Line FMV attributable to the assets acquired shall be made by wire transfer of immediately available funds to an account or accounts specified by the intended recipients.

(h) In the event that NS elects not to exercise the Line Option, it shall be entitled to exercise the contingent trackage rights described in Section 3 of the NSR Joint Use Agreement. For the avoidance of doubt, nothing in this Section 10.10 nor any decision of NS not to exercise the Line Option shall in any way limit the rights of NS and its Affiliates under the NSR Joint Use Agreement, the Western Haulage Agreement, the Contingent Haulage Agreement or any other Ancillary Agreement.

(i) Notwithstanding anything in this Section 10.10 to the contrary, the Line Option shall be exercised, and title to the Line Assets shall vest, if at all, on or prior to the date on which the last of the living descendants of Joseph P. Kennedy shall die, plus twenty one (21) years.

(j) In the event that no Appraiser is appointed pursuant to and in compliance with Section 10.10(d) an Appraiser will be appointed by arbitration in accordance with Section 14.13.

10.11 Determination and Payment of Real Property Taxes

. KCSR is contributing the Assets to the Company through one deed that excludes certain property. Because the Assets will be included in KCSR's Form R1 that is filed annually with the STB, Mississippi, Louisiana, and their local governments will assess property tax against KCSR (not the Company) that includes the Assets. Therefore, in connection with each annual property tax assessment, KCSR and NS will determine jointly and in good faith a reasonable and fair allocation of KCSR's property tax liability that is attributable to the Assets and that should be paid by the Company, and KCSR and NS will certify in writing that the determined amount is reasonable and fair. Thereafter, KCSR will bill the Company for, and the Company shall promptly pay to KCSR, the jointly determined share of the property tax.

10.12 NS Automotive Traffic

. From and after the date hereof, NS and KCS shall negotiate in good faith the terms of an agreement with respect to NS' rights to move automotive traffic over the Line or to interchange such traffic.

10.13 Vicksburg Bridge Lease Dispute

. KCS shall use its commercially reasonable efforts to resolve the Vicksburg Bridge Lease dispute referred to in, and in the manner contemplated by, Section 3.1(b).

11. Conditions to the Closing .

11.1 Mutual Conditions

. The respective obligations of the parties to complete the purchase/sale of the NS Interest on the Closing Date as contemplated by Section 2.1(a), the contribution of the Assets in exchange for the KCS Interest and to take the other actions required to be taken by each of the parties at the Closing is subject to the satisfaction, at or prior to the Closing, of each of the following conditions (any of which may be waived jointly by NS and KCS in writing, in whole or in part):

(a) Company Agreement. KCS and NS or their respective Affiliates shall have entered into the Company Agreement.

(b) Ancillary Agreements. KCS, KCSR, NS, the Company and their respective Affiliates, as applicable, shall have entered into each of Ancillary Agreements.

(c) Regulatory Approvals. All Required Governmental Consents (including from the STB) shall have been obtained and shall be in full force and effect, and not subject to conditions that any party deems unacceptable in its reasonable judgment, and shall not be subject to a pending petition for review before a U.S. Court of Appeals.

(d) No Order or Action. No Law shall have been enacted, entered, promulgated or enforced by any Governmental Authority which prohibits, restricts or makes illegal the consummation of the Closing or any of the material transactions contemplated thereby, or by the Company Agreement or any of the Ancillary Agreements, and no Action shall be pending or threatened that questions the validity of this Agreement, the Company Agreement or any of the Ancillary Agreements or declares or proposes to declare the same unlawful or seeks to enjoin the consummation of any of the material transactions contemplated hereby or thereby.

11.2 Additional Conditions of NS

. The obligation of NS to complete the purchase of the NS Interest on the Closing Date as contemplated by Section 2.1(a), and to take the other actions required to be taken by NS at the Closing is subject to the satisfaction, at or prior to the Closing, of each of the following additional conditions (any of which may be waived by NS in writing, in whole or in part):

(a) Representations and Warranties. The representations and warranties contained in Article 8 hereof and in all certificates delivered by KCS and KCSR to NS pursuant hereto or in connection with the transactions contemplated hereby shall be true and accurate in all respects (in the case of representations and warranties qualified by "materiality," "in all material respects," "Material Adverse Effect" or similar terms or phrases, and in the case of the representations and warranties set forth in Sections 8.1 and 8.2) or in all material respects (in the case of all other representations and warranties) as of the date of this Agreement and as of the Closing as though made at and as of the Closing (except for changes contemplated by this Agreement and except for representations and warranties that by their terms speak specifically as of the date of this Agreement or some other date, in which case as of such date).

(b) Performance. KCS and KCSR shall have performed all obligations and complied with in all material respects all covenants required by this Agreement to be performed or complied with by KCS or KCSR on or prior to the Closing Date.

(c) Certificate. KCS shall have delivered to NS a certificate, dated the Closing Date, signed on behalf of KCS by an officer of KCS, certifying that the conditions specified in Sections 11.2(a) and (b) of this Agreement have been satisfied.

(d) Consents. At the Closing, KCS shall have delivered to NS all consents, approvals and agreements of any third Persons required by the terms of any Material Contract in order that the rights of KCS or any of its Subsidiaries or the prospective rights of the Company under such Material Contract, in each case, as they relate to the Assets or the Assumed Liabilities, will not be impaired by the consummation of the transactions contemplated by this Agreement, the Company Agreement and the Ancillary Agreements, and such consents, approvals and agreements shall be in full force and effect.

(e) No Material Adverse Effect. There shall have been no Material Adverse Effect on KCS or KCSR.

(f) Opinions of Counsel. NS shall have received an opinion of Sonnenschein Nath & Rosenthal LLP, dated as of the Closing Date, substantially in the form attached as Exhibit P hereto, and an opinion of the Senior Vice President and General Counsel of KCS, dated as of the Closing Date, substantially in the form attached as Exhibit Q hereto.

(g) Bank Approval of Transaction Agreements. KCS shall have delivered to NS written confirmation by the Required Lenders (as such term is defined in KCS Credit Agreement Amendment No. 2) that the form and substance of this Agreement and the Ancillary Agreements are satisfactory to the Required Lenders as contemplated by Section 1(a)(xiv) of KCS Credit Agreement Amendment No. 2.

11.3 Additional Conditions of KCS

. The obligation of KCS and KCSR to complete the contribution of the Assets in exchange for the KCS Interest, and to take the other actions required to be taken by KCS and KCSR at the Closing is subject to the satisfaction, at or prior to the Closing, of each of the following additional conditions (any of which may be waived by KCS in writing, in whole or in part):

(a) Representations and Warranties. The representations and warranties contained in Article 9 hereof and in all certificates delivered by NS to KCS pursuant hereto or in connection with the transactions contemplated hereby shall be true and accurate in all respects (in the case of representations and warranties qualified by "materiality," "in all material respects," "material adverse effect" or similar terms or phrases, and in the case of the representations and warranties set forth in Sections 9.1 and 9.2) or in all material respects (in the case of all other representations and warranties) as of the date of this Agreement and as of the Closing as though made at and as of the Closing (except for changes contemplated by this Agreement and except for representations and warranties that by their terms speak specifically as of the date of this Agreement or some other date, in which case as of such date).

(b) Performance. NS shall have performed all obligations and complied with in all material respects all covenants required by this Agreement to be performed or complied with by NS on or prior to the Closing Date.

(c) Certificate. NS shall have delivered to KCS a certificate, dated the Closing Date, signed on behalf of KCS by an officer of NS, certifying that the conditions specified in Sections 11.3(a) and (b) of this Agreement have been satisfied.

(d) No Material Adverse Effect. There shall have been no Material Adverse Effect on NS or AGS.

(e) Opinions of Counsel. KCS shall have received an opinion of Skadden, Arps, Slate, Meagher & Flom LLP, dated as of the Closing Date, substantially in the form attached as Exhibit R hereto an opinion of the Vice President and Corporate Counsel of NS, dated as of the Closing Date, substantially in the form of Exhibit S hereto and an opinion of Cabannis, Johnston, Gardner, Dumas & O'Neal LLP, dated as of the Closing Date, substantially in the form of Exhibit T hereto.

12. Survival of Representations and Warranties; Indemnity .

12.1 Survival of Representations and Warranties

All representations and warranties made in this Agreement or made in any document delivered pursuant to this Agreement by or on behalf of any party shall survive the execution and delivery of this Agreement and the Closing, regardless of notice of or any investigation or right of investigation made after the date of this Agreement by or on behalf of any party, and shall terminate and expire one (1) year following the Closing Date, except that the representations and warranties made in Section 8.2(b)(ii) as they relate to the Indentures shall terminate and expire on the earlier of the date that is four (4) years following the Closing Date and the Maturity Date (as such term is defined in the Company Agreement) and the representations and warranties made in Sections 8.7, 8.10 and 8.14 shall terminate and expire sixty (60) days after the termination of the applicable statute of limitations, in each case, after which date they shall be of no further force or effect (except for bona fide claims of which a party has provided written notice in good faith to the other parties prior to the relevant expiration date).

12.2 Indemnification by KCS

(a) KCS and KCSR shall indemnify, save and hold harmless (i) NS and its Affiliates, and each of their respective officers, directors, employees and agents, and each of their respective successors and assigns (collectively, the "NS Indemnified Parties"), from and against any and all costs, losses, claims, liabilities, damages, fines, penalties, expenses and Cleanup costs (including any interest which may be imposed in connection therewith and court costs and reasonable fees and disbursements of counsel) ("Damages," which shall not include any claim of diminution of value of a Member's interest in the Company unless the Company shall have incurred actual loss) incurred in connection with, arising out of, resulting from or incident to: (A) any breach of the representations or warranties of KCS and KCSR in this Agreement, except for Section 8.7, (in each case, solely for the purpose of calculating the amount of Damages, without regard to any qualification or limitation with respect to "materiality," whether by reference to "material," "in all material respects" or "Material Adverse Effect"), or (B) any breach or default in any covenants or agreements made by KCS in this Agreement; and (ii) the Company and its Affiliates, and each of their respective officers, directors, employees and agents (other than KCS or its Subsidiaries) and each of their respective successors and assigns (collectively, the "Company Indemnified Parties") and any NS Indemnified Parties from and against any and all Damages incurred in connection with, arising out of, resulting from or incident to any obligation or liability, other than the Assumed Liabilities, incurred in connection with, arising out of, resulting from or incident to any act or omission by KCS or KCSR, any of its Affiliates prior to the Closing relating to the Assets, whether fixed or contingent, recorded or unrecorded, known or unknown.

(b) KCS and KCSR shall defend, indemnify and hold harmless any NS Indemnified Parties and any Company Indemnified Parties for, from, and against all Damages asserted against, resulting to, imposed on, or incurred by NS or the Company in connection with: (i) any misrepresentation or breach of any environmental representation or warranty set forth in Section 8.7 of this Agreement; (ii) (A) the Release or threatened Release of any Hazardous Materials prior to the Closing Date on, from or under the Properties or in connection with the operation of the Assets or (B) the Release of any Hazardous Materials on, from or under any other property where, prior to the Closing Date, Hazardous Materials are or were Released, discharged or disposed of which, on or prior to the Closing date, have impacted the Property or the Assets or (C) the Release or threatened Release of any Hazardous Materials on, from or under any other property where, prior to the Closing Date, Hazardous Materials are or were Released, threatened to be Released, discharged or disposed of in connection with disposal activities related to the Properties or the Assets, whether or not, in any case covered by this clause (ii), such Release, threatened Release, discharge or disposal was in compliance with Environmental Law; (iii) the violation prior to the Closing of any Environmental Law in effect prior to the Closing by KCS or KCSR, any of their Subsidiaries or any other Person in connection with the Properties or the Assets; and (iv) any Environmental Claim relating to the Properties or the Assets against any Person whose liability for such Environmental Claim KCS, KCSR or any of their respective Subsidiaries has retained or assumed either contractually or by operation of Law.

(c) KCS and KCSR shall have no obligation to indemnify the NS Indemnified Parties under Section 12.2(a)(i)(A) until the NS Indemnified Parties have suffered Damages in excess of \$2,000,000 in the aggregate, and then KCS and KCSR will be obligated to indemnify the NS Indemnified Parties for Damages only in excess of such amount, but KCS and KCSR shall not be liable for indemnification under Section 12.2(a)(i)(A) for Damages in excess of \$300,000,000 in the aggregate; provided, that such \$2,000,000 threshold shall not apply to any Damages arising from any breach of any representation or warranty in Section 8.10. If KCS and KCSR are obligated to indemnify the NS Indemnified Parties, then KCS and KCSR may, at their election, (i) pay such indemnification directly to the NS Indemnified Parties or the Company Indemnified Parties, as the case may be, (ii) pay any Damages arising from any liability or any Third Party Claim directly to the applicable third party (to the extent that such Damages are owed to such third party), or (iii) contribute amounts to the Company and cause the Company to pay any Damages arising from any liability or any Third Party Claim directly to the applicable third party (to the extent that such Damages are owed to such third party); provided, that the foregoing shall not limit in any way the obligation of KCS and KCSR to satisfy all such indemnification obligations.

(d) Except for fraud, injunctive and provisional relief and remedies that cannot be waived as a matter of Law, if the Closing occurs, this Section 12.2 shall be the exclusive remedy for any breach of any of KCS' or KCSR's representations and warranties or any breach of KCS' or KCSR's covenants contained in this Agreement.

12.3 Indemnification by NS

(a) NS shall indemnify, save and hold harmless KCS and its Affiliates, and each of their respective officers, directors, employees and agents and each of their respective successors and assigns, from and against any and all Damages incurred in connection with, arising out of, resulting from or incident to: (i) any breach of or any inaccuracy in any of, the representations or warranties of NS in this Agreement (in each case, solely for the purpose of calculating the amount of Damages, without regard to any qualification or limitation with respect to "materiality," whether by reference to "material," "in all material respects" or "Material Adverse Effect"); or (ii) any breach or default in covenants or agreements made by NS in this Agreement.

(b) Except for fraud, injunctive and provisional relief and remedies that cannot be waived as a matter of Law, if the Closing occurs, this Section 12.3 shall be the exclusive remedy for any breach of any of NS' representations and warranties or any breach of NS' covenants

contained in this Agreement.

12.4 Notification of Claims

. A party entitled to indemnification under Sections 12.2 or 12.3 (an "Indemnified Party") shall notify the other party (the "Indemnifying Party") within a reasonable period of time after becoming aware of any Damages which the Indemnified Party shall have determined has given or could give rise to a claim for indemnification under Sections 12.2 or 12.3 hereof. Such notice shall include an estimate of the Damages that the Indemnified Party has determined may be incurred to the extent then known or reasonably determinable. The failure to so notify the Indemnifying Party will not relieve the Indemnifying Party of any liability that it may have to any Indemnified Party, except to the extent of any prejudice to the Indemnifying Party resulting from such delay. As soon as practicable after the date of such notice, the Indemnified Party shall provide to the Indemnifying Party all information and documentation necessary to support and verify the Damages so claimed and the Indemnifying Party and its agents shall be given access to all books and records in the possession or control of the Indemnified Party which the Indemnifying Party reasonably determines to be related to such claim.

12.5 Matters Involving Third Parties .

(a) If any third party shall commence an Action against any Indemnified Party with respect to any matter (a "Third Party Claim") which may give rise to a claim for indemnification under Sections 12.2 or 12.3, or if an Indemnified Party otherwise becomes aware that a Third Party Claim may be asserted against the Indemnified Party, the Indemnified Party shall notify the Indemnifying Party in writing as soon as practicable. The failure to so notify the Indemnifying Party will not relieve the Indemnifying Party of any liability that it may have to any Indemnified Party, except to the extent of any prejudice to the Indemnifying Party resulting from such delay. If the Indemnifying Party notifies the Indemnified Party that it does not dispute the claim, or fails to notify the Indemnified Party within 30 days after delivery of such notice by the Indemnified Party whether the Indemnifying Party disputes the claim, all Damages incurred in connection with, arising out of, resulting from or incident to such Third Party Claim will be conclusively deemed a liability of the Indemnifying Party and the Indemnifying Party shall pay the amount of such Damages to the Indemnified Party promptly upon the final determination thereof.

(b) If the Indemnifying Party does not respond to the notice or elects not to assume the defense of such claim or demand, in each case within the period allowed after delivery of the notice, the Indemnified Party shall have the right to defend such claim or demand by appropriate proceedings or to settle or pay any such claim or demand for such an amount as the Indemnified Party shall deem appropriate, in either case at the sole cost and expense of the Indemnifying Party, provided that the Indemnified Party shall not settle any such claim without the prior written consent of the Indemnifying Party, which consent will not be unreasonably withheld, conditioned or delayed. In the event that the Indemnifying Party does not assume the defense of such claim or demand, the Indemnifying Party shall have the right to participate in such defense (including with counsel of its choice), at its own expense, and the Indemnified Party shall reasonably cooperate with the Indemnifying Party in connection with such participation.

(c) If the Indemnifying Party notifies the Indemnified Party that it desires to defend against such claim or demand, then the Indemnifying Party shall be entitled to participate in or, at the Indemnifying Party's option, assume at its own cost and expense the defense of any such claim or demand with counsel of its own choosing (which shall be reasonably acceptable to the Indemnified Party), provided, that, if the Indemnifying Party assumes the defense of such claim or demand it shall reimburse the Indemnified Party for out of pocket expenses incurred by the Indemnified Party (such as travel costs, but not internal time charges) and the Indemnified Party (i) shall reasonably cooperate with the Indemnifying Party; and (ii) may elect to participate in any such defense at its sole cost and expense, but the control of such defense and its settlement or resolution shall rest with the Indemnifying Party. In the event there is a significant conflict of interest between the Indemnified Party and the Indemnifying Party in the conduct of the defense of such claim or demand, the reasonable fees and disbursements of one counsel of the Indemnified Party shall be at the expense of the Indemnifying Party. The Indemnifying Party shall not compromise or settle any such claim or demand without the prior written consent of the Indemnified Party (which consent shall not be unreasonably withheld, conditioned or delayed), unless such settlement or compromise does not subject the Indemnified Party to any monetary liability, will not impose on the Indemnified Party any obligation, admission, restriction or further Damages and includes a complete, unconditional release of the Indemnified Party from all liability with respect to such claim or demand.

(d) In all cases the Indemnified Party and the Indemnifying Party shall keep each other reasonably informed as to all matters concerning any Third Party Claim and shall promptly notify the other party in writing of any and all significant developments relating thereto.

12.6 Taxes

. If any indemnity payment pursuant to this Article 12 is determined to be taxable to any Indemnified Party by any Governmental Authority, the indemnity payment shall be increased by such amount as is necessary so that, after taking into account the Tax liability imposed upon such Indemnified Party upon receipt of such indemnity payment, the Indemnified Party receives an amount equal to the amount it would have received had such indemnity payment not been subject to Tax (after taking into account, in accordance with Section 12.7(a), any Tax benefits and/or insurance coverage that may be available to the Indemnified Party).

12.7 Other Limits on Indemnification

(a) The amount of any Damages sustained by a Indemnified Party shall be reduced (i) by any amount received by such Indemnified Party with respect thereto under any insurance coverage relating thereto (other than insurance coverage provided by an Affiliate (other than Company) of such indemnitee) or from any other party alleged to be responsible therefor and (ii) by the amount of any Tax benefit actually realized with respect to the Damages. An Indemnified Party shall use its commercially reasonable efforts to collect any amounts available under such insurance coverage and from such other party alleged to have responsibility and to realize any Tax benefit with respect to the Damages. If an Indemnified Party realizes a Tax benefit or receives an amount under insurance coverage or from such other party with

respect to Damages sustained at any time subsequent to any indemnification provided pursuant to this Article 12, then such Indemnified Party shall promptly reimburse the applicable Indemnifying Party for any payment made by such Indemnifying Party in connection with providing such indemnification up to such amount realized or received by the Indemnified Party. Nothing in this Section 12.7(a) shall limit in any way the ability of KCS, NS or the Company to (i) take (or refrain from taking, as the case may be) any reasonable position for Tax purposes that KCS, NS or the Company determines to take (or refrain from taking) in its sole discretion or (ii) refrain from pursuing any third party insurance recovery that KCS, NS or the Company, as the case may be, determines would be commercially inadvisable to pursue.

(b) Each Indemnified Party shall use its commercially reasonable efforts to mitigate any claim or liability that an Indemnified Party asserts or may assert under this Article 12. In the event that an Indemnified Party shall fail to make such commercially reasonable efforts to mitigate any such claim or liability, then notwithstanding anything contained in this Agreement to the contrary, the Indemnifying Party shall not be required to indemnify any Indemnified Party for that portion of any Damages that would reasonably be expected to have been avoided if the Indemnified Party had made such efforts.

13. Termination .

13.1 Termination by Mutual Consent

. This Agreement may be terminated at any time prior to the Closing by the mutual agreement, in writing, of each of KCS and NS.

13.2 Termination by Final Order

. This Agreement may be terminated by KCS or NS upon written notice to the other party that any final, non-appealable Law shall have been enacted, entered, promulgated or enforced by any Governmental Authority of competent jurisdiction which prohibits, restricts or makes illegal the consummation of the Closing or any of the material transactions contemplated thereby, or by the Company Agreement or any of the Ancillary Agreements; provided, that the right to terminate this Agreement under this Section 13.2 shall not be available to any party whose breach of any provision or whose failure to perform any obligation under this Agreement (or the breach or failure of any Affiliate thereof) has been the cause of such Law.

13.3 Termination by NS

. NS may (but shall not be obligated to) terminate this Agreement prior to the Closing by giving written notice to KCS if:

(a) there has been a material violation or breach by KCS or KCSR of any of their agreements or covenants contained in this Agreement or there has been a material violation or breach by KCS or KCSR of any of their representations or warranties contained in this Agreement such that it is reasonably likely that either of the conditions set forth in Section 11.2(a) or 11.2(b) cannot be satisfied, and such violation or breach shall not have been cured or corrected within twenty days after receipt of notice thereof;

(b) the Closing does not occur on or prior to September 1, 2006, or such later date as may be agreed to in writing by the parties; provided, that, notwithstanding the satisfaction of the other conditions set forth in Sections 11.1 and 11.2 (other than any conditions which, by their terms, may only be satisfied on the Closing Date) if any of the Required Governmental Consents required by Section 11.1(c) have not been obtained by such date, such date shall be extended in additional one-month increments without any further action by the parties through February 1, 2007; and, provided, further, that the non-occurrence of the Closing is not due to a breach by NS of any condition or covenant hereunder;

(c) there has been imposed by a Governmental Authority a condition to any Required Governmental Consent, which condition is not acceptable to NS in NS' reasonable judgment; or

(d) there has been a Material Adverse Effect on KCS or KCSR which shall not have been cured or corrected within twenty days after receipt of notice thereof; provided that such Material Adverse Effect is not due to a breach by NS of any condition or covenant hereunder.

13.4 Termination by KCS

. KCS may (but shall not be obligated to) terminate this Agreement prior to the Closing by giving written notice to NS if:

(a) there has been a material violation or breach by NS of any of its respective agreements or covenants contained in this Agreement or there has been a material violation or breach by NS of any of its representations or warranties contained in this Agreement such that it is reasonably likely that either of the conditions set forth in Section 11.3(a) and (b) cannot be satisfied, and such violation or breach shall not have been cured or corrected within twenty days after receipt of notice thereof;

(b) the Closing does not occur on or prior to September 1, 2006, or such later date as may be agreed to in writing by the parties; provided, that, notwithstanding the satisfaction of the other conditions set forth in Sections 11.1 and 11.3 (other than any conditions which, by their terms, may only be satisfied on the Closing Date) if any of the Required Governmental Consents required by Section 11.1(c) have not been obtained by such date, such date shall be extended in additional one-month increments without any further action by the parties through February 1, 2007; and, provided, further, that the non-occurrence of the Closing is not due to a breach by KCS or KCSR of any condition or covenant hereunder;

(c) there has been imposed by a Governmental Authority a condition to any Required Governmental Consent, which condition is not acceptable to KCS in KCS' reasonable judgment; or

(d) there has been a Material Adverse Effect on NS or AGS which shall not have been cured or corrected within twenty days after receipt of notice thereof; provided that such Material Adverse Effect is not due to a breach by KCS or KCSR of any condition or covenant

hereunder.

13.5 Effect of Termination

. In the event of the termination of this Agreement as permitted by this Article 13, no party shall have any obligation under, or liability to any other in respect to, this Agreement, except with respect to, any willful breach of this Agreement that gives rise to such termination and except for the provisions of the Confidentiality Agreement and the confidentiality obligations contained in Section 10.2(a), this Section 13.5 and Article 14 hereof, which shall survive the termination of this Agreement.

14. Miscellaneous .

14.1 Notices

. All notices, requests, demands and other communications (collectively, "Notices") given pursuant to this Agreement shall be in writing, and shall be delivered by personal service, courier, overnight delivery service, facsimile transmission (which must be confirmed) or by United States registered or certified mail, postage prepaid, return receipt requested, to the following addresses:

(i) if to NS, to:

Norfolk Southern Corporation
Three Commercial Place
Norfolk, Virginia 23510
Facsimile No.: (757) 533-4872
Attn: James A. Squires, Esq.

with a copy to:

Skadden, Arps, Slate, Meagher & Flom LLP
4 Times Square
New York, New York 10036-6522
Facsimile No.: (212) 735-2000
Attn: Eric J. Friedman, Esq.

(ii) if to KCS or KCSR, to:

Kansas City Southern
427 West 12th Street
Kansas City, Missouri 64105
Facsimile No.: (816) 983-1227
Attn: Robert B. Terry, Esq.

with a copy to:

Sonnenschein Nath & Rosenthal LLP
4520 Main Street, Suite 1100
Kansas City, MO 64111
Facsimile No.: (816) 531-7545
Attn: John F. Marvin, Esq.

Any Notice, other than a Notice sent by registered or certified mail, shall be effective when received; a Notice sent by registered or certified mail, postage prepaid return receipt requested, shall be effective on the earlier of when received or the third day following deposit in the United States mails. Any party may from time to time change its address for further Notices hereunder by giving notice to the other parties in the manner prescribed in this Section.

14.2 Entire Agreement

. This Agreement, the Company Agreement, the Ancillary Agreements and the Confidentiality Agreement, in each case including any attached exhibits and schedules, contain the sole and entire agreement and understanding of the parties with respect to the entire subject matter of this Agreement, and any and all prior discussions, negotiations, commitments and understandings, whether oral or otherwise, related to the subject matter of this Agreement are hereby merged herein. Nothing in this Agreement, express or implied, is intended to confer upon any Person other than the parties hereto any rights or remedies under or by way of this Agreement.

14.3 Assignment

. No party may assign its rights or obligations under this Agreement, and any attempted or purported assignment or any delegation of any party's duties or obligations arising under this Agreement to any third party or entity shall be deemed to be null and void, and shall constitute a material breach by such party of its duties and obligations under this Agreement; provided that NS may assign its rights to any wholly-owned Subsidiary of NS.

14.4 Extension, Waiver and Amendment

. At any time prior to the Closing, the parties hereto may (a) extend the time for the performance of any of the obligations or other acts of any other party hereto, (b) waive any inaccuracies in the representations and warranties of any other party hereto contained herein or in any document delivered pursuant hereto, and (c) waive compliance by any other party hereto with any of the agreements or conditions contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid if set forth in writing in an instrument signed by or on behalf of such party. The waiver by any party hereto of a breach of this Agreement shall not operate or be construed as a waiver of any subsequent breach. This Agreement may be amended only by a written agreement executed by all of the parties to this Agreement.

14.5 Governing Law ; Submission to Jurisdiction .

(a) THE LAWS OF THE STATE OF DELAWARE SHALL GOVERN THE VALIDITY OF THIS AGREEMENT, THE CONSTRUCTION OF ITS TERMS AND THE INTERPRETATION OF THE RIGHTS AND DUTIES ARISING HEREUNDER.

(b) Subject to Section 14.13, each of the parties hereto (i) consents to submit itself to the exclusive jurisdiction of any Federal or state court located in the State of Delaware (the "Delaware Courts") in any action to enforce or in aid of the agreement to arbitrate in Section 14.13 herein or for provisional relief to maintain the status quo or prevent irreparable harm pending the appointment of the arbitrators, and to the non-exclusive jurisdiction of the Delaware Courts for enforcement of any award issued hereunder (ii) will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court, and (iii) waives any objection based on forum non conveniens or any other objection to venue thereof.

14.6 Specific Performance; Injunctive Relief

. Each of the parties hereto acknowledges, understands and agrees that any breach or threatened breach by such party or such party's Affiliates of the covenants contained herein will cause irreparable injury to the other party and that money damages will not provide an adequate remedy therefor. Accordingly, in the event of any such breach or threatened breach, a non-breaching party shall have the right and remedy (in addition to any other rights or remedies available at Law or in equity, including, money damages), subject to the provisions of Section 14.13, to have the provisions of this Agreement specifically enforced by, and to seek injunctive relief and other equitable remedies in, any court having competent jurisdiction. Each party further agrees to waive any requirement for the securing or posting of any bond or other security in connection with seeking such remedies.

14.7 Severability

. Whenever possible each provision of this Agreement shall be interpreted in such manner as to be effective and valid under applicable Law, but if any provision of this Agreement shall be or become prohibited or invalid under applicable Law, such provision shall be ineffective to the extent of such prohibition or invalidity without invalidating the remainder of such provision or the remaining provisions of this Agreement.

14.8 Captions

. The various captions of this Agreement are for reference only and shall not be considered or referred to in resolving questions of interpretation of this Agreement.

14.9 Counterparts

. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same instrument.

14.10 Costs and Attorneys' Fees

. Whether or not the transactions contemplated hereby are consummated, each of the parties shall bear and pay all costs and expenses incurred by it or on its behalf in connection with the transactions contemplated hereunder, including fees and expenses of its own financial or other consultants, investment bankers, accountants and counsel.

14.11 Judicial Interpretation

. Should any provision of this Agreement require judicial interpretation, it is agreed that a court or other tribunal, as described in Section 14.13, interpreting or construing the same shall not apply a presumption that the terms hereof shall be more strictly construed against any

Person by reason of the rule of construction that a document is to be construed more strictly against the Person who itself or through its agent prepared the same, it being agreed that all parties have participated in the preparation of this Agreement.

14.12 No Third Party Beneficiaries

. Except as expressly provided in this Agreement, this Agreement shall not benefit or create any right or cause of action in or on behalf of any Person other than the parties hereto; provided, however, that this Agreement will be binding upon, inure to the benefit of, and be enforceable by, the parties and their respective successors and permitted assigns.

14.13 Dispute Resolution

. Each of the parties hereto stipulates and agrees that any dispute controversy or claim, arising out of or relating to this Agreement or the breach, termination or validity thereof ("Dispute") that is not resolved by negotiations between senior officers of the parties within twenty (20) days after receipt by a party of written notice ("Dispute Notice") of such Dispute, will be submitted to mediation in accordance with the Commercial Mediation Procedures of the American Arbitration Association ("AAA"). If such dispute is not resolved within twenty (20) days after appointment of a mediator, or within sixty (60) days of receipt of Dispute Notice (whichever comes sooner), each of the parties hereto agrees that, at the demand of any party, such Dispute will be submitted to mandatory and binding arbitration before the AAA, in New York, New York by three arbitrators, under the Commercial Arbitration Rules and the Large Complex Case Procedures of the AAA then in effect (the "Rules"), under the following terms and conditions:

- (a) Selection of Arbitrators. A panel of three independent arbitrators shall be appointed by the AAA using the listing, ranking and striking procedure in the Rules. Any arbitrator appointed by the AAA shall be a retired judge or a practicing attorney with no less than fifteen years of experience with large commercial cases and an experienced arbitrator.
- (b) Conduct of Arbitration. The arbitration shall be held and the award shall be issued in New York, New York. In addition to Damages, the arbitral tribunal may award any remedy provided for under applicable Law and the terms of this Agreement, including, without limitation, specific performance or other forms of injunctive relief. The arbitrators shall apply the Law of the State of Delaware to the substance of the Dispute and will have no power or authority, under the rules of the AAA or otherwise, to amend or disregard any provision of this Agreement.
- (c) Replacement of Arbitrator(s). Should any of the arbitrator(s) refuse or be unable to proceed with arbitration proceedings, replacement arbitrator(s) will be selected using the same method of selection as the original arbitrator(s).
- (d) Findings and Conclusions. The arbitrators will, after reaching judgment and award, prepare and distribute to the parties a written award including the findings of fact and conclusions of Law relevant to such award and containing an opinion setting forth the reasons for the giving or denial of any award.
- (e) Time is of the Essence. The arbitrators are hereby instructed that time is of the essence in the arbitration proceeding, and that the arbitrators will have the right and authority to issue monetary sanctions against any party if, upon a showing that such party is unreasonably delaying the proceeding.
- (f) Temporary Equitable Relief. By agreeing to arbitration, the parties do not intend to deprive any Delaware Court of its jurisdiction to issue a pre-arbitral injunction, pre-arbitral attachment, or other order in aid of arbitration proceedings and the enforcement of any award. Without prejudice to such provisional remedies as may be available under the jurisdiction of a Delaware Court, the arbitral tribunal shall have full authority to grant provisional remedies and to direct the parties to request that any court modify or vacate any temporary or preliminary relief issued by such court, and to award Damages for the failure of any party to respect the arbitral tribunal's orders to that effect.
- (g) Consolidation. The parties hereto are committed to the prompt and efficient resolution of disputes. Accordingly, if one or more disputes arises under this Agreement, the Company Agreement or any of the Ancillary Agreements such disputes may be brought in a single arbitration. If more than one arbitration is brought with respect to disputes under this Agreement, the Company Agreement or any of the Ancillary Agreements, then any party hereto may request that any arbitration or any new dispute arising under this Agreement, the Company Agreement or any of the Ancillary Agreements be consolidated into any prior arbitration. The new dispute or arbitration shall be so consolidated, provided that the arbitral tribunal for the prior (or first filed) arbitration determines that (i) the new dispute or arbitration presents significant issues of Law or fact common with those in the pending arbitration; (ii) no party would be unduly prejudiced and (iii) consolidation under such circumstances would not result in undue delay for the prior arbitration. Any order of consolidation issued by such arbitral tribunal shall be final and binding upon the parties. Unless the parties otherwise agree, the arbitral tribunal appointed first in time shall serve as the arbitral tribunal for the consolidated arbitration. The parties waive any right they have to appeal or to seek interpretation, revision or annulment of such order of consolidation under the Rules or in any court. The parties hereto agree that upon such an order of consolidation, they will promptly dismiss any arbitration brought under this Agreement, the subject of which has been consolidated into another arbitral proceeding.
- (h) Discovery. Recognizing the express desire of the parties for an expeditious means of dispute resolution, the arbitrators will allow for limited discovery as may be reasonable under the circumstances.
- (i) Costs and Attorneys' Fees. Notwithstanding any rule of the AAA to the contrary, the arbitrators rendering judgment under this Section 14.13 will have the power to award the costs of the arbitration, including reasonable attorneys' fees and expenses to the prevailing party or parties in the arbitration. In any action to enforce this agreement to arbitrate or any arbitral award rendered hereunder, the court may award costs and attorneys' fees against the party resisting enforcement.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KANSAS CITY SOUTHERN

By: _____

Name: Michael R. Haverty

Title: Chairman, President and Chief Executive Officer

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

By: _____

Name: Michael R. Haverty

Title: Chairman of the Board

NORFOLK SOUTHERN CORPORATION

By: _____

Name: C. W. Moorman

Title: President and Chief Executive Officer

THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY

By: _____

Name: James A. Squires

Title: Vice President

Schedule 2.1(a)

1. Calculation of NS Interest. On the Closing Date and each Anniversary Date (each, an "Issuance Date"), KCS and NS shall cause the Company to issue and sell to AGS, and NS shall cause AGS to purchase from the Company, in exchange for cash consideration in an amount equal to the Capital Contribution Amount calculated in respect of such Issuance Date (in each case, the "NS Consideration" and, together with any NS Consideration previously paid to the Company in accordance with Sections 2.1(a) and 2.1(b), the "Aggregate NS Consideration") set forth in the applicable Officer's Certificate, a membership interest in the Company such that, upon the issuance thereof, the NS Interest will be a percentage equal to the quotient, rounded to four decimal places, of (a) the Aggregate NS Consideration, divided by (b) \$1,000,000,000; it being understood that the Aggregate NS Consideration shall in no event exceed \$300,000,000.

2. Calculation of KCS Interest. On each Issuance Date, KCS' percentage interest in the Company will be adjusted to be equal to (1) 100% less (2) the NS Interest.

3. Adjustment of Capital Accounts. The Capital Accounts (as such term is defined in the Company Agreement) of the NS Member (as such term is defined in the Company Agreement) will be established (in the case of the Closing Date) or adjusted on a dollar-for-dollar basis in accordance with Section 2.2 of the Company Agreement to reflect each payment of NS Consideration pursuant to Section 1 of this Schedule 2.1(a).

**AMENDMENT NO. 1 TO
TRANSACTION AGREEMENT**

THIS AMENDMENT NO. 1 TO TRANSACTION AGREEMENT (this "Amendment"), is made and entered into as of January 17, 2006, by and among KANSAS CITY SOUTHERN, a Delaware corporation ("KCS"), THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Missouri corporation ("KCSR"), NORFOLK SOUTHERN CORPORATION, a Virginia corporation ("NS"), and THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY, an Alabama corporation and Subsidiary of NS ("AGS"), with reference to the following facts:

- A.** KCS, KCSR, NS and AGS are parties to that certain Transaction Agreement entered into as of December 1, 2005 (the "Transaction Agreement"), pursuant to the terms of which the parties thereto have agreed to form a joint venture for purposes of owning and operating certain Assets.
- B.** The Transaction Agreement and the related Company Agreement to be entered into at Closing contemplated that KCS will make certain capital improvements to the Line after the Closing and NS has agreed to contribute certain amounts to the Company, among other things, to pay for such improvements.
- C.** KCS has determined those capital improvements to the Line set forth on Exhibit D of the Company Agreement will be undertaken in advance of the Closing as part of its 2006 infrastructure program and irrespective of the transaction among the parties to the Transaction Agreement. The parties have determined that it is in the best interest of all parties for KCS to begin making such capital improvements to the Line prior to the Closing. Further, the parties have determined that, should all Required Governmental Consents be obtained, including the approval of the United States Surface Transportation Board, these capital projects should be eligible to be reimbursed from the proceeds of the transactions contemplated by the Transaction Agreement. In order to do so, the Transaction Agreement and the form of Company Agreement attached as Exhibit A hereto must each be amended such that KCS will be reimbursed by the Company following Closing for making such capital improvements to the Line prior to Closing.

NOW, THEREFORE, with reference to the foregoing facts and in consideration of the mutual agreements and understanding set forth herein, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Defined Terms.

Capitalized terms used herein but not otherwise defined herein shall have the meaning assigned to such terms in the Transaction Agreement.

2. Amendments.

2.1 Section 1 of the Transaction Agreement is hereby amended by inserting the following new definitions therein in the appropriate alphabetical order:

"**Budget**" shall have the meaning given to that term in the Company Agreement.

"**Business Plan**" shall have the meaning given to that term in the Company Agreement.

"**Fiscal Year**" shall have the meaning given to that term in the Company Agreement.

"**Pre-Closing Capital Expenditures**" shall have the meaning given to that term in the Company Agreement.

2.2 Section 2.2 of the Transaction Agreement is hereby amended by deleting the first and second sentences thereof and inserting in lieu thereof the following two new sentences:

"KCS and NS shall cause the Company to use \$260,000,000 (less any Pre-Closing Capital Expenditures for which the Company reimburses KCS pursuant to clause (b) of the following sentence) of the proceeds from the sale of the NS Interest plus any interest earned thereon from time to time (the "Capital Proceeds") for the capital expenditures anticipated to be made in accordance with the Company Agreement and the Budgets (including any Rollover Budgets) and Business Plans (as each such term is defined in the Company Agreement) for the Company contemplated thereby. KCS and NS shall cause at Closing (a) up to \$40,000,000 of the proceeds from the sale of the NS Interest to be paid to reimburse KCS for capital expenditures other than Pre-Closing Capital Expenditures made by KCS on the Line within the two-year period ending on the Closing Date (none of which shall have been made in anticipation of this Agreement) as presented on a schedule delivered to NS prior to the Closing Date, which schedule shall be final and binding on NS if it accurately sets forth expenditures made in accordance with the principles expressed in this sentence (the difference between \$40,000,000 and such reimbursement shall be the "Excess Proceeds"), (b) up to \$20,000,000 of the proceeds from the sale of the NS Interest equal to the Pre-Closing Capital Expenditures to be paid to reimburse KCS for Pre-Closing Capital Expenditures made by KCS prior to the Closing Date in respect of the Proposed Capital Projects listed in Exhibit D to the Company Agreement as set forth in the Company Agreement, the Budget for the first Fiscal Year and the Business Plan for the first Fiscal Year, which amount shall be presented on a schedule delivered to NS prior to the Closing Date, which schedule shall be final and

binding on NS if it accurately sets forth expenditures made in accordance with the principles set forth in this sentence, and (c) the Excess Proceeds and any portion of the Capital Proceeds not allocated at such time for capital expenditures in accordance with the then current Budget or any Rollover Budget, as the case may be, and Business Plan (in the aggregate, the "Excess Capital") to be made available by the Company to provide the Partner Financing pursuant to Article 4 below.

2.3 Section 3.1(a) of the Transaction Agreement is hereby amended by deleting the first sentence thereof and inserting in lieu thereof the following new first sentence:

"Subject to the terms and conditions of this Agreement, at the Closing, KCS and KCSR shall , and shall cause their respective Subsidiaries, as applicable, to, transfer, convey, assign and delivery to the Company, all of their respective right, title and interest in the Assets, free and clear of all Liens other than Permitted Liens, and in exchange for the Assets, KCS and NS shall cause the Company to issue to KCS a membership interest in the Company determined in accordance with Section 2.1(a) (as adjusted pursuant to Section 2.1(b) and together with the Preferred Return, the "KCS Interest").

2.4 Exhibit A to the Transaction Agreement is hereby amended by amending and restating such Exhibit in its entirety to read as set forth on Exhibit A attached hereto.

2.5 Section 8.1 of the Transaction Agreement is hereby amended by inserting the following new third sentence:

"Since the date of its formation, the Company has been a wholly-owned subsidiary of KCS and has not (i) engaged in any business, (ii) conducted any operations, (iii) incurred any liabilities or (iv) entered into any agreements or arrangements, other than, in each case, in connection with the letter agreement by and between KCS and NS dated January 17, 2006, this Agreement and the transactions contemplated by this Agreement."

3. Limitation of Amendments.

The amendments set forth in Section 2 above are effective for the purposes set forth herein and will be limited precisely as written and will not be deemed to (a) be a consent to any amendment, waiver or modification of any other term or condition of the Transaction Agreement, (b) otherwise prejudice any right or remedy that any party to the Transaction Agreement may now have or may have in the future under or on in connection with the Transaction Agreement, or (c) be a consent to any future amendment, waiver or modification of any other term or condition of the Transaction Agreement.

4. Entire Agreement.

This Amendment, together with the Transaction Agreement, the Company Agreement, the Ancillary Agreements and the Confidentiality Agreement, in each case including any attached exhibits and schedules, contain the sole and entire agreement and understanding of the parties with respect to the entire subject matter contained herein and therein, and any and all prior discussions, negotiations, commitments and understandings, whether oral or otherwise, related to the subject matter contained herein and therein are hereby merged herein and therein. Nothing in this amendment, express or implied, is intended to confer upon any Person other than the parties hereto any rights or remedies under or by way of this Amendment.

5. Assignment.

No party may assign its rights or obligations under this Amendment, and any attempted or purported assignment or any delegation of any party's duties or obligations arising under this Amendment to any third party or entity shall be deemed to be null and void, and shall constitute a material breach by such party of its duties and obligations under this Amendment; provided that NS may assign its rights to any wholly-owned Subsidiary of NS.

6. Governing Law.

THE LAWS OF THE STATE OF DELAWARE SHALL GOVERN THE VALIDITY OF THIS AMENDMENT, THE CONSTRUCTION OF ITS TERMS AND THE INTERPRETATION OF THE RIGHTS AND DUTIES ARISING HEREUNDER.

7. Severability.

Whenever possible each provision of this Amendment shall be interpreted in such manner as to be effective and valid under applicable Law, but if any provision of this Amendment shall be or become prohibited or invalid under applicable Law, such provision shall be ineffective to the extent of such prohibition or invalidity without invalidating the remainder of such provision or the remaining provisions of this Amendment.

8. Captions.

The various captions of this Amendment are for reference only and shall not be considered or referred to in resolving questions of interpretation of this Amendment.

9. Counterparts.

This Amendment may be executed in any number of counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same instrument.

10. Judicial Interpretation.

Should any provision of this Amendment require judicial interpretation, it is agreed that a court or other tribunal, as described in Section 14.13 of the Transaction Agreement, interpreting or construing the same shall not apply a presumption that the terms hereof shall be more strictly construed against any Person by reason of the rule of construction that a document is to be construed more strictly against the Person who itself or through its agent prepared the same, it being agreed that all parties have participated in the preparation of this Amendment.

11. Dispute Resolution.

Each of the parties hereto stipulates and agrees that the dispute resolution procedures set forth in Section 14.13 of the Transaction Agreement shall apply to any dispute, controversy or claim arising out of or relating to this Amendment or the breach, termination or validity thereof.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have executed this Amendment No. 1 to Transaction Agreement as of the date first above written.

KANSAS CITY SOUTHERN

By: _____

Name: Michael R. Haverty

Title: Chairman, President and Chief Executive Officer

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

By: _____

Name: Michael R. Haverty

Title: Chairman of the Board

NORFOLK SOUTHERN CORPORATION

By: _____

Name: Kathryn B. McQuade

Title: Executive Vice President Planning and Chief Information Officer

THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY

By: _____

Name: James A. Squires

Title: Vice President

EXHIBIT A
COMPANY AGREEMENT

[See Attached]

Exhibit 12, Page 1 of 1

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Computation of Ratio of Earnings to Fixed Charges

(Millions of Dollars)

	Year ended December 31,				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
EARNINGS					
Income from continuing operations before income taxes as reported	\$ 1,697	\$ 1,302	\$ 586	\$ 706	\$ 553
Add (subtract):					
Total interest expenses (as detailed below)	552	567	609	663	674
Amortization of capitalized interest	5	5	5	6	5
Income of partially owned entities (1)	(61)	(58)	46	36	39
Subsidiaries' preferred dividend requirements	--	--	--	2	2
Total earnings	\$ 2,193	\$ 1,816	\$ 1,246	\$ 1,413	\$ 1,273
FIXED CHARGES					
Interest expense on debt	\$ 494	\$ 489	\$ 497	\$ 518	\$ 553
Other interest expense	6	18	5	32	2
Calculated interest portion of rent expense	52	45	39	40	41
NS' share of Conrail interest	--	15	68	73	78
Total interest expenses	552	567	609	663	674
Capitalized interest	11	10	12	11	17
Subsidiaries' preferred dividend requirement on a pretax basis	--	--	--	4	4
Total fixed charges	\$ 563	\$ 577	\$ 621	\$ 678	\$ 695
RATIO OF EARNINGS TO FIXED CHARGES	3.90	3.15	2.01	2.08	1.83

(1) Includes: (a) the distributed income of equity investees, net of equity earnings included in income from continuing operations before income taxes as reported and the minority income of consolidated entities which have fixed charges; and, for the periods before the Conrail Corporate Reorganization, (b) NS' share of Conrail's income before income taxes, net of equity in earnings of Conrail included in NS' income from continuing operations before taxes as reported.

The computations do not include \$0.3 million of interest expense related to \$7.8 million of debt guaranteed for a less than 50% owned entity.

CONSOLIDATED (MORE THAN 50% OWNED) SUBSIDIARIES

OF NORFOLK SOUTHERN CORPORATION AND STATES OF INCORPORATION

AS OF NOVEMBER 1, 2005

State or Country

of Incorporation

Atlantic Acquisition Corporation	Pennsylvania
Atlantic Investment Company	Delaware
General American Insurance Company	Vermont
General Security Insurance Company, Ltd.	Bermuda
Norfolk Southern Properties, Inc.	Virginia
Norfolk Southern Railway Company	Virginia
NS Fiber Optics, Inc.	Virginia
PDC Timber LLC	Delaware
Pennsylvania Investment Company, Inc.	Delaware
PLC Timber LLC	Delaware
Pocahontas Development Corporation	Kentucky
Pocahontas Land Corporation	Virginia
Scioto Fuels, LLC	Virginia
T-Cubed of North America, LLC	Delaware
Thoroughbred Funding, Inc.	Virginia
Thoroughbred Technology and Telecommunications, Inc.	Virginia

Norfolk Southern Railway Company Subsidiaries

Airforce Pipeline, Inc.	North Carolina
Alabama Great Southern LLC	Virginia
Alabama Great Southern Railroad Company, The	Alabama
Camp Lejeune Railroad Company	North Carolina
Central of Georgia LLC	Virginia
Central of Georgia Railroad Company	Georgia
Chesapeake Western Railway	Virginia
Cincinnati, New Orleans and Texas Pacific Railway Company, The	Ohio
Citico Realty Company	Virginia
Georgia Southern and Florida Railway Company	Georgia

High Point , Randleman, Asheboro and Southern Railroad Company	North Carolina
Interstate Railroad Company	Virginia
Lamberts Point Barge Company, Inc.	Virginia
Mobile and Birmingham Railroad Company	Alabama
Norfolk and Portsmouth Belt Line Railroad Company	Virginia
Norfolk Southern International, Inc.	Virginia
Norfolk Southern - Mexico , LLC	Virginia
NorfolkSouthernMexicana , S. de R.L. de C.V.	Mexico
North Carolina Midland Railroad Company, The	North Carolina
PLS Investment, LLC	Virginia
Rail Investment Company	Delaware

Reading Company, LLC (Delaware)	Delaware
Reading Company, LLC (Virginia)	Virginia
Shenandoah-Virginia Corporation	Virginia
South Western Rail Road Company, The	Georgia
Southern Rail Terminals, Inc.	Georgia
Southern Rail Terminals of North Carolina, Inc.	North Carolina
Southern Region Coal Transport, Inc.	Alabama
Southern Region Materials Supply, Inc.	Georgia
State University Railroad Company	North Carolina
TCS Leasing, Inc.	Oklahoma
TCV, Inc.	Delaware
Tennessee , Alabama & Georgia Railway Company	Delaware
Tennessee Railway Company	Tennessee
Thoroughbred Direct Intermodal Services, Inc.	Pennsylvania
Transworks Company	Indiana
Transworks , Inc.	Virginia
Transworks of Indiana, Inc.	Indiana
Triple Crown Services Company	--
Virginia and Southwestern Railway Company	Virginia
Wheelersburg Terminal LLC	Virginia
Yadkin Railroad Company	North Carolina

Norfolk Southern Properties, Inc. Subsidiaries:

Alexandria-Southern Properties, Inc.	Virginia
Arrowood -Southern Company	North Carolina
Charlotte-Southern Hotel Corporation	North Carolina
Lambert's Point Docks, Incorporated	Virginia
Nickel Plate Improvement Company, Inc., The	Indiana
Norfolk Southern Tower, L.L.C.	Virginia
Northmont Limited Partnership	Georgia
NS-Charlotte Tower Corporation	North Carolina
NS Transportation Brokerage Corporation	Virginia
Sandusky Dock Corporation	Virginia
Southern Region Industrial Realty, Inc.	Georgia
SRIR Timber, L.L.C.	Delaware
Virginia Holding Corporation	Virginia

In addition, NS owns direct or indirect equity interest in:

Conrail Inc.

Consolidated Rail Corporation and its consolidated subsidiaries

CRR Holdings LLC

Delaware Otsego Corporation

DOCP Acquisition, LLC

Green Acquisition Corp.

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Norfolk Southern Corporation:

We consent to the incorporation by reference in Registration Statements Nos. 33-52031, 333-71321, 333-60722, 333-100936 and 333-109069 on Form S-8 and 333-119398 on Form S-3 of Norfolk Southern Corporation of our reports dated February 21, 2006, with respect to the consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2005 and 2004, 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, 2005, and the related financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005, and the effectiveness of internal control over financial reporting as of December 31, 2005, which reports appear in the December 31, 2005, Annual Report on Form 10-K of Norfolk Southern Corporation. Our report on the consolidated financial statements and related financial statement schedule refers to the adoption by Norfolk Southern Corporation of Financial Accounting Standards Board Statement No. 143, *Accounting for Asset Retirement Obligations*, and Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*.

/s/ KPMG LLP
Norfolk, Virginia
February 21, 2006

Consent of Independent Registered Public Accounting Firms

The Board of Directors

Norfolk Southern Corporation:

We consent to the incorporation by reference in Registration Statements Nos. 33-52031, 333-71321, 333-60722, 333-100936 and 333-109069 on Form S-8 and 333-119398 on Form S-3 of Norfolk Southern Corporation of our report dated January 27, 2004, except for note 2, as to which the date is January 21, 2005, with respect to the consolidated statements of income, stockholders' equity, and cash flows of Conrail Inc. and subsidiaries for the year ended December 31, 2003, which report appears in the December 31, 2005, Annual Report on Form 10-K of Norfolk Southern Corporation. Our report refers to the adoption by Conrail Inc. of Financial Accounting Standards Board Statement No. 143, *Accounting for Asset Retirement Obligations*.

/s/ KPMG LLP

Norfolk , Virginia

February 21, 2006

/s/ Ernst & Young LLP

Jacksonville , Florida

February 21, 2006

CERTIFICATIONS OF CEO AND CFO PURSUANT TO
EXCHANGE ACT RULE 13a-14(a) OR RULE 15d-14(a)

I, Charles W. Moorman, certify that:

1. I have reviewed this Annual Report on Form 10-K of Norfolk Southern Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: Feb. 21, 2006

/s/ Charles W. Moorman

Charles W. Moorman
Chairman, President and Chief Executive Officer

I, Henry C. Wolf, certify that:

1. I have reviewed this Annual Report on Form 10-K of Norfolk Southern Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: Feb. 21, 2006

/s/ Henry C. Wolf

Henry C. Wolf

Vice Chairman and Chief Financial Officer

CERTIFICATIONS OF CEO AND CFO REQUIRED BY RULE 13a-14(b) OR RULE 15d-14(b) AND SECTION 1350 OF CHAPTER 63 OF TITLE 18 OF THE U. S. CODE

I certify, to the best of my knowledge, that the Annual Report on Form 10-K for the year ended Dec. 31, 2005, of Norfolk Southern Corporation fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Norfolk Southern Corporation.

Signed: /s/ Charles W. Moorman
Charles W. Moorman
Chairman, President and Chief Executive Officer
Norfolk Southern Corporation

Dated: Feb. 21, 2006

I certify, to the best of my knowledge, that the Annual Report on Form 10-K for the year ended Dec. 31, 2005, of Norfolk Southern Corporation fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Norfolk Southern Corporation.

Signed: /s/ Henry C. Wolf
Henry C. Wolf
Vice Chairman and Chief Financial Officer
Norfolk Southern Corporation

Dated: Feb. 21, 2006

Annual CEO Certification

(Section 303A.12(a))

As the Chief Executive Officer of Norfolk Southern Corporation,

(Name of the Company)

and as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual, I hereby certify that as of the date hereof I am not aware of any violation by the Company of NYSE's Corporate Governance listing standards, other than has been notified to the Exchange pursuant to Section 303A.12(b) and disclosed as Exhibit H to the Company's Section 303A Annual Written Affirmation.*

By: /s/ David R. Goode
Print Name: David R. Goode
Title: Chairman and Chief Executive Officer
Date: June 7, 2005

* No violations of the NYSE's Corporate Governance listing standards were identified in the Exhibit.

Report of Independent Registered Public Accounting Firms

The Stockholders and Board of Directors

Conrail Inc.:

We have audited the accompanying consolidated statements of income, stockholders' equity and cash flows of Conrail Inc. and subsidiaries for the year ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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 the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements of Conrail Inc. and subsidiaries referred to above present fairly, in all material respects, the results of their operations and their cash flows for the year ended December 31, 2003, in conformity with U.S. generally accepted accounting principles.

As discussed in note 1 to the consolidated financial statements, effective January 1, 2003, the Company adopted Financial Accounting Standards Board Statement No. 143, *Accounting for Asset Retirement Obligations*.

The accompanying financial statements for 2005 and 2004 were not audited by us and, accordingly we do not express an opinion on them.

/s/ KPMG LLP

/s/ Ernst & Young LLP

KPMG LLP

Ernst & Young LLP

Norfolk, Virginia

Jacksonville, Florida

January 27, 2004,

except for Note 2, as to which

the date is January 21, 2005

CONRAIL INC.
CONSOLIDATED STATEMENTS OF INCOME

	<u>Years ended December 31.</u>		
	(Unaudited)	(Unaudited)	
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(\$ in millions)		
Revenues - NSC/CSX	\$ 276	\$ 255	\$ 235
Revenues - Third parties	<u>102</u>	<u>97</u>	<u>81</u>
Total operating revenues	<u>378</u>	<u>352</u>	<u>316</u>
Operating expenses			
Compensation and benefits	187	189	168
Material, services and rents	103	121	118
Depreciation and amortization	27	29	30
Casualties and insurance	9	11	16
Fuel	10	7	6
Other	<u>10</u>	<u>13</u>	<u>14</u>
Total operating expenses	<u>346</u>	<u>370</u>	<u>352</u>
Income (loss) from operations	32	(18)	(36)
Interest expense	(7)	(8)	(9)
Other income, net (Note 11)	<u>88</u>	<u>61</u>	<u>58</u>
Income from continuing operations before income taxes and accounting changes	113	35	13
Provision for income taxes (Note 8)	<u>28</u>	<u>13</u>	<u>3</u>
Income from continuing operations before accounting changes	85	22	10
Income from discontinued operations, net of tax (Note 2)	--	119	191
Cumulative effect of changes in accounting principles, net of tax (Note 1)	<u>--</u>	<u>(1)</u>	<u>2</u>
Net income	\$ <u>85</u>	\$ <u>140</u>	\$ <u>203</u>

See accompanying notes to the consolidated financial statements.

CONRAIL INC.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	(Unaudited)	(Unaudited)
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 20	\$ 20
Accounts receivable, net	24	25
Income taxes receivable (Note 8)	5	73
Due from NSR/CSXT (Note 3)	134	165
Material and supplies	9	8
Deferred income taxes (Note 8)	38	40
Other current assets	3	3
Total current assets	233	334
Property and equipment, net (Note 5)	560	560
Due from NSR/CSXT (Note 3)	308	225
Due from NSC/CSX (Note 3)	105	--
Other assets (Note 6)	269	295
Total assets	\$ 1,475	\$ 1,414
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 30	\$ 18
Current maturities of long-term debt (Note 7)	44	50
Due to NSC/CSX (Note 3)	6	4
Wages and employee benefits	35	33
Casualty reserves	32	32
Accrued and other current liabilities (Note 6)	86	105
Total current liabilities	233	242
Long-term debt (Note 7)	215	266
Casualty reserves	87	109
Deferred income taxes (Note 8)	66	17
Other liabilities (Note 6)	439	419
Total liabilities	1,040	1,053
Commitments and contingencies (Note 12)		
Stockholders' equity (Notes 2 and 10)		
Common stock (\$1 par value; 100 shares authorized, issued and outstanding)	--	--

Additional paid-in capital	456	445
Retained earnings	102	17
Accumulated other comprehensive loss	<u>(123)</u>	<u>(101)</u>
Total stockholders' equity	<u>435</u>	<u>361</u>
Total liabilities and stockholders' equity	\$ <u>1,475</u>	\$ <u>1,414</u>

See accompanying notes to the consolidated financial statements.

CONRAIL INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
	(\$ in millions)			
Balance - Jan. 1, 2003	\$ 2,221	\$ 2,134	\$ (129)	\$ 4,226
Comprehensive income - 2003				
Net income	--	203	--	203
Minimum pension liability, net (Note 9)	--	--	25	<u>25</u>
Total comprehensive income				<u>228</u>
Balance - December 31, 2003	<u>2,221</u>	<u>2,337</u>	<u>(104)</u>	<u>4,454</u>
Comprehensive income - 2004 (unaudited)				
Net income (unaudited)	--	140	--	140
Minimum pension liability, net (unaudited) (Note 9)	--	--	3	<u>3</u>
Total comprehensive income (unaudited)				<u>143</u>
Conrail corporate reorganization (unaudited) (Note 2)	<u>(1,776)</u>	<u>(2,460)</u>	<u> </u>	<u>(4,236)</u>
Balance - December 31, 2004 (unaudited)	445	17	(101)	361
Comprehensive income - 2005 (unaudited)				
Net income (unaudited)	--	85	--	85
Minimum pension liability, net				

(unaudited) (Note 9)	--	--	(22)	<u>(22)</u>
Total comprehensive income				
(unaudited)				<u>63</u>
Tax refund allocation to spun-off subsidiaries (unaudited) (Note 8)	11			11
Balance - December 31, 2005 (unaudited)	\$ <u>456</u>	\$ <u>102</u>	\$ <u>(123)</u>	\$ <u>435</u>

See accompanying notes to the consolidated financial statements.

CONRAIL INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
	(Unaudited) <u>2005</u>	(Unaudited) Revised See Note 1 <u>2004</u>	- Revised See Note 1 <u>2003</u>
	(\$ in millions)		
Cash flows from operating activities			
Net income	\$ 85	\$ 140	\$ 203
Adjustments to reconcile net income to net cash provided by operating activities			
Net cumulative effect of changes in accounting principles	--	1	(40)
Depreciation and amortization	27	219	329
Deferred income taxes	48	(26)	(12)
Gains from sales of property	(9)	(3)	(7)
Pension cost (benefit)	12	10	(4)
Changes in:			
Accounts receivable, net	1	1	1
Income taxes receivable	68	--	--
Accounts and wages payable	14	(14)	4
Due to NSC/CSX	2	(1)	(4)
Other, net	<u>9</u>	<u>(30)</u>	<u>(58)</u>
Net cash provided by operating activities	<u>257</u>	<u>297</u>	<u>412</u>
Cash flows from investing activities			
Notes receivable from NSR/CSXT	(124)	--	--
Notes receivable from NSC/CSX	(105)	(213)	(339)
Property and equipment acquisitions	(26)	(31)	(35)
Other	14	3	14

Net cash used in investing activities	<u>(241)</u>	<u>(241)</u>	<u>(360)</u>
Cash flows from financing activities			
Payment of long-term debt, net	<u>(16)</u>	<u>(54)</u>	<u>(57)</u>
Net cash used in financing activities	<u>(16)</u>	<u>(54)</u>	<u>(57)</u>
Net change in cash and cash equivalents	--	2	(5)
Cash and cash equivalents			
At beginning of year	<u>20</u>	<u>18</u>	<u>23</u>
At end of year	\$ <u>20</u>	\$ <u>20</u>	\$ <u>18</u>
Supplemental cash flow information			
Cash paid during the year for:			
Interest	\$ 24	\$ 80	\$ 100
Income taxes	\$ 25	\$ 73	\$ 129

See accompanying notes to the consolidated financial statements.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

1. Summary of Significant Accounting Policies

Description of Business

Conrail Inc. ("Conrail" or the "Company") is a holding company whose principal subsidiary is Consolidated Rail Corporation ("CRC"), a principal switching and terminal railroad operating in Pennsylvania, New Jersey and Michigan. Norfolk Southern Corporation ("NSC") and CSX Corporation ("CSX"), two of the major railroad holding companies in the United States, jointly control Conrail through their ownership interests in CRR Holdings LLC ("CRR"), whose major subsidiary is Green Acquisition Corporation ("Green Acquisition"), which owns Conrail. NSC and CSX have equity interests in CRR of 58% and 42%, respectively, and voting interests of 50% each. Through its subsidiary, CRC, Conrail owns, manages and operates certain rail properties ("Shared Assets Area") for the joint and exclusive benefit of the railroad subsidiaries of NSC and CSX, Norfolk Southern Railway Company ("NSR") and CSX Transportation, Inc. ("CSXT"), respectively.

On August 27, 2004, Conrail, NSC and CSX completed a reorganization of Conrail ("Conrail Reorganization"), which resulted in the spin-off of two former CRC subsidiaries, Pennsylvania Lines LLC ("PRR") and New York Central Lines LLC ("NYC"), respectively. Prior to the Conrail Reorganization, PRR and NYC owned a substantial share of Conrail's assets and leased these assets through separate but identical operating agreements to NSR and CSXT, respectively. As a result of the Conrail Reorganization, the operating and lease agreements were terminated and PRR and NYC were merged into NSR and CSXT, respectively. Consequently, the results of operations, and assets and liabilities for PRR and NYC have been classified as discontinued operations in the consolidated financial statements for all periods presented. In addition, as part of the Conrail Reorganization, the Company restructured its existing unsecured and secured indebtedness, with the consent of CRC's debtholders (see Note 2 to the Consolidated Financial Statements).

The Conrail Reorganization did not involve the Shared Assets Area. Accordingly, subsequent to the Conrail reorganization the major source of the Company's revenues is from CSXT and NSR, related to fees paid for their joint access and reimbursable cost incurred by CRC in operating the Shared Assets Area. Also, effective with the Conrail Reorganization and the restructuring of its existing unsecured and secured debt, Conrail has entered into various sublease arrangements with NSR and CSXT.

Principles of Consolidation

The consolidated financial statements include the Company and its majority-owned subsidiaries. As of January 1, 2004, the financial statements also include the consolidated results for a variable interest entity for which the Company is the primary beneficiary (See Note 1 New Accounting Pronouncements). Investments in 20% to 50% owned companies are accounted for by the equity method. All significant intercompany accounts and transactions have been eliminated. Effective with the Conrail Reorganization, the Company no longer has any equity investees.

Cash Equivalents

Cash equivalents consist of highly liquid securities purchased with a maturity of three months or less, and are stated at cost which approximates market value.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

For 2004 and 2003, the Company has revised the Consolidated Statements of Cash Flows by combining cash flows from discontinued operations with cash flows from continuing operations within each category. Previously, cash flows from discontinued operations were reported as a single amount within operating cash flows.

Material and Supplies

Material and supplies consist of maintenance material valued at the lower of cost or market.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided using the group method over estimated service lives. Expenditures, including those on leased assets that extend an asset's useful life or increase its utility, are capitalized. Maintenance expense is recognized when repairs are performed. The cost (net of salvage) of depreciable property retired or replaced in the ordinary course of business is charged to accumulated depreciation and no gain or loss is recognized. Gains and losses on disposal of land and all other property are included in Other income, net (See Note 11). In 2005, the overall depreciation rate averaged 2.9% for all roadway and equipment.

During 2003, the Company completed a study to update the estimated useful lives of its roadway and track property and the associated accumulated depreciation reserves. This review did not have a material impact on the Company's consolidated financial statements.

Asset Impairment

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Expected future cash flows from the use and disposition of long-lived assets are compared to the current carrying amounts to determine the potential impairment loss.

New Accounting Pronouncements

Conrail adopted Financial Accounting Standards Board (" FASB ") Interpretation No. 46R, " Consolidation of Variable Interest Entities " (" FIN 46R ") which requires that a variable interest entity be consolidated by the company that is subject to a majority of the economic risks and/or rewards of that entity. Pursuant to FIN 46R, on January 1, 2004, the Company consolidated a locomotive leasing entity, Locomotive Management Services (" LMS ") and recorded a \$1 million net adjustment for the cumulative effect of this accounting change. The consolidation of LMS will not have an impact on net income in future periods as the Company previously accounted for its investment in LMS under the equity method of accounting.

Conrail also adopted FASB Statement of Financial Accounting Standards (" SFAS ") No. 143, " Accounting for Asset Retirement Obligations " , effective January 1, 2003 . Pursuant to SFAS 143, companies are precluded from accruing removal cost expenses that are not legal obligations. Previously, Conrail and most other railroads had accrued removal costs as a component of depreciation expense. In the first quarter of 2003, Conrail recorded income of \$40 million (\$65 million before taxes) for the cumulative effect of this change. Of this amount, \$38 million (\$62 million before taxes) is related to the discontinued operations of

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

PRR and NYC. Effective with this pronouncement, removal costs are expensed as incurred. This change did not have a material impact on the Company's consolidated financial statements.

Revenue Recognition

The Company's major sources of revenues are from NSC and CSX, primarily in the form of rental revenues and operating fees, which are recognized when earned. Conrail also has third party revenues, which are recognized when earned, related to the operations of Indiana Harbor Belt Railroad Company, a 51% owned terminal railroad subsidiary.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 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 postretirement benefits. Changes in facts and circumstances may result in revised estimates.

Reclassifications

Certain amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the 2005 presentation.

2. Conrail Reorganization

On August 27, 2004, Conrail, together with NSC and CSX, completed the Conrail Reorganization. Prior to the Conrail Reorganization, CRC's former subsidiaries, PRR and NYC owned a substantial share of Conrail's assets and leased these assets through separate but identical operating agreements to NSR and CSXT, respectively. Pursuant to the Conrail Reorganization, these agreements were terminated and the direct ownership of PRR and NYC was transferred to NSR and CSXT, respectively. The Conrail Reorganization has been approved by the Surface Transportation Board ("STB") and has received favorable rulings from the Internal Revenue Service ("IRS") regarding certain tax matters.

As a part of the Conrail Reorganization, the Company restructured its existing unsecured and secured public indebtedness, with the consent of CRC's debt holders. NSR and CSXT offered substantially similar unsecured debt securities in a 58%/42% ratio in exchange of CRC's unsecured debentures. Of the \$800 million total unsecured debentures, \$779 million were accepted for exchange and became direct unsecured obligations of NSR and CSXT. The Company's secured debt and lease obligations remained obligations of CRC and are supported by new leases and subleases which became the direct lease and sublease obligations, also in a 58%/42% ratio of NSR and CSXT, respectively. In accordance with EITF 87-24, "Allocation of Interest to Discontinued Operations," interest expense related to the exchanged debt and the direct lease and sublease obligations assumed by NSR and CSXT has been allocated to discontinued operations for all periods presented.

At August 27, 2004, the Company charged \$4.2 billion, principally the net assets of the discontinued operations of PRR and NYC against stockholders' equity to reflect the Conrail Reorganization. In addition,

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

Conrail recorded net operating loss carrybacks and carryforwards of approximately \$73 million and \$27 million, respectively, related to the Conrail Reorganization (See Note 8).

The following table summarizes the reporting of the discontinued operations on the Consolidated Statements of Income:

Condensed Statement of Operations

	Year-to-date period ended	
	<u>Aug. 27, 2004</u>	<u>December 31, 2003</u>
	(\$ in millions)	
Total operating revenues	\$ 406	\$ 602
Total operating expenses	<u>196</u>	<u>307</u>
Income from operations	210	295
Interest expense	(59)	(90)
Other income, net	<u>37</u>	<u>38</u>
Income before income taxes and accounting change	188	243
Provision for income taxes	<u>69</u>	<u>90</u>
Income before accounting change	119	153
Accounting change, net of tax	<u>--</u>	<u>38</u>
Income from discontinued operations	\$ <u>119</u>	\$ <u>191</u>

3. Related Parties Transactions

Shared Assets Area

NSR and CSXT pay Conrail a fee for joint and exclusive access to the Shared Assets Area. In addition, NSR and CSXT pay, based on usage, the costs incurred by Conrail to operate the Shared Assets Area plus a profit factor.

Payments made by NSR to Conrail under the Shared Assets agreements were \$149 million, \$109 million and \$135 million during 2005, 2004 and 2003, respectively, of which \$30 million, \$27 million and \$31 million, were minimum rents. Payments made by CSXT to Conrail under the Shared Assets agreements were \$112 million, \$91 million and \$124 million during 2005, 2004 and 2003, respectively, of which \$21 million, \$19 million and \$24 million, were minimum rents.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

Future minimum lease payments to be received from NSR/CSXT for the Shared Assets Area are as follows:

Year Ending December 31,	(\$ in millions)		
	From NSR	From CSXT	Total
2006	\$ 25	\$ 18	\$ 43
2007	25	18	43
2008	25	18	43
2009	25	18	43
2010	25	18	43
2011 and Beyond	331	240	571
Total	\$ 456	\$ 330	\$786

Equipment Financing Agreements

As part of the Conrail Reorganization, CRC obtained consents from debtholders and other related parties regarding amendments to certain of the Company's existing equipment financing obligations. Under the amended agreements, CRC's existing secured debt and lease obligations related to these equipment financings remain in effect but are supported by new leases and subleases which became the direct lease and sublease obligations in an approximate 58%/42% ratio of NSR and CSXT, respectively. In general, payments received by Conrail from NSR and CSXT under the direct lease and sublease agreements equal the Company's existing lease obligations and in 2005 totaled \$62 million and \$44 million from NSR and CSXT, respectively. Payments received in 2004 under these agreements totaled \$16 million and \$11 million from NSR and CSXT, respectively.

Future minimum lease payments to be received from NSR/CSXT under the Equipment Financing agreements are as follows:

Year Ending December 31,	(\$ in millions)		
	From NSR	From CSXT	Total
2006	\$52	\$38	\$90
2007	64	47	111
2008	41	29	70
2009	34	24	58
2010	19	13	32
2011 and Beyond	41	28	69

Total	\$ 251	\$179	\$430
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CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

Related Party Balances and Other Transactions

"Due from NSR/CSXT" at December 31, 2005 and 2004, is comprised of amounts due for the Shared Assets Area operations and the Equipment Financing Agreements. Also at December 31, 2005, "Due from NSR/CSXT" includes 30-year interest-bearing notes receivable issued in 2005 totaling \$101 million at 4.40% from NSR and \$23 million at 4.52% from CSXT. Interest income related to the notes receivables "Due from NSR/CSXT" was approximately \$1 million in 2005.

"Due from NSC/CSX" at December 31, 2005 is comprised of 30-year interest-bearing notes receivable issued in 2005 totaling \$32 million at 4.52% from NSC and \$73 million at 4.40% from CSX. Interest income related to the notes receivables "Due from NSC/CSX" was approximately \$2 million in 2005.

"Due to NSC/CSX" includes amounts payable for property and equipment rentals, as well as amounts related to service provider agreements with both NSC and CSX to provide certain general and administrative support to CRC.

A summary of the "Due to NSC/CSX" activity for the services described above follows:

	Payments To NSC		Payments To CSX	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>			
Service provider agreements	\$ 7	\$ 6	\$ 3	\$ 3
Material purchases	11	8	--	--
Rental of locomotives, equipment and facilities	4	6	3	4
Capital project activities	--	2	--	3
Total payments	\$ 22	\$ 22	\$ 6	\$ 10
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
"Due to NSC/CSX" at December 31	\$ 5	\$ 3	\$ 1	\$ 1

From time to time, NSC and CSX, as the indirect owners of Conrail, may need to provide some of the Company's cash requirements through capital contributions, loans or advances. Through December 31, 2005, there have been no transactions under these arrangements.

4. Other Items

In November 2004, a settlement was reached among Conrail and other parties relating to insurance recoveries for environmental remediation costs. Under the terms of the settlement, Conrail received approximately \$9 million in the first quarter of 2005. In the fourth quarter of 2004, the Company recognized a pretax gain of \$9 million resulting from the settlement, which is included in the "Other income, net" line item of the income statement.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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In 2004, Conrail made payments totaling approximately \$15 million, relating to obtaining consents from debtholders and other related parties regarding amendments to certain of the Company's existing equipment financing obligations. The amounts are included as operating activities in the cash flow statement.

5. Property and Equipment

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Roadway	\$ 727	\$ 709
Equipment	141	145
Accumulated depreciation	<u>(315)</u>	<u>(304)</u>
	<u>553</u>	<u>550</u>
Capital leases (primarily equipment)	49	52
Accumulated amortization	<u>(42)</u>	<u>(42)</u>
	<u>7</u>	<u>10</u>
	\$ <u>560</u>	\$ <u>560</u>

6. Composition of Certain Balance Sheet Amounts

The components of certain balance sheet accounts were as follows:

Other Assets

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Prepaid pension cost	\$ 111	\$ 121
Employee benefit trust	106	105
Yen denominated deposits	22	33
Other	<u>30</u>	<u>36</u>
	\$ <u>269</u>	\$ <u>295</u>

Accrued and Other Current Liabilities

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Operating leases	\$ 22	\$ 37
Income and other taxes	30	32

Other		<u>34</u>		<u>36</u>
	\$	<u>86</u>	\$	<u>105</u>

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

Other Liabilities

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Pension and other postretirement benefits	\$ 266	\$ 235
Environmental reserves	48	57
Unearned revenues	46	48
Minority interest	35	32
Other	<u>44</u>	<u>47</u>
	\$ <u>439</u>	\$ <u>419</u>

7. Long-term Debt and Leases

As part of the Conrail Reorganization, CRC obtained consents from debtholders and other related parties regarding amendments to certain of the Company's existing equipment financing obligations. Under the amended agreements, CRC's existing secured debt and lease obligations related to these equipment financings remain in effect but are supported by new leases and subleases which became the direct lease and sublease obligations in an approximate 58%/42% ratio of NSR and CSX, respectively. In general, payments received by Conrail from NSR and CSX under the direct lease and sublease agreements equal the Company's existing lease obligations.

Long-term Debt

Long-term debt outstanding, including the weighted average interest rates at December 31, 2005, is composed of the following:

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Capital leases	\$ 87	\$ 118
Debentures payable, 7.88%, due 2043	12	12
Debentures payable, 9.75%, due 2020	9	9
Equipment and other obligations, 7.21%	<u>151</u>	<u>177</u>
Total long-term debt	259	316
Current portion	<u>(44)</u>	<u>(50)</u>
Long-term debt excluding current portion	\$ <u>215</u>	\$ <u>266</u>

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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Equipment and other obligations mature in 2006 through 2043 and are collateralized by a net lease receivable of \$ 123 million at December 31, 2005 . Maturities of long-term debt other than capital leases net of the lease receivable amounts due under the equipment financing agreements are as follows:

Debentures, Equipment and Other Obligations

Year Ending December 31,	<u>Gross Commitments</u>	<u>Lease Receivable</u> <i>(\$ in millions)</i>	<u>Net</u>
2006	\$ 25	\$ 20	\$ 5
2007	47	43	4
2008	21	17	4
2009	15	11	4
2010	12	8	4
2011 and Beyond	52	24	28
Total	<u>\$172</u>	<u>\$123</u>	<u>\$49</u>

Leases

The Company's noncancelable long-term leases generally include options to purchase at fair value and to extend the terms. Certain lease obligations are payable in Japanese yen, which require the maintenance of yen-denominated deposits sufficient to satisfy the yen-denominated obligation. These deposits are included in the "Other assets" line item of the balance sheet and totaled \$ 22 million and \$33 million at December 31, 2005 , and December 31, 2004 , respectively. Capital leases have been discounted at rates ranging from 3.09% to 14.26% and are collateralized by net lease receivables of \$ 49 million at December 31, 2005 .

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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The future minimum lease payments for the capital and operating leases net of the lease receivable amounts due under the equipment financing agreements are as follows:

Capital Leases

Year Ending December 31,	<u>Gross Lease Commitments</u>	<u>Lease Receivable</u>	<u>Net</u>
		<i>(\$ in millions)</i>	
2006	\$ 24	\$ 17	\$ 7
2007	28	19	9
2008	15	11	4
2009	23	12	11
2010	12	1	11
2011 and Beyond	<u>--</u>	<u>--</u>	<u>--</u>
Total	<u>102</u>	<u>60</u>	<u>42</u>
Amount representing interest	<u>(15)</u>	<u>(11)</u>	<u>(4)</u>
	<u>\$87</u>	<u>\$49</u>	<u>\$38</u>

Operating Leases

Year Ending December 31,	<u>Gross Lease Commitments</u>	<u>Sublease Rentals</u>	<u>Net</u>
		<i>(\$ in millions)</i>	
2006	\$ 48	\$ 44	\$ 4
2007	54	43	11
2008	51	38	13
2009	44	31	13
2010	33	21	12
2011 and Beyond	<u>184</u>	<u>41</u>	<u>143</u>
Total	<u>\$414</u>	<u>\$218</u>	<u>\$196</u>

Operating lease rent expense was \$54 million in 2005 and \$60 million in both 2004 and 2003. Sublease rental income commencing in August 2004 with the Conrail Reorganization totaled \$50 million in 2005 and \$17 million in 2004.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

8. Income Taxes

Conrail is included in the consolidated federal income tax return of Green Acquisition Corporation and Subsidiaries ("Green").

Total income taxes for the years ended December 31, were allocated as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ In Millions)</i>		
Income from continuing operations	\$ 28	\$ 13	\$ 3
Discontinued operations (includes \$24 million in 2003 for accounting change)	--	69	114
Cumulative effect of changes in accounting principles	--	--	1
Stockholders' equity, for Accumulated Other Comprehensive Loss recognized for minimum pension liability	<u>(12)</u>	<u>9</u>	<u>16</u>
	<u>\$ 16</u>	<u>\$ 91</u>	<u>\$134</u>

The amount related to Accumulated Other Comprehensive Loss for 2004 includes \$4 million tax expense related to a change in the effective tax rate in connection with the Conrail reorganization.

The provisions for income taxes for continuing operations are composed of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions)</i>		
Current			
Federal	\$ (18)	\$ (6)	\$ (8)
State	<u>(2)</u>	<u>1</u>	<u>(1)</u>
	<u>(20)</u>	<u>(5)</u>	<u>(9)</u>
Deferred			
Federal	44	8	11
State	<u>4</u>	<u>10</u>	<u>1</u>
	<u>48</u>	<u>18</u>	<u>12</u>
	\$ <u>28</u>	\$ <u>13</u>	\$ <u>3</u>

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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Reconciliation of the U.S. statutory tax rates with the effective tax rates is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Statutory tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	1.1	1.5	1.3
Settlement of tax audit	(11.3)	--	--
Corporate-owned life insurance	(.1)	(1.1)	(10.0)
Other	<u>.3</u>	<u>.4</u>	<u>1.3</u>
 Effective tax rate	 <u>25.0%</u>	 <u>35.8%</u>	 <u>27.6%</u>

During the third quarter of 2005, the Internal Revenue Service (IRS) advised Green that the Congressional Joint Committee on Taxation had completed its consideration of the IRS special report (made to satisfy the requirements of section 6405 of the Internal Revenue Code of 1986) for Green's federal income tax returns for the short tax period beginning May 24, 1997 and ending December 1997, and calendar years ending December 1998 through December 2001, and have taken no exception to the conclusions reached by the IRS and approved a refund of approximately \$120 million (this included interest of approximately \$19 million). Conrail has recognized the interest portion of the refund in the " Other income, net " line item of the income statement.

In conjunction with the tax refund, the Company also recognized income tax benefits of approximately \$13 million, which is reflected in the "Provision for income taxes" line item of the income statement. The income tax benefit adjustment is net of the impact of additional tax liabilities required for reversing temporary differences and an increase in the Company's effective tax rate. Also in accounting for the tax refund, the Company under the provisions of a tax allocation agreement, distributed a share of the refund proceeds and other tax items to the former CRC subsidiaries PRR and NYC which were spun-off as part of the Conrail Reorganization. The net effect of the tax allocation transactions, approximately \$11 million, has been recognized in stockholders' equity.

As part of the Conrail Reorganization in 2004, a \$267 million bond redemption premium deduction was taken on the Green tax return for the period ended December 31, 2004, which contributed to Green having a consolidated federal taxable loss for 2004. The taxable loss resulted in the Company filing for refunds (\$66 million federal and \$7 million state) of the 2004 estimated tax payments.

The \$73 million income tax refund receivable is reflected in the "Income taxes receivable" line item of the Balance Sheet as of December 31, 2004.

During 2005, \$55 million of the federal income tax refund was received and the remaining \$11 million was applied and credited towards the 2005 federal income tax estimate. Also in 2005, \$5 million of the state income tax refund was received and \$1 million has been applied and credited towards the 2005 state income tax estimate.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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Significant components of the Company's deferred income tax assets (liabilities) are as follows:

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Current assets	\$ --	\$ --
Current liabilities	<u>38</u>	<u>40</u>
Current deferred tax asset, net	\$ <u>38</u>	\$ <u>40</u>
Noncurrent liabilities:		
Property and equipment	(155)	(97)
Other	<u>(65)</u>	<u>(98)</u>
	<u>(220)</u>	<u>(195)</u>
Noncurrent assets:		
Nondeductible reserves and other liabilities	<u>154</u>	<u>178</u>
Noncurrent deferred income tax asset (liability), net	\$ <u>(66)</u>	\$ <u>(17)</u>
Net deferred income tax asset (liability)	\$ <u>(28)</u>	\$ <u>23</u>

As of December 31, 2005, the Company had state net operating loss carryforwards of approximately \$37 million that are anticipated to be utilized through 2023.

The Company has not recorded a valuation allowance, as 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.

9. Pension and Other Postretirement Benefits

The Company and certain subsidiaries sponsor defined benefit qualified and nonqualified pension plans, covering principally non-union employees. The Company and certain subsidiaries also sponsor plans that provide for medical benefits and life insurance coverage to eligible retirees.

Pension Plan Asset Management

Six investment firms manage the Company's defined benefit pension plans' assets under investment guidelines approved by a pension fund investment committee. Investments are allocated among domestic fixed income investments, and domestic and international equity investments. Limitations restrict investment concentration and use of certain derivative instruments. Fixed income investments must have an average rating of 'AA' or better. Equity investments must be in liquid securities listed on national exchanges. However no direct investment is permitted in the securities of either NSC or CSX. Equity investment managers have specific equity strategies and their returns are expected to exceed selected market indices by prescribed margins.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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The target asset allocation range is for equity allocations to be between 44% and 56% of the fund's assets with approximately 10% of the assets allocated to international equity investments. The asset allocation on December 31, 2005, was 47% in fixed income investments and 53% in equity investments including 11% in international equities. This compared to 46% fixed income and 54% equity including 12% international equity as of December 31, 2004.

The plans' assumed future returns are based principally on the asset allocation and the historic returns for the plans' asset classes determined from both the actual plan returns and, over longer time periods, the market returns for those asset classes.

Obligations and Funded Status

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the two-year period ended December 31, 2005, and a statement of the funded status as of December 31 of both years:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	<i>(\$ in millions)</i>			
Change in benefit obligation				
Net benefit obligation at beginning of year	\$ 670	\$ 655	\$ 38	\$ 37
Service cost	2	2	--	--
Interest cost	37	40	2	2
Plan participants' contributions	--	--	7	9
Actuarial losses	31	34	2	2
Benefits paid	<u>(58)</u>	<u>(61)</u>	<u>(12)</u>	<u>(12)</u>
Net benefit obligation at end of year	\$ 682	\$ 670	\$ 37	\$ 38
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 588	\$ 576	\$ 5	\$ 6
Actual return on plan assets	24	71	--	--
Employer contributions	2	2	4	2
Plan participants' contributions	--	--	7	9
Benefits paid	<u>(58)</u>	<u>(61)</u>	<u>(12)</u>	<u>(12)</u>
Fair value of plan assets at end of year	\$ 556	\$ 588	\$ 4	\$ 5
Funded status at end of year	\$ (126)	\$ (82)	\$ (33)	\$ (33)
Unrecognized prior service cost	6	6	(1)	(1)
Unrecognized actuarial (gains) losses	<u>198</u>	<u>164</u>	<u>--</u>	<u>(2)</u>
Net amount recognized at year end	\$ 78	\$ 88	\$ (34)	\$ (36)

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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Accumulated Benefit Obligation

The accumulated benefit obligation is the actuarial present value of pension benefits based on current or past salary levels. The accumulated benefit obligation for all defined benefit plans was \$671 million and \$656 million as of December 31, 2005 and 2004, respectively.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets are as follows:

	December 31,	
	<u>2005</u>	<u>2004</u>
	(\$ in millions)	
Projected benefit obligation	\$ (671)	\$ (661)
Accumulated benefit obligation	(662)	(649)
Fair value plan assets	545	576
Unfunded accumulated benefit obligation	(117)	(73)

Minimum Pension Liability

During 2005 and 2004, the Company recorded changes to its minimum pension liability, which is required due to the Company's unfunded accumulated benefit obligation and recognized prepaid paid pension asset.

The changes do not impact net income but are recognized as adjustments to an intangible asset and accumulated other comprehensive income, net of tax. In 2005, the minimum pension liability increased \$33 million, decreasing accumulated other comprehensive income \$22 million, net of tax. In 2004, the minimum pension liability decreased \$13 million, increasing accumulated other comprehensive income \$3 million, net of tax. The intangible asset decreased \$1 million in both 2005 and 2004.

Amounts Recognized in Consolidated Balance Sheets

The following amounts have been recognized in the balance sheets as of December 31:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	(\$ in millions)			
Prepaid pension cost	\$ 111	\$ 121	\$ --	\$ --
Accrued benefit cost	(232)	(199)	(34)	(36)
Intangible asset	5	6	--	--
Accumulated other comprehensive loss	194	160	--	--
	<u>\$ 78</u>	<u>\$ 88</u>	<u>\$ (34)</u>	<u>\$ (36)</u>

The postretirement life insurance plan had plan assets totaling \$4 million and \$5 million at December 31, 2005, and December 31, 2004,

respectively. There are no plan assets for the postretirement medical plans.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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Actuarial Assumptions

The assumptions used in the measurement of the Company's benefit obligations and benefit cost for the year ended December 31 are as follows:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Funded status:				
Discount rate:	5.50%	5.75%	5.50%	5.75%
Rate of compensation increase	5.00%	5.00%	5.00%	5.00%
Benefit cost:				
Discount rate	5.75%	6.25%	5.75%	6.25%
Expected return on plan assets	9.00%	9.00%	8.00%	8.00%
Rate of compensation increase	5.00%	5.00%	5.00%	5.00%

A 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2005, gradually decreasing to 5% by the year 2010.

Assumed health care cost trend rates affect amounts reported for the health care plans. The effect of a one percentage point increase and (decrease) in the assumed health care cost trend rate on the accumulated postretirement benefit obligation is approximately \$1 million and \$(1) million, respectively.

Net Periodic Benefit Cost

The components of the Company's net periodic benefit cost (benefit) for the plans are as follows:

	<u>Pension Benefits</u>			<u>Other Postretirement Benefits</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<i>(\$ in millions)</i>					
Service cost	\$ 2	\$ 2	\$ 1	\$ --	\$ --	\$ --
Interest cost	37	40	41	2	2	2
Expected return on assets	(45)	(47)	(52)	--	(1)	--
Amortization of:						
Prior service cost	--	1	1	--	--	--

Actuarial loss		<u>18</u>		<u>14</u>		<u>5</u>		<u>--</u>		<u>--</u>		<u>--</u>
	\$	<u>12</u>	\$	<u>10</u>	\$	<u>(4)</u>	\$	<u>2</u>	\$	<u>1</u>	\$	<u>2</u>

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

and the years then ended is unaudited except for Note 2)

Contributions and Estimated Future Benefit Payments

The Company is not required to make cash contributions to its defined benefit qualified plan in 2006, but may elect to make discretionary contributions depending upon the plan's investment performance and the Company's operating cash flows. The Company expects to contribute approximately \$2 million to the non-qualified pension plan and \$3 million to the other postretirement benefit plans in 2006.

The estimated future benefits to be paid for pensions and other postretirement benefits (OPEB) are:

		Year ending December 31,	
		<u>Pensions</u>	<u>OPEB</u>
		(\$ in millions)	
2006	\$	57	\$ 3
2007		55	3
2008		54	3
2009		53	3
2010		52	3
2011 - 2015		247	15

Savings Plans

The Company and certain subsidiaries provide 401(k) savings plans for union and non-union employees. For the non-union savings plan, the Company matches a portion of employee contributions, subject to the applicable limitations. Savings plan expense related to the non-union savings plan was approximately \$1 million in each of the years 2005, 2004 and 2003. There is no Company match provision under the union employee plan except for certain unions, which negotiated a Company match as part of their contract provisions.

Incentive Compensation Plans

The Company has an incentive compensation plan for all non-union employees in which employees receive targeted cash awards upon attainment of certain performance criteria established by the Company's Board of Directors. Compensation expense under this plan was approximately \$3 million in each of the years 2005, 2004 and 2003.

The Company also has a long-term incentive plan under which phantom stock options are granted to officers and other key non-union employees. The option price for the phantom shares is equal to the blended fair market value of NSC and CSX common stock at the date of grant. Options will vest one year after grant date and the option term may not exceed ten years. Upon exercise, eligible participants will receive cash payments equal to the appreciation on the composite NSC and CSX common stock fair values. Compensation expense for this plan was \$5 million in 2005, \$6 million in 2004, and \$2 million in 2003.

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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Change in Control Payments

The Company has a long-term liability in connection with employment "change in control" agreements with certain former executives, which became operative as a result of the joint acquisition of Conrail. There were no payments in 2005, and payments were \$1 million in 2004 and \$4 million in 2003 made primarily from the Company's pension plan. The remaining amount, approximately \$27 million at December 31, 2005, will be paid out at the discretion of the participants in the program.

10. Stockholders' Equity

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In conjunction with the tax refund received in 2005, the Company under the provisions of a tax allocation agreement, distributed a share of the refund proceeds and other tax items to the former CRC subsidiaries PRR and NYC which were spun-off as part of the Conrail Reorganization. The net effect of the tax allocation transactions; approximately \$11 million, has been recognized in stockholders' equity (Note 8).

As a result of the Conrail Reorganization in 2004, the Company charged \$4.2 billion, principally the net assets of the discontinued operations of PRR and NYC, against stockholders' equity (Note 2).

11. Other Income, Net

	<u>2005</u>		<u>2004</u>		<u>2003</u>
			(\$ in millions)		
Rental income	\$ 48	\$	49	\$	46
Property sales	9		2		5
Interest income	28		3		3
Insurance settlements	3		10		1
Other, net	--		(3)		3
	<u>\$ 88</u>	\$	<u>61</u>	\$	<u>58</u>

The increase in interest income in 2005 is primarily attributable to \$19 million received in conjunction with the settlement of the tax audit (Note 8) and \$3 million related to interest from the issuance of long-term notes to NSR/CSXT and NSC/CSX (Note 3).

12. Commitments and Contingencies

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Environmental

The Company is subject to various federal, state and local laws and regulations regarding environmental matters. Conrail is a party to various proceedings brought by both regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. At December 31, 2005, Conrail has received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 25 locations. Due to the number of parties involved at many of these sites, the wide range of costs of possible remediation alternatives, the changing

CONRAIL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Information pertaining to December 31, 2005 and December 31, 2004

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technology and the length of time over which these matters develop, it is often not possible to estimate Conrail's liability for the costs associated with the assessment and remediation of contaminated sites.

At December 31, 2005 and 2004, the Company had accrued \$48 million and \$57 million respectively, related to future environmental costs at Superfund sites and other sites based on known information and using various estimating techniques. The Company anticipates that much of this liability will be paid out over five years; however some costs will be paid out over a longer period. The Company believes the ultimate liability for these matters will not materially affect its consolidated financial condition.

The Company spent \$2 million in 2005, \$6 million in 2004 and \$5 million in 2003 for environmental remediation and related costs.

Casualty

The Company is involved in various legal actions, principally relating to occupational health claims, personal injuries, casualties and property damage. The casualty claim liability is determined using the aid of an independent actuarial firm based upon claims filed and an estimate of claims incurred but not yet reported. The Company is generally self-insured for casualty claims. Claims in excess of self-insurance levels are insured up to excess coverage limits. While the ultimate amounts of claims incurred are dependent upon future developments, in management's opinion, the recorded liability is adequate to cover expected probable payments.

Labor

CRC had 1,217 employees at December 31, 2005 ; approximately 89% of whom are represented by 12 different labor organizations and are covered by 16 separate collective bargaining agreements. These agreements remain in effect until changed pursuant to the Railway Labor Act. The Company was engaged in collective bargaining at December 31, 2005 with labor organizations representing approximately 87% of its labor force.

Guarantees

The Company is contingently liable under indemnification provisions related to the sale of tax benefits. This liability is recorded in the "Other liabilities" line item of the balance sheet and totaled \$1 million at both December 31, 2005 , and December 31, 2004 .

13. Fair Values of Financial Instruments

The fair values of "Cash and cash equivalents," "Accounts receivable, net" and "Accounts payable" approximate the carrying values of these financial instruments at December 31, 2005 and 2004.

Using current market prices when available, or a valuation based on the yield to maturity of comparable debt instruments having similar characteristics, credit rating and maturity, the total fair value of the Company's long-term debt, including the current portion, but excluding capital leases, is \$188 million and \$222 million at December 31, 2005 and 2004, respectively, compared with carrying values of \$172 million and \$198 million at December 31, 2005 and 2004, respectively.