NORFOLK SOUTHERN CORP
Form 10-K
February 11, 2015

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

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended DECEMBER 31, 2014

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from ___________ to___________
Commission file number 1-8339

NORFOLK SOUTHERN CORPORATION
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation)	52-1188014 (IRS Employer Identification No.)
Three Commercial Place Norfolk, Virginia (Address of principal executive offices)	23510-2191 Zip Code
Registrant's telephone number, including area code:	(757) 629-2680

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T during the preceding 12 months. 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 the Form 10-K or any amendment to this Form 10-K. (X)

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

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

The aggregate market value of the voting common equity held by non-affiliates at June 30, 2014, was $31,787,780,476 (based on the closing price as quoted on the New York Stock Exchange on that date).

The number of shares outstanding of each of the registrant's classes of common stock, at January 31, 2015: 307,411,965 (excluding 20,320,777 shares held by the registrant's consolidated subsidiaries).

DOCUMENTS INCORPORATED BY REFERENCE:

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

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NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

PART I

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

Item 1. Business and Item 2. Properties

GENERAL – Our company, Norfolk Southern Corporation, is a Norfolk, Virginia based company that owns a major freight railroad, Norfolk Southern Railway Company. We were incorporated on July 23, 1980, under the laws of the Commonwealth of Virginia. Our common stock (Common Stock) is listed on the New York Stock Exchange (NYSE) under the symbol "NSC."

Unless indicated otherwise, Norfolk Southern Corporation and its subsidiaries, including Norfolk Southern Railway Company, are referred to collectively as NS, we, us, and our.

We are primarily engaged in the rail transportation of raw materials, intermediate products, and finished goods primarily in the Southeast, East, and Midwest and, via interchange with rail carriers, to and from the rest of the United States. We also transport overseas freight through several Atlantic and Gulf Coast ports. We provide comprehensive logistics services and offer the most extensive intermodal network in the eastern half of the United States.

We make available free of charge through our website, www.nscorp.com, our 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 U.S. Securities and Exchange Commission (SEC). In addition, the following documents are available on our website and in print to any shareholder who requests them:

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

RAILROAD OPERATIONS – At December 31, 2014, our railroads operated approximately 20,000 miles of road in 22 states and the District of Columbia.

Our system reaches many individual industries, electric generating facilities, mines (in western Virginia, eastern Kentucky, southern and northern West Virginia, western Pennsylvania, and southern Illinois and Indiana), distribution centers, transload facilities, and other businesses located in our service area.

Corridors with heaviest freight volume:

- New York City area to Chicago (via Allentown and Pittsburgh)
- Chicago to Macon (via Cincinnati, Chattanooga, and Atlanta)
- Appalachian coal fields of Virginia, West Virginia, and Kentucky to Norfolk, Virginia and Sandusky, Ohio
- Cleveland to Kansas City
- Birmingham to Meridian
- Memphis to Chattanooga

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

	Mileage Operated at December 31, 2014				
	Miles of Road	Second and Other Main Track	Passing Track, Crossovers and Turnouts	Way and Yard Switching	Total
Owned	14,991	2,754	1,974	8,274	27,993
Operated under lease, contract or trackage rights	4,768	1,914	398	834	7,914
Total	19,759	4,668	2,372	9,108	35,907

Triple Crown Operations – Triple Crown Services Company (Triple Crown), one of our subsidiaries, provides bimodal truckload transportation service primarily utilizing RoadRailer® trailers, a hybrid technology that facilitates both over-the-road and on-the-rail transportation utilizing enclosed trailers that are pulled over the highways in tractor-trailer configuration and over the rails by locomotives. In addition, Triple Crown utilizes conventional trailers that are also moved on rail flatcars. Triple Crown provides service in the eastern United States, as well as Ontario and Quebec, through a network of terminals strategically located in 13 cities.

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

	Years ended December 31,				
	2014	2013	2012	2011	2010
Revenue ton miles (billions)	205	194	186	192	182
Freight train miles traveled (millions)	74.8	74.8	76.3	75.7	72.6
Revenue per ton mile	$0.0567	$0.0581	$0.0595	$0.0582	$0.0523
Revenue ton miles per employee-hour worked	3,576	3,376	3,153	3,207	3,218
Ratio of railway operating expenses to railway operating revenues	69.2 %	71.0%	71.7%	71.2%	71.9%

RAILWAY OPERATING REVENUES – Total railway operating revenues were $11.6 billion in 2014. Following is an overview of our three major market groups.

COAL – Revenues from coal accounted for about 21% of our total railway operating revenues in 2014. We handled 141.8 million tons, or 1.3 million carloads, in 2014, most of which originated on our lines from major eastern coal basins, with the balance from major western coal basins received via the Memphis and Chicago gateways. Our coal franchise supports the electric generation market, serving approximately 84 coal generation plants, as well as the export, metallurgical and industrial markets, primarily through direct rail and river, lake, and coastal facilities, including various terminals on the Ohio River, Lambert's Point in Norfolk, Virginia, the Port of Baltimore, and Lake Erie.

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

GENERAL MERCHANDISE – Our general merchandise market group is composed of five major commodity groupings:

- Chemicals includes sulfur and related chemicals, petroleum products (including crude oil), chlorine and bleaching compounds, plastics, rubber, industrial chemicals, and chemical wastes.
- Metals and construction includes steel, aluminum products, machinery, scrap metals, cement, aggregates, sand, and minerals.
- Agriculture, consumer products, and government includes soybeans, wheat, corn, fertilizer, livestock and poultry feed, food oils, flour, beverages, canned goods, sweeteners, consumer products, ethanol, transportation equipment, and items for the U.S. military.
- Automotive includes finished vehicles for BMW, Chrysler, Ford, General Motors, Honda, Hyundai, Mercedes-Benz, Mitsubishi, Subaru, Toyota, and Volkswagen, and auto parts for BMW, Chrysler, Ford, General Motors, Honda, Hyundai, Mazda, Nissan, Subaru, Toyota, and Volkswagen.
- Paper, clay and forest products includes lumber and wood products, pulp board and paper products, wood fibers, wood pulp, scrap paper, and clay.

In 2014, 124 million tons of general merchandise freight, or approximately 61% of total general merchandise tonnage we handled, originated on our lines. The balance of general merchandise freight was received from connecting carriers at interterritorial gateways. Our principal interchange points for received freight included Chicago, New Orleans, East St. Louis, Memphis, Detroit, Toledo, Kansas City, Meridian, and Buffalo. General merchandise carloads handled in 2014 were 2.5 million, the revenues from which accounted for 57% of our total railway operating revenues.

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

INTERMODAL – Our intermodal market group 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 2014 were 3.8 million, the revenues from which accounted for 22% of our total railway operating revenues.

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

FREIGHT RATES – Private contracts and exempt price quotes are our predominant pricing mechanisms. Thus, a major portion of our freight business is not economically regulated by the federal government. In general, market forces are the primary determinant of rail service prices.

In 2014, our railroads were found by the U.S. Surface Transportation Board (STB), the regulatory board that has broad jurisdiction over railroad practices, to be "revenue adequate" on an annual basis based on results for the year

2013. The STB has not made its revenue adequacy determination for the year 2014. A railroad is "revenue adequate" on an annual basis 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 – Amtrak operates regularly scheduled passenger trains on our lines between the following locations:

- Alexandria and Lynchburg, Virginia
- Alexandria, Virginia and New Orleans, Louisiana
- Alexandria and Orange, Virginia
- Petersburg and Norfolk, Virginia
- Raleigh and Charlotte, North Carolina
- Selma and Charlotte, North Carolina
- Chicago, Illinois, and Porter, Indiana
- Chicago, Illinois, and Cleveland, Ohio
- Chicago, Illinois, and Pittsburgh, Pennsylvania
- Pittsburgh and Harrisburg, Pennsylvania

A consortium of two transportation commissions of the Commonwealth of Virginia operate commuter trains on our line between Manassas and Alexandria.

We lease the Chicago to Manhattan, Illinois, line to the Commuter Rail Division of the Regional Transportation Authority of Northeast Illinois (METRA).

We operate freight service over lines with significant ongoing Amtrak and commuter passenger operations, and conduct freight operations over trackage owned or leased by:

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

Amtrak and various commuter agencies conduct passenger operations over trackage owned by Conrail in the Shared Assets Areas (Note 5 to the Consolidated Financial Statements).

NONCARRIER OPERATIONS – Our 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 2014, no such noncarrier subsidiary or industry segment grouping of noncarrier subsidiaries met the requirements for a reportable business segment under relevant authoritative accounting guidance.

RAILWAY PROPERTY

Our railroad system extends across 22 states and the District of Columbia. The railroad infrastructure makes us capital intensive with net property of approximately $28 billion on a historical cost basis.

Property Additions – Property additions for the past five years were as follows (including capitalized leases):

	2014	2013	2012	2011	2010
	($ in millions)				
Road and all other property	$1,406	$1,421	$1,465	$1,222	$1,153
Equipment	712	550	776	938	317
Total	$2,118	$1,971	$2,241	$2,160	$1,470

Our capital spending and replacement programs are and have been designed to assure the ability to provide safe, efficient, and reliable rail transportation services. For 2015, we have budgeted $2.4 billion of property additions. See further discussion of our planned capital spending and replacement programs in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the subheading "Financial Condition, Liquidity, and Capital Resources."

We have invested and will continue to invest in various projects and corridor initiatives to expand our rail network to increase capacity and improve transit times, while returning value to shareholders. Initiatives include the following:

- The Crescent Corridor consists of a program of projects for infrastructure and other facility improvements geared toward creating seamless, high-capacity intermodal routes spanning 11 states from New Jersey to Louisiana and offering truck-competitive service along several major interstate highway corridors, including I-81, I-85, I-20, I-40, I-59, I-78, and I-75.
- The Heartland Corridor is a seamless, high-capacity intermodal route across Virginia and West Virginia to Midwest markets.
- Meridian Speedway LLC, a joint venture with Kansas City Southern, owns and operates a 320-mile rail line between Meridian, Mississippi and Shreveport, Louisiana designed to increase capacity and improve service.
- Pan Am Southern LLC, a joint venture with Pan Am Railways, Inc., owns and operates a 155-mile main line track that runs between Mechanicville, New York and Ayer, Massachusetts, along with 281 miles of secondary and branch lines, including trackage rights in New York, Connecticut, Massachusetts, New Hampshire, and Vermont designed to increase intermodal and automotive capacity.
- The CREATE project is a public-private partnership to reduce rail and highway congestion and add freight and passenger capacity in the metropolitan Chicago area. We and other railroads have agreed to participate in CREATE.

Equipment – At December 31, 2014, we owned or leased the following units of equipment:

	Owned[1]	Leased[2]	Total	Capacity of Equipment (Horsepower)
Locomotives:				
Multiple purpose	4,019	3	4,022	14,957,100
Auxiliary units	147	—	147	—
Switching	99	—	99	148,750
Total locomotives	4,265	3	4,268	15,105,850
				(Tons)
Freight cars:				
Gondola	30,368	3,335	33,703	3,669,559
Hopper	12,769	79	12,848	1,437,093
Box	11,046	1,366	12,412	1,039,594
Covered hopper	10,333	158	10,491	1,159,874
Flat	2,189	1,401	3,590	341,381
Other	4,596	14	4,610	221,362
Total freight cars	71,301	6,353	77,654	7,868,863
Other:				
Containers	12,468	8,531	20,999	
RoadRailer®	6,129	27	6,156	
Work equipment	4,482	303	4,785	
Vehicles	3,809	—	3,809	
Miscellaneous	20,131	4,246	24,377	
Total other	47,019	13,107	60,126	

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

(2) Includes short-term and long-term operating leases.

The following table indicates the number and year built for locomotives and freight cars owned at December 31, 2014:

	2014	2013	2012	2011	2010	2005-2009	2000-2004	1999& Before	Total
Locomotives:									
No. of units	73	50	60	90	42	362	663	2,925	4,265
% of fleet	2%	1%	1%	2%	1%	8%	16%	69%	100%
Freight cars:									
No. of units	900	0	2,018	3,831	150	4,639	572	59,191	71,301
% of fleet	1%	0%	3%	5%	0%	7%	1%	83%	100%

The following table shows the average age of our owned locomotive and freight car fleets at December 31, 2014, and information regarding 2014 retirements:

	Locomotives	Freight Cars
Average age – in service	23.1 years	30.1 years
Retirements	11 units	2,953 cars
Average age – retired	35.3 years	43.5 years

Our ongoing locomotive and freight car maintenance programs are intended to ensure the highest standards of safety, reliability, customer satisfaction, and equipment availability. The locomotive bad order ratio includes all units (owned and leased) out of service for required periodic inspections, unscheduled maintenance and program work which includes such activity as overhauls.

	Annual Average Bad Order Ratio									
	2014		2013		2012		2011		2010	
Locomotives	8.0	%	7.1	%	7.1	%	7.3	%	6.7	%
Freight cars	4.4	%	4.9	%	5.3	%	5.7	%	5.8	%

Encumbrances – Certain railroad equipment is subject to the prior lien of equipment financing obligations totaling $1 million at December 31, 2014.

Track Maintenance – Of the 35,900 total miles of track we operate, we are responsible for maintaining 28,750 miles, with the remainder being operated under trackage rights from other parties responsible for maintenance.

Over 82% of the main line trackage (including first, second, third, and branch main tracks, all excluding rail operated pursuant to trackage rights) has rail ranging from 131 to 155 pounds per yard with the standard installation currently at 136 pounds per yard. Approximately 45% of our lines, excluding rail operated pursuant to trackage rights, carried 20 million or more gross tons per track mile during 2014.

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

	2014	2013	2012	2011	2010
Track miles of rail installed	507	549	509	484	422
Miles of track surfaced	5,248	5,475	5,642	5,441	5,326
New crossties installed (millions)	2.7	2.5	2.6	2.7	2.6

Microwave System – Our microwave system, consisting of approximately 6,983 radio route miles, 423 core stations, 30 secondary stations, and 5 passive repeater stations, provides communications between most operating locations. We use the microwave system primarily for voice communications, VHF radio control circuits, data and facsimile transmissions, traffic control operations, and AEI data transmissions.

Traffic Control – Of the approximately 16,500 route miles we dispatch, about 11,025 miles are signalized, including 8,250 miles of centralized traffic control (CTC) and 2,775 miles of automatic block signals. Of the 8,250 miles of CTC, approximately 7,447 miles are controlled by data radio originating at 345 base station radio sites.

Computers – A computer network consisting of a centralized production and backup data center 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, our computer systems assist us in the performance of a variety of functions and services, including payroll, car and revenue accounting, billing, sourcing, inventory 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 one our principal goals. To date, such compliance has not had a material effect on our financial position, results of operations, liquidity, or competitive position. See “Legal Proceedings,” Part I, Item 3; “Personal Injury, Environmental, and Legal Liabilities” in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and Note 16 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:

	2014	2013	2012	2011	2010
Average number of employees	29,482	30,103	30,943	30,329	28,559
Average wage cost per employee	$76,000	$72,000	$69,000	$71,000	$69,000
Average benefit cost per employee	$35,000	$40,000	$38,000	$39,000	$37,000

More than 80% of our railroad employees are covered by collective bargaining agreements with various labor unions. See the discussion of “Labor Agreements” in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

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

The relaxation of economic regulation of railroads, following the Staggers Rail Act of 1980, included exemption from STB regulation of the rates and most service terms for intermodal business (trailer-on-flat-car, container-on-flat-car), rail boxcar shipments, lumber, manufactured steel, automobiles, and certain bulk commodities such as sand, gravel, pulpwood, and wood chips for paper manufacturing. Further, all shipments that we have under contract are effectively removed from regulation for the duration of the contract. About 90% of our revenues comes from either exempt shipments or shipments moving under transportation contracts; the remainder comes from shipments moving under public tariff rates.

Efforts have been made over the past several years to re-subject the rail industry to increased federal economic regulation, and such efforts are expected to continue in 2015. The Staggers Rail Act of 1980 substantially balanced the interests of shippers and rail carriers, and encouraged and enabled rail carriers to innovate, invest in their infrastructure, and compete for business, thereby contributing to the economic health of the nation and to the revitalization of the industry. Accordingly, we will continue to oppose efforts to reimpose increased economic regulation.

Government regulations concerning the safety and security of our railroads are discussed within the "Security of Operations" section contained herein.

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, semi-finished goods, and work-in-progress, users are increasingly sensitive to transport arrangements that minimize problems at successive production stages.

Our primary rail competitor is CSX Corporation; both railroads operate throughout much of the same territory. Other railroads also operate in parts of the territory. We also compete with motor carriers, water carriers, and with shippers who have the additional options of handling their own goods in private carriage, sourcing products from different geographic areas, and using substitute products.

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

SECURITY OF OPERATIONS - We continue to take measures to enhance the security of our rail system. Our comprehensive security plan is modeled on and was developed in conjunction with the security plan prepared by the Association of American Railroads (AAR) post September 11, 2001. The AAR Security Plan defines four Alert Levels and details the actions and countermeasures that are being applied across the railroad industry as a terrorist threat increases or decreases. The Alert Level actions include countermeasures that will be applied in three general areas: (1) operations (including transportation, engineering, and mechanical); (2) information technology and communications; and, (3) railroad police. All of our Operations Division employees are advised by their supervisors or train dispatchers, as appropriate, of any change in Alert Level and any additional responsibilities they may incur due to such change.

Our plan also complies with U.S. Department of Transportation (DOT) security regulations pertaining to training and security plans with respect to the transportation of hazardous materials. As part of the plan, security awareness training is given to all railroad employees who directly affect hazardous material transportation safety, and is integrated into hazardous material training programs. Additionally, location-specific security plans are in place for certain metropolitan areas and each of the six port facilities we serve. With respect to the ports, each facility plan has been approved by the applicable Captain of the Port and remains subject to inspection by the U.S. Coast Guard.

Additionally, we continue to engage in close and regular coordination with numerous federal and state agencies, including the U.S. Department of Homeland Security (DHS), the TSA, the Federal Bureau of Investigation (FBI), the FRA, the U.S. Coast Guard, U.S. Customs and Border Protection, and various state Homeland Security offices.

Similarly, we follow guidance from DHS and DOT regarding rail corridors in High Threat Urban Areas (HTUA). Particular attention is aimed at reducing risk in HTUA by: (1) the establishment of secure storage areas for rail cars carrying toxic-by-inhalation (TIH) materials; (2) the expedited movement of trains transporting rail cars carrying TIH materials; (3) substantially reducing the number of unattended loaded tank cars carrying TIH materials; and (4) cooperation with federal, state, local, and tribal governments to identify those locations where security risks are the highest.

In 2014, through participation in the Transportation Community Awareness and Emergency Response (TRANSCAER) Program, we provided rail accident response training to approximately 5,442 emergency responders, such as local police and fire personnel. Our other training efforts throughout 2014 included participation in drills for local, state, and federal agencies. We also have ongoing programs to sponsor local emergency responders at the Security and Emergency Response Training Course conducted at the AAR Transportation Technology Center in Pueblo, Colorado.

Item 1A. Risk Factors

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

Railroads are subject to safety and security regulation by the U.S. Department of Transportation and the U.S. Department of Homeland Security, which regulate most aspects of our operations. Compliance with the Rail Safety Improvement Act of 2008 will result in additional operating costs associated with the statutorily mandated implementation of positive train control by 2015. In addition to increased capital expenditures, implementation may result in reduced operational efficiency and service levels, as well as increased compensation and benefits expenses, and increased claims and litigation costs.

Our operations are subject to extensive federal and state environmental laws and regulations concerning, among other things, emissions to the air; discharges to waterways or groundwater 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. This risk includes property owned by us, whether currently or in the past, that is or has been subject to a variety of uses, including our railroad operations and other industrial activity by past owners or our past and present tenants.

Environmental problems that are latent or undisclosed may exist on these properties, and we 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 our financial position, results of operations, or liquidity in a particular year or quarter.

As a common carrier by rail, we 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 (including environmental) damage, and compromise critical parts of our rail network. A catastrophic rail accident involving hazardous materials could have a material adverse effect on our financial position, results of operations, or liquidity to the extent not covered by insurance. We have obtained insurance for potential losses for third-party liability and first-party property damages; however, 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 us.

We 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 our financial position, results of operations, or liquidity in a particular year or quarter. Because we play a critical role in the nation's transportation system, we 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 we currently maintain insurance coverage for third-party liability arising out of war and acts of terrorism, we maintain only limited insurance coverage for first-party property damage and damage to property in our care, custody, or control caused by certain acts of terrorism. In addition, premiums for some or all of our current insurance programs covering these losses could increase dramatically, or insurance coverage for certain losses could be unavailable to us in the future.

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

We may be affected by energy prices. Volatility in energy prices could have an effect on a variety of items including, but not limited to: the economy; demand for transportation services; business related to the energy sector, including crude and natural gas; fuel prices; and fuel surcharges. Any of these items could have a significant impact on our financial position, results of operations, or liquidity in a particular year or quarter.

We may be affected by climate change legislation or regulation. Concern over climate change has led to significant federal, state, and international legislative and regulatory efforts to limit greenhouse gas (GHG) emissions. Moreover, even without such legislation or regulation, government incentives and adverse publicity relating to GHGs could affect certain of our customers and the markets for certain of the commodities we carry. Restrictions, caps, taxes, or other controls on GHG emissions, including diesel exhaust, could significantly increase our operating costs, decrease the amount of traffic handled, and decrease the value of coal reserves we own, and thus could have an adverse effect on our financial position, results of operations, or liquidity in a particular year or quarter. Such restrictions could affect our customers that (1) use commodities that we carry to produce energy, including coal, (2) use significant amounts of energy in producing or delivering the commodities we carry, or (3) manufacture or produce goods that consume significant amounts of energy.

We face competition from other transportation providers. We are subject to competition from motor carriers, railroads and, to a lesser extent, ships, barges, and pipelines, on the basis of transit time, pricing, and quality and reliability of service. While we have used primarily internal resources to build or acquire and maintain our 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 we operate, or legislation granting materially greater latitude for motor carriers with respect to size or weight limitations, could have a material adverse effect on our financial position, results of operations, or liquidity in a particular year or quarter.

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

We rely on technology and technology improvements in our business operations. If we experience significant disruption or failure of one or more of our information technology systems, including computer hardware, software, and communications equipment, we could experience a service interruption, a security breach, or other operational difficulties. Additionally, if we do not have sufficient capital to acquire new technology or we are unable to implement new technology, we may suffer a competitive disadvantage within the rail industry and with companies providing other modes of transportation service. Any of these factors could have a material adverse effect on our financial position, results of operations, or liquidity in a particular year or quarter.

The vast majority of our employees belong to labor unions, and labor agreements, strikes, or work stoppages could adversely affect our operations. More than 80% of our 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, we could experience a significant disruption of our operations. Additionally, future national labor agreements, or renegotiation of labor agreements or provisions of labor agreements, could significantly increase our costs for healthcare, wages, and other benefits. Any of these factors could have a material adverse impact on our financial position, results of operations, or liquidity in a particular year or quarter.

We may be subject to various claims and lawsuits that could result in significant expenditures. The nature of our business exposes us to the potential for various claims and litigation related to labor and employment, personal injury, commercial disputes, freight loss and other property damage, and other matters. Job-related personal injury and occupational claims are subject to the Federal Employer's 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 property damage, personal injury, and environmental liability could have a material adverse effect on our financial position, results of operations, or liquidity to the extent not covered by insurance. We have obtained insurance for potential losses for third-party liability and first-party property damages. Specified levels of risk are retained on a self-insurance basis (currently up to $50 million and above $1.2 billion per occurrence and/or policy year for bodily injury and property damage to third parties and up to $25 million and above $200 million per occurrence and/or policy year for property owned by us or in our care, custody, or control). 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 us.

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

Unpredictability of demand for rail services resulting in the unavailability of qualified personnel could adversely affect our 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 our 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 our operational efficiency and otherwise have a material adverse effect on our financial position, results of operations, or liquidity in a particular year or quarter.

We may be affected by supply constraints resulting from disruptions in the fuel markets or the nature of some of our supplier markets. We consumed 494 million gallons of diesel fuel in 2014. Fuel availability could be affected by any limitation in the fuel supply or by any imposition of mandatory allocation or rationing regulations. A severe fuel supply shortage arising from production curtailments, increased demand in existing or emerging foreign markets, disruption of oil imports, disruption of domestic refinery production, damage to refinery or pipeline infrastructure, political unrest, war or other factors, could have a material adverse effect on our financial position, results of operations, or liquidity in a particular year or quarter. Also, such an event could impact us as well as our customers and other transportation companies.

Due to the capital intensive nature, as well as the industry-specific requirements of the rail industry, high barriers of entry exist for potential new suppliers of core railroad items, such as locomotives and rolling stock equipment. Additionally, we compete with other industries for available capacity and raw materials used in the production of locomotives and certain track and rolling stock materials. Changes in the competitive landscapes of these limited-supplier markets could result in increased prices or significant shortages of materials that could have a material adverse effect on our financial position, results of operations, or liquidity in a particular year or quarter.

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

Item 1B. Unresolved Staff Comments

None.

Item 3. Legal Proceedings

On November 6, 2007, various antitrust class actions filed against us and other Class I railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. On June 21, 2012, the court certified the case as a class action. The defendant railroads appealed this certification, and the Court of Appeals for the District of Columbia vacated the District Court's decision and remanded the case for further consideration. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases. We do not believe the outcome of these proceedings will have a material effect on our financial position, results of operations, or liquidity. A lawsuit containing similar allegations against us and four other major railroads that was filed on March 25, 2008, in the U.S. District Court for the District of Minnesota, was voluntarily dismissed by the plaintiff subject to a tolling agreement entered into in August 2008, and most recently extended in August 2013.

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

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

Item 4. Mine Safety Disclosures

Not applicable.

Executive Officers of the Registrant

Our 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 our 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, at February 1, 2015, relating to our officers.

Name, Age, Present Position	Business Experience During Past Five Years
Charles W. Moorman, 62, Chairman and Chief Executive Officer	Present position since February 1, 2006.
James A. Squires, 53, President	Present position since June 1, 2013. Served as Executive Vice President – Administration from August 1, 2012 to June 1, 2013. Served as Executive Vice President – Finance and Chief Financial Officer from July 1, 2007 to August 1, 2012.
Deborah H. Butler, 60, Executive Vice President – Planning and Chief Information Officer	Present position since June 1, 2007.
Cindy C. Earhart, 53, Executive Vice President – Administration	Present position since June 1, 2013. Served as Vice President Human Resources from March 1, 2007 to June 1, 2013.
James A. Hixon, 61, Executive Vice President – Law and Corporate Relations	Present position since October 1, 2005.
Mark D. Manion, 62, Executive Vice President and Chief Operating Officer	Present position since April 1, 2009.
Donald W. Seale, 62, Executive Vice President and Chief Marketing Officer	Present position since April 1, 2006.
Marta R. Stewart, 57, Executive Vice President – Finance and Chief Financial Officer	Present position since November 1, 2013. Served as Vice President and Treasurer from April 1, 2009 to November 1, 2013.
Thomas E. Hurlbut, 50, Vice President and Controller	Present position since November 1, 2013. Served as Vice President Audit and Compliance from February 1, 2010 to November 1, 2013. Served as Assistant Vice President Internal Audit from

February 1, 2008 to February 1, 2010.

PART II

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

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

STOCK PRICE AND DIVIDEND INFORMATION

Common Stock is owned by 29,575 stockholders of record as of December 31, 2014 and is traded on the New York Stock Exchange under the symbol "NSC." The following table shows the high and low sales prices as reported by Bloomberg L.P. on its internet-based service and dividends per share, by quarter, for 2014 and 2013.

	Quarter			
2014	1st	2nd	3rd	4th
Market Price				
High	$97.58	$104.09	$112.34	$117.24
Low	87.20	92.78	100.11	101.98
Dividends per share	0.54	0.54	0.57	0.57
2013	1st	2nd	3rd	4th
Market Price				
High	$75.59	$79.32	$77.84	$92.87
Low	61.63	69.55	70.73	75.82
Dividends per share	0.50	0.50	0.52	0.52

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares (or Units) Purchased[1]	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs[2]	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased under the Plans or Programs[2]
October 1-31, 2014	228,550	$108.53	228,081	36,371,413
November 1-30, 2014	375,357	113.79	372,778	35,998,635
December 1-31, 2014	795,764	105.76	794,798	35,203,837
Total	1,399,671		1,395,657	

(1) Of this amount, 4,014 represents shares tendered by employees in connection with the exercise of stock options under the stockholder-approved Long-Term Incentive Plan.

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

Item 6. Selected Financial Data

FIVE-YEAR FINANCIAL REVIEW

	2014	2013	2012	2011	2010
	($ in millions, except per share amounts)				
RESULTS OF OPERATIONS					
Railway operating revenues	$11,624	$11,245	$11,040	$11,172	$9,516
Railway operating expenses	8,049	7,988	7,916	7,959	6,840
Income from railway operations	3,575	3,257	3,124	3,213	2,676
Other income – net	104	233	129	160	153
Interest expense on debt	545	525	495	455	462
Income before income taxes	3,134	2,965	2,758	2,918	2,367
Provision for income taxes	1,134	1,055	1,009	1,002	871
Net income	$2,000	$1,910	$1,749	$1,916	$1,496
PER SHARE DATA					
Net income – basic	$6.44	$6.10	$5.42	$5.52	$4.06
– diluted	6.39	6.04	5.37	5.45	4.00
Dividends	2.22	2.04	1.94	1.66	1.40
Stockholders' equity at year end	40.25	36.55	31.08	30.00	29.85
FINANCIAL POSITION					
Total assets	$33,241	$32,483	$30,342	$28,538	$28,199
Total debt	9,026	9,448	8,682	7,540	7,025
Stockholders' equity	12,408	11,289	9,760	9,911	10,669
OTHER					
Property additions	$2,118	$1,971	$2,241	$2,160	$1,470
Average number of shares outstanding (thousands)	309,367	311,916	320,864	345,484	366,522
Number of stockholders at year end	29,575	30,990	32,347	33,381	35,416
Average number of employees:					
Rail	29,063	29,698	30,543	29,933	28,160
Nonrail	419	405	400	396	399
Total	29,482	30,103	30,943	30,329	28,559

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

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

OVERVIEW

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

Strong volume growth in our intermodal and merchandise businesses driven by higher demand for rail services offset declines in our coal business, resulting in a $379 million, or 3%, improvement in our operating revenues. Our continued focus on cost control helped stem growth in operating expenses (up $61 million, or 1%) despite higher volumes and led to an all-time low operating ratio (a measure of the amount of operating revenues consumed by operating expenses) of 69.2% for 2014.

The unexpected volume growth and severe winter weather led to resource shortages and network delays during the year. We are committed to improving our service and have added resources to meet the needs of our network. As a result of these efforts, in the latter part of the year we saw improvement in operational metrics and expect this to continue in 2015.

Looking forward to 2015, we expect the impact of lower oil prices on our fuel surcharge revenue programs to be offset by increased volumes and higher rates. We will continue to focus on safety, service levels, cost control, productivity, operational efficiency, and a market-based approach to pricing.

SUMMARIZED RESULTS OF OPERATIONS

2014 Compared with 2013

Net income in 2014 was $2.0 billion, or $6.39 per diluted share, up $90 million, or 5%, compared with $1.9 billion, or $6.04 per diluted share, in 2013, as a 10% increase in income from railway operations was only partially offset by the absence of a gain from a land sale in Michigan, which benefited net income by $60 million and earnings per share by $0.19 in 2013. Railway operating revenues rose 3%, while operating expenses increased only 1%, driven largely by higher volume-related expenses that were offset in part by lower compensation and benefits costs and fuel prices.

2013 Compared with 2012

Net income in 2013 was $1.9 billion, or $6.04 per diluted share, up $161 million, or 9%, compared with $1.7 billion, or $5.37 per diluted share, in 2012, a reflection of a 4% increase in income from railway operations, in addition to the favorable impact of the recognition of the gain from a land sale in Michigan (see above). Railway operating revenues rose 2%, while operating expenses increased 1%, driven largely by higher volume-related expenses.

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Railway operating revenues were $11.6 billion in 2014, $11.2 billion in 2013, and $11.0 billion in 2012. The following table presents a three-year comparison of revenues, volumes, and average revenue per unit by market group.

	Revenues			Units			Revenue per Unit		
	2014	2013	2012	2014	2013	2012	2014	2013	2012
	($ in millions)			(in thousands)			($ per unit)		
Coal	$2,382	$2,543	$2,879	1,284.4	1,346.7	1,414.1	$1,855	$1,888	$2,036
General merchandise:									
Chemicals	1,863	1,667	1,467	502.6	449.2	388.8	3,707	3,711	3,772
Metals/construction	1,521	1,405	1,335	725.6	666.9	669.7	2,096	2,106	1,993
Agr./consumer/gov't.	1,498	1,467	1,446	603.8	594.3	595.9	2,481	2,468	2,427
Automotive	1,004	984	897	410.1	402.1	374.6	2,447	2,448	2,395
Paper/clay/forest	794	795	775	303.2	309.4	305.8	2,619	2,570	2,536
General merchandise	6,680	6,318	5,920	2,545.3	2,421.9	2,334.8	2,624	2,609	2,536
Intermodal	2,562	2,384	2,241	3,845.2	3,572.3	3,358.3	666	667	667
Total	$11,624	$11,245	$11,040	7,674.9	7,340.9	7,107.2	$1,515	$1,532	$1,553

Revenues increased $379 million in 2014, and $205 million in 2013. As reflected in the table below, the increase in 2014 resulted from higher volumes, partially offset by lower average revenue per unit as the effects of lower rates and changes in the mix of business more than offset higher fuel surcharges. The increase in 2013 resulted from higher volumes, partially offset by lower average revenue per unit as lower market-based export coal rates, the effects of changes in the mix of business, and slightly lower fuel surcharges more than offset rate increases.

	Revenue Variance Analysis Increase (Decrease)	
	2014 vs. 2013	2013 vs. 2012
	($ in millions)	
Volume (units)	$512	$363
Revenue per unit	(133)	(158)
Total	$379	$205

Over 85% of our revenue base is covered by negotiated fuel surcharges, and revenues in 2014 included $1,329 million of such surcharges. This amount was divided about evenly between surcharges tied to the monthly average price of West Texas Intermediate Crude Oil (WTI) and surcharges tied to the weekly average price of On-Highway Diesel (OHD). More than two-thirds of the 2014 WTI-based surcharges were attributable to contracts with trigger prices above current WTI levels of about $50 per barrel (a predominant trigger price is $64 per barrel); therefore, if WTI prices remain below these triggers, traffic moving under these contracts will not be assessed any fuel surcharge. Almost all of the remaining WTI-based surcharges have trigger prices well below current WTI levels, and almost all of the OHD-based surcharges have trigger prices substantially below current OHD levels (of about $3 per gallon). As a result, if WTI and OHD prices remain at their current levels, traffic moving under these

contracts will continue to be assessed fuel surcharges; however, they will be substantially lower than those generated in 2014. Thus, total fuel surcharges for 2015 could be less than half of the amount in 2014. The WTI-related surcharges are reset the first day of each calendar month based on the WTI average price for the second preceding calendar month. This two-month lag in applying the WTI average price increased fuel surcharge revenue by approximately $84 million in 2014, decreased fuel surcharge revenue by approximately $29 million in 2013, and increased fuel surcharge revenue by approximately $39 million in 2012. Fuel surcharge revenue totaled $1,254 million in 2013, and $1,278 million in 2012.

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

COAL revenues decreased $161 million, or 6%, compared with 2013, reflecting a 5% decrease in carload volume. Average revenue per unit was down 2%, the result of lower pricing (mainly market-based export coal) and the negative effect of changes in mix.

In 2013, coal revenues decreased $336 million, or 12%, compared with 2012, reflecting a 5% decrease in carload volume (tonnage hauled declined 4%). Average revenue per unit was down 7%, the result of lower pricing (mainly market-based export coal) and decreased fuel surcharge revenue, partially offset by the positive effect of changes in mix.

For 2015, coal revenues are expected to decrease due to lower average revenue per unit (largely a result of lower fuel surcharge revenue) and decreased volumes.

Coal represented 21% of our revenues in 2014, and 79% of shipments handled originated on our lines. As shown in the following table, tonnage decreased in our export, utility, and domestic metallurgical markets but increased in our industrial markets.

	Coal Tonnage by Market		
	2014	2013	2012
	(tons in thousands)		
Utility	93,884	97,146	101,636
Export	23,218	28,631	28,304
Domestic metallurgical	16,130	16,905	18,793
Industrial	8,599	7,388	7,376
Total	141,831	150,070	156,109

Utility coal tonnage was down 3% in 2014, compared with 2013. Lower utility coal shipments to our northern region due to market share loss and competition from lower priced natural gas were offset in part by gains in our southern region, resulting from strong demand for electric generation and stockpile rebuilding after a harsh winter.

Utility coal tonnage was down 4% in 2013 as compared to 2012. Utility coal shipments in our southern region decreased due to lower demand as utility stockpiles remained high and natural gas prices remained low. This

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decrease was partially offset by increased shipments in our northern region as higher coal burn necessitated stockpile replenishments to maintain targeted levels.

For 2015, we expect utility coal tonnage to decrease as we expect lower demand resulting from a decline in natural gas prices and reduced coal burn at southern utilities we serve.

Export coal tonnage decreased 19% in 2014, compared with 2013. Strong competition in the global metallurgical and thermal coal markets resulting from excess coal supply, weakening economies in the global market, and a strong Australian currency advantage significantly reduced demand for U.S. export coal. Volume through Norfolk was down 4.3 million tons, or 20%, and volume through Baltimore was down 0.5 million tons, or 8%. Other export volume decreased 0.6 million tons, or 85%.

In 2013, export coal tonnage increased 1%, compared with 2012. Despite strong global competition, we handled higher export thermal and metallurgical coal shipments as an increase in steel production in developing markets offset weakness in the European market. Volume through Norfolk was up 2.1 million tons, or 11%, whereas Baltimore volume decreased 1.4 million tons, or 17%. Other export volume decreased 0.4 million tons, or 36%.

For 2015, export coal tonnage is expected to decrease as a result of strong competition in the overseas metallurgical coal market, in addition to soft demand for and an oversupply of thermal coal.

Domestic metallurgical coal tonnage was down 5% in 2014, compared with 2013, as lower metallurgical coal shipments resulting from plant curtailments and customer sourcing shifts were offset in part by higher shipments of coke.

In 2013, domestic metallurgical coal tonnage was down 10%, compared with 2012, due to weaker domestic steel production, sourcing shifts away from coal origins we serve, and the permanent closure of a steel plant in mid-2012 that impacted the year-over-year comparison for the first half of 2013.

For 2015, domestic metallurgical coal tonnage is expected to decline due to closure of a mine that we currently serve.

Industrial coal tonnage increased 16% in 2014, compared with 2013, as new business opportunities with existing customers was partially offset by declines in anthracite and petcoke shipments.

In 2013, industrial coal tonnage increased slightly compared with 2012, as increased shipments to existing customers were partially offset by weaker industrial demand in the print paper and cement sectors.

For 2015, industrial coal tonnage is expected to decrease, primarily due to conversions to natural gas.

GENERAL MERCHANDISE revenues in 2014 increased $362 million, or 6%, compared with 2013, reflecting 5% growth in carload volume and a 1% improvement in average revenue per unit that reflected favorable changes in fuel surcharge revenue and in mix.

In 2013, general merchandise revenues increased $398 million, or 7%, compared with 2012, reflecting 4% growth in carload volume and a 3% improvement in average revenue per unit that reflected favorable changes in mix as well as higher rates and fuel surcharges.

Chemicals revenues in 2014 increased 12%, compared with 2013, reflecting volume growth (up 12%) largely driven by higher shipments of crude oil originated from the Bakken and Canadian oil fields and growth in shipments of liquefied petroleum gas in the Utica Shale region.

In 2013, chemicals revenues increased 14%, compared with 2012, reflecting 16% growth in volume partially offset by a 2% decline in average revenue per unit that resulted from the negative effect of the changes in mix due to increased crude oil shipments. The volume improvement was primarily the result of more carloads of crude oil from the Bakken and Canadian oil fields. Additionally, there were more carloads of liquefied petroleum gas in the Utica Shale region.

For 2015, chemicals revenues are anticipated to increase, as we expect more shipments of crude oil and liquefied petroleum gas. However, a prolonged period of low oil prices could put pressure on demand for crude by rail. Average revenue per unit is expected to be lower, largely a result of the anticipated reduction in fuel surcharge revenue and the negative mix effect of the volume increase in lower-rated shipments.

Metals and construction revenues grew 8% in 2014, compared with 2013. The revenue improvement resulted from a 9% increase in carloads, as we moved more shipments of fractionating sand for natural gas drilling, in addition to higher coil shipments to support growing demand in the automotive and energy sectors, and increased shipments of iron and steel as a result of higher import activity.

In 2013, metals and construction revenues increased 5% compared with 2012. The improvement resulted from 6% higher average revenue per unit, which reflected the positive change in mix of business as we transported higher-rated shipments of slag and fractionating sand for natural gas drilling, higher rates, and increased fuel surcharges. Although we moved more slag and fractionating carloads, volume declined modestly as we handled reduced shipments of iron and steel (driven by fewer import slabs and a steel plant closure during the third quarter of 2012) and scrap metal (a result of weakening demand).

For 2015, metals and construction revenues are expected to decline, reflecting lower average revenue per unit as a result of the anticipated decline in fuel surcharge revenue, partially offset by improved volumes. We currently anticipate higher shipments of fractionating sand and other materials used for natural gas drilling, as well as additional shipments of aggregates due to growth in road construction activity and steel used by the automotive and energy sectors.

Agriculture, consumer products, and government revenues increased 2% in 2014, compared with 2013, as a result of a 2% improvement in volume and a 1% improvement in average revenue per unit, due primarily to higher rates that were slightly offset by a negative change in mix. The volume increase was driven by higher corn shipments due to increased demand for ethanol production, partially offset by fewer shipments of fertilizer due to production curtailments.

In 2013, agriculture, consumer products, and government revenues increased 1% compared with 2012, as a 2% improvement in average revenue per unit (reflecting pricing improvements that were slightly offset by a negative change in mix related to the increase of lower-rated shorter-haul movements of corn) was partially offset by a slight decrease in volume. The volume decrease was driven by reduced shipments of soybeans and related products caused by tightened supplies of domestic beans and a strong South American crop, in addition to fewer revenue movements of empty equipment. Carload volume declines were partially offset by higher shipments of food oils as we handled new business with existing customers and more biodiesel carloads in advance of the anticipated elimination of the biodiesel tax credit. We also hauled more shipments of fertilizer due to a strong farm economy and increased planting activity.

For 2015, agriculture, consumer products, and government revenues are expected to be flat as we expect higher volumes will be offset by lower average revenue per unit reflecting lower fuel surcharges offset in part by pricing gains. Volume growth is anticipated to come from higher shipments of soybeans as we return to a more normal crop cycle, more carloads of ethanol, and growth in feed product shipments as a result of increased export opportunities.

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Automotive revenues rose 2% compared to 2013, reflecting 2% growth in volume due to increased vehicle production at plants we serve that was offset in part by the diversion of shipments to other modes of transportation as a result of equipment shortages and network delays.

In 2013, automotive revenues rose 10% compared to 2012, reflecting 7% growth in volume due to increased vehicle production at plants we serve and new business from existing customers (including both auto parts and finished vehicles). Average revenue per unit improved 2%, reflecting improved pricing and higher fuel surcharges.

For 2015, automotive revenues are expected to slightly decrease as a result of lower average revenue per unit as lower fuel surcharges are expected to offset improved pricing. These average revenue per unit declines are expected to be partially offset by volume gains driven by a continued increase in domestic production at plants we serve and the return of diverted traffic.

Paper, clay and forest products revenues were flat as a 2% improvement in average revenue per unit (reflecting pricing gains and positive mix) was offset by a 2% decrease in volumes. Volume declines were driven by reduced shipments of municipal solid waste resulting from loss of business, lower shipments of newsprint and paper due to mill and plant closures, and fewer pulp shipments due to production issues and reduced export demand. These declines were offset in part by higher lumber shipments resulting from the continued housing recovery and new business.

In 2013, paper, clay and forest products revenues increased 3% compared with 2012, reflecting 1% gains in both volume and average revenue per unit. Volume increases for lumber, pulp, and pulpboard were offset by reduced demand for newsprint and paper.

For 2015, paper, clay, and forest products revenues are anticipated to decline reflecting lower fuel surcharge revenue and a negative mix of business, offset in part by slightly higher volumes. Volume growth is expected to be driven by higher woodchip, wood pellet, lumber, and pulp shipments as we anticipate the continued recovery of the housing market to increase demand, offset in part by lower municipal solid waste (loss of a customer) and newsprint and paper shipments as demand declines.

INTERMODAL revenues increased $178 million, or 7%, compared with 2013, reflecting an 8% growth in volume.

Domestic volume (including truckload and intermodal marketing companies, Triple Crown Services, and Premium business) improved 6%, a result of growth in strategic corridors, continued highway-to-rail conversions, and higher demand for rail service from existing customers. International volume grew 10% due to increased demand from existing customers and expanded service opportunities.

In 2013, intermodal revenues increased $143 million, or 6%, compared with 2012, reflecting a 6% growth in volume. Average revenue per unit was flat. Domestic volume improved 7%, the result of continued highway-to-rail conversions and additional business associated with the opening of new intermodal terminals. International volume grew 6% due to growth with existing customers as well as new service lanes.

For 2015, we anticipate higher intermodal revenues due to increased volumes as a result of continued highway conversions and growth associated with new and existing customers. Average revenue per unit is expected to be lower as pricing gains are offset by reduced fuel surcharge revenue.

Railway Operating Expenses

Railway operating expenses in 2014 were $8.0 billion, up $61 million, or 1%, compared to 2013. Expenses in 2013 were $8.0 billion, up $72 million, or 1%, compared to 2012. In 2014, increases in volume-related costs were offset in part by lower postretirement and pension benefit costs as well as lower fuel prices. For 2013, higher wage rates and volume-related expense increases were offset in part by lower costs resulting from network efficiencies.

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

	Operating Expense Variances Increase (Decrease)	
	2014 vs. 2013	2013 vs. 2012
	($ in millions)	
Materials and other	$112	$(31)
Purchased services and rents	58	25
Depreciation	35	—
Fuel	(39)	36
Compensation and benefits	(105)	42
Total	$61	$72

Materials and other expenses increased $112 million, or 14%, in 2014, but decreased $31 million, or 4%, in 2013, as shown in the following table.

	2014	2013	2012
	($ in millions)		
Materials	$470	$422	$408
Casualties and other claims	135	90	130
Other	335	316	321
Total	$940	$828	$859

Volume growth in 2014 and 2013 drove increases in locomotive and equipment maintenance and repair costs for both years. Additionally, the harsh winter weather experienced in the first quarter of 2014 resulted in increased maintenance activity, which negatively impacted the year-over-year comparison. Casualties and other claims expenses include the estimates of costs related to personal injury (PI), property damage, and environmental matters. The increase in expense in 2014 reflected lower favorable PI reserve adjustments for prior years' claim amounts than those seen in 2013, which were driven by improved historical trend rates related to PI liabilities.

We maintain substantial amounts of insurance for potential third-party liability and property damage claims. We also retain reasonable levels of risk through self-insurance. For further discussion of casualty claims and insurance see Note 16.

Purchased services and rents includes the costs of services purchased from outside contractors, including the net costs of operating joint (or leased) facilities with other railroads and the net cost of equipment rentals. This category of expenses increased $58 million, or 4%, in 2014, and $25 million, or 2%, in 2013.

	2014	2013	2012
	($ in millions)		
Purchased services	$ 1,394	$ 1,353	$ 1,321
Equipment rents	293	276	283
Total	$ 1,687	$ 1,629	$ 1,604

The increase in 2014 for purchased services expense reflected the impact of higher volumes and reduced network velocity on intermodal operations and joint facilities costs. Additionally, higher maintenance and repair costs were offset in part by reduced expenses associated with the shared asset areas (including equity in the earnings of Conrail, see Note 5). The increase in 2013 reflected higher volume-related activities and software expenses, partially offset by lower professional and consulting fees and travel expenses.

Equipment rents, which includes our cost of using equipment (mostly freight cars) owned by other railroads or private owners less the rent paid to us for the use of our equipment, increased in 2014 as a result of higher volumes and network congestion, but decreased in 2013 as a result of increased velocity and improved equipment utilization.

Depreciation expense increased by $35 million, or 4%, in 2014, and was flat in 2013. Both periods reflected our larger roadway and equipment capital base as we continue to invest in our infrastructure and rolling stock. In 2013, that increase was completely offset by the favorable impact of an equipment depreciation study that was completed during the first quarter of 2013.

Fuel expense, which includes the cost of locomotive fuel as well as other fuel used in railway operations, decreased $39 million, or 2%, in 2014 but increased $36 million, or 2%, in 2013. The decrease in 2014 was principally the result of lower locomotive fuel prices (down 6%), offset in part by higher locomotive fuel consumption (up 4%). The increase in 2013 reflected higher locomotive fuel consumption (up 4%), offset in part by lower locomotive fuel prices (down 2%). We consumed approximately 494 million gallons of diesel fuel in 2014 compared with 476 million gallons in 2013. Should fuel prices remain at current levels, we would expect to see a significant savings in fuel expenses in 2015 as compared to 2014.

Compensation and benefits, which represents 36% of total operating expenses, decreased $105 million, or 3%, in 2014, reflecting changes in:

- postretirement and pension benefit costs (down $152 million),
- health and welfare benefit costs (down $25 million),
- pay rates (up $57 million), and
- payroll taxes (up $21 million).

In 2013, compensation and benefits increased $42 million, or 1% over 2012, reflecting changes in:

- pay rates (up $59 million),
- incentive and stock-based compensation (up $39 million),
- lower activity levels (down $48 million) that reflected improved employee productivity, and
- payroll taxes (down $16 million).

Our employment averaged 29,482 in 2014, compared with 30,103 in 2013, and 30,943 in 2012. Looking forward to 2015, we expect employment levels to be higher than 2014 as we continue to add resources to our network.

Other Income – Net

Other income – net was $104 million in 2014, $233 million in 2013, and $129 million in 2012 (Note 2). Both comparisons reflect the Michigan land sale ($97 million) that occurred in 2013.

Income Taxes

Income tax expense in 2014 was $1.1 billion, an effective rate of 36.2%, compared with 35.6% in 2013 and 36.6% in 2012. The 2014 and 2013 years benefited from favorable reductions in deferred tax expense for state law changes and certain business tax credits.

The Tax Increase Prevention Act of 2014 (2014 Act), enacted on December 19, 2014, extended for the year 2014 fifty-percent bonus depreciation and certain business tax credits that benefit us. While bonus depreciation does not affect our total provision for income taxes or effective rate, the absence of bonus depreciation will increase current income tax expense and the related cash outflows for the payment of income taxes. The effect of this tax legislation will be seen as a reduction in our 2015 cash outflows for income taxes as our required year-end estimated tax payment was due and paid before the 2014 Act was enacted.

IRS examinations have been completed for all years prior to 2011. Our consolidated federal income tax returns for 2011 and 2012 are currently being audited by the IRS. We anticipate that the IRS will complete its examination in 2015. We do not expect that the resolution of the examination will have a material effect on our financial position, results of operations, or liquidity.

FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

Cash provided by operating activities, our principal source of liquidity, was $2.9 billion in 2014 and $3.1 billion in both 2013 and 2012. The decrease in 2014 reflected increased tax payments (see above), offset in part by improved operating results. We had working capital of $998 million at December 31, 2014, compared with $770 million at December 31, 2013, primarily reflecting reduced current maturities of long-term debt. Cash, cash equivalents, and short-term investment balances totaled $973 million and $1.6 billion at December 31, 2014 and 2013, respectively, and were invested in accordance with our corporate investment policy as approved by the Board of Directors. The portfolio contains securities that are subject to market risk. There are no limits or restrictions on our access to these assets. We expect cash on hand combined with cash provided by operating activities will be sufficient to meet our ongoing obligations.

Contractual obligations at December 31, 2014, were comprised of interest on fixed-rate long-term debt and capital leases, long-term debt and capital leases (Note 8), operating leases (Note 9), agreements with CRC (Note 5), unconditional purchase obligations (Note 16), long-term advances from Conrail (Note 5), and unrecognized tax benefits (Note 3):

	Total	2015	2016 - 2017	2018 - 2019	2020 and Subsequent	Other
	($ in millions)					
Interest on fixed-rate long-term debt and capital lease principal	$12,798	$515	$966	$822	$10,495	$—
Long-term debt and capital lease principal	9,400	2	1,050	1,185	7,163	—
Operating leases	711	83	140	105	383	—
Agreements with CRC	340	36	72	72	160	—
Unconditional purchase obligations	879	508	366	5	—	—
Long-term advances from Conrail	280	—	—	—	280	—
Unrecognized tax benefits*	61	29	—	—	—	32
Total	$24,469	$1,173	$2,594	$2,189	$18,481	$32

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

Off balance sheet arrangements consist of obligations related to operating leases, which are included in the table of contractual obligations above and disclosed in Note 9.

Cash used in investing activities was $2.0 billion in 2014, compared with $1.9 billion in 2013, and $2.0 billion in 2012. The increase in 2014 primarily reflected increased use of cash for property additions and COLI investments, which were partially offset by higher short-term investment maturities. The decrease in 2013 resulted from lower property additions and property sales that were partially offset by increased investment purchases, net of sales.

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.

Property Additions

	2014	2013	2012	2011	2010
	($ in millions)				
Road and other property	$1,406	$1,421	$1,465	$1,222	$1,153
Equipment	712	550	776	938	317
Total	$2,118	$1,971	$2,241	$2,160	$1,470

Track Structure Statistics (Capital and Maintenance)

	2014	2013	2012	2011	2010
Track miles of rail installed	507	549	509	484	422
Miles of track surfaced	5,248	5,475	5,642	5,441	5,326
New crossties installed (millions)	2.7	2.5	2.6	2.7	2.6

Average Age of Owned Railway Equipment

	2014	2013	2012	2011	2010
	(years)				
Freight cars	30.1	30.2	30.2	30.3	31.0
Locomotives	23.1	22.5	21.6	21.0	20.5
Retired locomotives	35.3	38.7	41.2	31.7	28.4

For 2015, we have budgeted $2.4 billion for property additions. The anticipated spending includes $930 million for the normalized replacement of rail, ties and ballast and the improvement or replacement of bridges. Planned equipment spending of $640 million includes used and rebuilt locomotives, intermodal containers and chasis, coal cars, covered and open coil cars, mill gondolas, multilevel automobile racks, and covered hoppers. Investments in facilities and terminals are anticipated to be $240 million and include terminals and equipment to add capacity to our intermodal network (including Crescent Corridor), new or expanded bulk transfer facilities, improvements to vehicle distribution facilities, and upgrades and expansions of our mechanical service shops. For 2015, we have budgeted $220 million for the continued implementation of positive train control (PTC) and expect post-2015 PTC-related property additions to total over $450 million. We also expect to spend $100 million on infrastructure improvements to increase mainline capacity, accommodate business growth and provide our share of funding for various public/private partnership investments such as Crescent Corridor and the Chicago CREATE project. Technology investments of $70 million are planned for new or upgraded systems and computers.

Additionally, in November 2014 we announced a proposed transaction under which we would acquire 282 miles of the Delaware & Hudson Railway Co. (D&H) rail line between Sunbury, Pennsylvania and Schenectady, New York for $217 million. The acquisition of this property is subject to approval by the STB and if approved, expected to be completed in 2015.

The Crescent Corridor consists of a program of projects for infrastructure and other facility improvements geared toward creating a seamless, high-capacity intermodal route spanning 11 states from New Jersey to Louisiana and offering truck-competitive service along several major interstate highway corridors, including I-81, I-85, I-20, I-40, I-59, I-78, and I-75. Based on the public benefits that stand to be derived in the form of highway congestion relief, we plan to implement certain elements of the Crescent Corridor through a series of public-private partnerships. Currently, the Crescent Corridor has received or expects to receive a total of $312 million in public capital funding commitments from the Commonwealths of Pennsylvania and Virginia, the State of Tennessee, the federal TIGER Stimulus Program and other federal funding sources related to projects in Alabama, Pennsylvania, Tennessee, and North Carolina. With respect to the private funding component, we currently anticipate spending up to $344 million ($291 million of which has been spent to date) for the substantial completion of work on these projects, which is expected in 2015. This includes planned investments for the Crescent Corridor that approximate $42 million in 2015. If and when demand warrants, additional improvements and expansions beyond these amounts may be made to the Crescent Corridor.

Cash used in financing activities was $1.3 billion in 2014, compared with $394 million in 2013, and $694 million in 2012. The increase in 2014 was driven primarily by higher debt repayments and lower debt proceeds, partially

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offset by reduced share repurchase activity (see Note 14). The change in 2013 reflected lower share repurchases and reduced proceeds from borrowings, net of debt repayments.

Share repurchases totaled $318 million in 2014, $627 million in 2013, and $1.3 billion in 2012 for the purchase and retirement of 3.1 million, 8.3 million, and 18.8 million shares, respectively. On August 1, 2012, our Board of Directors authorized the repurchase of up to an additional 50 million shares of Common Stock through December 31, 2017, and 35.2 million shares remain under this authority as of December 31, 2014. The timing and volume of future share repurchases will be guided by our assessment of market conditions and other pertinent factors. Any near-term purchases under the program are expected to be made with internally generated cash, cash on hand, or proceeds from borrowings.

During the fourth quarter of 2013, we issued $400 million of 3.85% senior notes due 2024. During the third quarter of 2013, we issued $500 million of 4.80% senior notes due 2043. Our debt-to-total capitalization ratio was 42.1% at December 31, 2014, compared with 45.6% at December 31, 2013.

We further discuss our current securities issuance authority from our our Board of Directors, our credit agreement, and our accounts receivable securitization program in Note 8 of our Notes to Consolidated Financial Statements, all of which provide for additional access to liquidity should the need arise.

Upcoming annual debt maturities are relatively modest (Note 8). Overall, our goal is to maintain a capital structure with appropriate leverage to support our business strategy and provide flexibility through business cycles.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. These estimates and assumptions may require significant judgment about matters that are inherently uncertain, and future events are likely to occur that may require us to make changes to these estimates and assumptions. Accordingly, we regularly review these estimates and assumptions based on historical experience, changes in the business environment, and other factors we believe to be reasonable under the circumstances. We regularly discuss the development, selection, and disclosures concerning critical accounting estimates with the Audit Committee of the Board of Directors.

Pensions and Other Postretirement Benefits

Accounting for pensions and other postretirement benefit plans requires us to make several estimates and assumptions (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. We make these estimates based on our historical experience and other information that we deem pertinent under the circumstances (for example, expectations of future stock market performance). We utilize an independent actuarial consulting firm's studies to assist us in selecting appropriate actuarial assumptions and valuing related liabilities.

Net pension expense, which is included in "Compensation and benefits" in the Consolidated Statements of Income, was $31 million for 2014. In recording this amount, we assumed a long-term investment rate of return of 8.25%, which was supported by the long-term total rate of return on plan assets since inception, as well as our expectation of future returns. A one-percentage point change to this rate of return assumption would result in a $18 million change in pension expense. During 2014, new mortality tables were released for consideration in determining defined benefit plan obligations. We analyzed the experience in our pension plans and updated our mortality rates accordingly, which resulted in an actuarial loss of approximately $165 million. We review assumptions related to our defined benefit plans annually, and while changes are likely to occur in assumptions concerning retirement age, projected earnings, and mortality, they are not expected to have a material effect on our net pension expense or net pension liability in the future. The net pension liability is recorded at 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. We utilize analyses in which the projected annual cash flows from the pension and postretirement benefit plans are matched with yield curves based on an appropriate universe of high-quality corporate bonds. We use the results of the yield curve analyses to select the discount rates that match the payment streams of the benefits in these plans.

Net benefit for other postretirement benefits, which is also included in "Compensation and benefits," was $6 million for 2014. Historically, medical inflation has been a significant component of the estimate for postretirement benefits, however, its effect has been reduced substantially due to the plan amendment made in 2014 (Note 11). Since there is a fixed benefit for Medicare-eligible retirees there is no medical inflation assumed for this population. The medical inflation factor is still applicable for pre-Medicare-eligible retirees.

Properties and Depreciation

Most of our total assets are long-lived railway properties (Note 6). As disclosed in Note 1, properties are depreciated using group depreciation. The primary depreciation method for our asset base is group life. Units of production is the principal method of depreciation for rail in high density corridors and for depletion of natural resources. Remaining properties are depreciated generally using the straight-line method over the lesser of estimated service or lease lives. See Note 1 for a more detailed discussion of the assumptions and estimates in this area.

Depreciation expense for 2014 totaled $951 million. Our composite depreciation rates for 2014 are disclosed in Note 6; a one-tenth percentage point increase (or decrease) in these rates would have resulted in a $36 million increase (or decrease) to depreciation expense. For 2014, roadway depreciation rates ranged from 0.83% to 33.33% and equipment depreciation rates ranged from 1.55% to 33.33%.

Personal Injury, Environmental, and Legal Liabilities

Casualties and other claims expense, included in "Materials and other," consists primarily of our accrual for personal injury liabilities and environmental remediation costs.

To aid in valuing personal injury liability and determining the amount to accrue during each period, we utilize studies prepared by an independent consulting actuarial firm. The actuarial firm studies our historical patterns of reserving for claims and subsequent settlements, taking into account relevant outside influences. We adjust the liability quarterly based upon our assessment and the results of the study. Our estimate of loss liabilities is subject to inherent limitation given the difficulty of predicting future events and as such the actual loss may vary from the estimated liability recorded.

We are subject to various jurisdictions' environmental laws and regulations. We record a liability where such liability or loss is probable and its amount can be estimated reasonably. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. Additionally, our Environmental Policy Council (composed of senior managers) oversees and interprets our environmental policy. Operating expenses, included in "Materials and other" and "Purchased services and rents," for environmental matters totaled $45 million in 2014, $57 million in 2013, and $40 million in 2012, and property additions for environmental matters totaled $9 million in 2014, $8 million in 2013, and $6 million in 2012. Property additions for environmental matters in 2015 are expected to be about $15 million.

We and/or certain subsidiaries are defendants in numerous lawsuits and other claims relating principally to railroad operations. When we conclude that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, it is accrued through a charge to earnings.

For a more detailed discussion of the assumptions and estimates in accounting for personal injury and environmental matters see Note 16.

Income Taxes

Our net long-term deferred tax liability totaled $8.8 billion at December 31, 2014 (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 our 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 we expect that it is more likely than not that deferred tax assets will not be realized. We had a $33 million valuation allowance on $606 million of deferred tax assets as of December 31, 2014, reflecting the expectation that almost all of these assets will be realized.

In addition, we have a recorded liability for our estimate of uncertain tax positions taken or expected to be taken in a tax return. Judgment is required in evaluating the application of federal and state tax laws and assessing whether it is more likely than not that a tax position will be sustained on examination and, if so, judgment is also required as to the measurement of the amount of tax benefit that will be realized upon settlement with the taxing authority. We believe this liability for uncertain tax positions to be adequate. Income tax expense is adjusted in the period in which new information about a tax position becomes available or the final outcome differs from the amounts recorded. For every one half percent change in the 2014 effective tax rate, net income would have changed by $16 million.

OTHER MATTERS

Labor Agreements

More than 80% of our railroad employees are covered by collective bargaining agreements with various labor unions. These agreements remain in effect until changed pursuant to the Railway Labor Act. We largely bargain nationally in concert with other major railroads, represented by the National Carriers Conference Committee (NCCC). Moratorium provisions in the labor agreements govern when the railroads and the unions may propose changes to the agreements. The moratorium provisions of the current agreements have now expired, formal proposals to change the agreements have been made, and negotiations with the various labor unions have begun. Separately, in January 2015 we reached an agreement covering wages and work rules through 2019 with the Brotherhood of Locomotive Engineers and Trainmen (BLET) which represents approximately 4,600 of our locomotive engineers. Changes to the BLET benefit plan will be bargained nationally through the NCCC.

Market Risks

We manage overall exposure to fluctuations in interest rates by issuing both fixed- and floating-rate debt instruments. At December 31, 2014, debt subject to interest rate fluctuations totaled $200 million. A one-percentage point increase in interest rates would increase total annual interest expense related to all variable debt by approximately $2 million. We consider it unlikely that interest rate fluctuations applicable to these instruments will result in a material adverse effect on our financial position, results of operations, or liquidity.

New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, "Revenue from Contracts with Customers." This update, effective for our annual and interim reporting periods beginning January 1, 2017, will replace most existing revenue recognition guidance in GAAP and requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Early application is not permitted, but once effective, permits the use of either the

retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures.

Inflation

In preparing financial statements, GAAP requires the use of historical cost that disregards the effects of inflation on the replacement cost of property. As a capital-intensive company, we have most of our capital invested in such property. The replacement cost of these assets, as well as the related depreciation expense, would be substantially greater than the amounts reported on the basis of historical cost.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that may be identified by the use of words like "believe," "expect," "anticipate," "estimate," "plan, "consider," "project," and similar references to the future. Forward-looking statements reflect our good-faith evaluation of information currently available.

However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which we have little or no control, including: transportation of hazardous materials as a common carrier by rail; acts of terrorism or war; general economic conditions including, but not limited to, fluctuation and competition within the industries of our customers; competition and consolidation within the transportation industry; the operations of carriers with which we interchange; disruptions to our technology infrastructure, including computer systems; labor difficulties, including strikes and work stoppages; commercial, operating, environmental, and climate change legislative and regulatory developments; results of litigation; natural events such as severe weather, hurricanes, and floods; unpredictable demand for rail services; fluctuation in supplies and prices of key materials, in particular diesel fuel; and changes in securities and capital markets. For additional discussion of significant risk factors applicable to our business, see Part II, Item 1A "Risk Factors." Forward-looking statements are not, and should not be relied upon as, a guarantee of future performance or results, nor will they necessarily prove to be accurate indications of the times at or by which any such performance or results will be achieved. As a result, actual outcomes and results may differ materially from those expressed in forward-looking statements. We undertake no obligation to update or revise forward-looking statements.

Item 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."

Item 8. Financial Statements and Supplementary Data

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Report of Management

February 11, 2015

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, 2014. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework (2013) 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, 2014.

KPMG LLP, independent registered public accounting firm, has audited the Corporation's financial statements and issued an attestation report on the Corporation's internal control over financial reporting as of December 31, 2014.

/s/Charles W. Moorman	/s/Marta R. Stewart	/s/Thomas E. Hurlbut
Charles W. Moorman	Marta R. Stewart	Thomas E. Hurlbut
Chairman and	Executive Vice President Finance	Vice President and
Chief Executive Officer	and Chief Financial Officer	Controller

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Norfolk Southern Corporation:

We have audited Norfolk Southern Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Norfolk Southern Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Norfolk Southern Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014, and our report dated February 11, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/KPMG LLP
KPMG LLP

Norfolk, Virginia
February 11, 2015

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Norfolk Southern Corporation:

We have audited the accompanying consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in Item 15(A)2. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norfolk Southern Corporation and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014, 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.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Norfolk Southern Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 11, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/KPMG LLP
KPMG LLP
Norfolk, Virginia
February 11, 2015

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Income

	Years ended December 31, 2014	2013	2012
	($ in millions, except per share amounts)		
Railway operating revenues	$11,624	$11,245	$11,040
Railway operating expenses:			
Compensation and benefits	2,897	3,002	2,960
Purchased services and rents	1,687	1,629	1,604
Fuel	1,574	1,613	1,577
Depreciation	951	916	916
Materials and other	940	828	859
Total railway operating expenses	8,049	7,988	7,916
Income from railway operations	3,575	3,257	3,124
Other income – net	104	233	129
Interest expense on debt	545	525	495
Income before income taxes	3,134	2,965	2,758
Provision for income taxes	1,134	1,055	1,009
Net income	$2,000	$1,910	$1,749
Per share amounts:			
Net income			
Basic	$6.44	$6.10	$5.42
Diluted	6.39	6.04	5.37

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income

	Years ended December 31,		
	2014	2013	2012
	($ in millions)		
Net income	$2,000	$1,910	$1,749
Other comprehensive income (loss), before tax:			
Pension and other postretirement benefits	(15)	1,122	(114)
Other comprehensive income (loss) of equity investees	(8)	42	(13)
Other comprehensive income (loss), before tax	(23)	1,164	(127)
Income tax benefit (expense) related to items of other comprehensive income (loss)	6	(436)	44
Other comprehensive income (loss), net of tax	(17)	728	(83)
Total comprehensive income	$1,983	$2,638	$1,666

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Balance Sheets

	At December 31,	
	2014	2013
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$973	$1,443
Short-term investments	—	118
Accounts receivable – net	1,055	1,024
Materials and supplies	236	223
Deferred income taxes	167	180
Other current assets	347	87
Total current assets	2,778	3,075
Investments	2,679	2,439
Properties less accumulated depreciation of $10,814 and $10,387, respectively	27,694	26,645
Other assets	90	324
Total assets	$33,241	$32,483
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$1,233	$1,265
Short-term debt	100	100
Income and other taxes	217	225
Other current liabilities	228	270
Current maturities of long-term debt	2	445
Total current liabilities	1,780	2,305
Long-term debt	8,924	8,903
Other liabilities	1,312	1,444
Deferred income taxes	8,817	8,542
Total liabilities	20,833	21,194
Stockholders equity:		
Common Stock $1.00 per share par value, 1,350,000,000 shares authorized; outstanding 308,240,130 and 308,878,402 shares, respectively, net of treasury shares	310	310
Additional paid-in capital	2,148	2,021
Accumulated other comprehensive loss	(398)	(381)
Retained income	10,348	9,339
Total stockholders equity	12,408	11,289
Total liabilities and stockholders equity	$33,241	$32,483

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Cash Flows

	Years ended December 31,		
	2014	2013	2012
	($ in millions)		
Cash flows from operating activities:			
Net income	$2,000	$1,910	$1,749
Reconciliation of net income to net cash provided by operating activities:			
Depreciation	956	922	922
Deferred income taxes	294	262	366
Gains and losses on properties and investments	(13)	(104)	(6)
Changes in assets and liabilities affecting operations:			
Accounts receivable	(31)	85	(64)
Materials and supplies	(13)	(7)	(7)
Other current assets	(260)	(5)	(6)
Current liabilities other than debt	53	5	82
Other – net	(134)	10	29
Net cash provided by operating activities	2,852	3,078	3,065
Cash flows from investing activities:			
Property additions	(2,118)	(1,971)	(2,241)
Property sales and other transactions	114	144	192
Investments, including short-term	(104)	(130)	(23)
Investment sales and other transactions	106	63	78
Net cash used in investing activities	(2,002)	(1,894)	(1,994)
Cash flows from financing activities:			
Dividends	(687)	(637)	(624)
Common Stock issued	130	131	89
Purchase and retirement of Common Stock	(318)	(627)	(1,288)
Proceeds from borrowings – net	200	989	1,491
Debt repayments	(645)	(250)	(362)
Net cash used in financing activities	(1,320)	(394)	(694)
Net increase (decrease) in cash and cash equivalents	(470)	790	377
Cash and cash equivalents:			
At beginning of year	1,443	653	276
At end of year	$973	$1,443	$653
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest (net of amounts capitalized)	$522	$492	$473
Income taxes (net of refunds)	1,102	735	618

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Accum. Other Comprehensive Loss	Retained Income	Total
	($ in millions, except per share amounts)				
Balance at December 31, 2011	$332	$1,912	$(1,026)	$8,693	$9,911
Comprehensive income:					
Net income				1,749	1,749
Other comprehensive loss			(83)		(83)
Total comprehensive income					1,666
Dividends on Common Stock, $1.94 per share				(624)	(624)
Share repurchases	(19)	(104)		(1,165)	(1,288)
Stock-based compensation, including tax benefit of $42	2	103		(10)	95
Balance at December 31, 2012	315	1,911	(1,109)	8,643	9,760
Comprehensive income:					
Net income				1,910	1,910
Other comprehensive income			728		728
Total comprehensive income					2,638
Dividends on Common Stock, $2.04 per share				(637)	(637)
Share repurchases	(8)	(49)		(570)	(627)
Stock-based compensation, including tax benefit of $38	3	159		(7)	155
Balance at December 31, 2013	310	2,021	(381)	9,339	11,289
Comprehensive income:					
Net income				2,000	2,000
Other comprehensive loss			(17)		(17)
Total comprehensive income					1,983
Dividends on Common Stock, $2.22 per share				(687)	(687)
Share repurchases	(3)	(20)		(295)	(318)
Stock-based compensation, including tax benefit of $37	3	147		(6)	144
Other				(3)	(3)
Balance at December 31, 2014	$310	$2,148	$(398)	$10,348	$12,408

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 (Norfolk Southern) is a Virginia-based holding company engaged principally in the rail transportation business, operating approximately 20,000 miles of road primarily in the East and Midwest. These consolidated financial statements include Norfolk Southern and its majority-owned and controlled subsidiaries (collectively, NS, we, us, and our). Norfolk Southern's major subsidiary is Norfolk Southern Railway Company (NSR). All significant intercompany balances and transactions have been eliminated in consolidation.

NSR and its railroad subsidiaries transport raw materials, intermediate products and finished goods classified in the following commodity groups (percent of total railway operating revenues in 2014): intermodal (22%); coal (21%); chemicals (16%); metals/construction (13%); agriculture/consumer products/government (13%); automotive (8%); and, paper/clay/forest products (7%). Although most of our 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 U.S. More than 80% of our railroad employees are covered by collective bargaining agreements with various labor unions.

Use of Estimates

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We periodically review our estimates, including those related to the recoverability and useful lives of assets, as well as liabilities for litigation, environmental remediation, casualty claims, income taxes and pension and other postretirement benefits. Changes in facts and circumstances may result in revised estimates.

Revenue Recognition

Transportation revenue is recognized proportionally as a shipment moves from origin to destination, and related expenses are recognized as incurred. Refunds (which are primarily volume-based incentives) are recorded as a reduction to revenues on the basis of management's best estimate of projected liability, which is based on historical activity, current shipment counts and the expectation of future activity. We regularly monitor our 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.

Cash Equivalents

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

Allowance for Doubtful Accounts

Our allowance for doubtful accounts was $6 million at December 31, 2014 and $3 million at December 31, 2013. To determine our allowance for doubtful accounts, we evaluate historical loss experience (which has not been significant), the characteristics of current accounts, and general economic conditions and trends.

Materials and Supplies

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

Investments

Debt securities classified as “held-to-maturity” are reported at amortized cost.

Investments where we have the ability to exercise significant influence over but do not control the entity are accounted for using the equity method, whereby the investment is carried at the cost of the acquisition plus our equity in undistributed earnings or losses since acquisition.

Properties

“Properties” are stated principally at cost and are depreciated using the group method whereby assets with similar characteristics, use, and expected lives are grouped together in asset classes and depreciated using a composite depreciation rate. This methodology treats each asset class as a pool of resources, not as singular items. We use approximately 70 depreciable asset classes. The primary depreciation method for our asset base is group life. Units of production is the principal method of depreciation for rail in high density corridors and for depletion of natural resources (Note 2). Remaining properties are depreciated generally using the straight-line method over the lesser of estimated service or lease lives. Depreciation in the Consolidated Statements of Cash Flows includes both depreciation and depletion.

Depreciation expense is based on our assumptions concerning expected service lives of our properties as well as the expected net salvage that will be received upon their retirement. In developing these assumptions, we utilize periodic depreciation studies that are performed by an independent outside firm of consulting engineers and approved by the Surface Transportation Board (STB). Our depreciation studies are conducted about every three years for equipment and every six years for track assets and other roadway property. The frequency of these studies is consistent with guidelines established by the STB. Key factors that are considered in developing average service life and salvage estimates include:

- statistical analysis of historical retirement data and surviving asset records;
- review of historical salvage received and current market rates;
- review of our operations including expected changes in technology, customer demand, maintenance practices and asset management strategies;
- review of accounting policies and assumptions; and
- industry review and analysis.

The units of production depreciation rate for rail in high density corridors is derived based on consideration of annual gross ton miles as compared to the total or ultimate capacity of rail in these corridors. Our experience has shown that traffic density is a leading factor in determination of the expected service life of rail in high density corridors. In developing the respective depreciation rate, consideration is also given to several rail characteristics including age, weight, condition (new or second hand) and type (curve or straight). As a result, a composite depreciation rate is developed which is applied to the depreciable base.

We adjust our rates based on the results of these studies and implement the changes prospectively. 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, as determined by the study. For 2014, roadway depreciation rates ranged from 0.83% to 33.3% and equipment depreciation rates ranged from 1.55% to 33.33%.

We capitalize interest on major projects during the period of their construction. Expenditures, including those on leased assets, that extend an asset's useful life or increase its utility are capitalized. Expenditures capitalized include those that are directly related to a capital project and may include materials, labor and equipment, in addition to an allocable portion of indirect costs that clearly relate to a particular project. Due to the capital intensive nature of the railroad industry, a significant portion of annual capital spending relates to the replacement of self-constructed assets. Because removal activities occur in conjunction with replacement, removal costs are estimated based on an average percentage of time employees replacing assets spend on removal functions. 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 in earnings. Actual historical cost values are retired when available, such as with equipment assets. The use of estimates in recording the retirement of certain roadway assets is necessary based on the impracticality of tracking individual asset costs. When retiring rail, ties and ballast, we use statistical curves that indicate the relative distribution of the age of the assets retired. The historical cost of other roadway assets is estimated using a combination of inflation indices specific to the rail industry and those published by the U.S. Bureau of Labor Statistics. The indices are applied to the replacement value based on the age of the retired assets. These indices are used because they closely correlate with the costs of roadway assets. Gains and losses on disposal of land and nonrail assets are included in "Other income – net" (Note 2) since such income is not a product of our railroad operations.

A retirement is considered abnormal if it does not occur in the normal course of business, if it relates to disposition of a large segment of an asset class and if the retirement varies significantly from the retirement profile identified through our depreciation studies, which inherently consider the impact of normal retirements on expected service lives and depreciation rates. Gains or losses from abnormal retirements are recognized in earnings.

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

Required Accounting Changes

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

2. Other Income – Net

	2014	2013	2012
	($ in millions)		
Income from natural resources:			
Royalties from coal	$33	$50	$72
Nonoperating depletion and depreciation	(5)	(6)	(6)
Subtotal	28	44	66
Rental income	75	61	54
Corporate-owned life insurance – net	24	25	13
Gains and losses from sale of properties	13	101	5
Interest income	9	8	8
Equity in earnings of Conrail Inc. (Note 5)	—	42	34
Taxes on nonoperating property	(9)	(10)	(10)
Charitable contributions	(9)	(11)	(9)
Other interest expense – net	(12)	(12)	(9)
Other	(15)	(15)	(23)
Total	$104	$233	$129

"Other income – net" includes income and costs not part of rail operations and the income generated by the activities of our noncarrier subsidiaries as well as the costs incurred by those subsidiaries in their operations.

3. Income Taxes

Provisions for Income Taxes

	2014	2013	2012
	($ in millions)		
Current:			
Federal	$729	$695	$569
State	111	98	74
Total current taxes	840	793	643
Deferred:			
Federal	299	270	339
State	(5)	(8)	27
Total deferred taxes	294	262	366
Provision for income taxes	$1,134	$1,055	$1,009

Other current assets include prepaid income taxes of $248 million and zero, respectively, at December 31, 2014 and 2013.

Reconciliation of Statutory Rate to Effective Rate

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

	2014 Amount	%	2013 Amount	%	2012 Amount	%
	($ in millions)					
Federal income tax at statutory rate	$1,097	35	$1,038	35	$965	35
State income taxes, net of federal tax effect	88	3	69	2	69	3
Internal Revenue Service (IRS) audit, settlement	—	—	—	—	(6)	—
State tax law changes, net of federal tax effect	(20)	(1)	(11)	—	(3)	—
Other, net	(31)	(1)	(41)	(1)	(16)	(1)
Provision for income taxes	$1,134	36	$1,055	36	$1,009	37

Deferred Tax Assets and Liabilities

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

	December 31, 2014	2013
	($ in millions)	
Deferred tax assets:		
Compensation and benefits, including postretirement	$454	$462
Accruals, including casualty and other claims	107	114
Other	45	54
Total gross deferred tax assets	606	630
Less valuation allowance	(33)	(32)
Net deferred tax asset	573	598
Deferred tax liabilities:		
Property	(8,768)	(8,494)
Other	(455)	(466)
Total gross deferred tax liabilities	(9,223)	(8,960)
Net deferred tax liability	(8,650)	(8,362)
Net current deferred tax asset	167	180
Net long-term deferred tax liability	$(8,817)	$(8,542)

Except for amounts for which a valuation allowance has been provided, we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets. The valuation allowance at the end of each year primarily relates to subsidiary state income tax net operating losses that may not be utilized prior to their expiration. The valuation allowance for 2014 also includes state investment tax credits that may not be utilized prior to their expiration. The total valuation allowance increased by $1 million in 2014 and $13 million in 2013.

Uncertain Tax Positions

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	December 31,	
	2014	2013
	($ in millions)	
Balance at beginning of year	$65	$63
Additions based on tax positions related to the current year	6	3
Additions for tax positions of prior years	1	4
Reductions for tax positions of prior years	(8)	(1)
Settlements with taxing authorities	(1)	(2)
Lapse of statutes of limitations	(2)	(2)
Balance at end of year	$61	$65

Included in the balance of unrecognized tax benefits at December 31, 2014, are potential benefits of $28 million that would affect the effective tax rate if recognized. Unrecognized tax benefits are adjusted in the period in which new information about a tax position becomes available or the final outcome differs from the amount recorded.

IRS examinations have been completed for all years prior to 2011. Our consolidated federal income tax returns for 2011 and 2012 are currently being audited by the IRS. We anticipate that the IRS will complete its examination in 2015. State income tax returns generally are subject to examination for a period of three to four years after filing of the return. In addition, we are generally obligated to report changes in taxable income arising from federal income tax examinations to the states within a period of up to two years from the date the federal examination is final. We have various state income tax returns either under examination, administrative appeal, or litigation. We expect that the total amount of unrecognized tax benefits at December 31, 2014, will decrease by approximately $6 million in 2015 due to tax positions for which there was an uncertainty about the timing of deductibility in earlier years, but deductibility may become certain by the close of 2015. We do not expect that the aforementioned potential change in unrecognized tax benefits will have a material effect on our financial position, results of operations, or liquidity.

Interest related to unrecognized tax benefits, which is included in “Other income – net,” totaled $1 million of expense in both 2014 and 2013, and $1 million of income in 2012. There were no penalties related to tax matters in 2014, 2013, and 2012. We have recorded a liability of $6 million at December 31, 2014, and $4 million at December 31, 2013, for the payment of interest on unrecognized tax benefits. We have no liability recorded at December 31, 2014 and 2013, for the payment of penalties on unrecognized tax benefits.

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4. Fair Value

Fair Value Measurements

ASC 820-10, "Fair Value Measurements," established a framework for measuring fair value and a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as follows:

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

Level 2 Inputs to the valuation methodology include:

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

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

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

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

Fair Values of Financial Instruments

We have evaluated the fair values of financial instruments and methods used to determine those fair values. The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable," "Accounts payable," and "Short-term debt" approximate carrying values because of the short maturity of these financial instruments. The carrying value of corporate-owned life insurance is recorded at cash surrender value and, accordingly, approximates fair value. The carrying amounts and estimated fair values for the remaining financial instruments, excluding investments accounted for under the equity method, consisted of the following at December 31:

	2014 Carrying Amount	Fair Value	2013 Carrying Amount	Fair Value
	($ in millions)			
Long-term investments	$162	$193	$148	$177
Long-term debt, including current maturities	(8,926)	(10,962)	(9,348)	(10,673)

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

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

	December 31, 2014		
	Level 1	Level 2	Total
	($ in millions)		
Long-term investments	$50	$143	$193
Long-term debt, including current maturities	(10,754)	(208)	(10,962)

	December 31, 2013		
	Level 1	Level 2	Total
	($ in millions)		
Long-term investments	$47	$130	$177
Long-term debt, including current maturities	(10,449)	(224)	(10,673)

5. Investments

	December 31,	
	2014	2013
	($ in millions)	
Short-term investments:		
Commercial paper, 2 months	$—	$98
Federal government bonds, held-to-maturity, 3 months	—	20
Total short-term investments	$—	$118
Long-term investments:		
Equity method investments:		
Conrail Inc.	$1,102	$1,075
TTX Company	425	404
Meridian Speedway LLC	277	278
Pan Am Southern LLC	152	155
Other	91	90
Total equity method investments	2,047	2,002
Company-owned life insurance at net cash surrender value	470	289
Other investments	162	148
Total long-term investments	$2,679	$2,439

Investment in Conrail

Through a limited liability company, we and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). We have a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. We are amortizing the excess of the purchase price over Conrail's net equity using the principles of purchase accounting, based primarily on the estimated useful lives of Conrail's depreciable property and equipment, including the related deferred tax effect of the differences in book and tax accounting bases for such assets, as all of the purchase price at acquisition was allocable to Conrail's tangible assets and liabilities.

At December 31, 2014, based on the funded status of Conrail's pension plans, we decreased our proportional investment in Conrail by $12 million. This resulted in expense of $11 million recorded to "Other comprehensive loss" and a combined federal and state deferred tax asset of $1 million.

At December 31, 2013, based on the funded status of Conrail's pension plans, we increased our proportional investment in Conrail by $37 million. This resulted in income of $34 million recorded to "Other comprehensive income" and a combined federal and state deferred tax liability of $3 million.

At December 31, 2014, the difference between our investment in Conrail and our share of Conrail's underlying net equity was $529 million. Our equity in the earnings of Conrail, net of amortization, included in "Purchased services and rents" was $39 million for 2014. For 2013 and 2012, this amounted to $42 million and $34 million and was included in "Other income – net."

CRC owns and operates certain properties (the Shared Assets Areas) for the joint and exclusive benefit of NSR and CSX Transportation, Inc. (CSXT). The costs of operating the Shared Assets Areas are borne by NSR and CSXT based on usage. In addition, NSR and CSXT pay CRC a fee for access to the Shared Assets Areas. "Purchased services and rents" and "Fuel" include expenses for amounts due to CRC for operation of the Shared Assets Areas totaling $144 million in 2014, $146 million in 2013, and $147 million in 2012. Future minimum lease payments due to CRC under the Shared Assets Areas agreements are as follows: $36 million in each of 2015 through 2019 and $160 million thereafter. We provide certain general and administrative support functions to Conrail, the fees for which are billed in accordance with several service-provider arrangements and approximate $8 million annually.

In 2014, we converted approximately $147 million of our accounts payable into the long-term advance from Conrail included in "Other Liabilities." "Accounts payable" includes $56 million at December 31, 2014, and $187 million at December 31, 2013, due to Conrail for the operation of the Shared Assets Areas. "Other liabilities" includes $280 million and $133 million at December 31, 2014 and 2013 for long-term advances from Conrail, maturing 2044 and 2035 that bear interest at an average rate of 2.9% and 4.4%, respectively.

6. Properties

At December 31, 2014	Cost ($ in millions)	Accumulated Depreciation	Net Book Value	Depreciation Rate [1]
Land	$2,260	$—	$2,260	—
Roadway:				
Rail and other track material	6,173	(1,848)	4,325	2.46%
Ties	4,628	(1,156)	3,472	3.25%
Ballast	2,360	(498)	1,862	2.63%
Construction in process	500	—	500	—
Other roadway	12,078	(2,989)	9,089	2.55%
Total roadway	25,739	(6,491)	19,248	
Equipment:				
Locomotives	5,120	(2,010)	3,110	3.27%
Freight cars	3,276	(1,411)	1,865	2.82%
Computers and software	487	(281)	206	11.60%
Construction in process	199	—	199	—
Other equipment	952	(349)	603	6.09%
Total equipment	10,034	(4,051)	5,983	
Other property	475	(272)	203	1.04%
Total properties	$38,508	$(10,814)	$27,694	

At December 31, 2013	Cost ($ in millions)	Accumulated Depreciation	Net Book Value	Depreciation Rate [1]
Land	$2,253	$—	$2,253	—
Roadway:				
Rail and other track material	5,934	(1,782)	4,152	2.46%
Ties	4,464	(1,100)	3,364	3.24%
Ballast	2,244	(468)	1,776	2.65%
Construction in process	405	—	405	—
Other roadway	11,704	(2,814)	8,890	2.55%
Total roadway	24,751	(6,164)	18,587	
Equipment:				
Locomotives	4,814	(1,918)	2,896	3.42%
Freight cars	3,225	(1,429)	1,796	2.78%
Computers and software	513	(292)	221	11.07%
Construction in process	139	—	139	—
Other equipment	862	(316)	546	6.15%
Total equipment	9,553	(3,955)	5,598	
Other property	475	(268)	207	1.15%
Total properties	$37,032	$(10,387)	$26,645	

(1) Composite annual depreciation rate for the underlying assets, excluding the effects of the amortization of any deficiency (or excess) that resulted from our depreciation studies.

Roadway and equipment property included $8 million at both December 31, 2014 and 2013, of assets recorded pursuant to capital leases with accumulated amortization of $3 million at both December 31, 2014 and 2013. Other property includes the costs of obtaining rights to natural resources of $336 million at both December 31, 2014 and 2013, with accumulated depletion of $196 million and $195 million, respectively.

Capitalized Interest

Total interest cost incurred on debt was $564 million in 2014, $543 million in 2013, and $515 million in 2012, of which $19 million, $18 million, and $20 million, respectively, was capitalized.

7. Current Liabilities

	December 31, 2014	2013
	($ in millions)	
Accounts payable:		
Accounts and wages payable	$748	$685
Casualty and other claims (Note 16)	187	166
Vacation liability	132	130
Due to Conrail (Note 5)	56	187
Other	110	97
Total	$1,233	$1,265
Other current liabilities:		
Interest payable	$118	$121
Postretirement and pension benefit obligations (Note 11)	14	64
Other	96	85
Total	$228	$270

8. Debt

Debt with weighted average interest rates and maturities is presented below:

	December 31, 2014	2013
	($ in millions)	
Notes and debentures:		