

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended **MARCH 31, 2003**

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

For the transition period from _____ to _____
Commission file numbers 1-743; 1-3744; 1-4793; 1-546-2



NORFOLK SOUTHERN RAILWAY COMPANY

(Exact name of registrant as specified in its charter)

Virginia

(State or other jurisdiction of
incorporation or organization)

53-6002016

(IRS Employer Identification No.)

Three Commercial Place

Norfolk, Virginia

(Address of principal executive offices)

23510-2191

Zip Code

Registrant's telephone number, including area code

(757) 629-2680

No Change

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

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

Indicate by check mark whether registrant is an accelerated filer (as defined in Rule 12b-2 of The Exchange Act). () Yes (X) No

The number of shares outstanding of each of the registrant's classes of Common Stock, as of the last practicable date:

Class

Common Stock (par value \$1.00)

Outstanding as of March 31, 2003

16,668,997

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation [NS])
Consolidated Statements of Income
(\$ in millions)
(Unaudited)

	Three Months Ended	
	March 31,	
	<u>2003</u>	<u>2002</u>
<i>Railway operating revenues</i>		
Coal	\$ 354	\$ 359
General merchandise	918	869
Intermodal	<u>247</u>	<u>229</u>
Total Railway Operating Revenues	<u>1,519</u>	<u>1,457</u>
<i>Railway operating expenses</i>		
Compensation and benefits	400	383
Materials, services and rents	459	453
Conrail rents and services (Note 2)	119	121
Depreciation	123	123
Diesel fuel	104	81
Casualties and other claims	51	35
Other	<u>74</u>	<u>61</u>
Total Railway Operating Expenses	<u>1,330</u>	<u>1,257</u>
Income from railway operations	189	200
Other income (expense) – net	(51)	(52)
Interest expense on debt	<u>(7)</u>	<u>(9)</u>
Income before income taxes and accounting changes	131	139
Provision for income taxes	<u>51</u>	<u>54</u>
Income before accounting changes	80	85
Cumulative effect of changes in accounting principles, net of taxes (Note 1)	<u>104</u>	<u>--</u>
Net income	<u>\$ 184</u>	<u>\$ 85</u>

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation [NS])
Consolidated Balance Sheets
(\$ in millions)
(Unaudited)

	March 31, <u>2003</u>	Dec. 31, <u>2002</u>
<i>Assets</i>		
Current assets:		
Cash and cash equivalents	\$ 63	\$ 130
Accounts receivable, net (Note 2)	119	117
Due from Conrail (Note 2)	3	6
Materials and supplies	98	95
Deferred income taxes	179	174
Other current assets	108	131
Total current assets	<u>570</u>	<u>653</u>
Investments (Note 4)	693	703
Properties less accumulated depreciation	11,157	10,837
Other assets	663	660
Total assets	<u>\$ 13,083</u>	<u>\$ 12,853</u>
<i>Liabilities and Stockholders' Equity</i>		
Current liabilities:		
Accounts payable	\$ 852	\$ 860
Income and other taxes	184	187
Due to NS - net (Note 2)	193	384
Due to Conrail (Note 2)	78	86
Other current liabilities	126	122
Current maturities of long-term debt	102	94
Total current liabilities	<u>1,535</u>	<u>1,733</u>
Long-term debt	879	763
Other liabilities	949	971
Due to Conrail (Note 2)	594	513
Minority interests	9	3
Deferred income taxes	4,141	4,057
Total liabilities	<u>8,107</u>	<u>8,040</u>
Stockholders' equity:		
Serial preferred stock	55	55
Common stock	167	167
Additional paid-in capital	709	709
Accumulated other comprehensive income (Note 4)	246	266
Retained income	3,799	3,616
Total stockholders' equity	<u>4,976</u>	<u>4,813</u>
Total liabilities and stockholders' equity	<u>\$ 13,083</u>	<u>\$ 12,853</u>

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation [NS])
Consolidated Statements of Cash Flows
(\$ in millions)
(Unaudited)

	Three Months Ended	
	March 31,	
	<u>2003</u>	<u>2002</u>
<i>Cash flows from operating activities</i>		
Net income	\$ 184	\$ 85
Reconciliation of net income to net cash provided by operating activities:		
Net cumulative effect of changes in accounting principles	(104)	--
Depreciation	124	124
Deferred income taxes	24	29
Gains and losses on properties and investments	(2)	(10)
Changes in assets and liabilities affecting operations:		
Accounts receivable	(2)	26
Materials and supplies	(3)	(4)
Other current assets and due from Conrail	22	27
Income tax liabilities	12	(1)
Other short-term liabilities	(25)	(43)
Other – net	(26)	(52)
Net cash provided by operating activities	<u>204</u>	<u>181</u>
<i>Cash flows from investing activities</i>		
Property additions	(104)	(179)
Property sales and other transactions	(3)	(9)
Investments, including short-term	<u>(20)</u>	<u>(22)</u>
Net cash used for investing activities	<u>(127)</u>	<u>(210)</u>
<i>Cash flows from financing activities</i>		
Dividends	(1)	(1)
Advances to NS	(192)	(112)
Advances and repayments from NS	1	2
Proceeds from borrowings	87	133
Debt repayments	<u>(39)</u>	<u>(40)</u>
Net cash used for financing activities	<u>(144)</u>	<u>(18)</u>
Net decrease in cash and cash equivalents	<u>(67)</u>	<u>(47)</u>
<i>Cash and cash equivalents</i>		
At beginning of year	<u>130</u>	<u>167</u>
At end of period	\$ <u><u>63</u></u>	\$ <u><u>120</u></u>
<i>Supplemental disclosures of cash flow information</i>		
Cash paid during the period for:		
Interest (net of amounts capitalized)	\$ 9	\$ 13
Income taxes	\$ 14	\$ 27

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES (NS RAIL)
(A Majority-Owned Subsidiary of Norfolk Southern Corporation [NS])
Notes to Consolidated Financial Statements
(Unaudited)

In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position as of March 31, 2003, its results of operations for the three months ended March 31, 2003 and 2002, and its cash flows for the three months ended March 31, 2003 and 2002.

Although management believes that the disclosures presented are adequate to make the information not misleading, these Consolidated Financial Statements should be read in conjunction with: (a) the financial statements and notes included in the Company's latest Annual Report on Form 10-K and (b) any Current Reports on Form 8-K.

1. Changes in Accounting Principles

NS Rail adopted Financial Accounting Standards Board (FASB) Statement No. 143, "Accounting for Asset Retirement Obligations," (SFAS No. 143) effective Jan. 1, 2003, and recorded a \$100 million net adjustment (\$165 million before taxes) for the cumulative effect of this change in accounting on years prior to 2003. Pursuant to SFAS No. 143, the cost to remove crossties must be recorded as an expense when incurred; previously these removal costs were accrued as a component of depreciation. This change in accounting in the first quarter of 2003 lowered depreciation expense by almost \$7 million (because the depreciation rate for crossties no longer reflects cost to remove) and increased compensation and benefits and other expenses by almost \$5 million (for the costs to remove retired assets).

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

2. Related Parties

General

NS is the parent holding company of NSR. Rail operations are coordinated at the holding company level by the NS Vice Chairman and Chief Operating Officer. NS charges NS Rail a fee for management services it performs for NS Rail (which totaled \$134 million and included an \$8 million mark-up in the first quarter of 2003 and totaled \$146 million and included a \$9 million mark-up in the first quarter of 2002). In addition, NS charges NS Rail a revenue-based licensing fee for use of certain intangible assets owned by NS. This fee amounted to \$21 million in each of the first quarters of 2003 and 2002.

NS Rail owns 21,169,125 shares of NS common stock.

Operations Over Conrail's Lines

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

Operations of Conrail's Lines -- NSR operates as a part of its rail system the routes and assets of Pennsylvania Lines LLC (PRR), a wholly owned subsidiary of CRC, pursuant to operating and lease agreements. CSX Transportation, Inc. (CSXT) operates the routes and assets of another CRC subsidiary under comparable terms.

The Operating Agreement between NSR and PRR governs substantially all nonequipment assets to be operated by NSR and has an initial 25-year term, renewable at the option of NSR for two five-year terms. Payments under the Operating Agreement are subject to adjustment every six years to reflect changes in values. NSR also has leased or subleased for varying terms from PRR a number of equipment assets. Costs necessary to operate and maintain the PRR assets, including leasehold improvements, are borne by NSR. NSR receives all freight revenues on the PRR lines.

NSR and CSXT also have entered into agreements with CRC governing other properties that continue to be owned and operated by CRC (the Shared Assets Areas). NSR and CSXT pay CRC a fee for joint and exclusive access to the Shared Assets Areas. In addition, NSR and CSXT pay, based on usage, the costs incurred by CRC to operate the Shared Assets Areas.

NS Rail's Consolidated Balance Sheet at March 31, 2003, includes \$50 million of liabilities related to the Conrail transaction, principally for contractual obligations to Conrail employees imposed by the Surface Transportation Board when it approved the transaction. Through March 31, 2003, NS Rail has paid \$133 million of these costs.

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

"Conrail rents and services" includes expenses for amounts due to PRR and CRC for use by NSR of operating properties and equipment and operation of the Shared Assets Areas.

A significant portion of payments made to PRR is borrowed back from a subsidiary of PRR under a note due in 2032. Amounts outstanding under the note comprise the long-term balance of "Due to Conrail." The interest rate for these loans is variable and was 1.56% at March 31, 2003. The current balance "Due to Conrail" is composed of amounts related to expenses included in "Conrail rents and services," as discussed above.

Sales of Accounts Receivable

NS Rail sells, without recourse, to a bankruptcy-remote special-purpose NS subsidiary, a pool of accounts receivable. NS Rail services and collects all of the sold receivables on behalf of the buyers; however, no servicing asset or liability has been recognized because the benefits of servicing are estimated to be just adequate to compensate NS Rail for its responsibilities. Payments collected from sold receivables are remitted to the special-purpose NS subsidiary, which, in turn, reinvests the amounts by purchasing new receivables from NS Rail. NS Rail has no retained interest in the sold receivables.

Under the terms of the new sale agreement, the receivables are treated as sold and, accordingly, \$585 million at March 31, 2003, and \$513 million at Dec. 31, 2002, of sold receivables are not included on the NS Rail Consolidated Balance Sheets. Fees associated with the sale, which are based on historical dilution and prevailing interest rates, are included in "Other income (expense) - net."

Intercompany Accounts

	March 31, 2003		Dec. 31, 2002	
	<u>Balance</u>	<u>Average Interest Rate</u> (\$ in millions)	<u>Balance</u>	<u>Average Interest Rate</u>
Advances due from NS	\$ 85	2%	\$ 68	2%
Advances and notes due to NS	<u>(278)</u>	3%	<u>(452)</u>	2%
Due to NS – net	\$ <u>(193)</u>		\$ <u>(384)</u>	

Interest is applied to certain advances at the average NS yield on short-term investments and to the notes at specified rates. NS Rail's results for the three months ended March 31 include interest income of \$2 million in 2003 and \$3 million in 2002 and interest expense of \$2 million in 2003 and \$3 million in 2002 related to these intercompany accounts. These amounts are included in "Other income (expense) - net."

Intercompany Federal Income Tax Accounts

In accordance with the NS Tax Allocation Agreement, intercompany federal income tax accounts are recorded between companies in the NS consolidated group. NS Rail had long-term intercompany federal income tax payables (which are included in "Deferred income taxes" in the Consolidated Balance Sheets) of \$941 million at March 31, 2003, and \$938 million at Dec. 31, 2002.

3. Derivative Financial Instruments

NS Rail uses derivative financial instruments to reduce the risk of volatility in its diesel fuel costs and to manage its overall exposure to fluctuations in interest rates. NS Rail does not engage in the trading of derivatives. NS Rail's management has determined that its derivative financial instruments qualify as either fair-value or cash-flow hedges, having values which highly correlate with the underlying hedged exposures, and has designated such instruments as hedging transactions. Credit risk related to the derivative financial instruments is considered to be minimal and is managed by requiring high credit standards for counterparties and periodic settlements.

Diesel Fuel Hedging

In the second quarter of 2001, NS Rail began a program to hedge a portion of its diesel fuel consumption. The intent of the program is to assist in the management of NS Rail's aggregate risk exposure to fuel price fluctuations, which can significantly affect NS Rail's operating margins and profitability. In order to minimize this risk, NS Rail instituted a continuous hedging strategy for a portion of its estimated future fuel needs by entering into a series of swaps in order to lock in the purchase prices of some of its diesel fuel. Management has designated these derivative instruments as cash-flow hedges of the exposure to variability in expected future cash flows attributable to fluctuations in diesel fuel prices.

Following is a summary of NS Rail's diesel fuel swaps:

	First Quarter		
	<u>2003</u>	<u>2002</u>	
Number of swaps entered into during the first quarter	72	72	
Approximate number of gallons hedged (millions)	94	101	
Approximate average price per gallon of Nymex No. 2 heating oil	\$0.74	\$0.61	
	Remainder of		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
Percent of estimated future diesel fuel consumption covered as of March 31, 2003	68%	33%	2%

Hedges are placed each month by competitive bid among selected counterparties. The goal of this hedging strategy is to average fuel costs over an extended period of time while minimizing the incremental cost of hedging. The program provides that NS Rail will not enter into any fuel hedges with a duration of more than 36 months, and that no more than 80% of NS Rail's average monthly fuel consumption will be hedged for any month within the 36-month period. Diesel fuel costs represented 8% and 6% of NS Rail's operating expenses for the first quarters of 2003 and 2002, respectively.

NS Rail's fuel hedging activity resulted in a net decrease in diesel fuel expense of \$26 million for first quarter 2003 and a net increase in diesel fuel expense of \$4 million for first quarter 2002. The effect of the hedges was to yield average costs of 75 cents per gallon for the first quarter of 2003 and 70 cents per gallon for the same period of 2002, including federal taxes and transportation. Ineffectiveness, or the extent to which changes in the fair values of the heating oil contracts do not offset changes in the fair values of the expected diesel fuel oil transactions, was approximately \$1 million for each quarter.

Interest Rate Hedging

NS Rail manages its overall exposure to fluctuations in interest rates by issuing both fixed and floating-rate debt instruments, and by entering into interest rate hedging transactions. NS Rail had \$211 million, or 34.9%, and \$220 million, or 35.4%, of its fixed rate debt portfolio hedged at March 31, 2003, and Dec. 31, 2002, respectively, using interest rate swaps that qualify for and are designated as fair-value hedge transactions. These swaps have been effective in hedging the changes in fair value of the related debt arising from changes in interest rates, and accordingly, there has been no impact on earnings resulting from ineffectiveness associated with these derivative transactions.

Fair Values

The fair values of NS Rail's diesel fuel derivative instruments at March 31, 2003 and Dec. 31, 2002, were determined based upon current fair market values as quoted by third party dealers. Fair values of interest rate swaps were determined based upon the present value of expected future cash flows discounted at the appropriate implied spot rate from the spot rate yield curve. Fair value adjustments are non-cash transactions, and accordingly, are excluded from the Consolidated Statement of Cash Flows. "Accumulated other comprehensive loss," a component of "Stockholders' equity," included unrealized gains of \$23 million and \$29 million (pretax) at March 31, 2003, and Dec. 31, 2002, respectively, related to the fair value of derivative fuel hedging transactions that will terminate within twelve months of the respective dates.

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

	<u>March 31,</u> <u>2003</u>	<u>Dec. 31,</u> <u>2002</u>
	<i>(\$ in millions)</i>	
Interest rate hedges:		
Gross fair market asset position	\$ 22	\$ 24
Gross fair market (liability) position	--	--
Fuel hedges:		
Gross fair market asset position	27	29
Gross fair market (liability) position	<u>(2)</u>	<u>--</u>
Total net asset position	\$ <u>47</u>	\$ <u>53</u>

4. Comprehensive Income

NS Rail's total comprehensive income was as follows:

	Three Months Ended	
	March 31,	
	<u>2003</u>	<u>2002</u>
	<i>(\$ in millions)</i>	
Net income	\$ 184	\$ 85
Other comprehensive income (loss)	<u>(20)</u>	<u>95</u>
Total comprehensive income	\$ <u>164</u>	\$ <u>180</u>

For NS Rail, "Other comprehensive income (loss)" is the unrealized gains and losses on certain investments in debt and equity securities, principally NS common stock, and net fair value adjustments to certain derivative financial instruments.

5. Commitments and Contingencies

Lawsuits

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

Presently, there are matters involving labor arbitration and other claims for "New York Dock" and other income protection benefits where the aggregated range of loss could be from zero to \$40 million. Management believes that NS Rail will prevail in these matters; however, an unfavorable outcome could result in accruals that could be significant to results of operations in a particular year or quarter.

Casualty Claims

NS Rail is generally self-insured for casualty claims. NS Rail has insurance for catastrophic events, but that coverage has upper limits. The casualty claims liability is determined actuarially, based upon claims filed and an estimate of claims incurred but not yet reported. While the ultimate amount of claims incurred is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payments of claims. However, it is possible that the recorded liability may not be adequate to cover the future payments of claims. Adjustments to the recorded liability are reflected in operating expenses in the periods in which such adjustments are known.

Environmental Matters

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

NS Rail's balance sheets included liabilities for environmental exposures in the amount of \$28 million at March 31, 2003, and \$29 million at Dec. 31, 2002 (of which \$8 million was accounted for as a current liability for each period). At March 31, 2003, the liability represented NS Rail's estimate of the probable cleanup and remediation costs based on available information at 113 identified locations. On that date, 10 sites accounted for \$15 million of the liability, and no individual site was considered to be material. NS Rail anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At some of the 113 locations, certain NS Rail subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for cleanup costs.

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

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

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

Purchase Commitments

At March 31, 2003, NS Rail had outstanding purchase commitments of approximately \$63 million in connection with its 2003 capital program.

Independent Accountants' Review Report

The Stockholders and Board of Directors
Norfolk Southern Railway Company:

We have reviewed the accompanying consolidated balance sheet of Norfolk Southern Railway Company and subsidiaries as of March 31, 2003, and the related consolidated statements of income and cash flows for the three-month periods ended March 31, 2003 and 2002. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

As discussed in Note 1 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Statement No. 143, "Accounting for Asset Retirement Obligations," and Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities," as of January 1, 2003.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Norfolk Southern Railway Company and subsidiaries as of December 31, 2002, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated January 28, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2002, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP
Norfolk, Virginia
April 22, 2003

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

**NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES (NS RAIL)
(A Majority-Owned Subsidiary of Norfolk Southern Corporation [NS])
Management's Discussion and Analysis of Financial Condition and Results of Operations**

RESULTS OF OPERATIONS

Net Income

First-quarter net income was \$184 million in 2003, and included \$104 million for the cumulative effect on years prior to 2003 of changes in accounting principles as required by the adoption of two accounting pronouncements (see Note 1). First-quarter income before accounting changes was \$80 million, down \$5 million, or 6%, compared with results for the first quarter of 2002, reflecting lower income from railway operations.

Railway Operating Revenues

First-quarter railway operating revenues were \$1.52 billion in 2003, up \$62 million, or 4%, compared with the first quarter of 2002. As shown in the following table, the increase was the result of higher traffic volume and increased average revenues.

	First quarter 2003 vs. 2002 <u>Increase (Decrease)</u> (\$ in millions)
Traffic volume (carloads)	\$ 38
Revenue per unit/mix	24
Total	<u>\$ 62</u>

Revenues and carloads for the commodity groups were as follows:

	First Quarter		First Quarter	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
	(\$ in millions)		(carloads in thousands)	
Coal	\$ 354	\$ 359	395	398
General merchandise:				
Automotive	242	228	167	163
Chemicals	194	186	107	104
Metals/construction	166	160	161	162
Agr./consumer prod./govt.	166	154	133	125
Paper/clay/forest	<u>150</u>	<u>141</u>	<u>107</u>	<u>105</u>
General merchandise	918	869	675	659
Intermodal	<u>247</u>	<u>229</u>	<u>578</u>	<u>549</u>
Total	<u>\$ 1,519</u>	<u>\$ 1,457</u>	<u>1,648</u>	<u>1,606</u>

Coal

First-quarter coal revenues decreased \$5 million, or 1%, compared with last year. Total traffic volume (tonnage) handled was down slightly for the quarter, as lower traffic volume for export, domestic metallurgical and industrial coal more than offset higher traffic volume for utility coal. Export coal volume was hampered by production

shortfalls from a key supplier. Domestic metallurgical coal shipments were lower as the harsh winter weather delayed shipments in the Great Lakes region. Utility coal traffic volume benefited from higher demand caused by the cold weather; however, the weather also resulted in delayed shipments as frozen coal slowed loading and unloading operations. Average revenue per carload declined 1% in the first quarter as the effects of more shorter-haul (lower revenue per unit) business more than offset the favorable effects of a fuel surcharge.

Coal volumes are expected to strengthen in the second quarter, as utilities' coal stockpiles were depleted during the winter. For the last half of the year, coal revenues are expected to be comparable to those of 2002.

General Merchandise

First-quarter general merchandise revenues increased \$49 million, or 6%, compared with last year. Traffic volume (carloads) increased 2%, as all commodity groups except the metals and construction group posted increases. Agriculture, consumer products and government volume increased 6% reflecting more shipments of corn into markets affected by the 2002 drought. This is expected to continue until late September when the 2003 crop comes to market. In addition, traffic volume benefited from increased volume for sweeteners and more shipments for the military. Chemicals traffic volume increased 3% on stronger demand for industrial intermediate products and increased plastics shipments, which was supported by higher vehicle production and consumer products demand. Automotive traffic volume increased 2%, primarily due to the resumption of production at a plant that had been curtailed during the first quarter of 2002. Automotive production for the year is expected to be lower than that of 2002. General merchandise average revenue per carload increased 3% reflecting increased rates, more longer haul (higher average revenue) business, a fuel surcharge and favorable changes in the mix of traffic.

General merchandise revenues are expected to weaken in the second quarter, when compared with the second quarter of 2002, reflecting lower vehicle production. However, for the last half of the year, general merchandise revenues are expected to be comparable to those of 2002 and largely reflect the performance of the economy.

Intermodal

First-quarter intermodal revenues increased \$18 million, or 8%, compared with last year. Container traffic volume benefited from increased international and domestic business as well as the conversion of truck traffic to rail. Intermodal revenue per unit increased 3% for the quarter, as the favorable effects of fuel surcharges and ancillary revenues were slightly offset by an unfavorable change in the mix of traffic.

Intermodal revenues are expected to continue to benefit from new business supported by continued improvements in service and conversion of truck traffic to rail; however, any weakening in consumer demand could dampen this outlook.

Railway Operating Expenses

First-quarter railway operating expenses were \$1.33 billion in 2003, up \$73 million, or 6%, compared with last year, as most expense line items were higher.

As discussed in Note 1, effective Jan. 1, 2003, NS Rail's method of accounting for crosstie removal was changed as a result of implementation of SFAS No. 143. This change in accounting in the first quarter lowered depreciation expense by almost \$7 million and increased compensation and benefits and other expenses by almost \$5 million. For the year, it is expected that the depreciation reduction will total approximately \$29 million, while the expense increases will total about \$20 million.

Compensation and benefits expenses increased \$17 million, or 4%, reflecting lower pension income, higher wage rates, increased medical costs (despite additional employee contributions) and the effects of the change in accounting (see Note 1). These increases more than offset reduced payroll taxes.

Materials, services and rents increased \$6 million, or 1%, principally because of higher material expenses, primarily for locomotive repairs, and volume-related intermodal expenses and equipment rents. These increases were partially offset by a lower management fee from NS (see Note 2).

Conrail rents and services expenses decreased \$2 million, or 2%, reflecting lower costs in the Shared Assets Areas.

Depreciation expense was even in the first quarter, as the effects of property additions were offset by the change in accounting related to crosstie removal costs (see Note 1).

Diesel fuel expenses increased \$23 million, or 28%, reflecting higher average prices and marginally higher consumption. Expenses in 2003 included a \$26 million benefit from favorable hedge settlements, while the first quarter of 2002 included \$4 million of cost related to the hedging program.

Casualties and other claims expense increased \$16 million, or 46%, primarily because of damage to equipment and lading incurred because of several derailments, continuing unfavorable personal injury claims development and higher insurance costs.

Other expense increased \$13 million, or 21%, reflecting the absence of two items that benefited 2002 — a favorable property tax settlement and a favorable bad debt settlement.

FINANCIAL CONDITION AND LIQUIDITY

Cash provided by operating activities, NS Rail's principal source of liquidity, was \$204 million in the first three months of 2003, compared with \$181 million in the first three months of 2002. The increase was primarily the result of favorable changes in working capital.

A significant portion of payments made to PRR (which are included in "Conrail rents and services" and, therefore, are a use of cash in "Cash provided by operating activities") are borrowed back from a PRR subsidiary and, therefore, are a source of cash in "Proceeds from borrowings." NS Rail's net cash flow from these borrowings amounted to \$80 million in the first three months of 2003 and \$66 million for the same period of 2002.

NS Rail's working capital deficit was \$965 million at March 31, 2003, compared with \$1.1 billion at Dec. 31, 2002. The improvement was principally the result of a reduction in the net amount due to NS.

NS Rail looks to NS to provide needed funding. NS currently has the capability to increase the amount of accounts receivable being sold under the revolving sale program. Over the last twelve months, the amount of receivables NS could sell under this program ranged from \$358 million to \$421 million, and the amount of receivables NS sold ranged from zero to \$400 million. Moreover, NS has a \$1 billion credit facility, which expires in 2006, that it can borrow under or use to support commercial paper debt; however, reductions in its credit rating could limit NS' ability to access the commercial paper markets.

As the major NS subsidiary, NS Rail provides funding to service NS' debt. NS' debt at March 31, 2003, totaled \$6.4 billion. Of this debt, \$1.8 billion is due between 2003 and 2007.

NS Rail expects to generate sufficient cash flow from operations to meet its ongoing obligations, as well as to advance amounts to NS to service its debt.

Cash used for investing activities decreased in the first three months of 2003, compared with the first three months of 2002, principally because of a decline in capital expenditures. The decrease reflected the absence of locomotive purchases in 2003; however, NS Rail expects to acquire locomotives later in the year.

Cash used for financing activities was \$144 million in the first three months of 2003, compared with \$18 million in the same period of 2002, reflecting an increase in advances to NS and the absence in 2003 of proceeds from equipment financing. Advances to NS typically account for most of the cash used for financing activities and reflect NS' requirements.

OTHER MATTERS

Labor Arbitration

Several hundred claims have been filed with NSR on behalf of employees furloughed after June 1, 1999, for various periods of time, alleging that the furloughs were a result of the Conrail transaction and seeking "New York Dock" income protection benefits. Several labor organizations have initiated arbitration on behalf of individual employees. One such dispute has been heard and NSR is awaiting a decision. Another dispute is scheduled to be heard in May. Other disputes are pending wherein similar benefits are sought under labor agreement provisions that, in management's judgment, do not apply to the involved circumstances. Based on known facts, including the availability of legal defenses, management believes that NS Rail will prevail in these disputes and that any potential liability for the involved claims should not have a material adverse effect on NS Rail's financial position, results of operations or liquidity. Depending on the outcome of these arbitrations and claims, other claims may be filed or progressed to arbitration. Should all such claimants prevail, there could be a significant effect on results of operations in a particular quarter (see Note 5).

Labor Agreements

Approximately 24,000 of NS Rail's employees are covered by collective bargaining agreements with 15 different labor unions. These agreements remain in effect until changed pursuant to the Railway Labor Act. Moratorium provisions in these agreements permitted NS Rail and the unions to propose such changes in late 1999; negotiations at the national level commenced shortly thereafter. Agreements have been reached with the Brotherhood of Maintenance of Way Employees (BMWE), which represents about 4,200 NS Rail employees; the Brotherhood of Locomotive Engineers (BLE), which represents about 4,500 NS Rail employees; the United Transportation Union (UTU), which represents about 6,700 NS Rail employees; the International Brotherhood of Boilermakers and Blacksmiths (IBB), which represents about 100 NS Rail employees; the Transportation Communications International Union (TCU), which represents about 4,400 NS Rail employees; and the American Train Dispatchers Department (ATDD), which represents about 400 NS Rail employees. The agreement previously reached with the BLE was through 2004; NS Rail recently reached a further contract extension with the BLE through 2009 (subject to ratification). Health and welfare issues have been resolved with the BMWE and TCU. The UTU agreement provides that, subsequent to a further period of negotiation, health and welfare issues may be submitted to arbitration. Health and welfare issues with the other organizations have not yet been resolved.

Market Risks and Hedging Activities

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

In 2001, NS Rail began a program to hedge a portion of its diesel fuel consumption. The intent of the program is to assist in the management of NS Rail's aggregate risk exposure to fuel price fluctuations, which can significantly affect NS Rail's operating margins and profitability, through the use of one or more types of derivative instruments.

Diesel fuel costs represented 8% of NS Rail's operating expenses for the first quarter of 2003. The program provides that NS Rail will not enter into any fuel hedges with a duration of more than 36 months, and that no more than 80% of NS Rail's average monthly fuel consumption will be hedged for any month within any 36-month period.

As of March 31, 2003, through swap transactions, NS Rail has hedged approximately 68% of expected 2003 diesel fuel requirements. The effect of the hedges is to yield an average cost of 75 cents per hedged gallon, including federal taxes and transportation. A 10% decrease in diesel fuel prices would reduce NS Rail's asset related to the swaps by approximately \$30 million as of March 31, 2003.

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

At March 31, 2003, NS Rail's debt subject to interest rate exposure totaled \$567 million. A 1 percentage point increase in interest rates would increase NS Rail's total annual interest expense related to all its

variable debt by approximately \$6 million. Management considers it unlikely that interest rate fluctuations applicable to these instruments will result in a material adverse effect on NS Rail's financial position, results of operations or liquidity.

Some of NS Rail's capital leases, which carry an average fixed rate of 7%, were effectively converted to variable rate obligations using interest rate swap agreements. On March 31, 2003, the average pay rate under these agreements was 2%, and the average receive rate was 7%. During the first quarters of 2003 and 2002, the effect of the swaps was to reduce interest expense by \$2 million and \$3 million, respectively. A portion of the lease obligations is payable in Japanese yen. NS Rail eliminated the associated exchange rate risk at the inception of each lease with a yen deposit sufficient to fund the yen-denominated obligation. Most of these deposits are held by foreign banks, primarily Japanese. As a result, NS Rail is exposed to financial market risk relative to Japan. Counterparties to the interest rate swaps and Japanese banks holding yen deposits are major financial institutions believed by management to be creditworthy.

Environmental Matters

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

Operating expenses for environmental matters totaled approximately \$2 million in the first quarters of 2003 and 2002. Capital expenditures totaled approximately \$1 million for the first quarter of 2003 and \$2 million for the first quarter of 2002.

NS Rail's balance sheets included liabilities for environmental exposures in the amount of \$28 million at March 31, 2003, and \$29 million at Dec. 31, 2002 (of which \$8 million was accounted for as a current liability in each period). At March 31, 2003, the liability represented NS Rail's estimate of the probable cleanup and remediation costs based on available information at 113 known locations. On that date, 10 sites accounted for \$15 million of the liability, and no individual site was considered to be material. NS Rail anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At some of the 113 locations, certain NS Rail subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for cleanup costs.

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

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

However, based on an assessment of known facts and circumstances, management believes that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on NS Rail's financial position, results of operations or liquidity.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that may be identified by the use of words like "believe," "expect," "anticipate" and "project." Forward-looking statements reflect management's good-faith evaluation of information currently available. However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which management has little or no control, including: domestic and international economic conditions; the business environment in industries that produce and consume rail freight; competition and consolidation within the transportation industry; fluctuation in prices of key materials, in particular diesel fuel; labor difficulties, including strikes and work stoppages; legislative and regulatory developments; changes in securities and capital markets; and natural events such as severe weather, floods and earthquakes. Forward-looking statements are not, and should not be relied upon as, a guaranty of future performance or results. Nor will they necessarily prove to be accurate indications of the times at or by which any such performance or results will be achieved. As a result, actual outcomes and results may differ materially from those expressed in forward-looking statements. The Company undertakes no obligation to update or revise forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risks.

The information required by this item is included in Part I, Item 2, "Management's Discussion and Analysis of Financial Conditions and Results of Operations" on page 16 under the heading "Market Risks and Hedging Activities."

Item 4. Controls and Procedures.**(a) Evaluation of Disclosure Controls and Procedures.**

NS Rail's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of NS Rail's disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, NS Rail's disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to NS Rail (including its consolidated subsidiaries) required to be included in NS Rail's periodic filings under the Exchange Act.

(b) Changes in Internal Controls.

Since the Evaluation Date, there have not been any significant changes in NS Rail's internal controls or in other factors that could significantly affect such controls.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibit

- 99 Certifications of the CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

None.

SIGNATURES

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

NORFOLK SOUTHERN RAILWAY COMPANY
Registrant

Date: April 30, 2003

/s/ Reginald J. Chaney
Reginald J. Chaney
Corporate Secretary (Signature)

Date: April 30, 2003

/s/ John P. Rathbone
John P. Rathbone
Vice President and Controller
(Principal Accounting Officer) (Signature)

I, David R. Goode, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Norfolk Southern Railway Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 30, 2003

/s/ David R. Goode

David R. Goode
President and Chief Executive Officer

I, Henry C. Wolf, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Norfolk Southern Railway Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 30, 2003

/s/ Henry C. Wolf

Henry C. Wolf
Vice President
Chief Financial Officer

EXHIBIT INDEX

**Electronic
Submission
Exhibit
Number**

Description

99

Certifications of the CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.