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Technical Director File Reference No. 1850-100 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

RE: Propos

Proposed Accounting Standards Update

Leases (Topic 840)

Norfolk Southern Corporation ("NS") is one of the nation's premier transportation companies and is a publicly held corporation with its common shares listed on the New York Stock Exchange. Its Norfolk Southern Railway subsidiary operates approximately 21,000 route miles in 22 states and the District of Columbia, serving every major container port in the eastern United States, and provides efficient connections to other rail carriers. NS operates the most extensive intermodal network in the East and is a major transporter of coal and industrial products.

NS appreciates the opportunity to provide, and respectfully submits, the following comments on the Proposed Accounting Standards Update ("ASU") regarding Leases (Topic 840), published by the Financial Accounting Standards Board and the International Accounting Standards Board (the Boards) – selections of which have been reproduced here in italics.

Question 3: Short-term leases

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65). (See also paragraphs BC41-BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

NS does not agree with this approach. The simplified approach in the proposed guidance would be extremely complex and onerous considering the company participates in thousands of short-term leases, and each such lease would need to be evaluated and monitored. Many of these leases are non-core and/or immaterial, both individually and in the aggregate, to the financial statements as a whole. It would be preferable if the same approach as that afforded lessors was made available to lessees — with no requirement to record an asset or liability.

Definition of a lease

This exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1-B4 and BC29-BC32). This exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59-BC62) and on distinguishing a lease from a service contract (paragraphs B1-B4 and BC29-BC32)

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

NS interprets the proposed guidance such that certain transactions that are unique to the railroad industry are arrangements outside the scope of this ASU. For example, Car Hire charges are incurred by Railroad A when a freight car belonging to Railroad B is interchanged and enters Railroad A's lines. Railroad A pays for the use of the freight car whether loaded or empty and, while it must deliver the contents of the car to its destination, it may use the empty freight car as it chooses or return it to Railroad B. The period of usage is typically short (days or weeks) but can extend for longer periods. Car Hire arrangements do not specify a term and the decisions to use or return cars are made on a daily basis as operating factors dictate. As such, the owning railroad (Railroad B) would not be able to determine the term. Additionally, Car Hire payments are on a per diem basis based on usage. Accordingly, NS treats Car Hire as rentals – income/expense is currently recognized in the income statement.

There are other asset utilization arrangements within our industry for which the counterparty obtains or controls an amount of output or utility of the asset, or whereby a right of access is granted rather than a right of use, and NS would interpret these arrangements to be similarly outside the scope of the ASU. Examples of these would include: haulage (rights obtained by one railroad to have its trains operated by another railroad over that railroad's tracks); trackage rights (rights obtained by one railroad to operate its trains and crews over tracks of another railroad); joint facilities (a railway property which two or more carriers either own, maintain or operate by formal agreement for this common benefit); and easements (including for fiber optics and telecommunications towers). We believe that additional clarification and examples in the guidance would be helpful with respect to the right of use of an asset and the right of access to an asset. It would also be beneficial to provide clarification regarding land as a "right of use" asset.

Measurement

This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

- (a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).
- (b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121-BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be reliably measured.
- (c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132-BC135).

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

NS believes that recording a liability based on such highly subjective assessments of probability of occurrence for each possible term conflicts with current accounting literature, specifically the two criteria noted within ASC 450-20-25-2. Utilization of a lease term "defined as the longest possible term that is more likely than not to occur," is not representative of the "probable" and "estimable" criteria; i.e., companies would have to recognize a liability that does not meet the definition of a liability. Moreover, valuation of lease assets and liabilities based on subjective judgments about lease extensions or terminations could be misleading.

Should the ASU be adopted, NS respectfully requests that the Boards omit the inclusion of options to extend or terminate a lease. Alternatively, a practical solution may recognize the present value of the lease payments over the non-cancellable term, and reassess the liability if facts or circumstances have changed since the last reporting period.

The proposed ASU allows for the selection of the amortization method for the right-of use asset (lessee); however, the interest method is required for the lease liability or right to receive lease payments. The application of the interest method will cause more expense to be incurred during the early periods of a lease term and is not necessarily representative of how the economic benefits are realized during that term. For instance, in the case of NS, a leased rail car will provide economic benefits over the periods utilized; e.g., hours or miles. The recognition of more expense during the earlier periods, in accordance with the interest method, may not necessarily correlate with how the economic benefits are realized according to usage.

Should the ASU be adopted, NS respectfully requests that the interest method not be mandated. It is NS' belief that the amortization methodology chosen should be consistently applied to both the liability and right-of-use-asset or receivable, thereby, focusing on the types of economic benefits received or conveyed as opposed to an arbitrary methodology that creates imbalance. Additionally, further clarification with respect to land as a right-of-use asset would be beneficial as it appears that a scope exception was not presented for amortization.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

NS does not believe that contingent rentals, expected payments under term option penalties, or residual value guarantees should be included in the measurement of assets and liabilities. Companies would have to use significant judgment to forecast activities that are beyond their normal budgeting or planning cycles. Such use of judgment could lead to significant variances between companies for similar transactions. The calculation would be complicated by the wide range of possible outcomes, the length of the lease term and the nature of the contingency itself. The implementation of this requirement would be costly and time consuming for relatively little requisite benefit to the financial statement user.

Presentation

This exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25-27, 42-45, 60-63 and BC142-BC159).

Question 12: Statement of financial position

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment, but separately from assets that the lessee does not lease (paragraphs 25 and BC143-BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

It is NS' opinion that presentation of material liabilities to make lease payments separately from other financial obligations and material right of use assets separately from non-leased assets are appropriate as it will give readers of financial statements more granularity into how the business operates. This presentation will also give further insight into the rights and obligations of a company. In the event these amounts do not warrant standalone presentation, disclosure within the footnotes should suffice.

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totaling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

It is NS' opinion that separate balance sheet presentation totaling to a net amount is appropriate and consistent with the proposed income statement presentation. If the individual amounts are immaterial, it would be beneficial to have the option to present net within a single line with additional footnote disclosure.

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

It is NS' opinion that presentation of rights to receive lease payments separately from other financial assets and separate presentation of residual assets from other property, plant and equipment are appropriate as it is consistent with the rights and obligations of the company. In the event these amounts are immaterial, net presentation should suffice with the additional footnote disclosures.

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

It is NS' opinion that preference should be given to footnote disclosure as opposed to distinguishing on the balance sheet. Balance sheet presentation would become more complex, thus potentially leading to more confusion than benefit.

Question 13: Income statement

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in the income statement (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

It is NS' opinion that it is appropriate for a lessee and lessor to present material lease income and lease expense separately from other income and expense in the income statement as this information may be informative for readers of the financial statements – specifically the analyst community. For certain companies, lessee amortization and expense may be immaterial, thus the option to present the data within the notes is a practical alternative.

From the lessor performance obligation perspective, it is also appropriate to present separate components of material income and expense line items totaling to a net amount. Furthermore, it also appropriate from the lessor derecognition perspective to present net, in a single line within the income statement. It is NS' opinion that net presentation is consistent with balance sheet presentation.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

It is NS' opinion that it is appropriate to present separate cash flows; however, presenting them solely as financing activities is not representative of how a railroad operates or, necessarily, the nature of a lease. In essence, a portion of current operating leases are decision criteria as well as managing residual value risk. Presentation of cash flows as financing activities in conjunction with the recognition of former operating leases as assets could be misleading in a capital intensive industry.

Transition

Question 16

- (a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

It is NS' opinion that a simplified retrospective approach is appropriate for the purposes of comparative data presented.

Benefits and costs

Ouestion 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

It is NS' belief that implementation of the proposed guidance on measurement will be complex and onerous both at transition and for subsequent periods, considering the company participates in thousands of leases, of which many are non-core and/or immaterial, both individually and in the aggregate, to the financial statements as a whole. Substantial effort and cost will be incurred to analyze, review and audit (internally and externally) documentation on a lease-by-lease basis to meet the proposed requirements. It is NS' belief that the benefits from the ASU as currently written do not justify the added costs that will be incurred.

Other comments

Ouestion 18

Do you have any other comments on the proposals?

It is NS' opinion that comparability within an industry may suffer as a result of distorted financial ratios caused by the proposed ASU. It may be beneficial to reach out to the Analyst community to assess the impact on their benchmarking. Credit constraints/issues may also occur due to inflated liabilities, the inability to meet debt covenants, reduced working capital, etc. Finally, given the requirements contained within the proposed ASU, significant lead time will be essential to support proper implementation (which will include development of new processes and information systems that will have extensive, far-reaching effects throughout our organization).

Thank you for this opportunity to comment on the ASU. If you would like to discuss this further or would like additional information, please feel free to call me at (757) 629-2765.

Very truly yours,

C. H. Allison, Jr.

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Vice President and Controller