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PRESENTATION

Operator

Greeting, and welcome to the Norfolk Southern Corporation second quarters earnings conference call. At this time all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions). As a reminder, the conference is being recorded.

It is now my pleasure to introduce your host, Leanne Marilley, Norfolk Southern Director of Investor relations. Thank you. Ms. Marilley, you may now begin.

Leanne Marilley *- Norfolk Southern Corp - Director, IR*

Thank you, and good morning. Before we begin today's call, I would like to mention a few items. First, we remind our listeners and internet participants that the slides of the presenters are available for your convenience on our Web site at NScorp.com in the investor section.

Additionally, MP-3 downloads of today's call will be on our Web site for your convenience. As usual, transcripts of the cal will be posted on our Web site and available upon request from our corporate communications department. At the end of the prepared portion of today's call, we will conduct a question-and-answer session. At that time, if you choose to ask a question, an operator will instruct you how to do so from your telephone keypad.

Any forward-looking statements made during the course of this presentation represent our best good-faith judgment as to what may occur in the future. Statements that are forward-looking can be identified by the use of words such as "believe," "expect," "anticipate," or "project." Our actual results may differ materially from those projected and will be subject to a number of risks and uncertainties, some of which may be outside our control. Please refer to our annual and quarterly reports filed with the SEC for discussions of those risks and uncertainties we view as most important.

Additionally, keep in mind that all references to reported results excluding certain adjustments have been reconciled on our Web site at NScorp.com in the investor section. Now it is my pleasure to introduce Norfolk Southern Chairman, President and CEO, Wick Moorman.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Thank you, Leanne and good morning, everyone. It's my privilege to welcome all of you to our second quarter 2009 earnings conference call. I'm joined today by several members of our senior management team, including Don Seale, our Chief Marketing Officer, Mark Manion, Chief Operating Officer, and Jim Squires, our Chief Financial Officer, all of whom you'll hear from today.

Norfolk Southern's second quarter results, while obviously adversely impacted by the continued recession, reflect solid operating performance and aggressive cost control. While revenues declined 33% on a 26% reduction in volume, we reduced operating expenses by 29%. Out pacing the very substantial volume drop and partially offsetting the reduction reduction in revenues. The result was second quarter railway operating profits of $468 million, which was 41% below last year. Earnings per share were down 44% year over year, and our second quarter operating ratio was 74.8%, an increase of 3.7 percentage points over the comparable period last year.

In the face of these steep volume declines, we demonstrated considerable ability to shed costs from the system while maintaining and improving the safety, service and efficiency of our operations. Our track 2012 initiatives are driving Norfolk Southern to the next level, and while Mark will discuss the details of our cost control programs with you in a few minutes. I, too, want to underscore the disciplined and deliberate fashion with which we are approaching these efforts. Let me give you some examples.

First we achieved an all-time best system average train speed in the quarter. Importantly, this milestone was achieved by careful planning and disciplined execution that resulted not only in an overall average speed improvement, but continuing improvements in fuel consumption, which declined by more than both train starts and gross ton models.

Second, the decrease in volume related labor was driven not only by reduced crew starts, as Mark will outline, but also by a focus on reducing overtime hours, which accounted for nearly half of the quarterly declines.

Third, our work force reductions, which are down year over year and sequentially, reflect a location by location sophisticated analysis of projected labor requirements, demographics and business volumes.

We achieved these efficiencies while meeting or exceeding customer service requirements. In fact, every measure within our service composite performance index, plan adherence, train performance and connection performance, improved in the second quarter.

While we expect our revenues and volumes to remain under pressure, we continue to restructure our franchise to remain positioned as the premier rail network. We also fully intend to ensure that many of these efficiencies will remain in place as the economy revives.

A reliable, efficient and environmentally sound way to ship freight is a critical part of the solution to our nation's transportation crisis. To that end, we announced plans this month to invest in new intermodal terminals in Alabama and Tennessee, both supporting local economic development as well as our crescent corridor rail infrastructure initiative, which will establish a high-speed rail route from the mid South and Gulf Coast to the northeast and New England.

While there's still a lot of work to be done, our hope is to open these new terminals in 2012. I'm pleased with our progress this quarter and confident that when the economy emerges from the recession, we be in an excellent position to attract and accommodate volume growth. As we manage the enterprise for the long term, we will continue to control costs, improve our service product and enhance our franchise by investing in projects that position Norfolk Southern for the future.

I'm now going to turn the program over to Don, who will provide full details about our revenues, followed by an operations overview from Mark and a discussion of our financial results by Jim. I'll then wrap up with some closing comments before we take your questions. Don?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

Thank you, Wick, and good morning, everyone. During the second quarter, further economic contraction, as Wick indicated, continued to depress freight transportation demand. As a result, our revenue for the quarter totaled $1.86 billion, down $908 million or 33% below the same period of last year. This decline was driven by a 26% reduction in volume, which represented $711 million of the total revenue decline. Fuel related revenue was down $348 million versus 2008 as a result of lower oil prices and reduced volumes, which represented approximately 38% of the quarterly decrease in revenue. In addition, we experienced a $35 million negative fuel surcharge lag effect in the quarter and negative mix effect equating to $53 million for the quarter.

On the plus side, continued improvements in pricing partially offset volume and fuel revenue declines and provided a positive offset of $204 million.

With respect to yield on next slide, all of our groups with the exception of agriculture posted year over year declines. Lower fuel revenue and negative traffic mix impacted $38 per unit drove this result. Total revenue per unit was $1,315, falling $140 or 10% below the second quarter of 2008. Agriculture revenue per unit was up 2% in the quarter due to repricing gains which offset a decline in fuel surcharge revenue. And overall pricing was up 7% in the quarter as continued progress was made in marketing the overall value of our high quality rail service.

Turning to volume as shown on the next slide, we experienced recession driven declines across our book of business. Total volume in the quarter was 1.4 million units, down 489,000 loads or 26% below the second quarter of last year. Significant declines in steel, automotive, international and intermodal volumes in the face of weak consumer demand, coupled with production cuts and plant closures led volume declines for the quarter.

Now transitioning to our individual business groups in the next slide, coal revenue was $511 million for the quarter, down $264 million or 34% compared to the second quarter of 2008. Revenue per car of $1,538 was down 11%. Reduced fuel surcharge revenue was the predominant driver followed by the downward adjustment in the RCAF-U. Lower volumes of export coal also contributed to negative mix, which reduced RPU in the quarter.

Total coal volume fell by 26% in the quarter as business across all segments of the market softened against strong comps from last year. Utility volume declined by 16%, driven by a 5.5% drop in electricity output in the region that we serve. Stockpiles during the quarter remain high going into the summer season, and further weakness in coal burn was evident from increased generation from natural gas, as natural gas prices fell 65% from a year ago.

Our export business, which is predominantly metallurgical coal for the European steel industry,y experienced tough comparisons to second quarter of last year when a low US dollar and tight worldwide coal supply converged with higher global demand. During this quarter we saw export volume fall 62%, driven by a 46% decline in European steel production, and stronger competition from Australian coal. Within the US , our domestic net coal volume went up 50% as steel production fell 52% in the quarter. And coal shipments to industrial clients declined by 19% in the face of lower demand.

Turning to intermodal in slide 7, revenue for the quarter was $368 million, down $164 million or 31% from the same period last year. Revenue per unit of $600 fell $98 or 14% compared to the second quarter of 2008. The decline was driven by lower fuel surcharge revenue, slightly offset by positive mix effects from a higher percentage of domestic shipments and some incremental pricing gain in the intermodal book of business.

Intermodal volumes, summarized in slide 8, were down 20% compared to the second quarter of last year. Weak domestic and global economic conditions and related excess trucking capacity impacted volumes across our lines of business. Within our intermodal segments, after several quarters of gains domestic volumes fell 2% as highway conversions could not offset declines driven by the economy. International volume fell 34% as a result of reduced consumer spending and a depressed global economy. While triple crown volumes fell 17% in the face of declines in automotive action. And premium volume fell 18% driven by lower partial volumes.

Turning to slide 9, as you recall I shared our overall corridor strategy with you during our June investor's day conference in Atlanta. As part of this strategic initiative, we announced the first two terminals to be built as part of our crescent corridor project. These new facilities, which will be constructed in Memphis and Birmingham, are vital links in the crescent corridor, and both will support growing intermodal opportunity within the southeast and eastern seaboard. We expect construction of these terminals to be complete in 2012.

We're also progressing upgraded work on the northeastern extension of crescent which encompasses our PanAm Southern joint venture in Boston. We expect to have 90% of the required track work completed by the end of this year. During the quarter we also launched new products and service to further enhance our intermodal network, including the fastest scheduled intermodal reefer trailer service available between California and Atlanta in conjunction with Union Pacific over our meridian speedway connection at Shreveport.

Now turning to our carload business in slide 10, revenue from our merchandise sector was $978 million down $480 million or 33%. Continued manufacturing and economic weakness across the board resulted in a 30% decline in total volume in this book of business. Revenue per car reached $2,093, down 1% for the quarter, as solid pricing gains could not offset the impact of lower fuel revenue.

Looking at our industrial carload segments quickly, agricultural volume fell 14% in the second quarter. Soft fertilizer and export grain shipments along with increased truck competition for soy beans to southeast processors drove the decline. Paper and forest product shipments in the next slide were down 28%. Significant declines in paper and pulp production led to lower paper and clay shipments, and lumber and wood product shipments declined as single family housing starts in the first half of the year hit the lowest level in the 59 years the data has been collected .

Chemicals volume fell 23%, with weaker housing starts contributing to 38% of the decline. And lower auto production and chemical plant closures accounted for 20% of the quarter's decline.

And finally in the next slide, metals and construction volume was down 44%, domestic steel production fell 52% in the quarter as I mentioned earlier, resulting in the permanent closure of two mills and the idling of 16 other steel facilities in our service territory. Construction volume also continued to fall due to softness in housing and highway construction.

Concluding with the automotive market on slide 15, carloads were down 48% in the second quarter, driven by production cuts by all manufacturers in response to declining sales. Bankruptcy filings and related productions cuts at Chrysler and General Motors accounted for 29% of our volume decline for the quarter. We're seeing positive signs in the automotive industry that hopefully suggest some stabilization in the industry. Toyota recently announced plans to spend approximately $500 million to upgrade its Princeton, Indiana assembly plant. And General Motors announced the retooling of its Fort Wayne, Indiana assembly plant to absorb some of the production cuts at other plants.

Last of all, our strong service product continues to be recognized in the automotive industry. We were pleased to receive the 2008 Carrier of the Year award presented by UPS Autogistics in conjunction with Ford Motor Company for overall logistics excellence among all North American rail carriers for the transportation of Ford vehicles. We received the top quality ratings in the industry for both origin and destination ramp operations as measured by the double AR audit process.

Turning to the next slide and going forward, automotive volumes will continue to see negative year-over-year comps as North American light vehicle production is forecast to fall 16% to 8.5 million units per year, the lowest level since 1962. On the plus side, the market appears to have hit a low point, with most manufacturers planning to increase second half production. For example, Ford recently announced it plans to increase third quarter production by 10% versus last year. We expect our agricultural business to see positive year over year comps before the end of the year, with increased ethanol and fertilizer volume.

Metals and construction comparisons will likely remain negative for the second half, but the magnitude of the declines should lessen as steel production is projected to increase by 15% in the second half. And in chemicals, we are seeing some restocking of lower inventory levels of plastics and related miscellaneous chemicals. We've also begun to move unit train loads of fly ash from Kingston,Tennessee to Alabama for disposal, which should add significant new volume and revenue in the months ahead.

Turning to intermodal, 2009 will be another year without an obvious peak season. Import and export volumes expected to be soft for the remainder of the year with limited recovery in US and overseas markets. On the domestic side, beneficial owners continue to seek more efficient and sustainable modes of transportation, which will result in ongoing highway conversions that will offset some of the economic related declines.

With respect to coal, volumes will remain challenged over the course of the year, resulting from mild summer weather and high utility stockpiles. We'll also face strong comps from 2008 in the third and fourth quarters as coal volumes last year in those quarters set new records for the year.

On the positive side, we've recently seen increased activity in the export market over both Lamberts Point and Baltimore . Volumes will not approach 2008 levels, but we do expect improvement versus second quarter 2009.

In addition, we also expect increased shipments of domestic met coal in the second half for two of our large steel customers, and several NS serve plants are scheduled to take more contracted coal in the third and fourth quarters. In summary, economic conditions remain unstable and uncertain for the second half of the year, but it does appear we've experienced the bottom in the economy.

Looking at our respective markets, we foresee continued year over year declines through the second half for most of our commodities in the face of tough second half comps. But continued project growth will help to offset some of the unprecedented effect of this deep recession.

And last of all, but certainly key going forward, we expect continued pricing improvement as we match market value with our strong service product. Thank you for your attention, and I'll now turn the program over to Mark for our

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Mark Manion - ***Norfolk Southern Corp - COO***

Thanks, Don. And good morning, everyone. As Don pointed out, business volumes continue at historically low levels. And in response to these volumes, we continue to pursue cost reductions in order to right-size the operation. We are, however, mindful for the need for a focused and balanced balanced approach to those reductions. Therefor,e even with volume down we continue to push for improvements in our safety of operations as well as service delivery. Consistent service delivery is critical to both customer service and efficient operation.

I'll outline some of the results of our efforts, but first let's begin with a review of our safety performance. As shown here on slide 2, based on preliminary estimates, we continue to lead the industry in safety of operations and remain committed to pursuing initiatives to drive further improvement. Our estimated injury ratio for six months of 2009 is 1.13. Our train engine employees are paid on an activity basis. And turning to slide 3, with adjustments to our operating plan, both in reduced train operation, as well as reduced yard operations, we've been able to significantly reduce our crew starts. Looking at the slide, road crew starts were reduced 20% year over year and yard assignment starts were reduced 19%.

We continue to monitor business conditions and make adjustments to the operating plan accordingly, but these adjustments have to be carefully balanced to assure both continued service delivery for our customers as well as to maintain network velocity to maximize network operating efficiency. Some of you may have had the opportunity to hear about the tools we employ to analyze and model changes to the network operating plan at our investor day in Atlanta. These tools, particularly OPD, or operating plan developer, have enabled us to respond quickly to changing business condition,s reducing operations and costs without delays to customer shipments or additional costs associated with less efficient use of key assets, such as rail cars and locomotives.

As volumes started to fall late last year and as we adjusted our operating plan, we began reductions in our T&E workforce. On slide four, you can see that further plan reductions have diminished our need for T&E employees. Second quarter, year over year we reduced our T&E employee count by 14%.

Now let's turn to service delivery. On slide 5, we continue to drive better performance even as we have taken costs out of the operation. A key measurement of overall service delivery is our composite service measure, which combines the key service drivers of train performance, connection performance and plan adherence. We continue to push toward higher levels of service and service consistency with a gain of five points in the second quarter as compared to the same period in 2008. Turning to slide 6, we drill down to the individual components of the composite measure. As you can see, we're driving service improvements in all of the key components of service delivery. Second quarter performance includes a 14.7% improvement in train performance, a 0.9% improvement in connection performance and a 3.7% improvement in plan adherence. While the improvements in connection performance and plan adherence seem modest, they are improvements above already high levels.

As I mentioned earlier, network velocity is a key driver for savings in the areas of rail cars and locomotives. As shown on slide 7, second quarter average train speed improved 13%, and as Wick mentioned, was an all-time best. Terminal dwell time increased less than 2% as our models anticipated, and was an appropriate trade-off for the record-setting velocity as well as crew start improvements that I previously mentioned.

Looking at network velocity a slightly different way, let's turn to slide 8 which illustrates car hire days per carload. As a reminder, care hire is the rent that we pay for the use of other carriers rail equipment, and car hire days is the total amount of time most cars are on Norfolk Southern. As you can see, car hire days paid per carload has remained largely unchanged, overall less than a 1% increase in the second quarter indicating we maintained network velocity as we make changes to the train and yard operation. This is critical in keeping car hire payments in line with changes in volume. Loss of velocity results in longer equipment cycles and higher car expenses per carload. Due to continuing low demand, we continue to increase the number of rail cars in storage.

On slide 9, at the end of June, we had just over 35,000 cars stored. This includes about 28,000 cars owned or leased by Norfolk Southern as well as Norfolk Southern's allocation of stored national pools managed by TTX for automotive and intermodal as well as TTX flats and some boxcar equipment. It includes about 900 cars stored under car hire agreements with various short lines.

Turning to slide 10, at the end of June, we had just over 600 locomotives stored, about 16% of our fleet. You'll notice, in June, we started to reduce the number of locomotives stored from a high of 700 at the end of May. This represents in part a need for more locomotives to handle an increase in coal trains from May to June, but more importantly to support an effort to cycle our stored locomotives. In the past when storing locomotives it's been for a periods of time of less than a year. With the uncertainty of the economy, we're taking additional preventive maintenance action to assure our stored power remains in good working order. So when demand justifies their return to service, we can do so smoothly and with minimal delay.

On slide 11, the impact of a greatly reduced operating plan is reflected in locomotive fuel consumption, a 26% reduction in the second quarter of 2009 versus the same period in 2008. Fuel consumption was also aided by conservation efforts in the areas of train pacing, idle reduction efforts, and ensuring that the locomotive consist is correctly sized for the train. In addition to reductions in locomotive and other fuel, we are also seeing significant expense reduction in other areas of our operations, including our maintenance away, locomotive repair and rail car programs. Much like the first quarter, moving forward we will continue to build on the basics - safety, commitment to service and operating efficiency. More than anything else, we want every employee to end their work assignment in the same condition they started it.

Beyond that, we will continue to right-size the operating plan for the business delivered to us and make sure our asset bases are also correctly sized. And concurrently, we're going to maintain network velocity and service throughout this effort. However, we really view this environment as an opportunity to raise the bar on both our network velocity and service, now and going forward. And now I'd like to turn it over to Jim Squires.

Jim Squires - ***Norfolk Southern Corp - CFO***

Thank you, Mark. And good morning, everyone. I'll now provide a review of our overall financial results for the second quarter. Let's start with our operating results. As Don described, railway operating revenues for the quarter were $1.9 billion, down $908 million or 33% compared to last year. Slide 3 displays our corresponding operating expenses, which decreased by $577 million or 29% for the quarter. The resulting income from railway operations was $468 million, down 41%. The substantial decrease in revenues due to lower volumes and lower fuel surcharges was partially offset by significantly lower operating expenses resulting in an operating ratio of 74.8.

Turning to our expenses, the next slide presents the major components driving the$577 million decrease. As you can see, all of our expense categories are down this quarter with the exception of depreciation, which reflects our ongoing investment in infrastructure. Similar to first quarter, the biggest driver of our overall operating expense decline was sharply lower fuel costs which decreased by $338 million or 69%. As Mark noted earlier, locomotive fuel consumption is down 26% year over year in the second quarter, which reflects efficiency gains relative to a 25% decline in gross ton miles and a 20% decrease in crew starts. This accounted for the vast majority of our $126 million consumption related decrease in fuel expense this quarter.

As reflected on slide 6, lower prices provided a $212 million benefit. The graph on the next slide shows our average price per gallon for each of the last 10 quarters. The $1.55 average price in the second quarter of 2009 was a 57% decline compared with the $3.58 price per gallon in the second of 2008. The next largest expense decline was compensation and benefits, which decreased by $111 million or 17%.

Slide 9 presents the major components driving this change. First, volume related labor was reduced by $66 million in the quarter and I'll review this item in more detail momentarily. Second, stock-based and other incentive compensation fell $58 million due largely to decreased performance in 2009 relative to financial measures versus increased performance in the second quarter of 2008. Share prices contributed to lower expenses as well.

Third, payroll taxes decreased reflecting lower compensation levels. Somewhat offsetting these reductions were higher wage rates, up by $12 million, reflective of the agreement pay increase that went into effect last July. Pension benefits increased by $11 million primarily due to reduced asset values. Also medical benefits for active and retired employees were up $7 million.

Turning to slide 10, as I mentioned volume related labor savings were $66 million for the quarter. Taking closer look at T&E labor, load train and yard crew assignments were down 20% in the second quarter. This reduction was the primary driver of a $41 million decrease in T& E volume related expenses in the quarter. As you can see, this expense item has decreased relative to first quarter levels as we further streamlined operations in light of lower volumes. The remaining $25 million of volume related payroll savings primarily reflects reductions in engineering and mechanical requirements also related to lower volumes.

Materials and other expenses decreased $70 million or 33%. Slide 12 provides additional details to define this decrease. First, reductions in materials contributed $20 million, primarily related to materials used in operations as we have aligned locomotive freight car and engineering material use to confirm with lower traffic volumes. This is largely related to the increase in stored locomotive and freight cars that Mark highlighted for you earlier.

Second, casualties and other claims benefited from lower loss and damage claims largely related to derailment related costs incurred last year and favorable personal injury claims development in the current year. Third, other expenses benefited from reduced state tax accruals of $21 million resulting from settlement of a multi-year state dispute, as well as other volume reductions such as reduced travel expenses. Purchase services and rents decreased $66 million or 17%, reflecting decreased volumes. Our success in maintaining network velocity while reducing expenses has enabled us to realize volume related savings here.

Turning to slide 14, let me give you some examples. Intermodal expenses declined $19 million, transportation services and operations fell $16 million, which includes automotive related costs and lower crew transportation expenses and equipment rents decreased $14 million. In addition, mechanical expenses were down$5 million largely due to fewer freight car repairs.

Now let's turn to our nonoperating items on slide 15. Gains on property sales were $15 million lower than last year. Both quarters benefited from favorable adjustments to interest expense for settlement of prior year's tax matters. The resulting difference in these favorable adjustments created a $4 million headwind. Interest income was also down by $2 million. These decreases were partially offset by higher returns from corporate on life insurance.

As illustrated on slide 16, income before income taxes decreased $342 million or 47% largely related to lower operating income. Income taxes for the second quarter were $144 million or an effective tax rate of 36.8% which compares to $280 million or an effective rate of 38.2% last year.

Slide 18 depicts our bottom line results. Second quarter net income was $247 million, a decrease of $206 million or 45%. Diluted earnings per share were $0.66, which was $0.52 per share or 44% below last year. Thank you for your attention, and now I will turn the program back over to Wick.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Thank you, Jim. Well, as you've heard, while the second quarter was still clearly challenging, with the volume decline that exceeded what we saw in the first quarter, our balanced approach of cost reductions and service improvements created solid results for our shareholders. Looking ahead, our economic crystal ball remains as cloudy as it has ever been. The duration of the recession and the shape of the recovery are still question marks, but we're encouraged that the erosion of our traffic volumes we've seen for the past eight or nine months seems to at least have stabilized.

As Don mentioned, we have seen a couple of signs of increased economic activity with a few of our customers over the past few weeks; and while I think it's too early to tell if these are genuine green shoots or not, we're at least encouraged we're not seeing large parts of the lawn continue to die off. It does feel, as Don says, like we've reached a bottom. It also seems likely that the economic recovery will take some time. But it's my hope and anticipation that as the economy improves, rail traffic and Norfolk Southern's traffic in particular can revive at a pace that is faster than that of the overall economy.

As we continue to improve our efficiency and our industry leading service levels, the value proposition that we offer to shippers who are looking for smart transportation alternatives becomes more and more attractive. As we discussed many times before, the long-term trends still point to freight railroads as the preferred way to move goods and relieve highway congestion.

All of the factors that propelled our recent year's growth are intact, and the advantages of rail in terms of energy independence and carbon footprint are becoming more and more important in the considerations of many transportation buyers. I'll close by saying, again, that at Norfolk

Southern, we never lose sight of the fact that we're a service company, and we continually strive to improve our service product by intensively managing all of our assets.

We know that providing a superior level of service provides higher value for our customers, and for that reason, we will continue to invest. We will continue to improve service delivery, and we will continue our long-term focus.

Thank you, and I'll now turn the program over to the operator, who will instruct our telephone participants how to ask a question.

QUESTION AND ANSWER

Operator

Thank you. We will now be conducting a question-and-answer session. (Operator Instructions). Thank you. Our first question is coming from William Greene of Morgan Stanley.

William Greene - ***Morgan Stanley - Analyst***

Good morning. Wick, I'm wondering if we could talk a little bit about some of the investing you're doing. It seems like coal may be facing longer term pressures, whether we think of the competitiveness of eastern mines or the medical experts or at some point even a climate bill. Most of us would argue that's one of your more profitable commodities, but you're investing a lot in intermodal, which by definition is less captive. How should we think about the return profile going forward. It seems to me that will be challenged if that's sort of the secular trend, but how do you think about that?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Well, there's no question that the long-term secular trend, if the country is to move away from coal generation, will presently some issues for not only Norfolk Southern, but all of the rail industry. And for that reason, we and all of the other carriers have been active on Capitol Hill with a lot of other people in terms of expressing our views and our positions on the advantages of coal-fired generation.

Having said that, from an investment and a returns profile, we continue to invest in a lot of different areas of our franchise. Don highlighted the crescent corridor which we talk a lot about, because we think that that is a long-term very significant growth opportunity for us with traffic that we think we can earn a very good return on.

But I'll point out that we also are investing in other parts of our network, including the parts of our network that are focused on coal. A great example of that is the recently announced mid-American quarter venture that we announced with CN, which will give Norfolk Southern great access into the Illinois Basin coal fields, which we think will be a long-term player in coal-fired generation and a lot of our service territory. We also continue to invest in facilities that will improve our transportation ability for western coal to reach a lot of our primary utilities, and we have done some investment as well where it made sense, even looking at the opportunity for imported coal. So as you look at our investment profile, we certainly are continuing to invest in coal. I will personally say that I think that coal has a good future, and that Norfolk Southern will benefit from that.

William Greene - ***Morgan Stanley - Analyst***

And if volumes stay at current levels, maybe like plus or minus a few percent, i.e., not a huge rebound in the volumes, how do you think about CapEx going forward? Could it realistically be cut from current levels or do you maintain the investment profile you've got?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Well, let me say there are two components of that. There's the CapEx component that keeps our operating condition at the level that we want it that continues to reinvest in the property and in assets. There may well be parts of our property where if volumes are down, we don't have to renew them quite so frequently. And that will have an impact on that portion of our capital investment profile.

Having said that, though, as I mentioned and as we just discussed, to the extent that we see good business opportunities, which will result in significant volume growth and the addition of business that we don't handle today, we plan to continue to invest in those opportunities and invest in them aggressively. So we will have to balance it out as we see what volumes look like in the future.

William Greene - ***Morgan Stanley - Analyst***

And one quick question for Jim. The reduction in incentive comp was lower than I think it was in the first quarter. Is that a reversal of an accrual or suggestive of what you're thinking you need to accrue as you plan out your budget for the full year?

Jim Squires - ***Norfolk Southern Corp - CFO***

The adjustments to stock-based incentive compensation were in two areas, first the assumed bonus earn-out, that part of the incentive compensation. And there we actually decreased the assumed earn-out in the second quarter versus the assumption in the first quarter based on the trend of results. And the other big driver in the stock-based compensation is our performance share units, and there as well in the quarter, we reduced the assumed performance share unit earn-out versus first quarter. Conversely last year, with results improving, we actually took up the assumed earn-out for the PSUs, and so that's driving the favorable comparison. And lastly, share price also affects the assumed stock-based compensation expense, and that was a tailwind favorable item in stock based compensation as well this quarter.

William Greene - ***Morgan Stanley - Analyst***

Thanks for the time.

Operator

Thank you. Our next question comes from Matt Troy of Citigroup.

Matt Troy - ***Citigroup - Analyst***

Good morning. Could you give us a sense -- I know capacity utilization is difficult to assess in a network based business, but the current network, what can it handle? How much room do you have into a recovery to handle more traffic on a capacity basis?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Well, if you look at railroad capacity, you can define it in a lot of different ways. How many locomotives and cars you have, how much track infrastructure do you have, how many people do you have to run the trains. Clearly, we have taken down our T& E headcount, but we have the ability to rev that up fairly quickly. If you just look at the pure numbers, we are down second quarter from a volume standpoint in excess of 30% over our highs in 2006.

That was a traffic level that while we were doing some infrastructure investment on some pinch points we were able to handle with a relative degree of comfort, so I think there's -- right now there's a significant amount of capacity in the network; and as the economy recovers, we're taking a lot of steps to make sure that we can bring our operations back up from a volumes standpoint very smoothly and efficiently.

A great example of that is what Mark mentioned. We are in the process right now of implementing a program where we are cycling our stored road power out of storage every six or nine months in order to make sure that it all stays in good running order. When you store mechanical equipment for a long period of time, bad things can happen; and we're going to make sure that all of this power is ready to go when we need it.

Matt Troy - ***Citigroup - Analyst***

That's where I was going with the question, would be the ability to handle pickup. To your comment about the broader economy being probably set for a longer or drawn-out recovery process, I'm just curious, in the past obviously fixed assets network business, you've seen a lot of operating leverage into an economic recovery of the rails, might that not play out as in past cycles this time, particularly if you have a slow recovery. You've got to reintroduce train starts that might not be a full train. You have issues with coal, which is a profitable commodity for the rails. How should we think about the good job you've done in taking out costs with the fact that it will probably require some investment to accommodate traffic in a slow recovery.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Well, I would say that our -- we're highly confident that as the economy comes back, that we'll be able to ramp up our operations on an incremental basis. As Mark discussed, we've got great tools in terms of managing our network and managing our train operations to make sure that as the economy revives, as traffic revives, we're not out there running a lot of short trains to get ready for it. We can add them very smoothly using the tools that we have.

I mentioned the locomotives. We are to the extent we can storing our rail cars in serviceable condition, trying to store them to the best of our ability, where we're going to need them and as we recall crews and we -- based on recent experience we have a pretty high success rate in bringing folks back, it doesn't take too long to get them retrained, re-acclimated to the railroad.

I think we're confident we can pick the operation back up on an as-needed basis without incurring a lot of overhead cost; and in fact, also really kind of maintaining some substantial portion of the cost savings we've been able to generate.

Matt Troy - ***Citigroup - Analyst***

Excellent. And one last question just in terms of pricing. Looking at 2010, what percentage of your contract base is negotiated for 2010, and what is pricing looking like? Is it consistent with what we've seen thus far?

Mark Manion - ***Norfolk Southern Corp - COO***

We have about 40% of our total book priced in for 2010, and the pricing is in line with our current expectations.

Matt Troy - ***Citigroup - Analyst***

Right. Great. Thanks for the time.

Operator

Thank you. Our next question comes from Walter Spracklin of RBC Capital Markets.

Walter Spracklin - ***RBC Capital Markets - Analyst***

Thanks very much. Good morning.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Good morning.

Walter Spracklin - ***RBC Capital Markets - Analyst***

Just on the pricing; just curious. Your 7% that you mentioned seems to be down a little bit from what you had been in the first quarter, just north of 8%. Just curious, what is causing the drag? Is it in a particular segment, or is there some seasonality there we should be looking at?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Well, in the first quarter, we mentioned RCAF effect in the first quarter. It was less in the first quarter than it was the second, approximately $7 million impact in the first and the RCAF effect in the second quarter, which is included in the price was a negative $26 million. Which impacted RPU by $18 a car across the book of business. And about $79 per car impact in coal where the RCAF-U contract adjustment predominantly dwells.

Walter Spracklin *- RBC Capital Markets - Analyst*

Okay. If you were to exclude -- I don't know if you've done this, but the fuel component of RCAF from those two numbers, how would they look?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

If we excluded RCAF from the calculation of price it's about 8.3%.

Walter Spracklin *- RBC Capital Markets - Analyst*

In the second quarter?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Right.

Walter Spracklin *- RBC Capital Markets - Analyst*

Is there any -- so it sounds to me it's fairly consistently. You're not seeing any particular areas that are concerning you on the pricing front? We have heard obviously intermodal is a little bit of a challenge for the trucks. Is there any other areas that might pop up in terms of where you have a concern?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Obviously today's environment is a more challenging environment in which to negotiate price. We're seeing demand obviously soft. We're seeing transportation capacity exceed demand. So that in itself is a challenge to a greater extent than we saw this time last year. Of course, current pricing entails some contracts that were priced last year, perhaps the year before, that are continuing on. So as those contracts are renegotiated in the current environment. If we don't see improvement, we will face considerable challenges with respect to renegotiation and price.

Walter Spracklin *- RBC Capital Markets - Analyst*

Okay. And perhaps, Wick, if you can weigh in what's going on in Washington. If you are bracing for -- once we do get this Bill out, more challenges. Is there any pent-up in impending challenges that you see down the pike once we do see some clarity from Washington on this upcoming Bill?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Well, I don't know that there's anything pent up, and I'm not sure we're braced for it, but we're certainly looking forward to seeing what might emerge in terms of legislation. As you know, as all of the CEOs have discussed, we've had, I think, some very good dialogue in Washington, with in particular, the Senate Commerce Committee. We've done a good job of outlining to them what our issues are for the long term and the importance of producing a Bill that doesn't just address whatever railroad issue d'jour is out there, but establishes a regulatory and economic framework where the railroads continue to be successful for a long period of time, because that's what this country needs.

Our expectation is we will see a draft of that sometime -- I think the word that's being bandied about is soon, and we'll see what it looks like and go from there. If it's legislation that we think is good for the industry, I think the industry will get behind it, and get behind it aggressively. If it's not good for the industry, we'll oppose it equally or more aggressively.

Walter Spracklin - ***RBC Capital Markets - Analyst***

That's all my questions, thanks, guys.

Operator

Thank you. Our next question is coming from Chris Ceraso of Credit Suisse group.

Chris Ceraso - ***Credit Suisse - Analyst***

Thanks. Good morning.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Good morning.

Chris Ceraso - ***Credit Suisse - Analyst***

A couple of items here. It looks like for Norfolk Southern, the contribution on lost revenue or so-called decremental margins was larger at Norfolk Southern than it was at other railroads. In other words, the decline in your operating profit was greater for the given decline in revenue that we saw in other railroads. Is there something specific to the Norfolk network or cost structure or was it a different tact you took on managing headcount? Maybe you can explain why that's so and what we should expect in subsequent quarters?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Chris, I guess we're not really seeing that. I think that certainly the margin effect in the quarter for us was largely the result of a greater revenue decline. And that really was what pressured margin. As we had been through that was the impact of volumes and lower fuel surcharges and a negative mix impact. On the expense side, I think we did a good job of offsetting to the extent possible through volume related labor reductions, through other compensation reductions, materials reductions, services reductions that that steep revenue decline; but with that, it was difficult for us, and the margin did bump up to some extent. But greater than others in terms of the decremental margin. I guess I'm just not seeing it.

Chris Ceraso - ***Credit Suisse - Analyst***

Don, your comment about considerable challenge on renegotiating contracts. What does that mean in terms of what kind of price we should expect? Is it 3% or 4% instead of the 7% or 8% that you've been doing, or is it negative? Can you put some frame around that?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

Well, Chris, as I mentioned, the 40% of the book that we've renegotiated and repriced for 2010, those prices are in line with our current expectations. It remains to be seen whether the market improves. We certainly see some signs that we may be at bottom. Hopefully we're at bottom of this unprecedented recession, and if we are and we see steel production pick up by 15% in the second half, auto production increase by about 10%, we see some increased activity on the consumer front with respect to imports and exports, we will see a better alignment of transportation capacity and demand, which will be good for pricing. We don't know that yet. But at least we're beginning to see some signs of it.

Chris Ceraso *- Credit Suisse - Analyst*

Okay. And then just one last one, the $21 million favorable item for the tax settlement. Why was that in other as opposed to on the tax line?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Because that's -- that's not income taxes. That's other state taxes. That's why it was in other expense, and so that was 27 of the favorable 29 as you point out. Then we also had some other favorable volume-related expense reductions in that other line travel as we mentioned as well, netting to the 29 favorable.

Chris Ceraso *- Credit Suisse - Analyst*

You said it was 27. I saw a note here that it was 21.

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

I apologize. It was 21 and 7 for travel, this and that netting to 29 total for the line.

Chris Ceraso *- Credit Suisse - Analyst*

Thanks a lot.

Operator

Thank you. Our next question coming from Tom Wadewitz of JPMorgan Chase and Company.

Tom Wadewitz *- JPMorgan Chase & Company - Analyst*

Yes. Good morning.

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Good morning, Tom.

Tom Wadewitz *- JPMorgan Chase & Company - Analyst*

I wanted to follow up -- there had been a couple questions, Don when you talked about pricing in 2010 being in line with your expectations; but unless I missed it, I don't think you talked about what your expectations are. So assuming you're not going to be too precise on that, does that mean inflation plus pricing in 2010 is what you achieved, or is there any kind of ballpark you can put us in so that we have a little better sense of what you're getting in the 2010 contract repricing.

Don Seale *- Norfolk Southern Corp - Chief Marketing Officer, EVP*

Our pricing going forward will be in excess of the inflation rate. There will be a plus factor above the inflation rate.

Tom Wadewitz - ***JPMorgan Chase & Company - Analyst***

And my assumption is typically on those comments that you think of inflation as 2% or 3%? Is that also reasonable?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

I'm not sure that's reasonable going forward. It could be higher. We don't know.

Tom Wadewitz - ***JPMorgan Chase & Company - Analyst***

Okay. But when you think inflation plus pricing, you're probably thinking something north of 2% or 3% pricing.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

It's safe to say that.

Tom Wadewitz - ***JPMorgan Chase & Company - Analyst***

Okay. I appreciate that. Let's see. In terms of the margin performance, you did do a pretty good job on the cost side. You ramped that up, versus the pace in the first quarter; but yet if we look at year over year margin performance, the other US rails had improved margins. I think a lot of that was due to year over year comparison on fuel and fuel impact, but you had margins which were down year over year. So do you think that that is largely a function of a different fuel impact for you, or are there other factors that we should consider. And I guess, if you look at the second half, is there any reason to think that the margin -- things affecting your margin on fuel would change?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Well, certainly the second half of the year, we're going to face some strong headwinds in terms of the fuel surcharges, because our fuel surcharges in the second half of last year were quite sizable. I guess the other thing I would mention on the margin change in the quarter, us versus the others, is we were starting out with a lower operating ratio. So I think that factors into it as well.

And I guess, lastly, back to the second half we did have some substantial favorable impact from the lag effect from fuel surcharges as well in the second half. So that's going to be a headwind as well.

Tom Wadewitz - ***JPMorgan Chase & Company - Analyst***

Okay. And then one more, and I'll turn to someone else. But on incentive comp when you look at third quarter, does it look like you could have a meaningful reduction on incentive comps like you did in the second quarter, or is it tough to duplicate that $58 million. I know that includes the stock; but how would you look at incentive and stock based comp in the third quarter year over year?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

I guess looking ahead to the second half, really more at the fourth quarter, there we're going to start running up against a declining stock price last year. And that is a pretty significant element of the change in stock-based compensation. So looking ahead to fourth quarter, I would expect some pressure from that factor. Third quarter, we should still see some favorability depending on how things go.

Tom Wadewitz - ***JPMorgan Chase & Company - Analyst***

Okay. All right. Thank you for the time.

Operator

Thank you. Our next question is coming from Gary Chase of Barclays Capital.

Gary Chase - ***Barclays Capital - Analyst***

Good morning, everybody. I wanted to just ask a few questions, and then one for Don. Jim, I know you've kind of answered this twice. I just am curious, as you think about the incentive comp for the second quarter , I guess the way to ask it, is there any unsustainable component of it. I mean, I understand the year on year stuff; but as you look forward into the third and fourth versus where it is now, is kind of the run rate sustainable, or is there something unique about what happened in the quarter that we shouldn't look to

Jim Squires - ***Norfolk Southern Corp - CFO***

Again, the one thing I would point you do is, in the fourth quarter of last year, we did experience a fairly significant decline in our stock price, which will translate into a relative headwind in the fourth quarter of this year. But as far as third quarter is concerned we would expect to see continuing favorability into improved results in the third quarter of last year, which we are now lapping, and deterioration in results based on financial targets for stock based compensation this year.

Gary Chase - ***Barclays Capital - Analyst***

Okay. And then, just two for Don, the first one real easy. You were going through with your prepared remarks pretty quickly. I thought I might have heard you say you expected agriculture comps to be positive year on year in the second half. Did I?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

That's correct.

Gary Chase - ***Barclays Capital - Analyst***

And were you referring to volume that?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

Volume; that's correct.

Gary Chase - ***Barclays Capital - Analyst***

You expect your agriculture business to be up year on year for volume.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

By the end of the year.

Gary Chase - ***Barclays Capital - Analyst***

Okay. Thank you for clarifying that. And then finally, Don, as I look through your slides, we kind of do a simple calculation. I know there are a lot of things we don't know about exactly how you do this, to come to your 7%. But if we look at an arc where we take revenue minus your surcharge revenue and divide it by car loads, we have that growing year on year by about 2.6%. I understand there's a significant mix component in there, but if I look at -- I think it was$ 53 million that you defined it, I mean, that's somewhere inside of 2%. And I'm just wondering how we get from the 2.6 that the mathematics would suggest, add the 2% that you think is apparently mix-related, how do you explain the gap to 7? Is that a rebaselining of surcharges in there? How do you get there ?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

Well, as I mentioned, RCAF is included in that number, too, and that was $26 million. And I don't know if you've taken that into account.

Gary Chase - ***Barclays Capital - Analyst***

RCAF was in the 53 or it was not in?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

The 53 is the negative mix, that's excluded. Then the RCAF is included in the calculation of 7%. And the net effect of the RCAF for the quarter was $26 million to the minus. So --

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Gary Chase - ***Barclays Capital - Analyst***

Right. But -- yes, exactly. RCAF would have been unfavorable. So if you hit 7 inclusive of RCAP headwinds, as you said the core is even better, up at, like, 8.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

8.3.

Gary Chase - ***Barclays Capital - Analyst***

Right. I'm just wondering, it doesn't look like the mix impact you're showing is enough to explain the gap between what you've reported and what you're saying is 7 or 8. I'm just wondering what part of the calculation we're missing. I guess how do you define the $53 million in mix? How do you come to what you think the mix impact was? Maybe that will help us.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

The negative mix impact are things like export coal, that was down 62%, some other longer-haul traffic versus shorter-haul traffic. That's how we calculate negative mix.

Gary Chase - ***Barclays Capital - Analyst***

Okay. And do you also -- like with less auto volume and that being higher rated business, is that in your mix number, or it just --

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Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

That would be included in negative mix as well.

Gary Chase - ***Barclays Capital - Analyst***

Okay. Thanks.

Operator

Thank you. Our next question is coming from Ken Hoexter from Banc of America.

Ken Hoexter - ***Banc of America - Analyst***

Hi. Good morning. Just following up on the pure pricing, are you talking about this over the entire base, or is the pure pricing only related to a certain portion of your entire revenue base?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Over the base, Ken.

Ken Hoexter - ***Banc of America - Analyst***

So it is the entire revenue base. Don, let me just, on intermodal, what changed on the domestic side? It seemed like, when you hosted the conference, and for a few weeks after we were even continuing to see some of the domestic side show some growth, and it sounded like in your remarks, you talk about domestic being down a touch. At the end of the quarter, have you seen a surprising increase in truck competition, or are they getting more aggressive? What are you seeing shift on the intermodal side lately to change all that?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

No real shifts. We're facing strong comps from last year. If you look back at the second and third and fourth quarters on our domestic business, we were double digit increases, 17% in the third quarter, about 11% in the fourth quarter. So we saw strong domestic truck-load conversions, in particular east of the Mississippi, all of last year. So we're hitting those stronger comps. We have not seen any true deterioration or slow-down in terms of our conversion rate, and we're continuing to be optimistic about that piece of the business.

Ken Hoexter - ***Banc of America - Analyst***

Okay. That makes sense. Yes, that makes sense, because fuel was starting to climb at this point. What -- the utilities demand, why was there such a large difference in the utilities demand being down 5.5% to the volumes being down 16%?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Stock piles are very, very high across our utility network. As we had a good export year last year, that was metallurgical coal going out, so there was steam coal available for us to haul to our utilities. And as you recall, we set a record last year in terms of total coal tonnage of 194 million tons for the year. So we entered this year with our utilities in fairly good shape stockpile-wise with steam coal, because it was available on Norfolk Southern, and we hauled it last year.

I mentioned gas competition, we're also seeing that in our territory, particularly in the southeast. Some in the northeast, but it's actually gotten stronger in the southeast. And I'll give you an example. Our coal burn in -- in our service territory is off about 15%, but gas consumption is up about 19%.

Ken Hoexter - ***Banc of America - Analyst***

Okay. Great. Thanks. And then, on the -- Mark, on the velocity side, is there -- as obviously mix change plays a part in this, but is there a structural limit that you're viewing on how fast you want to run the network or based on the track that you've got installed? What kind of structural limit do you see on velocity getting up to?

Mark Manion - ***Norfolk Southern Corp - COO***

Well undoubtedly, the lower -- the lower volumes out there play a part in our improvement in velocity; but another thing that's a significant piece of this is our network people working with our field people in order to improve from a scheduling standpoint, and get velocity improvement on account of that. And the extent to which that continues to improve, we're glad to see it; and there's not -- that's not a top end that we've got defined for that. But as we see an improved operation out there, we'll continue to enjoy the increased velocity we've got.

Ken Hoexter *- Banc of America - Analyst*

And, Wick, if I could just wrap up -- if I look at revenues down this 33%, expenses down 28%, what else -- are you looking to maybe pick up the pace on some of the expense reductions, or are you still concerned that, as Don mentioned, some of the volumes start to come back, you want to be more prepared, as you mentioned on cycling some of the equipment through. But do you look to kind of expedite some of those cost cuts as we go forward?

Wick Moorman *- Norfolk Southern Corp - Chairman, President & CEO*

Well if you look at this 29% expense reduction for the second quarter, we reduced expenses more than volumes, by 3 percentage points, and we continue to look at this, Ken, in the way that we always have. We clearly want to take costs out of the system wherever and however we can, but we are going to be equally mindful of maintaining our service levels. There's a lot of conversation, always about pricing, and one of the things that Don consistently tells us is that even in tough times, with tough conversations, our service levels and the value we're providing to our customers because of the service levels helps the conversations, even in times like these, and we keep that in mind.

We're also going to do exactly what Mark outlined and I discussed. We're not going to do things that precludes us from reacting in the appropriate fashion when volumes start to increase. So we've got some good momentum on the cost side, our costs came down throughout the quarter. We're continuing -- Mark and his team are continuing to look everywhere we can to continue to reduce costs, and I think we will. But it's with the caveats of maintaining that service level and not doing things that will hurt us when volumes start to grow. Great. Thanks for the time. I appreciate it.

Operator

Thank you. Our next question is coming from Edward Wolfe of Wolfe Research.

Edward Wolfe *- Wolfe Research - Analyst*

Thanks. Good morning. Jim, can you talk to the expense line casualty claims, look like they're down about 50% to $21 million. Is there anything unusual in the quarter, or is this a fair run rate moving forward?

Jim Squires *- Norfolk Southern Corp - CFO*

Let me give components of that $21 million change in casualty claims first. The largest component was the loss in damages in third-party equipment change, and that was $14 million favorable. And that's really a reflection of a higher than usual derailment related expenses last year in the second quarter.

The personal injury reserve adjustment was $8 million favorable, which is modestly above the run rate there in terms of the improvement going back a couple of years. So that really was not a big swing in our view this year, as this quarter as part of casualty and other claims change. And then we had a modest $3 million negative in environmental reserves and $2 million positive in all other, for the net $21 million.

Edward Wolfe *- Wolfe Research - Analyst*

Okay. In terms of the headcount, can you -- the average head count at 27.987, where did the quarter end; and from there, should it go up or down as we go into the third quarter given the seasonality and other things?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

The 27,987. The quarter ended up right about there. It is slightly lower than the average, and we anticipate right now that the headcount will continue to decline. We're fairly stable now in terms of our furloughs, but we are continuing trip people out, and we have obviously a lot of restrictions on bringing anyone into the company. So I would expect modest continuing declines. Mark, is that a fair --

Mark Manion - ***Norfolk Southern Corp - COO***

Yes, absolutely. One thing that stabilizes it a little bit and will not drop it quite as quickly as it has been, is as we come into this season of the year, we bring a few people back in order to handle the heavier vacation season and that sort of thing. So it will be -- it will continue to decline not quite as rapidly as what it has.

Edward Wolfe - ***Wolfe Research - Analyst***

That's helpful. On the incentive stock-based comp, if I just look at the stock was up 12% in the 2009 period. It was up 15% in the second quarter 2008 period. It feels like the positive swing of $30 million was a lot considering that you talked about, Jim, in your comments, that you lowered your assumptions for that. How do we think about your lowered assumptions as we go into third and fourth? You also mentioned that the fourth quarter comp from the stock perspective is very difficult; but if you -- hello?

Operator

Looks like his line disconnected. We'll go to the next question, coming from Randy Cousins of BMO Capital Markets.

Randy Cousins - ***BMO Capital Markets - Analyst***

Good morning. Don, one question for you. I think I caught it in your introductory remarks. Did you say that there was some intermodal price increase?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

We had a modest price effect across the book of business for intermodal in the quarter.

Randy Cousins - ***BMO Capital Markets - Analyst***

There was a lot of interference there. Did you say modest across the whole book of business?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

Yes. A modest increase effect across the book. That's not to say that we have price increases across the book of business; but the overall price was positive for the book in the quarter.

Randy Cousins - ***BMO Capital Markets - Analyst***

Okay. And on the coal side, natural gas prices go down, natural gas prices go up. Have you got a sense from your customers and the utilities that you're serving in your area as to where the point is? Is it $5 in MCF, or is it $6 or $7 where the utilities have switched back to using coal and have cut back on the gas consumption.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

Generally in the $4 per million BTU range is where coal and gas start to converge in terms of competitive options. We are currently at about $3.69, $3.70 per million BTU. Forward curve is higher than that. One of the other dynamics in this is that most of the utilities have contracted coal. They bought, and we are being told that they will start taking more of that contracted coal in the second half despite gas prices of $3.69 currently.

Randy Cousins - ***BMO Capital Markets - Analyst***

Okay. So if we think about the second half you said that coal volumes are coming back. Could we see Q3 coal volumes back to Q1 levels?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

We will see an improvement in the second half over the first half for sure. Our export business is showing a little bit of a rebound in terms of net coal; and as I mentioned, several of our utilities are indicating they will take more of their contracted coal. So we do -- we do foresee the second half going forward this year being better than the first half on a tonnage basis.

Randy Cousins - ***BMO Capital Markets - Analyst***

Okay. And one other sort of coal question. You talked about the mid American, and obviously that's some years out. But if we go forward two, three, five years, is this an opportunity that's, like, 5 million tons, 10 million tons, 15 million tons? Can you give us an idea of the scale you're seeing here as a potential or is this just a rounding error?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

First, with respect to mid American, it is not three to four to five year out project. We will be investing some capital to start upgrading that route structure next year in 2010. Illinois Basin coal and coal production is beginning to ramp up. New investments are being made in terms of coal production in the Illinois Basin, and we foresee significant volume opportunities out of the coal basin going into the utility universe that we serve, about 70% of our utilities, 70 out of one hundred we serve have now installed scrubbers, and the Illinois Basin coal will be ideal for that type of application. So we see the opportunity for some fairly significant volumes as early as late next year on into 2011.

Randy Cousins - ***BMO Capital Markets - Analyst***

Okay. That's good. Year over year comparisons are almost irrelevant given where we're at. If we think about Q3 versus Q2 and have a 10% increase in volume, just to use a number and keep it simple from Q2 into Q3, how much would costs actually go up? Would they go up 2% of the 10, or 40% of the 10? Can you give us some sense of what you guys actually think your scale is to volume in terms of 10% volume increase relative to what that's going to do on the cost side?

Mark Manion - ***Norfolk Southern Corp - COO***

I cannot put a number on that, but I can tell you this. One of the advantages that we have is being able to absorb business into our existing train schedules. That certainly gives us good leverage. And also keep in mind that many of the things we've done in terms of cost reductions have been things where we've really tried to build in permanency and do things that will last and help us with the lower cost structure going forward. So I can't pin a number on it, but as business comes back, I'm sure we'll be reasonably successful in terms of keeping our costs in check.

Randy Cousins - ***BMO Capital Markets - Analyst***

So Mark, on that point, let's talk about train length -- that's the obvious one. If you have an existing train moving from A to B leaving at 9:00 and you put four more cars on it. The costs are virtually zero. Did you have a lot of ability to add volume by adding cars on existing trains? The network schedule does not have to move?

Mark Manion - ***Norfolk Southern Corp - COO***

Yes. And that's what I was trying to explain is we can add volume to our existing schedule trains.

Randy Cousins - ***BMO Capital Markets - Analyst***

So is your train length down year over year, or is it --

Mark Manion - ***Norfolk Southern Corp - COO***

Yes. It is down. Because you get to a point -- in some cases you get to a point where you've got, in a more extreme case you have one train running between origin and destination. So the size of that train goes down and gives you an opportunity to ramp back up without increasing your cost.

Randy Cousins - ***BMO Capital Markets - Analyst***

Just can you tell us what has happened to average train length? Is it down 2%? 5%?

Mark Manion - ***Norfolk Southern Corp - COO***

I don't have the exact percentage. It would be less than 5%.

Randy Cousins - ***BMO Capital Markets - Analyst***

Okay. Thank you.

Operator

Thank you. We'll take the next question coming from Edward Wolfe.

Edward Wolfe - ***Wolfe Research - Analyst***

Thanks. Sorry about that. I apologize because I dropped off. On the incentive stock based if you answered this, I was just trying to understand what your assumptions were in third and fourth quarter relative to lowering them in the second quarter for the stock based component.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Right, Ed. Just going back to your hypothesis on second quarter, the components of the change in stock based, you're right. The change in the earn-out assumption was a more significant factor than the change in the stock price in the second quarter. I don't know for sure, because I don't know what the outlook and the results are going to be, which the stock based earn-out is based on, but I suspect that in the third quarter and the fourth quarter, we'll see some favorability there as well. But in the fourth quarter, we will see -- we will be lapping a substantial decline in the stock price last year, and that's going to be a headwind for the comp and benefits expense, that part of it.

Edward Wolfe - ***Wolfe Research - Analyst***

Okay. Do you have any updated CapEx guidance or thoughts for the year?

Jim Squires - ***Norfolk Southern Corp - CFO***

We're still anticipating that we'll have capital expenditures this year about 1.3 billion. We announced previously that we reduced that by about $125 million, but we don't, at this point, anticipate any significant change in where we are right now.

Edward Wolfe - ***Wolfe Research - Analyst***

Okay. And, Don, I think on domestic intermodal, volumes were down 2%. How do you look at domestic intermodal given difficult comps in third quarter and what you're seeing in the economy? Directionally how we think about the volumes? They held up to date so much better than international. What's your sense of that?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

We talked about that previously. We continue to see the domestic market as being an opportunity, and our truckload partners that we're working with in our IMCs, we continue to feel good about the rate. We are facing some very difficult comps from the third and fourth quarter last year, double digit, as you'll recall, and -- but we don't see a slow-down in the interest and conversion by beneficial owners, such as Wal-Mart, Target, Proctor & Gamble, et cetera.

Edward Wolfe - ***Wolfe Research - Analyst***

So maybe minus 2 gets a little worse in the near term, but that's a comp, not a reflection on demand?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

It's the comp that we're facing, we faced in this quarter and we'll face in the third and fourth quarter, not the product itself.

Edward Wolfe - ***Wolfe Research - Analyst***

On pricing, I know you said 40% of the full book is price for 2010. I'm going to guess a lot of that, though, is stuff that's in multiple-year deals and stuff like that. Is that correct.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

It's a mix of business.

Edward Wolfe - ***Wolfe Research - Analyst***

On the more recent stuff, if you signed some new business in the last month or two, what kind is relative to the 7% pricing, are you seeing in the most recently signed kind of business?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

As we indicated, we are attaining price levels that we're comfortable with that meet our expectations in terms of the value of our rail service.

Edward Wolfe - ***Wolfe Research - Analyst***

But directionally with volumes down where they are in the world. No one is expecting them to stay at 7? Just trying to understand how well, or if you're not comfortable with that, can you talk about relative to each other, which areas are staying relatively firmer or maybe even increasing and which are a little tougher right now given the competitive environment?

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

I think the best statement I can make -- the one I made previously is that our objective is to continue to protect the service levels that we provide our customers. Certainly we're operating in the marketplace, and we compete in the marketplace, and we're going to have our product properly placed in front of our customers. And we expect price levels to exceed the rate of inflation plus an acceptable factor to us in terms of our margins. So that's our strategy going forward and our expectation on pricing.

Edward Wolfe - ***Wolfe Research - Analyst***

Okay. And that's what you've been seeing most recently is what you're saying.

Don Seale - ***Norfolk Southern Corp - Chief Marketing Officer, EVP***

That's correct.

Edward Wolfe - ***Wolfe Research - Analyst***

Okay. Thanks, everybody for the time.

Operator

Thank you. Our last question is coming from William Greene of Morgan Stanley.

William Greene - ***Morgan Stanley - Analyst***

Sorry. I just had one question on this locomotive maintenance issue. If you're going to be bringing them back in sooner, should be we assuming a higher run rate for maintenance expense or is that not the way it sort of flows through?

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

You're referring to the rotating flow of locomotive out of our storage. No. Keep in mind that when we store our power, we store it serviceable, even if that means doing some maintenance and repairs in the process. So when they go in there are, with few exception, ready to come back out again and it's just a matter of getting them out on the road and exercising those locomotives and putting others back in storage. So you shouldn't see any change in that.

William Greene - ***Morgan Stanley - Analyst***

Thank you.

Operator

Thank you. There are no further questions at this time. I'd like to hand the floor back over to management for any closing comments.

Wick Moorman - ***Norfolk Southern Corp - Chairman, President & CEO***

Thank you, everyone. We look forward to talking to you in the near future.

Operator

This concludes today's teleconference, you may disconnect your lines at this time. Thank you all for your participation.