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issues. If NS Rail were so affected, it could receive daily indemnities from non-affected parties; if parties other than NS Rail were affected, it could be required to pay indemnities to those parties. If NS Rail were required to pay the maximum amount of indemnities required of it under these agreements--an event considered unlikely at this time--such liability should not exceed approximately $85 million.

OPERATING REVENUES - NS Rail's total railway operating revenues were $4.1 billion in 1996. Revenue, shipments and revenue yield by principal railway operating revenue sources for the past five years are set forth in the following table:

Principal Sources of Railway Operating Revenues	Year Ended December 31, 1996	1995	1994	1993	1992
(Revenues in millions, shipments in thousands, revenue yield in dollars per shipments)					
COAL					
Revenues	$ 1,304.7	$ 1,267.8	$ 1,290.2	$ 1,239.2	$ 1,324.1
% of total revenues	31.8%	31.6%	32.9%	33.3%	35.7%
Shipments	1,309.6	1,266.8	1,274.2	1,208.7	1,291.9
% of total shipments	28.8%	28.5%	29.6%	30.0%	32.7%
Revenue Yield	$ 996	$ 1,001	$ 1,013	$ 1,025	$ 1,025
CHEMICALS					
Revenues	$ 555.9	$ 536.5	$ 534.7	$ 499.0	$ 498.9
% of total revenues	13.6%	13.4%	13.7%	13.4%	13.4%
Shipments	378.6	368.3	370.7	341.6	327.4
% of total shipments	8.3%	8.3%	8.6%	8.5%	8.3%
Revenue Yield	$ 1,468	$ 1,457	$ 1,442	$ 1,461	$ 1,524
PAPER/FOREST					
Revenues	$ 513.0	$ 537.3	$ 521.8	$ 522.2	$ 517.2
% of total revenues	12.5%	13.4%	13.3%	14.0%	13.9%
Shipments	438.2	459.1	464.2	466.3	465.4
% of total shipments	9.6%	10.3%	10.8%	11.6%	11.8%
Revenue Yield	$ 1,171	$ 1,170	$ 1,124	$ 1,120	$ 1,111
AUTOMOTIVE					
Revenues	$ 488.7	$ 449.1	$ 429.0	$ 425.8	$ 391.6
% of total revenues	11.9%	11.2%	11.0%	11.4%	10.6%
Shipments	354.3	328.4	317.2	317.8	287.7
% of total shipments	7.8%	7.4%	7.3%	7.9%	7.3%
Revenue Yield	$ 1,379	$ 1,368	$ 1,352	$ 1,340	$ 1,361
AGRICULTURE					
Revenues	$ 393.3	$ 393.7	$ 379.5	$ 357.0	$ 344.4
% of total revenues	9.6%	9.8%	9.7%	9.6%	9.3%
Shipments	376.3	391.1	382.5	359.1	352.4
% of total shipments	8.3%	8.8%	8.9%	8.9%	8.9%
Revenue Yield	$ 1,045	$ 1,007	$ 992	$ 994	$ 977

Principal Sources of Railway Operating Revenues	Year Ended December 31, 1996	1995	1994	1993	1992
(Revenues in millions, shipments in thousands, revenue yield in dollars per shipments)					
METALS/CONSTRUCTION					
Revenues	$ 358.0	$ 353.1	$ 334.2	$ 310.9	$ 289.4
% of total revenues	8.7%	8.8%	8.5%	8.3%	7.8%
Shipments	364.9	372.3	371.3	339.6	312.8
% of total shipments	8.0%	8.3%	8.6%	8.4%	7.9%
Revenue Yield	$ 981	$ 948	$ 900	$ 915	$ 925
INTERMODAL (Trailers, Containers and RoadRailers)					
Revenues	$ 487.4	$ 474.3	$ 428.7	$ 373.5	$ 343.5
% of total revenues	11.9%	11.8%	10.9%	10.0%	9.3%
Shipments	1,331.0	1,262.6	1,127.3	994.7	916.2
% of total shipments	29.2%	28.4%	26.2%	24.7%	23.1%
Revenue Yield	$ 366	$ 376	$ 380	$ 376	$ 375
Total Railway Operating Revenues	$ 4,101.0	$ 4,011.8	$ 3,918.1	$ 3,727.6	$ 3,709.1
Total Railway Shipments	4,552.9	4,448.6	4,307.4	4,027.8	3,953.8

Note: Revenues previously reported as "other railway revenues" (principally switching and demurrage) have been allocated to revenues reported for each commodity group.

Shipments include general merchandise and coal rail carloads, intermodal rail and RoadRailer(RT) units.

COAL TRAFFIC - Coal, coke and iron ore--most of which is bituminous coal--is NS Rail's principal commodity group. NS Rail originated 116.8 million tons of coal, coke and iron ore in 1996 and handled a total of 130.2 million tons. Originated tonnage increased 2 percent from 114.2 million tons in 1995, and total tons handled increased 4 percent from 125.1 million tons in 1995. Revenues from coal, coke and iron ore account for about 32 percent of NS Rail's total operating revenues.

The following table shows total coal, coke and iron ore tonnage originated on line, received from connections and handled for the past five years:

	Tons of Coal, Coke and Iron Ore (Millions) 1996	1995	1994	1993	1992
Originated	116.8	114.2	114.8	111.9	117.9
Received	13.4	10.9	11.1	6.1	6.5
Handled	130.2	125.1	125.9	118.0	124.4

Of the 116.8 million tons of coal, coke and iron ore originated on NS Rail's lines in 1996, the approximate breakdown by origin state was as follows:

Origin State	Millions of Tons
West Virginia	40.7
Virginia	35.4
Kentucky	26.8
Alabama	5.4
Illinois	5.1
Tennessee	1.8
Indiana	0.9
Ohio	0.5
New York	0.2
Total	116.8

Of this originated coal, coke and iron ore, approximately 26.9 million tons moved for export, principally through NS Rail's pier facilities at Norfolk (Lamberts Point), Virginia; 19.7 million tons moved to domestic and Canadian steel industries; 62.3 million tons of steam coal moved to electric utilities; and 7.9 million tons moved to other industrial and miscellaneous users.

NS Rail moved 8.7 million tons of originated coal, coke and iron ore to various docks on the Ohio River and 3.6 million tons to various Lake Erie ports. Other than coal for export, virtually all coal handled by NS Rail was terminated in states situated east of the Mississippi River.

Total coal handled through all system ports in 1996 was 41.7 million tons. Of this total, 71 percent moved through the pier facilities at Lamberts Point. In 1996, total tonnage handled at Lamberts Point, including coastwise traffic, was 29.5 million tons, a 2 percent increase from the 28.9 million tons handled in 1995.

The quantities of NS Rail export coal handled through Lamberts Point for the past five years were as follows:

	Export Coal through Lamberts Point (Millions of tons)				
	1996	1995	1994	1993	1992
Originated	26.3	25.4	23.9	24.6	30.8
Handled	26.4	25.5	24.1	24.9	31.2

See the discussion of coal traffic, by type of coal, in Part II, Item 7, "Management's Discussion and Analysis," on page 26.

MERCHANDISE RAIL TRAFFIC - The merchandise traffic group consists of Intermodal and five major commodity groupings (Paper/Forest; Chemicals; Automotive; Agriculture; and Metals/Construction). Total NS Rail merchandise revenues in 1996 were $2.8 billion, a 2 percent increase over 1995. Merchandise carloads handled in 1996 were 3.24 million, compared with 3.18 million handled in 1995, an increase of 2 percent.

In 1996, 106.2 million tons of merchandise freight, or approximately 68 percent of total rail merchandise tonnage handled by NS Rail, originated on line. The balance of NS Rail's merchandise traffic was received from connecting carriers (mostly railroads, with some truck, water and highway as well), usually at interterritorial gateways. The principal interchange points for NS Rail-served received traffic included Chicago, Memphis, New Orleans, Cincinnati, Kansas City, Detroit, Hagerstown, St. Louis/East St. Louis, and Louisville.

Revenues in four of the six market groups comprising merchandise traffic improved in 1996 over 1995. The biggest gains were in Automotive, up $39.6 million; Chemicals, up $19.4 million; and Intermodal, up $13.1 million.

See the discussion of merchandise rail traffic by commodity group in Part II, Item 7, "Management's Discussion and Analysis," on page 26.

OPERATING STATISTICS - The following table sets forth certain statistics relating to NS Rail's operations for the past five years:

	Year Ended December 31,				
	1996	1995	1994	1993	1992
Revenue ton miles (billions)	129.8	126.6	122.3	111.6	107.6
Freight train miles traveled (millions)	49.4	48.5	46.0	43.3	41.1
Revenue per ton mile	$0.0316	$0.0317	$0.0320	$0.0334	$0.0345
Revenue tons per train	2,625	2,611	2,655	2,577	2,618
Revenue ton miles per man-hour worked	2,764	2,679	2,579	2,304	2,184
Percentage ratio of railway operating expenses to railway operating revenues	71.6	73.5	73.2	75.3	75.0

FREIGHT RATES - In 1996, NS Rail continued its reliance on private contracts and exempt price quotes as the predominant pricing mechanism. Thus, a major portion of NS Rail's freight business is not economically regulated by the government. In general, market forces have been substituted for government regulation and now are the primary determinant of rail service prices.

In 1996, NS Rail was found by the STB to be "revenue adequate" based on results for the year 1995. A railroad is "revenue adequate" under the applicable law when its return on net investment exceeds the rail industry's composite cost of capital.

The revenue adequacy measure is one of several factors considered by the STB when it is called upon to rule on the reasonableness of regulated rates.

PASSENGER OPERATIONS - Regularly scheduled passenger operations on NS Rail's railroads' lines consist of Amtrak trains operating between Alexandria and New Orleans, and between Charlotte and Selma, North Carolina. Former Amtrak operations between East St. Louis and Centralia, Illinois, were discontinued by Amtrak on November 3, 1993. Commuter trains continued operations on the NS Rail line between Manassas and Alexandria under contract with two transportation commissions of the Commonwealth of Virginia, providing for rental and for reimbursement of related expenses incurred by NS Rail. During 1993, a lease of the Chicago to Manhattan, Illinois, line to the Commuter Rail Division of the Regional Transportation Authority of Northeast Illinois replaced an agreement under which NS Rail had provided commuter rail service for the Authority.

RAILWAY PROPERTY:

EQUIPMENT - As of December 31, 1996, NS Rail owned or leased the following units of equipment:

Type of Equipment	Number of Units: Owned*	Leased	Total	Capacity of Equipment
Locomotives:				(Horsepower)
Multiple purpose	1,974	0	1,974	6,149,850
Switching	119	0	119	174,450
Auxiliary units	65	0	65	0
Total locomotives	2,158	0	2,158	6,324,300
Freight Cars:				(Tons)
Hopper	24,933	41	24,974	2,643,019
Box	19,976	428	20,404	1,584,306
Covered Hopper	12,489	2,272	14,761	1,549,737
Gondola	24,170	105	24,275	2,584,134
Flat	4,078	819	4,897	352,762
Caboose	231	0	231	0
Other	1,111	4	1,115	88,728
Total freight cars	86,988	3,669	90,657	8,802,686
Other:				
Work equipment	6,959	5	6,964	
Vehicles	3,698	0	3,698	
Highway trailers and containers	2,348	3,181	5,529	
Miscellaneous	1,518	1,199	2,717	
Total other	14,523	4,385	18,908	

* Includes equipment leased to outside parties and equipment subject to equipment trusts and capitalized leases.

The following table indicates the number and year of purchase for locomotives and freight cars owned by NS Rail at December 31, 1996:

	Year Built								
	1996	1995	1994	1993	1992	1986-1991	1980-1985	1979 & Before	Total
Locomotives:									
Number of units	120	125	25	31	55	452	426	924	2,158
Percent of fleet	5.6	5.8	1.2	1.4	2.6	21.0	19.7	42.7	100.0
Freight cars:									
Number of units	871	932	778	930	579	4,918	10,210	67,770	86,988
Percent of fleet	1.0	1.1	0.9	1.1	0.7	5.7	11.7	77.8	100.0

The average age of the freight car fleet at December 31, 1996, was 22.3 years. During 1996, 7,485 freight cars were retired. As of December 31, 1996, the average age of the locomotive fleet was 15.4 years. During 1996, 105 locomotives, the average age of which was 24.4 years, were retired. Since 1988, more than 23,000 coal cars have been rebodied. As a result, the remaining serviceability of the freight car fleet is greater than may be inferred from the high percentage of freight cars built in earlier years.

Ongoing freight car and locomotive maintenance programs are intended to ensure the highest standards of safety, reliability, customer satisfaction and equipment marketability. In past years, the bad order ratio reflected the storage of certain types of cars which were not in high demand. The ratio has declined more recently as a result of a disposition program for underutilized, unserviceable and over-age revenue cars. In this connection, an orderly disposition of 17,000 freight cars, begun in October 1994, was substantially complete at the end of 1996.

	Annual Average Bad Order Ratio				
	1996	1995	1994	1993	1992
Freight Cars (excluding cabooses):					
NS Rail	4.8%	5.8%	6.7%	7.3%	7.6%
All Class I railroads	5.0*	6.0*	7.3	7.1	7.5
Locomotives:					
NS Rail	4.5	4.7	4.7	4.3	4.4

* In 1996 and 1995, the industry bad order ratio was as of June 1. Prior years' industry ratios were based on a monthly average.

TRACKAGE - All NS Rail trackage is standard gauge, and the rail in approximately 95 percent of the main line trackage (including first, second, third and branch main tracks, all excluding trackage rights) ranges from 100 to 140 pounds per yard. Of the 22,369 miles of track maintained as of December 31, 1996, 15,877 were laid with welded rail.

The density of traffic on running tracks (main line trackage plus passing tracks) during 1996 was as follows:

Gross tons of freight carried per track mile (Millions)	Track miles of running tracks*	Percent of total
0-4	4,837	30
5-19	4,682	29
20 and over	6,529	41
	16,048	100

* Excludes trackage rights.

The following table summarizes certain information about track roadway additions and replacements during the past five years:

	1996	1995	1994	1993	1992
Track miles of rail installed	401	403	480	574	660
Miles of track surfaced	4,686	4,668	4,760	5,048	5,690
New crossties installed (millions)	1.9	2.0	1.7	1.6	1.9

MICROWAVE SYSTEM - The NS Rail microwave system, consisting of 6,960 radio path miles, 398 active stations and 5 passive repeater stations, provides communications between most operating locations. The microwave system is used principally for voice communications, VHF radio control circuits, data and facsimile transmissions, traffic control operations, AEI data transmissions and relay of intelligence from defective equipment detectors.

TRAFFIC CONTROL - Of a total of 12,762 road miles operated by NS Rail, excluding trackage rights over foreign lines, 5,400 road miles are governed by centralized traffic control systems (of which 230 miles are controlled by data radio from 14 microwave site locations) and 2,600 road miles are equipped for automatic block system operation.

COMPUTERS - Data processing facilities connect the yards, terminals, transportation offices, rolling stock repair points, sales offices and other key system locations to the central computer complex in Atlanta, Ga. Operating and traffic data are compiled and stored to provide customers with information on their shipments throughout the system. Data processing facilities are capable of providing current information on the location of every train and each car on line, as well as related waybill and other train and car movement data. Additionally, these facilities afford substantial capacity for, and are utilized to assist management in the performance of, a wide variety of functions and services, including payroll, car and revenue accounting, billing, material management activities and controls, and special studies.

OTHER - NS Rail has extensive facilities for support of railroad operations, including freight depots, car construction shops, maintenance shops, office buildings, and signals and communications facilities.

ENCUMBRANCES - Certain rail equipment is subject to the prior lien of equipment financing obligations amounting to $589.9 million as of December 31, 1996, and $540.4 million as of December 31, 1995. In addition, a portion of NS Rail's properties is subject to liens securing as of December 31, 1996, and 1995, approximately $1.5 million and $27.5 million of mortgage debt, respectively.

CAPITAL EXPENDITURES - Capital expenditures for road, equipment and other property for the past five years were as follows:

	Capital Expenditures				
	1996	1995	1994	1993	1992
	(In millions of dollars)				
Railway property					
Road	$428.4	$379.5	$382.3	$411.0	$425.1
Equipment	325.6	332.6	235.0	218.1	187.8
Other property	--	1.2	22.3	0.1	4.2
Total	$754.0	$713.3	$639.6	$629.2	$617.1

Capital spending and maintenance programs are and have been designed to assure the ability to provide safe, efficient and reliable transportation services. For 1997, NS Rail is planning $781 million of capital spending. Looking further ahead, total capital spending is expected to be similar to 1995 and 1996 levels. A substantial portion of future capital spending is expected to be funded through internally generated cash, although debt financing will continue as the primary funding source for equipment acquisitions.

Acquisition by NS of all or part of Conrail (see page 4) could cause a change in the planned capital spending for NS Rail.

ENVIRONMENTAL MATTERS - Compliance with federal, state and local laws and regulations relating to the protection of the environment is a principal NS Rail goal. To date, such compliance has not affected materially NS Rail's capital additions, earnings, liquidity or competitive position.

See the discussion of "Environmental Matters" in Part II, Item 7, "Management's Discussion and Analysis," on page 26, and in Note 16 to the Consolidated Financial Statements on page 61.

EMPLOYEES - NS Rail employed an average of 23,361 employees in 1996, compared with an average of 24,488 in 1995 (including Norfolk Southern Corporation's employees whose primary duties relate to rail operations). The approximate average cost per employee during 1996 was $46,423 in wages and $18,943 in employee benefits. Approximately 81 percent of these employees are represented by various labor organizations. As of the end of 1996, NS Rail had negotiated labor agreements with all of its unions, except the American Train Dispatchers, which represents about 200 employees. The accords with the 12 other union organizations, which include compensation settlements in line with other major industries, will not be due for change until after January 1, 2000.

GOVERNMENT REGULATION - In addition to environmental, safety, securities and other regulations generally applicable to all businesses, NS Rail is subject to regulation by the STB, which succeeded the ICC on January 1, 1996. The STB has jurisdiction over some rates, routes, conditions of service, and the extension or abandonment of rail lines. The STB also has jurisdiction over the consolidation, merger or acquisition of control of and by rail common carriers. The Department of Transportation regulates certain track and mechanical equipment standards.

The relaxation of economic regulation of railroads, begun over a decade ago by the ICC under the Staggers Rail Act of 1980, is expected to continue under the STB. Thus it appears that additional rail business will be exempted from regulation in the future. Significant exemptions are TOFC/COFC (i.e., "piggyback") business, rail boxcar traffic, lumber, manufactured steel, automobiles and certain bulk commodities such as sand, gravel, pulpwood and wood chips for paper manufacturing. Transportation contracts on regulated shipments, which no longer require regulatory approval, effectively remove those shipments from regulation as well. Over 80 percent of NS Rail's freight revenues come from either exempt traffic or traffic moving under transportation contracts.

COMPETITION - There is continuing strong competition among rail, water and highway carriers. Price is usually only one factor of importance as shippers and receivers choose a transport mode and specific hauling company. Inventory carrying costs, service reliability, ease of handling, and the desire to avoid loss and damage during transit are increasingly important considerations, especially for higher valued finished goods, machinery and consumer products. Even for raw materials, semi-finished goods and work-in-process, users are increasingly sensitive to transport arrangements which minimize problems at successive production stages.

NS Rail's primary competitor is the CSX system, both operate throughout much of the same territory. Other railroads also operate in parts of the territory. NS Rail also competes with motor carriers and water carriers, and with shippers who have the additional option of handling their own goods in private carriage. Consummation of the proposed merger agreement between Conrail and CSX (see page 4) could result in a serious imbalance in rail competition in the East--an outcome NS is resisting vigorously on a number of fronts and that the negotiations with CSX could prevent.

Certain cooperative strategies between railroads and between railroads and motor carriers enable carriers to compete more effectively in specific markets. A subsidiary of NS, which is not part of NS Rail, entered into such a strategy with a Conrail subsidiary forming a partnership in 1993 which offered intermodal service using RoadRailer (Registered Trademark) equipment. NS Rail provides some of the rail line-haul for this partnership.

Item 3. Legal Proceedings.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of security holders during the fourth quarter of 1996.

Executive Officers of the Registrant.

Norfolk Southern Railway's officers are elected annually by the Board of Directors at its first meeting held after the annual meeting of stockholders, and they hold office until their successors are elected. There are no family relationships among the officers, nor any arrangement or understanding between any officer and any other person pursuant to which the officer was selected. The following table sets forth certain information, as of March 1, 1997, relating to these officers:

Name, Age, Present Position	Business Experience during past 5 Years
David R. Goode, 56, President and Chief Executive Officer	Present position since September 1992. Also, Chairman, President and Chief Executive Officer of Norfolk Southern Corporation since September 1992, and prior thereto as President. Served as Vice President of Norfolk Southern Railway from February to September 1992, and prior thereto was Vice President-Administration.
Paul N. Austin, 53, Vice President-Personnel	Present position since June 1994. Also, Vice President-Personnel of Norfolk Southern Corporation since June 1994. Served as Assistant Vice President-Personnel of Norfolk Southern Corporation from February 1993 to June 1994, and prior thereto was Director Compensation.
William B. Bales, 62, Vice President	Present position since October 1995. Also, Senior Vice President-International of Norfolk Southern Corporation since October 1995. Served as Vice President-Coal Marketing of Norfolk Southern Railway and Norfolk Southern Corporation from August 1993 to October 1995, and prior thereto was Vice President-Coal and Ore Traffic.
James C. Bishop, Jr., 60, Vice President-Law	Present position since March 1, 1996. Also, Executive Vice President-Law of Norfolk Southern Corporation since March 1, 1996, and prior thereto was Vice President-Law.

Name, Age, Present Position	Business Experience during past 5 Years
R. Alan Brogan, 56, Vice President-Transportation Logistics	Present position since December 1992. Also, Executive Vice President-Transportation Logistics of Norfolk Southern Corporation since December 1992, and prior thereto was Vice President-Quality Management.
David A. Cox, 60, Vice President-Properties	Present position since December 1995. Also, Vice President-Properties of Norfolk Southern Corporation since December 1995, and prior thereto was Assistant Vice President-Industrial Development.
Thomas L. Finkbiner, 44, Vice President-Intermodal	Present position since August 1993. Also, Vice President-Intermodal of Norfolk Southern Corporation since August 1993. Served as Senior Assistant Vice President-International and Intermodal of Norfolk Southern Corporation from April to August 1993, and prior thereto was Assistant Vice President-International and Intermodal.
Robert C. Fort, 52, Vice President-Public Relations	Present position since December 1996. Also, Vice President-Public Relations of Norfolk Southern Corporation since December 1996, and prior thereto was Assistant Vice President-Public Relations.
John W. Fox, Jr., 49, Vice President-Coal Marketing	Present position since October 1995. Also, Assistant Vice President-Coal Marketing of Norfolk Southern Corporation from August 1993 to October 1995, and prior thereto was General Manager Eastern Region.
Thomas J. Golian, 63, Vice President	Present position since October 1995. Also, Executive Assistant to the Chairman, President and CEO of Norfolk Southern Corporation from April 1993 to October 1995, and prior thereto was Special Assistant to the President.

Name, Age, Present Position	Business Experience during past 5 Years
James A. Hixon, 43, Vice President-Taxation	Present position since June 1993. Also, Vice President-Taxation of Norfolk Southern Corporation since June 1993, and prior thereto was Assistant Vice President-Tax Counsel.
Jon L. Manetta, 58, Vice President-Transportation & Mechanical	Present position since December 1995. Also, Vice President-Transportation & Mechanical of Norfolk Southern Corporation since December 1995. Served as Vice President-Transportation of Norfolk Southern Railway and Norfolk Southern Corporation from June 1994 to December 1995, Assistant Vice President-Transportation from October 1993 to June 1994, Assistant Vice President-Strategic Planning from January to October 1993, and prior thereto was Director Joint Facilities and Budget.
Harold C. Mauney, Jr., 58, Vice President-Operations Planning and Budget	Present position since December 1996. Also, Vice President-Operations Planning and Budget of Norfolk Southern Corporation since December 1996, and prior thereto was Vice President-Quality Management.
Donald W. Mayberry, 53, Vice President-Research and Tests	Present position since December 1995. Also, Vice President-Research and Tests of Norfolk Southern Corporation since December 1995, and prior thereto was Vice President-Mechanical.
James W. McClellan, 57, Vice President-Strategic Planning	Present position since October 1993. Also, Vice President-Strategic Planning of Norfolk Southern Corporation since October 1993, and prior thereto was Assistant Vice President-Corporate Planning.

Name, Age, Present Position	Business Experience during past 5 Years
Kathryn B. McQuade, 40, Vice President-Internal Audit	Present position since December 1992. Also, Vice President-Internal Audit of Norfolk Southern Corporation since December 1992, and prior thereto was Director-Income Tax Administration.
Charles W. Moorman, 45, Vice President-Information Technology	Present position since October 1993. Also, Vice President-Information of Norfolk Southern Corporation since October 1993. Served as Vice President-Employee Relations of Norfolk Southern Railway and Norfolk Southern Corporation from December 1992 to October 1993, and prior thereto was Vice President-Personnel and Labor Relations.
Phillip R. Ogden, 56, Vice President-Engineering	Present position since December 1992. Also, Vice President-Engineering of Norfolk Southern Corporation since December 1992, and prior thereto was Assistant Vice President-Maintenance.
L. I. Prillaman, Jr., 53, Vice President and Chief Traffic Officer	Present position since October 1995. Also, Executive Vice President-Marketing of Norfolk Southern Corporation since October 1995. Served as Vice President-Properties of Norfolk Southern Railway and Norfolk Southern Corporation from December 1992 to October 1995, and prior thereto was Vice President and Controller.
John P. Rathbone, 45, Vice President and Controller	Present position since December 1992. Also, Vice President and Controller of Norfolk Southern Corporation since December 1992, and prior thereto was Assistant Vice President-Internal Audit.
William J. Romig, 52, Vice President	Present position since December 1992. Also, Vice President and Treasurer of Norfolk Southern Corporation since December 1992, and prior thereto was Assistant Vice President-Finance.

Name, Age, Present Position	Business Experience during past 5 Years
Donald W. Seale, 44, Vice President-Merchandise Marketing	Present position since August 1993. Also, Vice President-Merchandise Marketing of Norfolk Southern Corporation since August 1993. Served as Assistant Vice President-Sales and Service of Norfolk Southern Corporation from May 1992 to August 1993, and prior thereto was Director-Metals, Waste and Construction.
Robert S. Spenski, 62, Vice President-Labor Relations	Present position since June 1994. Also, Vice President-Labor Relations of Norfolk Southern Corporation since June 1994, and prior thereto was Senior Assistant Vice President-Labor Relations.
Rashe W. Stephens, Jr., 55, Vice President-Quality Management	Present position since December 1996. Also, Vice President-Quality Management of Norfolk Southern Corporation since December 1996. Served as Assistant Vice President-Public Affairs of Norfolk Southern Corporation from February 1993 to December 1996, and prior thereto was Director, EEO and Manpower Planning.
Stephen C. Tobias, 52, Vice President	Present position since October 1993. Also, Executive Vice President-Operations of Norfolk Southern Corporation since July 1994, and Senior Vice President-Operations from October 1993 to July 1994. Served as Vice President-Strategic Planning of Norfolk Southern Railway and Norfolk Southern Corporation from December 1992 to October 1993, and prior thereto was Vice President-Transportation.
Henry C. Wolf, 54, Vice President-Finance	Present position since June 1993. Also, Executive Vice President-Finance of Norfolk Southern Corporation since June 1993, and prior thereto was Vice President-Taxation.

Name, Age, Present Position	Business Experience during past 5 Years
Sandra T. Pierce, 42, Corporate Secretary	Present position since June 1995. Also, Assistant Corporate Secretary of Norfolk Southern Corporation since June 1995. Served as Assistant Corporate Secretary-Planning of Norfolk Southern Corporation from October 1993 to June 1995, and prior thereto was Assistant to Corporate Secretary.
Ronald E. Sink, 54, Treasurer	Present position since September 1987.

PART II

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

COMMON STOCK

Since June 1, 1982, NS has owned all the common stock of Norfolk Southern Railway Company. The common stock is not publicly traded.

SERIAL PREFERRED STOCK

There are 10,000,000 shares of no par value serial preferred stock authorized. This stock may be issued in series from time to time at the discretion of the Board of Directors with any series having such voting and other powers, designations, dividends and other preferences as deemed appropriate at the time of issuance.

The $2.60 Cumulative Preferred Stock, Series A (Series A Stock), of which 1,197,027 shares were issued and 1,096,907 shares were held other than by subsidiaries as of December 31, 1996, has no par value but has a $50 per share stated value. As indicated in the title, the stock pays a dividend of $2.60 per share annually, payable quarterly on March 15, June 15, September 15 and December 15. Dividends on this stock are cumulative and in preference to dividends on all other classes of stock. Except for any shares held by Norfolk Southern Railway Company's subsidiaries and/or in a fiduciary capacity, each share is entitled to one vote per share on all matters, voting as a single class with holders of other stock. Should dividends become delinquent for six quarters, this class of stock, voting as a class, may elect two directors so long as any default in dividend payments continues. The Series A Stock is redeemable at the option of Norfolk Southern Railway Company at $50 per share plus accrued dividends. On liquidation, the stock is entitled to $50 per share plus accrued dividends before any amounts are paid on any other class of stock.

In June 1989, NS announced its intention to purchase up to 250,000 shares of the outstanding Series A Stock during the subsequent two-year period. Since then, NS extended the stock purchase program through 1996. As of December 31, 1996, NS had purchased 176,608 shares of Series A Stock at a total cost of $6.7 million; as of the same date, NS held a total of 176,703 shares.

Item 6. Selected Financial Data.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)
Five-Year Financial Review

	1996	1995	1994	1993(1)	1992
			($ in millions)		
RESULTS OF OPERATIONS:					
Railway operating revenues	$ 4,101.0	$ 4,011.8	$ 3,918.1	$ 3,727.6	$ 3,709.1
Railway operating expenses	2,936.3	2,948.5	2,869.2	2,805.9	2,781.7
Income from railway operations	1,164.7	1,063.3	1,048.9	921.7	927.4
Other income - net	39.1	43.3	46.6	57.6	49.5
Interest expense on debt	33.9	33.0	28.3	32.3	44.6
Income before income taxes	1,169.9	1,073.6	1,067.2	947.0	932.3
Provision for income taxes	401.4	371.9	385.2	412.8	325.8
Income before accounting changes	768.5	701.7	682.0	534.2	606.5
Cumulative effect of accounting changes	--	--	--	247.8	--
Net income	$ 768.5	$ 701.7	$ 682.0	$ 782.0	$ 606.5
FINANCIAL POSITION:					
Total assets	$ 11,053.3	$ 10,752.3	$ 10,289.2	$ 9,760.4	$ 9,675.5
Total long-term debt, including current maturities	$ 597.9	$ 574.4	$ 539.8	$ 604.9	$ 714.5
Stockholders' equity	$ 5,771.8	$ 5,645.4	$ 5,440.5	$ 5,184.9	$ 4,784.3
OTHER:					
Capital expenditures	$ 754.0	$ 713.3	$ 639.6	$ 629.2	$ 617.1
Number of stockholders at year-end	2,763	3,025	3,281	3,517	3,725
Average number of employees (2)	23,361	24,488	24,710	25,531	25,650

(1) 1993 results include a $60.8 million increase in the provision for income taxes reflecting a 1% increase in the federal income tax rate. The cumulative effect of accounting changes increased 1993 earnings by $247.8 million. The change in accounting for income taxes increased net income by $470.4 million, with a corresponding reduction in deferred taxes. The changes in accounting for postretirement and postemployment benefits decreased net income by $222.6 million.

(2) The employee count includes Norfolk Southern Corporation's employees whose primary duties relate to rail operations.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

The following discussion and analysis (which--with the exception of "Proposed Acquisition of Conrail"--is identical to what is contained in the Corporation's 1996 Annual Report to Stockholders) should be read in conjunction with the Consolidated Financial Statements and Notes beginning on page 40 and the Five-Year Financial Review on page 25.

SUMMARIZED RESULTS OF OPERATIONS

1996 Compared with 1995

Net income in 1996 was $768.5 million, an increase of 10%. However, results in 1995 were affected by a $33.6 million early retirement charge, which reduced net income by $20.4 million.

Absent the effects of that charge, 1996 net income was up 6%. The improvement was due to increased income from railway operations of $67.8 million, or 6%, reflecting higher operating revenues, up 2%, and generally flat operating expenses, up less than 1% (excluding the early retirement charge).

1995 Compared with 1994

Net income in 1995 was $701.7 million, up 3%. Excluding the 1995 early retirement charge, net income rose 6%. These results were driven primarily by improved income from railway operations, up $48.0 million, or 5% (excluding the early retirement charge). Railway operating revenues increased 2%, while railway operating expenses, excluding the early retirement charge, were up 2%. Interest expense on debt was up $4.7 million, largely due to a lower level of capitalized interest.

RAILWAY OPERATING REVENUES AND EXPENSES
(Shown as a Graph in the Annual Report to Stockholders)
($ in millions)

	1996	1995	1994	1993	1992
Revenues	$4,101.0	$4,011.8	$3,918.1	$3,727.6	$3,709.1
Expenses	2,936.3	2,948.5	2,869.2	2,805.9	2,781.7

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Railway operating revenues were $4.1 billion in 1996, compared with $4.0 billion in 1995 and $3.9 billion in 1994. The $89.2 million improvement in 1996, compared with 1995, was the result of improvements in all market groups except paper/forest and agriculture. The $93.7 million improvement in 1995, compared with 1994, was primarily attributable to increases in the intermodal, automotive and metals/construction market groups.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

The following table presents a three-year comparison of revenues by market group.

RAILWAY OPERATING REVENUES BY MARKET GROUP
(Also Shown as a Graph in the Annual Report to Stockholders)
($ in millions)

	1996	1995	1994
Coal	$ 1,304.7	$ 1,267.8	$ 1,290.2
Chemicals	555.9	536.5	534.7
Paper/forest	513.0	537.3	521.8
Automotive	488.7	449.1	429.0
Agriculture	393.3	393.7	379.5
Metals/construction	358.0	353.1	334.2
Intermodal	487.4	474.3	428.7
Total	$ 4,101.0	$ 4,011.8	$ 3,918.1

Note: Revenues previously reported as "Other railway revenues" (principally switching and demurrage) have been reclassified into each of the commodity groups.

In 1996, increases in coal, automotive, intermodal and chemicals traffic offset decreases in the remaining market groups. For 1995 improvements in automotive, agriculture, metals/construction and intermodal traffic offset declines in the other groups. The traffic volume gains in both years accounted for most of the revenue improvement as shown in the table below. Average revenue per unit rose in both 1996 and 1995 due to moderate rate increases.

RAILWAY OPERATING REVENUE VARIANCE ANALYSIS
Increases (Decreases)
($ in millions)

	1996 vs. 1995	1995 vs. 1994
Traffic volume	$ 72.6	$ 62.6
Revenue per unit	16.6	31.1
Total	$ 89.2	$ 93.7

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

COAL traffic volume increased 4%, and revenues increased 3% in 1996, primarily due to increased utility and export coal tonnage. Coal revenues represented almost 32% of total railway operating revenues in 1996, and 90% of coal shipments originated on NS Rail's lines. Coal traffic volume declined 1%, and revenues were down 2% in 1995, compared with 1994, as coal tonnage by type remained relatively stable.

TOTAL COAL, COKE AND IRON ORE TONNAGE
(In millions of tons)

	1996	1995	1994
Utility	74.7	70.3	71.6
Export	27.0	25.8	25.2
Steel	20.6	22.1	21.6
Other	7.9	6.9	7.5
Total	130.2	125.1	125.9

Note: Certain prior year amounts have been reclassified to conform to the current year presentation.

Utility coal traffic increased 6% in 1996, compared with 1995. Several utility customers in the NS Rail service region shifted more generation to coal-fired plants, as many nuclear power plants experienced downtime. In addition, NS Rail gained market share at several Southeastern utilities.

In 1995, utility coal traffic decreased slightly due to moderate weather throughout much of the NS Rail service region during the first half of the year and to sustained periods of maximum generation from several Southeastern nuclear power plants. Partially mitigating these declines were increased shipments of both NS Rail- and foreign-line-originated, low-sulfur coal related to utilities' compliance with Phase I of the Clean Air Act Amendments, which took effect on January 1, 1995.

The near-term outlook for utility coal is positive, as a significant number of the mines served by NS Rail produce coals that satisfy both Phase I and the more stringent Phase II requirements, which take effect on January 1, 2000. However, adoption of tighter restrictions on nitrous oxide particulate emissions, as proposed by the Environmental Protection Agency, could impose added cost burdens on some coal-fired plants.

Utilities in the Southeast, NS Rail's largest steam coal market, are expected to increase their demand for Central Appalachian coal. Utility deregulation is likely to affect the structure and development of that market. Specifically, it is widely anticipated that U.S. utilities will have greater flexibility in selling electricity to, and buying it from, other regional markets. At present, however, transmission line capacity is somewhat strained on the lines leading to and from the Southeastern U.S., and resistance by environmentalists and the high cost of adding new line capacity could deter its development. Less certain is the outlook for demand for Central Appalachian coal from utilities in the Midwest, as the delivered cost of Western coal tends to be lower. However, NS Rail expects to participate in the movement of any Western coal that displaces NS Rail-originated deliveries.

Export coal traffic increased 5% in 1996, compared with 1995, as NS Rail benefited from increased steam coal exports to Italy and greater metallurgical shipments to Germany, a result of reduced subsidies to German coal producers that enhanced the competitiveness of U.S. coal. Increased exports of U.S. coal to Brazil also contributed to the improvement.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

Export coal traffic increased 2% in 1995, benefiting from the continued recovery of European steel production. Demand from other parts of the world also improved. Brazil, Belgium, France, Romania and Japan took increased amounts of NS Rail coal. In addition, NS Rail began handling metallurgical coal for steel production in Mexico. Congestion and high barge rates on the Mississippi River caused an increase in movements over NS Rail's coal piers in Norfolk, Va.

Metallurgical coal exports are expected to experience slight to modest growth through the year 2000, as continued reductions in European government subsidies to coal producers should benefit NS Rail-served exporters. A gradual decline is projected in the long term, as new steel-making technologies replace those requiring coking coal. Demand for export steam coal is expected to increase, and NS Rail is working to increase its participation in this market.

Steel coal domestic traffic was down 7%, as aggressive producer pricing of higher volatile metallurgical coals not located on NS Rail's lines resulted in a loss of traffic. In 1995, traffic was up 2% due to completion of extended coke oven work at one facility and continued strong demand for domestic coke for making steel. Advanced technologies that allow production of steel with little or no coke could cause this market to decline slowly over the long term. However, NS Rail could participate in the movement of non-coking coal used by technologies such as pulverized coal injection.

Other coal traffic, primarily steam coal shipped to manufacturing plants, increased 14% in 1996, compared with 1995, reflecting gains from other modes of transportation and more seasonal weather conditions in 1996. Traffic volume declined 8% in 1995, compared with 1994, resulting from lower demand for in-plant use of electricity due to mild weather. In addition, some industries have switched to natural gas as a fuel source. This market is expected to remain stable in coming years, as growth through innovative packaged delivery services offsets losses from natural gas conversions.

MERCHANDISE traffic volume in 1996 decreased slightly, compared with 1995, as increases in automotive, intermodal and chemicals traffic were more than offset by declines in the remaining commodity groups. However, increased average revenues for most commodity groups resulted in a 2% improvement in revenues. In 1995, merchandise traffic volume increased 5%, driven by increases in intermodal, automotive and agriculture traffic. Merchandise revenues in 1995 increased 4%, compared with 1994.

CHEMICALS traffic and revenues grew 3% and 4%, respectively, for 1996. Fertilizer and plastics markets strengthened during 1996, which resulted in increased traffic and revenues for these two groups. In addition, the harsh winter resulted in greater movements of liquid petroleum gas, and industrial chemicals remained strong throughout the year. These 1996 results compared favorably with relatively flat carloads and revenues in 1995, as increases for general chemicals were overshadowed by weakness in the plastics and fertilizer markets. The chemicals market group is expected to continue to show moderate growth through 1997, as NS Rail expands its Thoroughbred Bulk Distribution facilities and chemicals production nationwide is expected to increase.

PAPER/FOREST traffic and revenues each declined 5% in 1996, due to the overall downturn in the paper and forest products industry. Early in 1995, the paper industry enjoyed record price levels and associated volumes, but growth slowed and inventories of paper products swelled in late 1995 and into 1996. To correct the inventory problems, many large paper producers operated mills well below capacity and shut down mills to balance capacity with demand. This compares to a 1% decrease in volume and a 3% increase in revenues for 1995. Paper and pulpwood products traffic in 1995 was about even with 1994, while lumber traffic suffered from weak housing starts. These markets are expected to begin a slight turnaround by mid-1997.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

AUTOMOTIVE traffic rose 8%, and revenues increased 9%, both the highest in this group's history. Auto parts provided the majority of the growth as volume increased 21%, while vehicle traffic increased 3%. NS Rail opened two just-in-time (JIT) rail centers at Hagerstown, Md., and near Buffalo, N.Y., in 1996 for distribution of vehicle parts for GM. Also, GM awarded NS Rail another JIT rail center to be constructed in 1997 near Dayton, Ohio. These three centers are expected to handle over 23,000 carloads annually by 1998. 1996 also marked the first time in several years that all NS Rail-served assembly plants were on-line. GM's Wentzville, Mo., assembly plant returned to production early in the year after a two-year retooling, and GM's Doraville, Ga., plant returned midyear from a one-year retooling. In 1996, BMW's new plant at Greer, S.C., reached full production. In 1995, automotive traffic increased 4%, and revenues were up 5%. Strong production at selected plants that produce popular cars and trucks mitigated the effects of several plants' being shut down or operated at reduced capacity.

Good market growth is expected in 1997, supported by the new JIT rail centers, full production levels at existing plants, the start of production at the new Mercedes plant in Tuscaloosa, Ala., and the expansion of Toyota's plant in Georgetown, Ky. Supporting long-term growth, Ford awarded NS Rail a 12-year contract in 1996 to handle approximately 3 million new vehicles annually through four mixing centers to be built in 1997. When operational in 1998, NS Rail expects to increase its motor vehicle business with Ford by 60%. In addition, Toyota's new Princeton, Ind., truck plant may add to 1998-1999 traffic. For the automotive industry as a whole, annual production increases are forecast through 2002, as transplants bring production to North America, exports continue to rise and the Mexican and Canadian economies improve.

AGRICULTURE traffic declined 4% and revenues were flat in 1996. Despite strong demand for feed grains in the Southeast, grain traffic suffered, as poor crops and strong export demand left NS Rail receivers competing for limited supplies. Slight average revenue growth occurred, resulting primarily from longer hauls, as receivers reached farther west for grain supplies. In 1995, agriculture traffic rose 2%, and revenues increased 4%, due to higher grain shipments from the Midwest to the Southeast poultry industry.

Moderate growth is expected in 1997, as 1996 crops should provide abundant supplies throughout the year, and demand from the poultry market for feed grain continues to grow. Also for 1997, a full year of new business is expected from two feed mills which were ramping up production in 1996, and from a new major grain elevator located on a line purchased during 1996 from Conrail.

METALS/CONSTRUCTION traffic declined 2%, but revenues were up 1% for 1996. Construction carloads fell behind in early 1996 due to inclement weather and were flat the rest of the year; however, higher average revenues more than offset the volume decline. In the metals market, NS Rail's shipments remained strong due to a healthy domestic steel market, which has added capacity through improved efficiency at integrated mills and new mini-mills. In 1995, metals/construction traffic was up slightly, and revenues increased 6%, as increases in the steel and aluminum markets were somewhat offset by reduced demand for construction products.

Moderate growth is expected for 1997. New steel production facilities in Decatur, Ala., and Memphis, Tenn., are expected to contribute to growth in late 1997. Although construction starts are expected to decrease in 1997 versus 1996, projects already begun, such as at the Chesapeake Bay Bridge Tunnel, the opening of new cement terminals and the expansion of various on-line plants, are expected to produce moderate growth for construction in 1997 and beyond.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

INTERMODAL traffic volume increased 5% and revenues increased 3%, both reaching record levels in 1996, driven by increased domestic container and Triple Crown Services Company (TCSC) volume.

EMP, the container equipment-sharing arrangement with Union Pacific and Conrail, contributed significantly to domestic growth. International container volume declined only slightly, despite an industry slowdown that began in the spring and lasted until the fall. NS Rail's overall market share improved slightly due to new international business and the continued domestic container and TCSC growth.

Intermodal volume rose 12%, and revenues increased 11% in 1995. Although intermodal traffic levels nationwide declined in 1995, NS Rail intermodal achieved record levels of volume, revenues and profitability, led by container shipments in both domestic and international service.

During 1995, a seven-year agreement with Hanjin Shipping Company was signed under which NS Rail will handle nearly all of Hanjin's international container business in NS Rail's territory east of the Mississippi River.

EMP contributed significantly to domestic growth. Almost all the increase in international container business was attributable to new services, thereby increasing NS Rail's market share. Domestic business also was augmented by growth in the trucking segment, as both truckload and less-than-truckload companies increased their use of NS Rail intermodal. Additionally, intermodal marketing companies increased their business on NS Rail.

NS Rail's intermodal volume is expected to remain strong, resulting from continued domestic container and TCSC volume growth and the recovery in the international market. Higher wages in the trucking industry may encourage shippers to use NS Rail's intermodal and TCSC networks. In addition, growth of steamship companies' use of Suez Canal services may have a positive impact on international container shipments into and out of Southeast ports.

Railway Operating Expenses

Railway operating expenses in 1996 decreased slightly; however, 1995's expenses included a $33.6 million charge for an early retirement program (see Note 12). Excluding that early retirement charge, railway operating expenses increased 1%, despite a 2% increase in traffic volume. Railway operating expenses in 1995 were up 3% (up 2%, excluding the early retirement charge) on a 3% increase in traffic volume.

As a result, the NS Rail railway operating ratio, which measures the percentage of railway revenues consumed by expenses, was a record 71.6 in 1996, compared with 73.5 (72.7 excluding the early retirement charge) in 1995 and 73.2 in 1994. NS Rail's railway operating ratio continues to be the best among the major railroads in the United States.

RAILWAY OPERATING RATIO
(Shown as a Graph in the Annual Report to Stockholders)

1996	1995	1994	1993	1992
71.6%	73.5%	73.2%	75.3%	75.0%

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

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

RAILWAY OPERATING EXPENSES
Increases (Decreases)
($ in millions)

	1996 vs. 1995	1995 vs. 1994
Compensation and benefits	$ (81.3)*	$ 108.9 *
Materials, services and rents	6.3	(45.4)
Depreciation	20.1	22.3
Diesel fuel	43.6	1.5
Casualties and other claims	2.1	(13.7)
Other	(3.0)	5.7
Total	$ (12.2)	$ 79.3

*Includes the $33.6 million early retirement charge in 1995.

COMPENSATION AND BENEFITS, which represents about half of total railway operating expenses, decreased 5% in 1996 and increased 8% in 1995. Excluding the 1995 early retirement charge, compensation and benefits expenses were down 3% in 1996 and up 5% in 1995.

The 1996 decrease (excluding the effect of the 1995 early retirement charge) was principally attributable to: (1) reduced employment resulting from the 1995 early retirement program and productivity improvements due to ongoing reductions in train crew sizes and train efficiencies and (2) lower costs for fringe benefits, principally medical costs for salaried employees. These decreases were somewhat offset by increases attributable to higher volume and increased wage rates resulting from new labor agreements.

The 1995 increase was primarily a result of: (1) higher wages; (2) increased performance-based compensation accruals, particularly those linked to the market price of NS stock, which rose nearly $19 per share in 1995; and (3) higher health care costs for agreement employees.

As of the end of 1996, NS Rail had negotiated labor agreements with all of its unions, except the American Train Dispatchers which represents about 200 employees. The accords with the 12 other union organizations, which include compensation settlements in line with other major industries, will not be due for change until after January 1, 2000.

MATERIALS, SERVICES AND RENTS includes items used for the maintenance of the railroads' lines, structures and equipment; the costs of services purchased from outside contractors, including the net costs of operating joint (or leased) facilities with other railroads; and the net cost of equipment rentals. This category of expenses increased 1% in 1996 and decreased 7% in 1995.

The increase in 1996 resulted from higher intermodal expenses due to increased volume, as well as higher equipment rent costs, that more than offset lower locomotive and car repair costs.

Equipment rents, which represent the cost to NS Rail of using equipment (mostly freight cars) owned by other railroads or private owners, less the rent paid to NS Rail for the use of its equipment, were up 10% in 1996. This increase was due to a variety of factors, including increased intermodal container traffic, lower receipts from short-term leases of locomotives to various railroads and increased freight car leases to meet customer requirements. These increased costs were somewhat offset by lower net costs for multilevel equipment.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

Locomotive repair costs continued to be reduced as a result of the replacement of older units with newer ones. NS Rail expects to acquire 120 new locomotives in 1997. Freight car repair costs continued to benefit from the effects of initiatives launched in 1995 to improve asset utilization that resulted in the re-engineering of maintenance practices, facilitating the closure of two repair facilities in 1995 and the disposition of 17,000 excess freight cars, which was substantially completed in 1996.

The decrease in "Materials, services and rents" in 1995 reflected initial results from the initiatives to improve asset utilization, as well as reduced locomotive repair costs and lower net equipment rental expense. The reduction in equipment rents in 1995 was due to the short-term leasing of certain older locomotives to other railroads and the deregulation of car-hire rates among railroads, which began in 1994. These favorable results were somewhat offset by increased expenses related to the 12% growth in intermodal traffic.

DEPRECIATION expense (see Note 1, "Properties," for NS Rail's depreciation policy) was up 5% in 1996 and 6% in 1995. Both increases were due to property additions, reflecting substantial levels of capital spending over the last several years.

DIESEL FUEL costs rose 23% in 1996, but were up less than 1% in 1995. The increase in 1996 was due to a 20% increase in the average price per gallon, as prices reached levels unseen since 1991 during and following the Persian Gulf Crisis. Consumption was up 3% on a similar increase in carloadings. The 1995 increase was primarily due to a small increase in the average price per gallon.

CASUALTIES AND OTHER CLAIMS (including estimates of costs related to personal injury, property damage and environmental matters) increased 2% in 1996, but declined 10% in 1995. In 1996, higher accruals for environmental remediation costs more than offset reduced accruals for personal injury liabilities and the effects of a nonrecurring liability insurance premium refund. The 1995 decrease was primarily attributable to environmental costs in 1994 associated with a tankcar leak.

The largest component of "Casualties and other claims" is personal injury expense. NS Rail continued to benefit from a reduction in the number of reportable injuries in 1996; however, as in prior years, much of that benefit was offset by an increase in the cost of third-party injury claims and by the continuing costs associated with the handling of non-accidental "occupational" claims. NS Rail continues to work actively to reduce the risk of all accidents.

The rail industry remains uniquely susceptible to litigation involving job-related accidental injury and occupational claims because of an outmoded law, the Federal Employers' Liability Act (FELA), originally passed in 1908 and applicable only to railroads. This law, which covers employees' claims for on-the-job injuries, promotes an adversarial claim settlement environment and produces results that are unpredictable and inconsistent, at far greater cost to the rail industry than the no-fault workers' compensation system to which non-rail competitors are universally subject. The railroads have been unsuccessful so far in efforts to persuade Congress to replace FELA with a no-fault workers' compensation system.

OTHER expenses were down 2% in 1996, but were up 4% in 1995. The 1995 increase was due to higher sales, use and franchise taxes.

NS Rail expects to complete work to make its software year-2000 compliant by the end of 1998. It is anticipated that the total cost of conversion will not be material to NS Rail's financial statements.

Income Taxes

Income tax expense in 1996 was $401.4 million for an effective rate of 34.3%, compared with an effective rate of 34.6% in 1995 and 36.1% in 1994.

The effective rates in 1996 and 1995 were below the statutory federal and state rates as a result of investments in corporate-owned life insurance and coal-seam gas properties and from favorable adjustments upon filing the prior year tax returns. In

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

addition, 1996 benefited from favorable adjustments resulting from settlement of federal income tax years 1990-1992. The effective rate in 1994 also was below the statutory federal and state rates due to favorable adjustments resulting from settlement of federal income tax years 1988 and 1989, an adjustment to the valuation allowance for deferred tax assets and a favorable adjustment upon filing the 1993 tax return. Deferred tax expense was an unusually high portion of total tax expense in 1994. A corresponding reduction is reflected in 1994's current tax expense for the effects of expenditures that affect book and tax accounts in different years, primarily in the areas of compensation and property.

Accounting Changes and New Accounting Pronouncements

As discussed in Note 1 under "Required Accounting Changes," effective January 1, 1996, NS Rail adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS 121), which had no material effect on NS Rail's financial statements.

Effective January 1, 1994, NS Rail adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). The principal result was a significant write-up of NS Rail's investment in NS stock. This non-cash adjustment had no income statement effect but increased "Investments" and "Stockholders' equity" in the Consolidated Balance Sheets (see also Note 14).

On October 10, 1996, the AICPA issued Statement of Position 96-1, "Environmental Remediation Liabilities" (SOP 96-1), which is effective for fiscal years beginning after December 15, 1996. SOP 96-1 provides guidance with respect to recognition and measurement of environmental remediation liabilities and disclosure of such liabilities in financial statements. SOP 96-1 is not expected to have a material effect on NS Rail's financial statements.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

FINANCIAL CONDITION refers to the assets, liabilities and stockholders' equity of an organization (see Consolidated Balance Sheets on page 41). LIQUIDITY refers to the ability of an organization to generate adequate amounts of cash, principally from operating results or through borrowing power, to meet its short-term and long-term cash requirements (see Consolidated Statements of Cash Flows on page 42). CAPITAL RESOURCES refers to the ability of an organization to raise funds through the sale of either debt or equity (stock) securities.

($ in millions)	1996	1995	1994	1993	1992
Cash and short-term investments	$315.5	$230.0	$180.9	$152.0	$ 64.0
Current assets to current liabilities	1.2	1.0	1.1	1.3	1.2
Debt to total capitalization	9.8%	9.6%	9.4%	10.9%	13.4%
Return on average stockholders' equity	13.5%	13.0%*	12.8%	12.0%*	13.1%

* Excluding unusual items: In 1995, the early retirement charge; and, in 1993, the cumulative effects of required accounting changes and the prior years' effect of the federal income tax rate increase.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

Cash provided by operating activities, NS Rail's principal source of liquidity, decreased $49.9 million, or 4%, in 1996 and increased $96.4 million, or 8%, in 1995. Since the consolidation in 1982, cash provided by operating activities has been sufficient to fund dividend requirements, debt repayments and a significant portion of capital spending. The decrease in 1996 was largely attributable to lump-sum wage payments associated with labor contract settlements and higher income tax payments related to the settlement of federal income tax years 1990-1992. The improvement in 1995 was primarily a result of increased income from operations (excluding the early retirement charge, a non-cash item) and improved billing and collection of receivables.

Cash used for investing activities decreased 7% in 1996 and was up 56% in 1995. Property additions account for most of the spending in this category. In 1994, large borrowings on corporate-owned life insurance offset much of the use of cash for property additions in that year.

The following tables show capital spending, track and equipment statistics for the past five years.

CAPITAL EXPENDITURES

(Also Shown as a Graph in the Annual Report to Stockholders)

($ in millions)	1996*	1995*	1994	1993	1992
Road	$428.4	$379.5	$382.3	$411.0	$425.1
Equipment	325.6	332.6	235.0	218.1	187.8
Other property	--	1.2	22.3	0.1	4.2
Total	$754.0	$713.3	$639.6	$629.2	$617.1

* Includes non-cash equipment expenditures of $107.8 million in 1996 and $104.5 million in 1995 (see Note 8 on page 51).

TRACK STRUCTURE STATISTICS (CAPITAL AND MAINTENANCE)

	1996	1995	1994	1993	1992
Track miles of rail installed	401	403	480	574	660
Miles of track surfaced	4,686	4,668	4,760	5,048	5,690
New crossties installed (millions)	1.9	2.0	1.7	1.6	1.9

AVERAGE AGE OF RAILWAY EQUIPMENT

(Years)	1996	1995	1994	1993	1992
Freight cars	22.3	22.0	21.9	21.3	20.9
Locomotives	15.4	15.7	15.8	15.1	14.5
Retired locomotives	24.4	22.6	23.6	24.7	24.0

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

Since 1988, NS Rail has rebodied about 23,000 coal cars and plans to continue that program, although at a slower rate, in 1997. This work, performed at NS Rail's Roanoke Car Shop, converts hopper cars into high-capacity steel gondolas or hoppers. As a result, the remaining service life of the freight car fleet is greater than may be inferred from the increasing average age shown in the table above.

Efforts to hold down capital spending while increasing business are ongoing as NS Rail seeks to maximize utilization of its assets. In this connection, NS Rail began an orderly disposition of approximately 17,000 freight cars in October 1994. This was substantially completed in 1996 with total proceeds of $92 million included in "Property sales and other transactions" in the 1996 and 1995 Consolidated Statements of Cash Flows. In 1996, this line item also reflected proceeds from large land sales (see Note 3).

For 1997, NS Rail is planning $781 million of capital spending. Barring unforeseen events, total capital spending is expected to continue to be similar to 1995 and 1996 levels.

Cash used for financing activities decreased 18% in 1996 and 14% in 1995. The higher uses in 1995 and 1994 were due to significant advances made to NS. In addition, 1994 debt repayments were high due to the maturity of a large mortgage.

Hedging Activities

As discussed under "Capital Leases" in Note 8, NS Rail has made limited use of interest rate swaps in connection with certain equipment financings.

PROPOSED ACQUISITION OF CONRAIL BY NS

As discussed in Note 16, NS commenced an all-cash tender offer for all Shares of Conrail Inc. (Conrail), on October 24, 1996, in response to the October 15, 1996, announcement that Conrail had entered into a merger agreement with CSX.

On February 11, 1997, NS acquired 8.2 million Shares of Conrail stock (approximately 9.9%), representing the approximate maximum number of Shares NS can buy without triggering Conrail's current anti-takeover defenses, at a cost of $115 per Share, or $943 million in the aggregate. The purchase was financed with commercial paper backed by a portion of the debt commitments secured for the transaction. These Shares have been placed in a voting trust and under certain circumstances might have to be sold at a loss.

On February 12, 1997, NS commenced a second tender offer for the remaining Shares and has notified Conrail of its intention to conduct a proxy contest in connection with Conrail's 1997 Annual Meeting of shareholders, currently scheduled for December 19, 1997, seeking, among other things, to remove certain of the current members of the Conrail Board and to elect a new slate of nominees designated by NS.

Pursuant to an amendment to the merger agreement between CSX and Conrail announced on March 7, 1997, CSX has offered to purchase all Shares for $115 per Share in cash and CSX is permitted to enter into negotiations with other parties, including NS, concerning the acquisition of the securities or assets, or concessions relating to the assets or operations, of Conrail. NS and CSX are negotiating a comprehensive resolution of the issues confronting the eastern railroads based on the proposal submitted by NS to both CSX and Conrail on February 24, 1997. Such a resolution could involve a joint acquisition of Shares by NS and CSX. However, unless and until such negotiations are successfully concluded, NS intends to continue in effect its tender offer for all Shares not owned by NS.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

For additional information concerning NS' pending tender offer for Shares not owned by NS, reference is made to NS' Tender Offer Statement on Schedule 14D-1, together with the exhibits thereto, initially filed with the Securities and Exchange Commission on February 12, 1997, as amended.

ENVIRONMENTAL MATTERS

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

Operating expenses for environmental protection totaled approximately $25 million in 1996 and are anticipated to increase somewhat in 1997. Capital expenditures for environmental projects amounted to approximately $6 million in 1996 and are expected to be at the same level in 1997. As of December 31, 1996, NS Rail's balance sheet included a reserve for environmental exposures in the amount of $53 million (of which $12 million is accounted for as a current liability), which is NS Rail's estimate of the probable costs based on available information at 111 identified locations. On that date, nine sites accounted for $19 million of the reserve, and no individual site was considered to be material. NS Rail anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At many of the 111 locations, NS Rail and/or certain of its subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for clean-up costs.

At one such site, the EPA alleged in 1995 that The Alabama Great Southern Railroad Company (AGS), a subsidiary of NS Rail, is responsible, along with several other entities believed to be financially solvent, for past and future clean-up and monitoring costs at the Bayou Bonfouca NPL Superfund site located in Slidell, La. The EPA bases its claim of NS Rail's responsibility primarily on the alleged activities in the 1880s of a company not at the time owned or controlled by an NS Rail subsidiary, but acquired in 1916. Liability has been contested. Because the amount of liability that the EPA may assert against NS Rail or AGS is not known, the materiality of such amount to NS Rail's financial position, results of operation or liquidity in a particular quarter or year cannot be assessed at this time. The EPA has indicated that it has expended or expects to expend a total of approximately $130 million at the site.

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

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued)

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

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

INFLATION

Generally accepted accounting principles require the use of historical cost in preparing financial statements. This approach disregards the effects of inflation on the replacement cost of property. NS Rail, a capital-intensive company, has approximately $13 billion invested in such assets. The replacement cost of these assets, as well as the related depreciation expense, would be substantially greater than the amounts reported on the basis of historical cost.

TRENDS

- Utility Deregulation--The potential deregulation of the electrical utility industry is expected to increase competition among electric power generators; deregulation in time would permit wholesalers and possibly retailers of electric power to sell or purchase increasing quantities of power to or from far-distant generators. The effects of deregulation on NS Rail and on its patrons cannot be predicted with certainty; however, NS Rail serves a number of efficient power producers and is working diligently to assure that its customers remain competitive in this evolving environment.

- FELA--NS Rail and the rail industry are continuing their efforts to replace the FELA with no-fault workers' compensation laws comparable to those covering employees in other industries.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Annual Report contain forward-looking statements that are based on current expectations, estimates and projections. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed in such forward-looking statements.

Item 8. Financial Statements and Supplementary Data.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)
Quarterly Financial Data (Unaudited)

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	($ in millions, except per share amounts)			
1996				
Railway operating revenues	$1,016.7	$1,038.0	$1,020.1	$1,026.2
Income from railway operations	261.8	300.0	300.3	302.6
Net income	163.1	190.6	208.8	206.0
Dividends per serial preferred share	$ 0.65	$ 0.65	$ 0.65	$ 0.65
1995				
Railway operating revenues	$ 999.2	$1,016.4	$ 996.0	$1,000.2
Income from railway operations	250.4	284.3	277.9	250.7
Net income	153.3	180.3	193.9	174.2
Dividends per serial preferred share	$ 0.65	$ 0.65	$ 0.65	$ 0.65

Index to Financial Statements: Page

The Index to Consolidated Financial Statement Schedule appears in Item 14 on page 67.

Item 8. Financial Statements and Supplementary Data. (continued)

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)
Consolidated Statements of Income

	Years ended December 31, 1996	1995	1994
	($ in millions)		
Railway operating revenues	$ 4,101.0	$ 4,011.8	$ 3,918.1
Railway operating expenses:			
Compensation and benefits (Note 12)	1,398.7	1,480.0	1,371.1
Materials, services and rents	629.5	623.2	668.6
Depreciation	403.0	382.9	360.6
Diesel fuel	233.4	189.8	188.3
Casualties and other claims	123.4	121.3	135.0
Other	148.3	151.3	145.6
Railway operating expenses	2,936.3	2,948.5	2,869.2
Income from railway operations	1,164.7	1,063.3	1,048.9
Other income - net (Note 3)	39.1	43.3	46.6
Interest expense on debt (Note 6)	33.9	33.0	28.3
Income before income taxes	1,169.9	1,073.6	1,067.2
Provision for income taxes (Note 4)	401.4	371.9	385.2
Net income	$ 768.5	$ 701.7	$ 682.0

See accompanying notes to consolidated financial statements.

Item 8. Financial Statements and Supplementary Data. (continued)

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)
Consolidated Balance Sheets

	As of December 31, 1996	1995
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$ 172.1	$ 49.3
Short-term investments (Note 14)	143.4	180.7
Accounts receivable net of allowance for doubtful accounts of $3.6 million and $2.8 million, respectively	545.7	542.1
Materials and supplies	61.2	59.8
Deferred income taxes (Note 4)	95.3	98.8
Other current assets	119.8	92.1
Total current assets	1,137.5	1,022.8
Due from NS - net (Note 2)	--	186.8
Investments (Notes 5 and 14)	870.7	771.0
Properties less accumulated depreciation (Note 6)	9,014.9	8,750.4
Other assets	30.2	21.3
Total assets	$ 11,053.3	$ 10,752.3
Liabilities and stockholders' equity		
Current liabilities:		
Short-term debt (Note 8)	$ 27.2	$ 27.2
Accounts payable (Note 7)	549.8	567.2
Income and other taxes	158.3	179.4
Due to NS - net (Note 2)	64.9	--
Other current liabilities (Note 7)	109.0	124.3
Current maturities of long-term debt (Note 8)	54.3	79.7
Total current liabilities	963.5	977.8
Long-term debt (Note 8)	543.6	494.7
Other liabilities (Note 10)	886.0	870.8
Minority interests	2.4	2.3
Deferred income taxes (Note 4)	2,886.0	2,761.3
Total liabilities	5,281.5	5,106.9
Stockholders' equity:		
Serial preferred stock (Note 11)	54.8	54.8
Common stock (Note 11)	166.7	166.7
Other capital	525.5	525.5
Unrealized gain on marketable securities (Note 14)	397.8	337.3
Retained income	4,627.0	4,561.1
Total stockholders' equity	5,771.8	5,645.4
Total liabilities and stockholders' equity	$ 11,053.3	$ 10,752.3

See accompanying notes to consolidated financial statements.

Item 8. Financial Statements and Supplementary Data. (continued)

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)
Consolidated Statements of Cash Flows

	Years ended December 31, 1996	1995	1994
	($ in millions)		
Cash flows from operating activities:			
Net income	$ 768.5	$ 701.7	$ 682.0
Reconciliation of net income to net cash provided by operating activities:			
Special charge payments	(18.0)	(29.3)	(41.9)
Depreciation	404.2	383.8	361.3
Deferred income taxes	89.4	43.2	114.2
Nonoperating gains on property sales	(25.5)	(8.7)	(7.8)
Changes in assets and liabilities affecting operations:			
Accounts receivable	(3.6)	10.6	(29.8)
Materials and supplies	(1.4)	(1.3)	7.4
Other current assets	(13.5)	(2.3)	(12.5)
Current liabilities other than debt	(33.6)	104.5	6.7
Other - net	34.4	48.6	74.8
Net cash provided by operating activities	1,200.9	1,250.8	1,154.4
Cash flows from investing activities:			
Property additions	(646.2)	(603.8)	(639.6)
Property sales and other transactions	96.0	80.4	52.9
Investment purchases	(59.7)	(65.6)	(45.9)
Investment sales and other transactions	22.0	29.4	249.2
Short-term investments - net	36.1	(31.3)	1.0
Net cash used for investing activities	(551.8)	(595.9)	(382.4)
Cash flows from financing activities:			
Dividends (Note 2)	(288.6)	(291.5)	(279.4)
Due to/from NS - net (Note 2)	(162.3)	(285.1)	(394.2)
Proceeds from long-term borrowings	9.6	7.6	41.4
Long-term debt repayments	(85.0)	(70.4)	(108.3)
Net cash used for financing activities	(526.3)	(639.4)	(740.5)
Net increase in cash and cash equivalents	122.8	15.5	31.5
Cash and cash equivalents:			
At beginning of year	49.3	33.8	2.3
At end of year	$ 172.1	$ 49.3	$ 33.8
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest (net of amounts capitalized)	$ 66.7	$ 48.9	$ 49.1
Income taxes	$ 351.3	$ 272.5	$ 252.2

See accompanying notes to consolidated financial statements.

Item 8. Financial Statements and Supplementary Data. (continued)

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)
Consolidated Statements of Changes in Stockholders' Equity

	Serial Preferred Stock	Common Stock	Other Capital	Unrealized Gain on Marketable Securities	Retained Income	Total
	($ in millions)					
Balance December 31, 1993	$ 54.8	$ 166.7	$ 515.0	$ --	$ 4,448.4	$ 5,184.9
Net income - 1994					682.0	682.0
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $16.59 per share					(276.5)	(276.5)
Non-cash dividends on common stock (Note 2)					(400.1)	(400.1)
Unrealized gain on investments				253.1		253.1
Balance December 31, 1994	54.8	166.7	515.0	253.1	4,450.9	5,440.5
Net income - 1995					701.7	701.7
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $17.31 per share					(288.6)	(288.6)
Non-cash dividends on common stock (Note 2)					(300.0)	(300.0)
Contribution from NS (Note 2)			10.5			10.5
Unrealized gain on investments (Note 14)				84.2		84.2
Balance December 31, 1995	54.8	166.7	525.5	337.3	4,561.1	5,645.4
Net income - 1996					768.5	768.5
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $17.14 per share					(285.7)	(285.7)
Non-cash dividends on common stock (Note 2)					(414.0)	(414.0)
Unrealized gain on investments (Note 14)				60.5		60.5
Balance December 31, 1996	$ 54.8	$ 166.7	$ 525.5	$ 397.8	$ 4,627.0	$ 5,771.8

See accompanying notes to consolidated financial statements.

Item 8. Financial Statements and Supplementary Data. (continued)

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

The following notes (which--with the exception of Note 17--are identical to those contained in the Corporation's 1996 Annual Report to Stockholders) are an integral part of the consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Norfolk Southern Railway Company, together with its consolidated subsidiaries (collectively, NS Rail), is engaged principally in the transportation of freight by rail, primarily in the Southeast and Midwest. The consolidated financial statements include Norfolk Southern Railway Company, Norfolk and Western Railway Company and their majority-owned and controlled subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation (see Note 15 for the Norfolk and Western Railway Company and Subsidiaries (NW) summarized consolidated financial information).

Rail freight consists of raw materials, intermediate products and finished goods classified in the following market groups: coal, chemicals, paper/forest, automotive, agriculture, metals/construction and intermodal. All groups are approximately equal in size based on revenues except for coal, which accounts for almost one third of total railway operating revenues. Ultimate destinations for some of the freight and a portion of the coal shipped are outside the United States.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

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

Investments

Marketable equity and debt securities are reported at amortized cost or fair value depending upon their classification as held-to-maturity, trading or available-for-sale securities. At December 31, 1996 and 1995, all "Short-term investments," consisting primarily of United States government and federal agency securities and all marketable equity securities consisting principally of NS stock, were designated as available for sale. Accordingly, unrealized gains and losses, net of taxes, are recognized in "Stockholders' equity" (see also Note 14).

Materials and Supplies

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

Item 8. Financial Statements and Supplementary Data. (continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Properties

"Properties" are stated principally at cost and are depreciated using group depreciation. Rail is primarily depreciated on the basis of use measured by gross ton miles. The effect of this method is to depreciate these assets over 42 years on average. Other properties are depreciated generally using the straight-line method over estimated service lives at annual rates that range from 1% to 20%. In 1996, the overall depreciation rate averaged 2.8% for roadway and 4.0% for equipment. NS Rail capitalizes interest on major capital projects during the period of their construction. Maintenance expense is recognized when repairs are performed. When properties, other than land and non-rail assets, are sold or retired in the ordinary course of business, the cost of the assets, net of sale proceeds or salvage, is charged to accumulated depreciation rather than recognized through income. Gains and losses on disposal of land and non-rail assets are included in other income (see Note 3).

Revenue Recognition

Revenue is recognized proportionally as a shipment moves from origin to destination.

Required Accounting Changes

1996 - Effective January 1, 1996, NS Rail adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS 121). SFAS 121 establishes the accounting and reporting requirements for recognizing and measuring impairment of long-lived assets either to be held and used or to be held for disposal. SFAS 121 did not have a material effect on NS Rail's financial statements.

1994 - Effective January 1, 1994, NS Rail adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115), which addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. The implementation of SFAS 115 increased "Investments," the deferred tax liability and "Stockholders' equity" at December 31, 1994, and had no impact on earnings. The total unrealized holding gain on NS Rail's investments classified as "available for sale," net of the related deferred taxes, is reflected as a separate component of "Stockholders' equity" in the Consolidated Balance Sheets (see also Note 14).

2. RELATED PARTIES

General

NS is the parent holding company of NS Rail. The costs of functions performed by NS are allocated to NS Rail. Rail operations are coordinated at the holding company level by the NS Executive Vice President-Operations.

Non-cash Dividends

In 1996, 1995 and 1994, NS Rail declared and issued to NS non-cash dividends of $414.0 million, $300.0 million and $400.1 million, respectively, which were settled by reduction of NS Rail's interest-bearing advances due from NS.

Non-cash dividends are excluded from the Consolidated Statements of Cash Flows.

Item 8. Financial Statements and Supplementary Data. (continued)

2. RELATED PARTIES (continued)

Intercompany Accounts

	December 31,			
	1996		1995	
	Balance	Average Interest Rate	Balance	Average Interest Rate
	($ in millions)			
Due from NS:				
Advances	$ 155.6	4.1%	$ 407.1	3.4%
Due to NS:				
Notes	220.5	6.1%	220.3	6.6%
Due (to) from NS - net	$ (64.9)		$ 186.8	

During 1995, NW issued notes for $75.5 million to an NS subsidiary for the purchase of a portfolio of short-term investments. This non-cash transaction was excluded from the Consolidated Statement of Cash Flows.

Interest is applied to certain advances at the average NS yield on short-term investments and to the notes at specified rates. Included in interest income is $13.9 million, $17.8 million and $15.6 million in 1996, 1995 and 1994, respectively, related to amounts due from NS.

Transfer of Investment from NS

In December 1995, NS transferred its $10.5 million equity interest in a nonoperating subsidiary to Norfolk Southern Railway Company. This transfer was recorded at historical cost and was reflected as a contribution to capital.

Intercompany Federal Income Tax Accounts

In accordance with the NS Tax Allocation Agreement, intercompany federal income tax accounts are recorded between companies in the NS consolidated group. At December 31, 1996 and 1995, NS Rail had long-term intercompany federal income tax payables (which are included in "Deferred income taxes" in the Consolidated Balance Sheets) of $292.5 million and $254.7 million, respectively.

Cash Required for NS Stock Purchase Program and NS Debt

Since 1987, the NS Board of Directors has authorized the purchase and retirement of up to 95 million shares of NS common stock. Purchases under the programs have been made with internally generated cash, and with proceeds from the sale of NS commercial paper notes and from the issuance of NS long-term debt.

Since the first purchases in December 1987 and through October 22, 1996, NS had purchased and retired 68,545,000 shares of its common stock under these programs at a cost of $3.2 billion.

Item 8. Financial Statements and Supplementary Data. (continued)

2. RELATED PARTIES (continued)

On October 23, 1996, NS announced that the stock purchase program had been suspended (see also Note 16). Future purchase decisions are dependent on the outcome of the proposed Conrail acquisition, the economy, cash needs and alternative investment opportunities.

Consistent with the earlier purchases, a significant portion of the funding for future NS stock purchases, either in the form of direct cash or cash used for debt service, will come from NS Rail through intercompany advances or dividends to NS. In addition, some of the costs associated with the proposed Conrail acquisition (see Note 16, "Proposed Acquisition of Conrail by NS" and "NS Debt Commitments") are likely to be funded by NS Rail.

3. OTHER INCOME - NET

	1996	1995	1994
	($ in millions)		
Interest income (Note 2)	$ 29.9	$ 36.3	$ 34.4
Rental income	18.2	18.5	18.0
Dividends from NS	16.2	15.1	13.9
Gains from sales of properties	25.5	8.7	7.8
Corporate-owned life insurance - net	6.0	7.4	7.9
Other interest expense	(44.1)	(32.2)	(24.9)
Taxes on nonoperating property	(3.7)	(2.4)	(3.7)
Other - net	(8.9)	(8.1)	(6.8)
Total	$ 39.1	$ 43.3	$ 46.6

4. INCOME TAXES

Provision for Income Taxes

	1996	1995	1994
	($ in millions)		
Current:			
Federal	$ 277.7	$ 286.3	$ 236.0
State	34.3	42.4	35.0
Total current taxes	312.0	328.7	271.0
Deferred:			
Federal	72.7	35.1	95.2
State	16.7	8.1	19.0
Total deferred taxes	89.4	43.2	114.2
Provision for income taxes	$ 401.4	$ 371.9	$ 385.2

Item 8. Financial Statements and Supplementary Data. (continued)

4. INCOME TAXES (continued)

Reconciliation of Statutory Rate to Effective Rate

Total income taxes as reflected in the Consolidated Statements of Income differ from the amounts computed by applying the statutory federal corporate tax rate as follows:

	1996		1995		1994	
	Amount	%	Amount	%	Amount	%
			($ in millions)			
Federal income tax at statutory rate	$ 409.5	35.0	$ 375.8	35.0	$ 373.5	35.0
State income taxes, net of federal tax benefit	33.1	2.8	32.7	3.0	35.1	3.3
Corporate-owned life insurance	(15.5)	(1.3)	(17.1)	(1.6)	(10.6)	(1.0)
Other - net	(25.7)	(2.2)	(19.5)	(1.8)	(12.8)	(1.2)
Provision for income taxes	$ 401.4	34.3	$ 371.9	34.6	$ 385.2	36.1

Inclusion in Consolidated Return

NS Rail is included in the consolidated federal income tax return of NS. The provision for current income taxes in the Consolidated Statements of Income reflects NS Rail's portion of NS' consolidated tax provision. Tax expense or tax benefit is recorded on a separate company basis.

Deferred Tax Assets and Liabilities

Certain items are reported in different periods for financial reporting and income tax purposes. Deferred tax assets and liabilities were recorded in recognition of these differences.

Item 8. Financial Statements and Supplementary Data. (continued)

4. INCOME TAXES (continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities were as follows:

	December 31, 1996	December 31, 1995
	($ in millions)	
Deferred tax assets:		
Reserves, including casualty and other claims	$ 148.3	$ 161.6
Employee benefits	147.7	158.7
Retiree health and death benefit obligation	137.2	138.1
Taxes, including state and property	163.1	157.1
Other	1.1	1.2
Total gross deferred tax assets	597.4	616.7
Less valuation allowance	(0.6)	(0.5)
Net deferred tax assets	596.8	616.2
Deferred tax liabilities:		
Property	(2,839.0)	(2,760.3)
Unrealized holding gains	(220.0)	(219.0)
Other	(36.0)	(44.7)
Total gross deferred tax liabilities	(3,095.0)	(3,024.0)
Intercompany federal tax payable - net	(292.5)	(254.7)
Net deferred tax liability	(2,790.7)	(2,662.5)
Net current deferred tax assets	95.3	98.8
Net long-term deferred tax liability	$ (2,886.0)	$ (2,761.3)

Except for amounts for which a valuation allowance is provided, Management believes the deferred tax assets will be realized. The net change in the total valuation allowance was a $0.1 million increase for 1996, a $0.1 million decrease for 1995 and a $1.4 million decrease for 1994.

Internal Revenue Service (IRS) Reviews

Consolidated federal income tax returns have been examined and Revenue Agent Reports have been received for all years up to and including 1992. The consolidated federal income tax returns for 1993 and 1994 are being audited by the IRS. Management believes that adequate provision has been made for any additional taxes and interest thereon that might arise as a result of these examinations.

Item 8. Financial Statements and Supplementary Data. (continued)

4. INCOME TAXES (continued)

Tax Benefit Leases

In January 1995, the United States Tax Court issued a preliminary decision that would disallow some of the tax benefits a subsidiary of NS Rail purchased from a third party pursuant to a safe harbor lease agreement in 1981. Management continues to believe that NS Rail ultimately should incur no loss from this decision, because the lease agreement provides for full indemnification if any such disallowance is sustained.

5. INVESTMENTS

	December 31, 1996	December 31, 1995
	($ in millions)	
Marketable equity securities at fair value (Note 14)	$ 639.0	$ 576.2
Corporate-owned life insurance at net cash surrender value	213.2	176.6
Other	18.5	18.2
Total	$ 870.7	$ 771.0

6. PROPERTIES

	December 31, 1996	December 31, 1995
	($ in millions)	
Transportation property:		
Road	$ 8,405.0	$ 8,151.7
Equipment	4,664.7	4,586.8
Other property	79.3	84.2
	13,149.0	12,822.7
Less: Accumulated depreciation	4,134.1	4,072.3
Net properties	$ 9,014.9	$ 8,750.4

Capitalized Interest

Total interest cost incurred on debt in 1996, 1995 and 1994 was $45.8 million, $47.0 million and $46.1 million, respectively, of which $11.9 million, $14.0 million and $17.8 million was capitalized.

Item 8. Financial Statements and Supplementary Data. (continued)

7. CURRENT LIABILITIES

	December 31, 1996	December 31, 1995
	($ in millions)	
Accounts payable:		
Accounts and wages payable	$ 227.4	$ 255.3
Casualty and other claims	165.4	163.6
Vacation liability	75.0	72.5
Equipment rents payable - net	60.9	62.0
Other	21.1	13.8
Total	$ 549.8	$ 567.2
Other current liabilities:		
Prepaid amounts on forwarded traffic	$ 62.7	$ 69.7
Interest payable	14.4	23.7
Retiree health and death benefit obligation (Note 13)	23.2	24.5
Other	8.7	6.4
Total	$ 109.0	$ 124.3

8. DEBT

Short-Term Debt

Short-term debt consists of $27.2 million of notes assumed in connection with the 1990 acquisition of a coal terminal facility.

Capital Lease Obligations

During 1996 and 1995, NS Rail entered into capital leases covering new locomotives. The related capital lease obligations totaling $107.8 million in 1996 and $104.5 million in 1995 were reflected in the Consolidated Balance Sheets as debt and, because they were non-cash transactions, were excluded from the Consolidated Statements of Cash Flows. The lease obligations carry an average stated interest rate of 6.5% for those entered into in 1996 and 8.4% for those entered into in 1995. All were converted to variable rate obligations using interest rate swap agreements. The interest rates on these obligations are based on the six-month London Interbank Offered Rate and are reset every six months with changes in interest rates accounted for as an adjustment of interest expense over the terms of the leases. As a result, NS Rail is exposed to the market risk associated with fluctuations in interest rates. To date, while such rate fluctuations have been nominal, their effects have been favorable. Counterparties to the interest rate swap agreements are major financial institutions believed by Management to be credit-worthy. NS Rail's use of interest rate swaps has been limited to those discussed above.

Item 8 Financial Statements and Supplementary Data. (continued)

8. DEBT (continued)

Long-Term Debt

	December 31, 1996	1995
	($ in millions)	
Equipment obligations at an average rate of 7.8% maturing to 2009	$ 392.9	$ 439.5
Capitalized leases at an average rate of 5.9% maturing to 2015	197.0	100.9
Other debt at an average rate of 5.4% maturing to 2015	8.0	34.0
Total long-term debt	597.9	574.4
Less: Current maturities	54.3	79.7
Long-term debt less current maturities	$ 543.6	$ 494.7

Long-term debt matures as follows:

1998	$ 55.5
1999	127.2
2000	57.7
2001	51.8
2002 and subsequent years	251.4
Total	$ 543.6

A substantial portion of NS Rail's properties and certain investments in affiliated companies are pledged as collateral for much of the debt.

Item 8. Financial Statements and Supplementary Data. (continued)

9. LEASE COMMITMENTS

NS Rail is committed under long-term lease agreements, which expire on various dates through 2067, for equipment, lines of road and other property. Future minimum lease payments are as follows:

	Operating Leases	Capital Leases
	($ in millions)	
1997	$ 53.6	$ 28.6
1998	49.3	28.6
1999	37.4	28.6
2000	31.9	28.5
2001	30.3	28.0
2002 and subsequent years	637.0	143.1
Total	$ 839.5	285.4
Less imputed interest on capital leases at an average rate of 7.4%		88.4
Present value of minimum lease payments included in debt		$ 197.0

Operating Lease Expense

	1996	1995	1994
	($ in millions)		
Minimum rents	$ 64.7	$ 58.9	$ 46.7
Contingent rents	38.3	36.0	45.4
Total	$ 103.0	$ 94.9	$ 92.1

Item 8. Financial Statements and Supplementary Data. (continued)

10. OTHER LIABILITIES

	December 31, 1996	December 31, 1995
	($ in millions)	
Casualty and other claims	$ 247.3	$ 257.3
Net pension obligation (Note 12)	81.9	93.9
Retiree health and death benefit obligation (Note 13)	283.2	283.5
Other	273.6	236.1
Total	$ 886.0	$ 870.8

11. STOCK

Preferred

There are 10,000,000 shares of no par value serial preferred stock authorized. This stock may be issued in series from time to time at the discretion of the Board of Directors with any series having such voting and other powers, dividends and other preferences as deemed appropriate at the time of issuance. At December 31, 1996 and 1995, 1,197,027 shares of $2.60 Cumulative Preferred Stock, Series A (Series A Stock) were issued, and 1,096,907 shares were held other than by subsidiaries. The Series A Stock has a $50 per share stated value. The Series A Stock is callable at any time at $50 per share plus accrued dividends and has one vote per share on all matters, voting as a single class with holders of other stock.

In June 1989, NS announced its intention to purchase up to 250,000 shares of the outstanding Series A Stock during the subsequent two-year period. Since then, NS extended the stock purchase program through 1996. NS had purchased 176,608 shares at a total cost of approximately $6.7 million as of December 31, 1996. NS purchased the shares in regular brokerage transactions on the open market at prevailing prices. At year end 1996 and 1995, NS held 176,703 shares and 122,923 shares, respectively.

Preference

There are 10,000,000 shares of no par value serial preference stock authorized. None of these shares has been issued.

Common

There are 50,000,000 shares of no par value common stock with a stated value of $10 per share authorized. NS owns all 16,668,997 shares issued and outstanding at December 31, 1996 and 1995.

Item 8. Financial Statements and Supplementary Data. (continued)

12. PENSION PLANS

NS Rail's defined benefit pension plans, which principally cover salaried employees, are part of NS' retirement plans. Pension benefits are based primarily on years of creditable service with NS and its participating subsidiary companies and compensation rates near retirement. Contributions to the plans are made on the basis of not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. Assets in the plans consist mainly of common stocks. The following data relate principally to NS Rail's portion of the combined NS plans.

Pension Cost (Benefit) Components

	1996	1995	1994
	($ in millions)		
Service cost-benefits earned during the year	$ 12.3	$ 9.6	$ 10.2
Interest cost on projected benefit obligation	67.1	65.1	59.9
Actual return on assets in plan	(170.3)	(257.0)	(16.6)
Net amortization and deferral	83.4	172.1	(62.9)
Net pension benefit	(7.5)	(10.2)	(9.4)
Cost of early retirement benefits	--	23.4	--
Total	$ (7.5)	$ 13.2	$ (9.4)

Pension cost is determined based on an actuarial valuation that reflects appropriate assumptions as of the beginning of each year. The funded status of the plans is determined using appropriate assumptions as of each year end. A summary of the major assumptions follows:

	1996	1995	1994
Discount rate for determining funded status	7.75%	7.25%	8.50%
Future salary increases	5.25%	6%	6%
Return on assets in plans	9%	9%	9%

Item 8. Financial Statements and Supplementary Data. (continued)

12. PENSION PLANS (continued)

The funded status of the plans and the amounts reflected in the accompanying balance sheets were as follows:

	December 31,			
	1996		1995	
	Funded Plans	Unfunded Plans	Funded Plans	Unfunded Plans
	($ in millions)			
Actuarial present value of benefit obligations:				
Vested benefits	$ 758.6	$ 58.8	$ 788.2	$ 50.8
Non-vested benefits	1.2	--	0.1	--
Accumulated benefit obligation	759.8	58.8	788.3	50.8
Effect of expected future salary increases	68.1	5.6	115.3	11.5
Projected benefit obligation	827.9	64.4	903.6	62.3
Fair value of assets in plans	1,157.7	--	1,060.6	--
Funded status	329.8	(64.4)	157.0	(62.3)
Unrecognized initial net asset	(30.2)	--	(36.9)	--
Unrecognized (gain) loss	(343.3)	20.9	(179.2)	20.9
Unrecognized prior service cost	2.1	3.2	2.8	3.8
Net pension liability included in the balance sheets	$ (41.6)	$ (40.3)	$ (56.3)	$ (37.6)

Early Retirement Program in 1995

During 1995, NS completed a voluntary early retirement program for certain salaried employees. The principal benefit for those who participated in this program was enhanced pension benefits, which are reflected in the accumulated benefit obligation. The charge for the 272 employees who accepted the offer is included in "Compensation and benefits" expense and totaled $33.6 million (including $8.3 million related to postretirement benefits other than pensions).

Item 8. Financial Statements and Supplementary Data. (continued)

12. PENSION PLANS (continued)

401(k) Plans

NS Rail provides 401(k) savings plans for employees. Under the plans, NS Rail matches a portion of employee contributions, subject to applicable limitations. NS Rail's expenses under these plans were $8.0 million, $6.9 million and $5.0 million in 1996, 1995 and 1994, respectively.

13. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

NS Rail provides specified health care and death benefits to eligible retired employees and their dependents by participating in welfare benefit plans sponsored by NS. Under the present plans, which may be amended or terminated at NS' option, a defined percentage of health care expenses is covered, reduced by any deductibles, co-payments, Medicare payments and, in some cases, coverage provided by other group insurance policies. The cost of such health care coverage to a retiree may be determined, in part, by the retiree's years of creditable service with NS and its participating subsidiary companies prior to retirement. Death benefits are determined based on various factors, including, in some cases, salary at time of retirement.

NS Rail continues to fund benefit costs principally on a pay-as-you-go basis. However, in 1991, NS established a Voluntary Employee Beneficiary Association (VEBA) account to fund a portion of the cost of future health care benefits for its retirees and those of its participating subsidiary companies. The last corporate contribution to the VEBA was $10 million in 1994.

Effective January 1, 1994, NS amended the attribution period for postretirement health care benefits. The amendment generally provides for benefits to be determined ratably over a 10-year period based on creditable service commencing at age 45, or from date of hire if employment began after age 45. The amendment reduced the accumulated postretirement health care benefit obligation by $80 million, which will be amortized as a reduction in annual cost on a pro rata basis over a six-year period.

A summary of the postretirement benefit cost follows:

	1996	1995	1994
	($ in millions)		
Service cost-benefits attributable to service during the year	$ 10.0	$ 9.1	$ 13.1
Interest cost on accumulated postretirement benefit obligation	24.1	27.2	23.8
Actual return on plan assets	(13.7)	(17.5)	--
Net amortization and deferral	(4.0)	1.9	(13.9)
Net postretirement benefit cost	16.4	20.7	23.0
Cost of early retirement benefits	--	8.3	--
Total	$ 16.4	$ 29.0	$ 23.0

Item 8. Financial Statements and Supplementary Data. (continued)

13. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (continued)

The following table sets forth these plans' total accumulated postretirement benefit obligation, reconciled with the accrued postretirement benefit obligation:

	December 31,			
	1996		1995	
	Health Care Benefits	Death Benefits	Health Care Benefits	Death Benefits
	($ in millions)			
Accumulated post-retirement benefit obligation:				
Retirees	$ 162.8	$ 82.3	$ 216.1	$ 82.8
Fully eligible active plan participants	20.6	7.0	21.4	7.8
Other active plan participants	41.8	11.9	47.3	12.6
Total	225.2	101.2	284.8	103.2
Plan assets at fair value	85.8	--	72.1	--
Funded status	(139.4)	(101.2)	(212.7)	(103.2)
Unrecognized loss (gain)	(26.7)	(2.3)	52.2	4.7
Unrecognized prior service cost (benefit)	(36.8)	--	(49.0)	--
Accrued post-retirement benefit obligation	$ (202.9)	$ (103.5)	$ (209.5)	$ (98.5)

For measurement purposes, a 10.4% increase in the per capita cost of covered health care benefits was assumed for 1997. The rate was assumed to decrease gradually to an ultimate rate of 5.5% and remain at that level for 2005 and thereafter. The health care cost trend rate has a significant effect on the amounts reported in the financial statements. To illustrate, increasing the assumed trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1996, by about $25 million and the aggregate of the service and interest cost components of net postretirement benefit cost for the year 1996 by about $4 million.

The weighted-average discount rate used in determining the accumulated postretirement benefit obligation, the salary increase assumption and the long-term rate of return on plan assets are the same as those used for the pension plans (see table of rate assumptions in Note 12).

Item 8. Financial Statements and Supplementary Data. (continued)

13. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (continued)

The VEBA trust holding the plan assets is not expected to be subject to federal income taxes, as the assets are invested entirely in trust-owned life insurance.

Under collective bargaining agreements, NS Rail and certain subsidiaries participate in a multiemployer benefit plan, which provides certain postretirement health care and life insurance benefits to eligible union employees. Premiums under this plan are expensed as incurred and amounted to $3.6 million, $3.7 million and $4.8 million in 1996, 1995 and 1994, respectively.

14. FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable," "Short-term debt" and "Accounts payable" approximate carrying values because of the short maturity of these financial instruments.

The fair value of long-term "Investments" approximated $943 million and $837 million at December 31, 1996 and 1995, respectively (see Note 5 for carrying values of "Investments"). The fair value of corporate-owned life insurance approximates carrying value. Quoted market prices were used to determine the fair value of marketable securities which, beginning in 1994 (see Note 1, "Required Accounting Changes"), were recorded at fair value. Carrying value adjustments, which are non-cash transactions, are not included in the Consolidated Statement of Cash Flows. Underlying net assets were used to estimate the fair value of other investments.

Under SFAS 115, NS Rail increased the reported carrying value of short-term and long-term investments classified as "available for sale" as follows:

	December 31,			
	1996		1995	
	Short-term Securities	Equity Securities	Short-term Securities	Equity Securities
	($ in millions)			
Cost	$ 335.0	$ 20.6	$ 242.2	$ 20.6
Gross unrealized holding gain (loss)	(0.6)	618.4	0.7	555.6
Fair value	$ 334.4	$ 639.0	$ 242.9	$ 576.2

The short-term securities are principally U.S. Treasury securities. Equity securities consist almost entirely of 7,252,634 shares of NS Common Stock.

The change in the unrealized holding gain was $61.5 million for 1996 and $138.8 million for 1995. These changes primarily reflect changes in the NS stock price. As a result, stockholder's equity increased $60.5 million in 1996 and $84.2 million in 1995.

The fair value of "Long-term debt," including current maturities, approximated $627 million at December 31, 1996, and $606 million at December 31, 1995. The fair values of debt were estimated based on quoted market prices or discounted cash flows using current interest rates for debt with similar terms, company rating and remaining maturity (see Note 8 for carrying values of "Long-term debt"). The fair value of interest rate swaps is immaterial.

Item 8. Financial Statements and Supplementary Data. (continued)

15. NW--SUMMARIZED CONSOLIDATED FINANCIAL INFORMATION

NW is operated as an integral part of NS Rail. Revenues are allocated to NW based on actual traffic movements as determined by revenue ton miles within market groups. Expenses are allocated to NW based on appropriate criteria for the type of expense. The costs of functions performed by NS, the parent holding company of NS Rail, are also allocated to its rail operating subsidiaries.

NORFOLK AND WESTERN RAILWAY COMPANY AND SUBSIDIARIES
Summarized Consolidated Statements of Income

	Years ended December 31,		
	1996	1995	1994
	($ in millions)		
Railway operating revenues	$ 1,958.6	$ 1,911.3	$ 1,858.1
Railway operating expenses	1,351.6	1,402.6	1,382.7
Income from railway operations	607.0	508.7	475.4
Other - net	49.8	38.8	25.8
Income before income taxes	656.8	547.5	501.2
Provision for income taxes	228.4	186.8	175.1
Net income	$ 428.4	$ 360.7	$ 326.1

NORFOLK AND WESTERN RAILWAY COMPANY AND SUBSIDIARIES
Summarized Consolidated Balance Sheets

	As of December 31,	
	1996	1995
	($ in millions)	
Assets		
Current assets	$ 353.4	$ 298.3
Noncurrent assets	5,631.2	4,778.2
Total assets	$ 5,984.6	$ 5,076.5
Liabilities and Stockholder's Equity		
Current liabilities	$ 205.7	$ 246.2
Noncurrent liabilities	1,812.5	1,603.9
Stockholder's equity	3,966.4	3,226.4
Total liabilities and stockholder's equity	$ 5,984.6	$ 5,076.5

Item 8. Financial Statements and Supplementary Data. (continued)

15. NW--SUMMARIZED CONSOLIDATED FINANCIAL INFORMATION (continued)

On August 1, 1996, NS Rail transferred 5,294,931 shares of NS stock to NW as a contribution to capital. The transfer was recorded at historical cost, and in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," unrealized appreciation was recognized which increased "Noncurrent assets" $478.2 million, "Noncurrent liabilities" $167.4 million, and "Stockholder's equity" $310.8 million.

16. COMMITMENTS AND CONTINGENCIES

Proposed Acquisition of Conrail by NS

On October 23, 1996, NS announced its intention to commence an all-cash tender offer for all shares of Conrail Inc. (Conrail), a Pennsylvania corporation. On October 24, 1996, Atlantic Acquisition Corporation, a Pennsylvania corporation and a wholly owned subsidiary of NS, offered to purchase all outstanding shares of Conrail's common stock and Series A ESOP Convertible Junior Preferred Stock (collectively, the Shares), including, in each case, the associated Common Stock Purchase Rights, at a price of $100 per Share--approximately $9.1 billion in the aggregate. Shares tendered in the offer or acquired in any subsequent merger would be held in a voting trust pending regulatory approval by the STB. The offer followed the October 15 announcement that Conrail had entered into a merger agreement with CSX Corporation (CSX), whereby Conrail stockholders would receive $92.50 in cash per Share for up to 40 percent of their Shares and receive CSX common stock for the balance of their Shares. On November 6, 1996, CSX and Conrail announced that CSX had raised the cash portion of its offer to $110 per Share and left unchanged the ratio pursuant to which certain Conrail stockholders would receive shares of CSX common stock. On November 8, 1996, NS announced that it had increased its all-cash offer to $110 per Share--approximately $10.0 billion in the aggregate. On December 19, 1996, CSX and Conrail announced that CSX was adding preferred stock (convertible into CSX common stock) to its offer--a feature said to be worth $16 per Share. On December 20, NS increased its all-cash offer to $115 per Share--approximately $11 billion in the aggregate--and on January 13, 1997, NS announced that it would offer to purchase up to 8.2 million Shares (approximately 9.9%), the approximate maximum number of Shares NS can buy without triggering Conrail's current anti-takeover defenses, for $115 per Share, if Conrail stockholders disapproved at a special meeting certain management recommendations designed to facilitate the merger with CSX.

At that special meeting on January 17, 1997, Conrail stockholders did disapprove those recommendations. Accordingly, on January 22, 1997, NS amended its pending all-cash tender offer by reducing the number of Shares sought to 8.2 million; on February 11, 1997, it acquired 8.2 million Shares for a total of $943 million, pursuant to that amended offer. These Shares have been placed in a voting trust and under certain circumstances might have to be sold at a loss. The Conrail board repeatedly has affirmed its commitment to a merger with CSX.

On February 12, 1997, NS commenced a second tender offer for the remaining Shares. NS' second tender offer is conditioned upon, among other things, the valid tender of at least Shares sufficient, with those already owned by NS, to constitute at least a majority of the Shares on a fully diluted basis, Subchapter 25F of Pennsylvania's Business Corporation Law not being applicable to the offer, Conrail's Rights Agreement (or poison pill) having been redeemed or otherwise made inapplicable to NS' tender offer, the merger agreement between CSX and Conrail having been terminated in accordance with its terms or otherwise, and other conditions. NS has received a favorable opinion from the STB regarding the use of a voting trust and has obtained sufficient financing commitments (see "NS Debt Commitments").

Item 8. Financial Statements and Supplementary Data. (continued)

16. COMMITMENTS AND CONTINGENCIES (continued)

The STB has proposed a schedule for handling Conrail control applications which could result in an STB decision in late 1997 or early 1998. If the STB does not approve NS' application or if NS deems any conditions imposed by the STB too onerous, NS would have the right and obligation to sell all Shares held in the voting trust. Such a disposition could result in a significant loss.

Through December 31, 1996, NS had incurred $76 million of costs associated with the proposed acquisition.

See also Note 17.

NS Debt Commitments

In connection with the proposed acquisition of Conrail, NS has secured debt commitments sufficient for the tender offer and subsequent merger. The commitments expire on August 1, 1997, except for a portion of a revolving credit facility expiring on August 1, 1998. The total commitment fees will approximate $200 million if the entire facility is used. At December 31, 1996, NS had incurred $57 million of commitment fees.

In connection with the purchase of the 8.2 million Shares, NS arranged for commercial paper debt in an aggregate amount not to exceed $1.0 billion. All or part of this amount could be refinanced either by issuing additional commercial paper or through drawing on the debt commitment that has been arranged in connection with the all-cash $115 per share tender offer for all Shares.

Lawsuits

Norfolk Southern Railway Company and certain subsidiaries are defendants in numerous lawsuits relating principally to railroad operations. While the final outcome of these lawsuits cannot be predicted with certainty, it is the opinion of Management, after consulting with its legal counsel, that the amount of NS Rail's ultimate liability will not materially affect NS Rail's consolidated financial position.

Environmental Matters

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

As of December 31, 1996, NS Rail's balance sheet included a reserve for environmental exposures in the amount of $53 million (of which $12 million is accounted for as a current liability), which is NS Rail's estimate of the probable costs at 111 identified locations based on available information. On that date, nine sites accounted for $19 million of the reserve, and no individual site was considered to be material. NS Rail anticipates that the majority of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At many of the 111 locations, Norfolk Southern Railway and/or certain of its subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for clean-up costs.

Item 8. Financial Statements and Supplementary Data. (continued)

16. COMMITMENTS AND CONTINGENCIES (continued)

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

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

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

Change-in-Control Arrangements

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

Capital Expenditure Commitment

In connection with a long-term transportation contract entered into during 1996, NS Rail has committed to construct and operate four motor vehicle distribution centers. These facilities are scheduled for completion in 1998.

Debt Guarantees

As of December 31, 1996, NS Rail and certain of its subsidiaries are contingently liable as guarantors with respect to $48.7 million of indebtedness of related entities.

Item 8. Financial Statements and Supplementary Data. (continued)

17. EVENTS SUBSEQUENT TO THE DATE OF THE INDEPENDENT AUDITORS' REPORT-CONRAIL DEVELOPMENTS (UNAUDITED)

Pursuant to an amendment to the merger agreement between CSX and Conrail announced on March 7, 1997, CSX has offered to purchase all Shares for $115 per Share in cash and CSX is permitted to enter into negotiations with other parties, including NS, concerning the acquisition of the securities or assets, or concessions relating to the assets or operations, of Conrail. NS and CSX are negotiating a comprehensive resolution of the issues confronting the eastern railroads based on the proposal submitted by NS to both CSX and Conrail on February 24, 1997. Such a resolution could involve a joint acquisition of Shares by NS and CSX. However, unless and until such negotiations are successfully concluded, NS intends to continue in effect its tender offer for all Shares not owned by NS.

INDEPENDENT AUDITORS' REPORT

The Stockholders and Board of Directors
Norfolk Southern Railway Company:

We have audited the consolidated financial statements of Norfolk Southern Railway Company and subsidiaries as listed in the index in Item 8. In connection with our audits of the consolidated financial statements, we have also audited the consolidated financial statement schedule listed in Item 14(a)2. These consolidated financial statements and this consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and this consolidated financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norfolk Southern Railway Company and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1996, in conformity with generally accepted accounting principles. Also, in our opinion, the related consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth herein.

/s/ KPMG Peat Marwick LLP

Norfolk, Virginia
January 28, 1997, except as to the second and third paragraphs of Note 16, which are as of February 12, 1997

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

None.

PART III

Item 10. Directors and Executive Officers of the Registrant.

Item 11. Executive Compensation.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

and

Item 13. Certain Relationships and Related Transactions.

In accordance with General Instruction G(3), the information called for by Part III is incorporated herein by reference from Norfolk Southern Railway's definitive Proxy Statement, to be dated April 15, 1997, for the Norfolk Southern Railway Annual Meeting of Stockholders to be held on May 27, 1997, which definitive Proxy Statement will be filed electronically with the Commission pursuant to Regulation 14A. The information regarding executive officers called for by Item 401 of Regulation S-K is included in Part I hereof beginning on page 18 under "Executive Officers of the Registrant."

PART IV

Item 14. Exhibits, Financial Statement Schedule, and Reports on Form 8-K.

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

1. Index to Consolidated Financial Statements:

2. Financial Statement Schedule:

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

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

3. Exhibits

Exhibit Number	Description
3	Articles of Incorporation and Bylaws -
3(i)	The amended Restated Articles of Incorporation of Norfolk Southern Railway Company are incorporated herein by reference from Exhibit 3(a) of Norfolk Southern Railway's 1990 Annual Report on Form 10-K.

Item 14. Exhibits, Financial Statement Schedule, and Reports on Form 8-K. (continued)

Exhibit Number	Description
3(ii)	The Bylaws of Norfolk Southern Railway Company, as last amended March 3, 1993, are incorporated herein by reference from Exhibit 3(b) of Norfolk Southern Railway's 1992 Annual Report on Form 10-K.
4	Instruments Defining the Rights of Security Holders, Including Indentures - In accordance with Item 601(b)(4)(iii) of Regulation S-K, copies of instruments of Norfolk Southern Railway and its subsidiaries with respect to the rights of holders of long-term debt are not filed herewith, or incorporated by reference, but will be furnished to the Commission upon request.
10	Material Contracts - (a) The Supplementary Agreement, entered into as of January 1, 1987, between the Trustees of the Cincinnati Southern Railway and The Cincinnati, New Orleans and Texas Pacific Railway Company (the latter a wholly owned subsidiary of Norfolk Southern Railway) - extending and amending a Lease, dated as of October 11, 1881 (both the Lease and Supplementary Agreement, formerly incorporated by reference from Exhibit 10(b) to Southern's 1987 Annual Report on Form 10-K) - is incorporated herein by reference from Exhibit 10(a) to Norfolk Southern Railway's 1994 Annual Report on Form 10-K.
21	Subsidiaries of the Registrant.
27	Financial Data Schedule.

(b) Reports on Form 8-K.

No reports on Form 8-K were filed for the three months ended December 31, 1996.

(c) Exhibits.

The Exhibits required by Item 601 of Regulation S-K as listed in Item 14(a)3 are filed herewith or incorporated herein by reference.

Item 14. Exhibits, Financial Statement Schedule, and Reports on Form 8-K. (continued)

Exhibit Number	Description
(d)	Financial Statement Schedules.
	Financial statement schedules and separate financial statements specified by this Item are included in Item 14(a)2 or are otherwise not required or are not applicable.

POWER OF ATTORNEY

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Norfolk Southern Railway Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 17th day of March, 1997.

NORFOLK SOUTHERN RAILWAY COMPANY

By /s/ David R. Goode

(David R. Goode, President and Chief Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on this 17th day of March, 1997, by the following persons on behalf of Norfolk Southern Railway Company and in the capacities indicated.

Signature	Title
/s/ David R. Goode (David R. Goode)	President and Chief Executive Officer and Director (Principal Executive Officer)
/s/ John P. Rathbone (John P. Rathbone)	Vice President and Controller (Principal Accounting Officer)
/s/ Henry C. Wolf (Henry C. Wolf)	Vice President-Finance (Principal Financial Officer)

Signature	Title
/s/ James C. Bishop, Jr. --------------------------- (James C. Bishop, Jr.)	Director
/s/ Jon L. Manetta --------------------------- (Jon L. Manetta)	Director
/s/ L. I. Prillaman --------------------------- (L. I. Prillaman)	Director
/s/ Stephen C. Tobias --------------------------- (Stephen C. Tobias)	Director
/s/ Henry C. Wolf --------------------------- (Henry C. Wolf)	Director

STB FD 33388 6-23-97 A 180274V7A 5/10

Schedule II
Page 1 of 2

Norfolk Southern Railway Company and Subsidiaries

Valuation and Qualifying Accounts
Years Ended December 31, 1994, 1995 and 1996
(In millions of dollars)

	Beginning Balance	Additions charged to Expenses	Additions charged to Other Accounts	Deductions	Ending Balance
Year ended December 31, 1994					
Valuation allowance (included net in deferred tax liability) for deferred tax assets	$ 2.0	$ --	$ --	$ 1.4	$ 0.6
Casualty and other claims included in other liabilities	$ 277.7	$ 105.3	$ 2.5 (1)	$ 121.3 (2)	$ 264.2
Current portion of casualty and other claims included in accounts payable	$ 155.5	$ 26.8	$ 163.7 (1)	$ 181.9 (3)	$ 164.1
Year ended December 31, 1995					
Valuation allowance (included net in deferred tax liability) for deferred tax assets	$ 0.6	$ --	$ --	$ 0.1	$ 0.5
Casualty and other claims included in other liabilities	$ 264.2	$ 99.5	$ 3.1 (1)	$ 109.5 (2)	$ 257.3
Current portion of casualty and other claims included in accounts payable	$ 164.1	$ 21.1	$ 163.5 (1)	$ 185.1 (3)	$ 163.6

(1) Includes revenue overcharges provided through charges to operating revenues and transfers from other accounts.

(2) Payments and reclassifications to/from accounts payable.

(3) Payments and reclassifications to/from other liabilities.

(continued)

Schedule II
Page 2 of 2

Norfolk Southern Railway Company and Subsidiaries

Valuation and Qualifying Accounts
Years Ended December 31, 1994, 1995 and 1996
(In millions of dollars)

	Beginning Balance	Additions charged to: Expenses	Additions charged to: Other Accounts	Deductions	Ending Balance
Year ended December 31, 1996					
Valuation allowance (included net in deferred tax liability) for deferred tax assets	$ 0.5	$ 0.1	$ --	$ --	$ 0.6
Casualty and other claims included in other liabilities	$ 257.3	$ 115.1	$ 4.0 (1)	$ 129.1 (2)	$ 247.3
Current portion of casualty and other claims included in accounts payable	$ 163.6	$ 15.6	$ 154.5 (1)	$ 168.3 (3)	$ 165.4

(1) Includes revenue overcharges provided through charges to operating revenues and transfers from other accounts.

(2) Payments and reclassifications to/from accounts payable.

(3) Payments and reclassifications to/from other liabilities.

EXHIBIT INDEX

EXHIBIT 21
Page 1 of 1

NAME AND STATE OF INCORPORATION OF SUBSIDIARIES
OF NORFOLK SOUTHERN RAILWAY COMPANY
AS OF MARCH 1, 1997

Airforce Pipeline, Inc., North Carolina
Alabama Great Southern Railroad Company, The; Alabama
Atlantic and East Carolina Railway Company, North Carolina
Camp Lejeune Railroad Company, North Carolina
Central of Georgia Railroad Company, Georgia
Chesapeake Western Railway, Virginia
Cincinnati, New Orleans and Texas Pacific Railway Company, The; Ohio
Citico Realty Company, Virginia
Georgia Southern and Florida Railway Company, Georgia
High Point, Randleman, Asheboro and Southern Railroad Company, North Carolina
Interstate Railroad Company, Virginia
Lamberts Point Barge Company, Inc., Virginia
Memphis and Charleston Railway Company, Mississippi
Mobile and Birmingham Railroad Company, Alabama
Norfolk and Portsmouth Belt Line Railroad Company, Virginia
Norfolk and Western Railway Company, Virginia
North Carolina Midland Railroad Company, The; North Carolina
Rail Investment Company, Delaware
Shenandoah-Virginia Corporation, Virginia
South Western Rail Road Company, The; Georgia
Southern Rail Terminals, Inc., Georgia
Southern Rail Terminals of North Carolina, Inc., North Carolina
Southern Region Coal Transport, Inc., Alabama
Southern Region Materials Supply, Inc., Georgia
Southern Region Motor Transport, Inc., Georgia
State University Railroad Company, North Carolina
Tennessee, Alabama & Georgia Railway Company, Delaware
Tennessee Railway Company, Tennessee
Virginia and Southwestern Railway Company, Virginia
Yadkin Railroad Company, North Carolina

NOTE: Of the above subsidiaries, each of which is more than 50% owned, only Norfolk and Western Railway Company meets the Commission's "significant subsidiary" test on an individual basis.

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]

For the fiscal year ended December 31, 1996

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the Transition Period from ________________ to ____________________

Commission File No. 1-12184

CONRAIL INC.
(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of incorporation or organization)

23 2728514
(I.R.S. Employer Identification Number)

2001 Market Street, Two Commerce Square
Philadelphia, Pennsylvania
(Address of principal executive offices)

19101-1417
(Zip Code)

Registrant's telephone number, including area code (215) 209-4000

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

Title of each class	Name of each exchange on which registered
Conrail Inc. Common Stock (Par Value $1.00) and Common Stock Purchase Rights	New York Stock Exchange Philadelphia Stock Exchange

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Aggregate market value of voting stock held by non-affiliates of the Registrant (as of March 3, 1997): $9,260,302,728

Shares of Common Stock outstanding (as of March 3, 1997): 83,144,397

DOCUMENTS INCORPORATED BY REFERENCE: None

TABLE OF CONTENTS

PART I

Item 1. Business.
and
Item 2. Properties.

GENERAL. Conrail Inc. was incorporated in Pennsylvania on February 12, 1993 and on July 1, 1993 became the holding company of Consolidated Rail Corporation. Consolidated Rail Corporation is Conrail Inc.'s only significant subsidiary and primary asset. Conrail Inc.'s common stock is listed on the New York and Philadelphia Stock Exchanges.

Consolidated Rail Corporation is a Pennsylvania corporation incorporated on February 10, 1976 to acquire, pursuant to the Regional Rail Reorganization Act of 1973, the rail properties of many of the railroads in the northeast and midwest region of the United States which had gone bankrupt during the early 1970's, the largest of which was the Penn Central Transportation Company ("Penn Central").

Reports on Form 10-K for years prior to 1993 were filed by Consolidated Rail Corporation, and historic data presented herein and therein reflect the results of Consolidated Rail Corporation for those time periods. Unless otherwise indicated, references to Conrail prior to July 1, 1993 denote Consolidated Rail Corporation and its consolidated subsidiaries, and references to Conrail after July 1, 1993 denote Conrail Inc. and its consolidated subsidiaries.

PROPOSED MERGER. On October 14, 1996, Conrail, CSX Corporation ("CSX") and a subsidiary of CSX entered into an Agreement and Plan of Merger (as amended, the "Merger Agreement"), pursuant to which Conrail was to be merged with a subsidiary of CSX in a merger-of-equals transaction.

On October 24, 1996, Norfolk Southern Corporation ("Norfolk") commenced an unsolicited tender offer for all outstanding Conrail voting stock at $100 per share in cash. Norfolk has since increased its offer to $115 per share in cash.

On November 20, 1996, CSX concluded its first tender offer and purchased approximately 19.9% of Conrail's outstanding shares for $110 per share.

On December 18, 1996, CSX and Conrail entered into a second amendment to the Merger Agreement (the "Second Amendment") that would, among other things, (i) increase the consideration payable pursuant to the merger, (ii) accelerate the consummation of the merger to immediately following the receipt of applicable shareholder approvals and prior to the Surface Transportation Board ("STB") approval and (iii) extend until December 31, 1998 an exclusivity period during which the Conrail Board agreed not to withdraw or modify its recommendations of the CSX transactions, approve or recommend any takeover proposal or cause Conrail to enter into any agreement related to any takeover proposal.

On January 13, 1997, Norfolk issued a press release announcing that it would offer to purchase shares representing 9.9% of the outstanding shares for $115 per share, in the event that Conrail shareholders did not approve a proposal to opt out of a Pennsylvania statute (the "Opt Out Proposal") at the meeting of shareholders to be held on January 17, 1997 (the "Special Shareholders Meeting").

On January 17, 1997, Conrail shareholders voted at the Special Shareholders Meeting against the Opt Out Proposal.

On February 4, 1997, the amended Norfolk tender offer expired, and Norfolk subsequently purchased approximately 8.2 million Shares pursuant thereto.

On March 7, 1997, Conrail and CSX entered into a Third Amendment (the "Third Amendment") to the Merger Agreement. Pursuant to the Third Amendment, (i) the price per share has been increased from $110 to $115, and the number of shares to be purchased in the tender offer has been increased to all outstanding shares. The tender offer is scheduled to close April 18, 1997 (subject to extension by CSX to June 2, 1997 whether or not the conditions have been satisfied), (ii) the consideration paid per share in the merger for all remaining outstanding shares following consummation of the offer has been increased to $115 in cash and (iii) the conditions to the offer relating to certain provisions of Pennsylvania law becoming inapplicable to Conrail and relating pending governmental actions or proceedings have been deleted.

The Third Amendment also provides that CSX will have sole control over the regulatory approval process and will be free to conduct by itself discussions with other railroads, including Norfolk, relating to competitive issues raised by the CSX transactions, and to enter into any resulting agreement. It is anticipated that CSX and Norfolk will negotiate an appropriate division of Conrail's assets; however, neither the pending CSX tender offer nor the merger is conditioned on CSX's reaching an agreement with Norfolk.

Pursuant to the Third Amendment, three members of Conrail's Board of Directors approved by CSX shall be invited to join the CSX Board of Directors and a transition team will be established, the leadership of which will include senior executive officers of CSX and Conrail to ensure the orderly operation of Conrail during the regulatory approval process and an orderly transition thereafter.

Under the Third Amendment, Conrail and CSX agreed to reduce from December 31, 1998 to December 31, 1997 the period of time during which the Conrail Board is prohibited from (i) withdrawing or modifying, or publicly proposing to withdraw or modify, its approval or recommendation of the CSX transactions, in a manner adverse to CSX, (ii) approving or recommending, or publicly proposing to approve or recommend, any competing proposal or (iii) causing Conrail to enter into any agreement related to any such competing proposal.

Under the Merger Agreement as amended, Conrail may terminate the Merger Agreement in the event that after June 2, 1997, CSX fails to consummate the tender offer for any reason other than the non-occurrence of any condition to the tender offer. In the event that CSX fails to consummate the tender offer under such circumstances, Conrail will be entitled to exercise any additional remedies it may have.

The full terms and conditions of the CSX and Norfolk offers and Conrail's position with respect to the CSX and Norfolk offers are set forth in documents filed by Conrail with the Securities and Exchange Commission.

RAIL OPERATIONS. Conrail, through its wholly-owned subsidiary Consolidated Rail Corporation, provides freight transportation services within the northeast and midwest United States. Conrail interchanges freight with other United States and Canadian railroads for transport to destinations within and outside Conrail's service region. Conrail operates no significant line of business other than the freight railroad business and does not provide common carrier passenger or commuter train service.

Conrail serves a heavily industrial region that is marked by dense population centers which constitute a substantial market for consumer durable and non-durable goods, and a market for raw materials used in manufacturing and by electric utilities. Conrail's traffic levels and, as a result, its financial performance are substantially affected by its ability to compete with trucks and other railroads, the economic strength of the industries and metropolitan areas that produce and consume the freight Conrail hauls and the traffic generated by Conrail's connecting railroads. Conrail remains dependent on non-bulk traffic, which tends to generate higher revenues than bulk commodities, but also involves higher costs and is more vulnerable to truck competition.

The Service Group System. Beginning in 1994, Conrail's Marketing and Sales Department and related segments of its Operating Department were organized into four service groups: CORE Service, Intermodal Service, Unit Train Service and Automotive Service. Petrochemicals and Minerals, food and agriculture products, forest and manufactured products, and metals are handled by the CORE Service Group. The Intermodal Service Group handles intermodal trailers and containers. The Unit Train Service Group handles coal and ore traffic. The Automotive Service Group handles automotive parts and finished vehicles. Each of these groups controls the integrated planning, pricing and operating functions that will enable them to tailor services, develop products and make capital investments directed toward the special requirements of their respective customers.

Revenues for the Service Groups for 1992 through 1996, together with total annual traffic volumes, are set forth in the following tables.

SERVICE GROUPS - REVENUES ($ in Millions)

	Years ended December 31,				
	1996	1995	1994	1993	1992
CORE Service Group(1)					
Revenues(2)	$1,542	$1,557	$1,587	$1,514	$1,468
Percent of total	43.9%	44.5%	44.5%	45.9%	46.0%
Intermodal Service Group					
Revenues(2)	747	701	742	647	597
Percent of total	21.3%	20.0%	20.8%	19.6%	18.7%
Unit Train Service Group					
Revenues(2)	666	659	631	583	673
Percent of total	19.0%	18.8%	17.7%	17.7%	21.1%
Automotive Service Group					
Revenues(2)	543	549	558	505	443
Percent of total	15.5%	15.7%	15.7%	15.3%	13.9%
Total Unassigned Revenue(2)	11	36	46	48	10
	0.3%	1.0%	1.3%	1.5%	0.3%
Total line haul revenue	$3,509	$3,502	$3,564	$3,297	$3,191
Miscellaneous revenue(3)	205	184	169	156	154
Total freight revenue	$3,714	$3,686	$3,733	$3,453	$3,345

(1) Petrochemicals and Minerals	$582	$584	$603	$565	$541
Food and Agriculture	335	353	361	351	347
Forest and Mfg. Products	318	329	326	308	315
Metals	307	291	297	290	265
Total CORE Srv. Grp.	$1,542	$1,557	$1,587	$1,514	$1,468

(2) Revenues for the years 1992 through 1994 have been reclassified to exclude unassigned revenue from Service Group totals to provide more accurate comparisons to the current period.

(3) Includes switching, demurrage and other miscellaneous revenues.

SERVICE GROUPS - VOLUME IN UNITS
(FREIGHT CARS AND INTERMODAL TRAILERS AND CONTAINERS)
(In Thousands)

	Years ended December 31,				
	1996	1995	1994	1993	1992
CORE Service Group (1)	1,235	1,254	1,321	1,302	1,213
Intermodal Service Group	1,584	1,473	1,589	1,355	1,220
Unit Train Service Group	862	862	912	878	964
Automotive Service Group	392	399	396	360	319
Total Volume	4,073	3,988	4,218	3,895	3,716
(1) Petrochemicals and Minerals	350	358	376	374	360
Food and Agriculture	257	265	289	295	284
Forest and Mfg. Products	290	306	318	309	290
Metals	338	325	338	324	279
Total CORE Srv. Grp.	1,235	1,254	1,321	1,302	1,213

CORE Service Group:

In 1996, revenues and volume for this service group declined 1% and 1.6%, respectively, from 1995. Revenue in each of the business units comprising the CORE Service Group declined in 1996, except in the Metals Business Group which experienced revenue growth of 5.4% over 1995.

Petrochemicals and Minerals: This commodity group consists of a wide variety of commodities, including agricultural and organic chemicals, plastic pellets, soda ash, construction minerals, petroleum products and waste. The majority of traffic is joint-line and the primary flows are between Louisiana and Texas, (as originating sources), and Delaware, New Jersey, and Pennsylvania (as destination points). This commodity group's customer base and origin/destination pair mix are both large and diverse, with none occupying a dominant position in terms of Conrail's traffic volume or revenues. Conrail's traffic in this commodity group increased in 1992 and 1993, leveled off in 1994, and declined slightly in 1995 and 1996, with revenue and volume down 0.3% and 2.5% respectively. Revenues from minerals products, which accounted for one-fourth of this group's volume in 1996, declined approximately 5% as the result of several plant closings.

The largest component of this business is chemical traffic, accounting for approximately 44% of the revenue and 38% of the volume in 1996. This traffic includes chlorine, smaller volumes of other hazardous chemicals and non-hazardous substances which, if spilled or released into the atmosphere, could be dangerous and could result in significant liability to Conrail. Under catastrophic circumstances, such liability could exceed Conrail's $300 million in insurance coverage for such accidents. It is impossible to eliminate the risk of such liability; however, Conrail has not experienced any significant liability as a result of an accident involving chlorine or any other such substance. Furthermore, Conrail has safety procedures designed to prevent the occurrence of such accidents, or limit their impact should they occur, and works in concert with chemical manufacturers to reduce the risks in transporting these commodities, subscribing to the policies and procedures defined under Responsible Care partnerships. The year 1996 marked Conrail's first complete year as a Responsible Care partner.

Increasing regulation by federal, state and local governments of the transportation and handling of hazardous and non-hazardous substances and waste has increased the administrative burden and costs of transporting certain commodities in this group.

Food and Agriculture: This commodity group includes fresh and processed food products moving primarily in boxcars, grain, grain products and agricultural chemicals moving in covered hopper and tank cars. Conrail's revenue declined by 5.1% and units declined by 2.8% in 1996 from 1995 levels. In the food commodities area, market share declines of several large customers account for the difference in volume and revenue from 1995 levels. Agriculture volume declined as record grain prices caused domestic users to reduce their use of grain and grain products. The 13.8% revenue decline in grain and grain products is primarily attributable to an increase in grain shippers' use of private cars.

Forest and Manufactured Products: This commodity group includes paper and wood products moving in boxcars, certain lumber and related products moving on flatcars, and general manufactured commodities moving in boxcars. Paper products account for 57% of 1996 revenue for this group, followed by wood products (30%), and manufactured products (13%). A 5.3% volume decline was partially offset by increases in revenue per unit, which yielded a net revenue decrease of 3.3%. High inventories and product prices drove paper receivers to work off existing inventories, reducing rail volume. Most of the inventory adjustments have taken place and shipments are expected to return to normal for 1997.

Metals: This commodity group includes scrap ferrous products and semi-finished, finished and sheet steel. In 1995, this group experienced decreases in revenue and volume due to increased truck competition and selective price increases on low margin business. In 1996, volume increased 4% and revenues grew 5.4% over 1995. Market share gains from new mini-mills located on Conrail, capacity increases due to the acquisition of new coil cars and aggressive business development activity contributed to the year over year growth.

Intermodal Service Group

Conrail continues to be one of the rail industry's leaders in handling intermodal traffic. Volume and revenue increased 7.6% and 6.6%, respectively, in 1996 from 1995. Conrail handled nearly 1.6 million units of intermodal traffic in 1996.

Conrail's intermodal traffic consists of three segments. The first segment is Conrail's parcel/package traffic, which principally involves shipments for the U.S. Postal Service, United Parcel Service and less-than-truck-load companies. Revenue in this segment increased by 7.3% in 1996.

The second segment is domestic traffic, which includes a variety of commodities and customers. Revenue in this segment increased by 7.8% in 1996. Traffic from major truckload companies continued to increase, as did traffic from intermodal marketing companies (or third party freight consolidators and brokers).

International container traffic constitutes the third segment of Conrail's intermodal traffic. International container traffic chiefly involves goods produced in the Pacific Basin and shipped by rail from west coast ports to east coast markets. Conrail and its western railroad connections are able to participate in this traffic because they have established superior transit time compared with the all-water route through the Panama Canal. Conrail also participates in traffic moving through Atlantic ports for import and export trade with European and Mediterranean markets. Revenue from Conrail's international intermodal traffic increased 4.6% in 1996.

In 1996, Conrail opened a new intermodal terminal in Pittsburgh, PA, initiated service from the Ameriport terminal in Philadelphia and reopened its intermodal terminal in Buffalo.

Unit Train Service Group

In 1996, revenues for this service group increased by approximately 1.1%, despite no increase in traffic volume.

Utility coal traffic, which makes up the majority of Conrail's coal business, increased 10.4% with a 13.5% increase in revenue in 1996. Utility coal moves from mines located on and off Conrail's system to electric utilities located on Conrail. Annual traffic volumes fluctuate with the inventory practices of the electric utilities, their use of alternative sources of energy and the weather. The 1996 increase reflects a very cold winter with lower utilization of nuclear units in Conrail's service area.

The utility industry is undergoing a process of deregulation which is changing the competitive environment in this key Conrail market. Deregulation will increase the downward pressure on utility coal transportation rates and increase service requirements as utilities strive to reduce their costs to remain competitive. Deregulation, coupled with more stringent sulfur dioxide emission limits, should help Conrail's lower cost and lower sulfur coal sources in southwestern Pennsylvania and northern West Virginia to remain competitive. Shipments of Conrail-served coal from these areas increased 7.0% in 1996 over 1995.

Export, industrial/cogeneration and metallurgical coal represent the three remaining segments of Conrail's coal traffic, with export coal volumes being one-third greater than industrial/cogeneration volumes and more than twice as great as metallurgical coal volumes.

Export coal traffic volume declined 6% in 1996, after having increased 58% in 1995, due to strong domestic demand for coal which reduced the amount of coal available for the export market.

Conrail's traffic volume and revenue for industrial/cogeneration coal was essentially unchanged from 1995.

Conrail's traffic volume and revenue from metallurgical coal continues to decline, having decreased 38% in 1996 after a decline of 9% in 1995. Revenue in 1996 was down approximately 44%. The large decline in 1996 volume and revenue was due to the loss of a significant customer in the first half of the year. Sixty percent of this business was recovered in June of 1996, although at significantly lower rates.

Conrail serves directly, or via short line switching carriers, many of the nation's largest active integrated steel production facilities. Although a significant portion of the active domestic steel industry is along the Cleveland-Chicago corridor on Conrail's system, the traditional domestic steel industry (using integrated steel production facilities) continues to eliminate inefficient production capacity, which in past years has adversely affected the volume of raw materials for steel production handled by Conrail, and could continue to do so. Volume in this segment is expected to continue to decline in 1997. This trend is continuing as iron ore and coke volume declined 12% in 1996, while revenues declined 3.5%.

Automotive Service Group

Conrail's Automotive Service Group experienced a slight decrease in volume and revenue in 1996, despite continued slow growth in North American Light Vehicle Production, which increased 1% in 1996 over 1995. As a whole, the Automotive Service Group's revenues decreased 1.1%. Finished vehicles revenue increased 1%, and Autoparts experienced a 4% revenue reduction.

General Motor's strike in the Fall of 1996 was the major factor contributing to the group's overall decline in volume and revenue, with a particularly negative impact on the autoparts business.

Continued strong production by the foreign-based domestic manufacturers, and the shift of import traffic from East coast ports to cross-country landbridge shipments, resulted in an increase in finished vehicles traffic, despite the mid-year closing of General Motor's Tarrytown, NY plant and Chrysler's Newark, DE plant.

Certain Statistics. The following tables provide various measurements relating to Conrail's rail operations from 1992 through 1996:

PRODUCTIVITY DATA

	Years ended December 31,				
	1996	1995	1994	1993	1992
Operating ratio (1)...................	83.8%	87.6%	83.8%	82.9%	84.0%
Compensation and benefits ratio.......	32.5%	33.9%	33.7%	35.6%	37.0%
Employees (average)...................	21,280	23,510	24,833	25,406	25,380
Gross ton miles per freight employee hour worked (2)(3)................	4,634	4,352	4,135	3,805	3,746
Gross ton miles per freight train hour (thousands) (2)(3)............	113.4	118.7	113.0	119.0	122.1
Gross ton miles per locomotive in service (millions) (2)(3)...........	114.2	110.1	104.8	102.4	107.1
Gross ton miles per gallon of fuel (2)	773	774	749	745	770

(1) The 1996 operating ratio (operating expenses as a percent of revenues) includes the effect of a one-time $135 million charge for non-union voluntary separation programs and related losses on certain non-cancelable leases. Without this charge, Conrail's operating ratio would have been 79.7%. See Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 3 to the Consolidated Financial Statements elsewhere in this Annual Report. Without the $285 million special charge in 1995, Conrail's operating ratio would have been 79.9%. See Note 10 to the Consolidated Financial Statements elsewhere in this Annual Report. Without the $84 million special charge in 1994, Conrail's operating ratio would have been 81.5%. See Note 11 to the Consolidated Financial Statements elsewhere in this Annual Report.

(2) Excluding subsidiaries, except Consolidated Rail Corporation.

(3) Locomotive weight not included.

QUALITY OF SERVICE DATA(1)

	Years ended December 31,				
	1996	1995	1994	1993	1992
Miles of track under slow order.......	12	43	49	62	73
Locomotive out of service ratio.......	9.4%	9.1%	8.7%	8.3%	8.8%
Freight cars requiring heavy repairs..	5.6%	5.6%	4.9%	4.7%	4.0%
Reportable train accidents	180	141	160	155	148
Cost of loss and damage incidents as a percent of revenue...........	.52%	.47%	.48%	.39%	.39%

(1) Excluding subsidiaries, except Consolidated Rail Corporation.

COMPETITION. Conrail's rail services face significant competition from trucks, from other railroads, and from the availability of the same or substitute goods produced at points not served by Conrail. The trucking industry is especially competitive in Conrail's service area because, among other reasons, freight in this region is moved shorter distances than in the West, and the cost characteristics of the railroad and trucking industries generally make trucks more competitive over shorter distances.

Price and service competition from trucks, while present for all commodities, is especially evident in the movement of intermodal freight, auto parts, and finished steel. Competition from trucks has been increased by the passage of legislation removing certain barriers to entry into the trucking business and allowing the use of wider, longer, and heavier trailers and multiple trailer combinations. Larger trailers and multiple trailer combinations have substantially increased productivity in the trucking industry, and any future legislation permitting further increases in truck capacity could have a substantial adverse effect on the competitiveness of railroads.

Conrail is also subject to competition from other railroads. In most of Conrail's service territory, one or more other railroads can serve customers directly. Elsewhere, the ability to provide joint service with the many short lines whose operations have proliferated throughout the east, and/or in partnership with trucks (for pick-up, delivery, and draying services) allows rail competitors whose tracks do not reach given customers or points to constrain Conrail prices and to compete effectively for movement of the freight. In addition, recent changes in the nature of rail service offerings and in technology have expanded the scope of rail service beyond the physical limitations of lines, which has resulted in increased railroad competition.

An important influence on Conrail's competitive position is regulation by the Federal government. Prior to 1980, regulation significantly inhibited the ability of railroads to respond to increasing customer demands, overall logistics needs, and changing transportation markets. The Staggers Rail Act of 1980 ("Staggers Act") substantially reduced the restrictions of regulation. In particular, railroads were given more opportunity to reduce costs and more freedom to adjust prices and service offerings, which enabled them to compete more effectively. Under the Staggers Act, the former Interstate Commerce Commission ("ICC") deregulated a significant amount of railroad traffic, including intermodal and most boxcar traffic, finished vehicles and numerous other commodities moving in other types of equipment.

The Staggers Act further enhanced railroads' competitive options by permitting the use of railroad-shipper contracts for traffic still regulated, under which the parties can negotiate customer-specific prices, service standards and terms. These contracts generally provide prices lower than tariff rates and many do not guarantee that any given amount of freight will be shipped during their term. As of December 31, 1996, Conrail was a party to 3,362 such contracts for regulated traffic, which Conrail estimates accounted for 29% of its line-haul revenues in 1996. Although some contracts have a term longer than one year, most contracts are for one year or less. The majority of Conrail's multi-year contracts are subject to cost-related adjustments that provide for flat percentage increases. The cost-based provisions in certain of these contracts are tied to indices formerly under the jurisdiction of the ICC. Action to adjust these indices for productivity gains by the railroads has had an adverse impact on Conrail's ability to recover costs under such contracts, which accounted for less than 2% of Conrail's line haul revenues in 1996.

Effective January 1, 1996, pursuant to the ICC Termination Act of 1995, the authority of the ICC to regulate railroads was transferred to the Department of Transportation ("DOT") to be administered by the Surface Transportation Board. The prior regulatory scheme remains substantially intact, with the following significant changes: (1) access to freight railroad tracks by rail operators (both freight and passenger) operating on behalf of local governmental authorities has been eased; (2) some types of abandonments may take appreciably longer; (3) tariffs and most contracts will no longer be filed (other mechanisms are required for advising customers of rates and rate changes); (4) minimum rate levels will no longer be regulated; and (5) DOT will not regulate railroad issuances of securities or assumptions of debt. Other changes will require development of new regulations and/or of a body of precedent before their impact can be fully assessed.

PROPERTY. Conrail directly holds no real property. The only significant property holdings are those of Consolidated Rail Corporation.

As of December 31, 1996, Consolidated Rail Corporation (excluding its subsidiaries) maintained 16,970 miles of track including track for crossovers, turnouts, second main, other main, passing and switch track, on its 10,543 mile route system. Of total route miles, 8,459 are owned, 87 are leased or operated under contract and 1,997 are operated under trackage rights, including approximately 300 miles operated pursuant to an easement over Amtrak's Northeast Corridor. As of December 31, 1996, virtually all track over which at least 10 million gross tons moved annually (5,923 track miles) was heavy-weight rail of at least 127 pounds per yard, and 100% of such track had continuous welded rail. Continuous welded rail reduces track maintenance costs and, in general, permits trains to travel at higher speeds. As of December 31, 1996, Conrail had 8,804 miles of continuous welded rail on track it maintained.

As of December 31, 1996, 83% of the 3,814 track miles maintained for fast freight traffic had a maximum operating speed of 50 MPH or more, and 70% had a maximum operating speed of at least 60 MPH. As of December 31, 1996, approximately 96% of the track over which at least 10 million gross tons moved annually was governed by automatic signal systems. In all, as of December 31, 1996, 7,656 miles of track were controlled by automatic signal systems.

Conrail is engaged in an ongoing process to identify certain under-utilized rail lines and other underperforming assets to avoid future capital costs and to improve its return on assets. Conrail recorded a $285 million charge in 1995 to cover the expected losses upon disposition of approximately 1,800 miles of lines and other assets not required to support Conrail's service. See Note 10 to the Consolidated Financial Statements elsewhere in this Annual Report.

The following table indicates the number of locomotives and freight cars owned (or subject to capitalized leases) and includes 21,435 freight cars used by Conrail under operating leases. These total figures are as of December 31, 1996, and include stored or surplus units, but exclude subsidiaries other than Consolidated Rail Corporation, which have an immaterial number of locomotives and freight cars:

LOCOMOTIVES AND FREIGHT CARS

	Number of Units	
	Total	Stored(1)
LOCOMOTIVES	2,006	122
Road	1,834	78
Switching	172	44

	Total	Surplus(2)
FREIGHT CARS	45,988	6,333
Box	7,855	1,661
Covered Hopper	3,400	315
Open Hopper	11,464	3,265
Gondola	4,459	638
Coil Steel	11,294	0
Multi-Level	6,005	165
Flat and Other	1,511	289

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(1) Serviceable locomotives not required for current operations on December 31, 1996.

(2) Freight cars which did not move during the seven days immediately preceding December 31, 1996 and which were available for loading. The number of surplus freight cars during 1996 fluctuated due to variations in traffic and fleet adjustments.

On December 31, 1996, the average age of Conrail's road locomotives, not including stored-serviceable units, was 11.1 years. The average age of the total locomotive fleet was 15.6 years, and the average age of the total freight car fleet was 22 years.

CAPITAL EXPENDITURES. The following tables provide information concerning capital expenditures from 1992 through 1996:

CAPITAL EXPENDITURES
(In Millions)

	Years ended December 31,				
	1996	1995	1994	1993	1992
Track rehabilitation......	$203	$206	$221	$207	$275
Rolling stock and transportation equipment..	139	170	139	314	57
Other(1).................	136	118	148	129	159
Total....................	$478	$494	$508	$650	$491
Subsidiaries of Consolidated Rail Corporation (included in Total)...................	$ 5	$ 4	$ 3	$ 3	$ 12

(1) Includes communications and signals, bridges and tunnels, computers and telecommunications, and other improvements.

TRACK REHABILITATION

	Years ended December 31,				
	1996	1995	1994	1993	1992
Track miles surfaced......	4,685	3,162	2,749	3,154	3,671
Track miles of rail laid..	241	255	207	201	312
Ties installed (millions).	0.9	1.1	1.1	1.0	1.4

EMPLOYEES AND LABOR. Including subsidiaries, Conrail's average number of employees for 1996 was 21,280. Consolidated Rail Corporation (excluding subsidiaries) averaged 20,761 employees in 1996, 87% of whom are represented by a total of 14 labor organizations and are covered by 22 separate collective bargaining agreements.

Conrail has concluded collective bargaining agreements with organizations representing approximately 66% of its total employees. These agreements contain moratorium clauses providing that they may not be reopened prior to January 1, 2000. However, certain issues remain outstanding with one of the above-mentioned organizations, the Transportation Communications International Union, representing approximately 2,250 Conrail employees. The parties are currently in mediation under the auspices of the National Mediation Board (NMB). In addition, the United Transportation Union, which represents approximately 4,100 Conrail employees, contends that certain issues remain outstanding. The Company disputes this contention and the parties are in mediation.

Conrail is currently in negotiations with organizations representing approximately 22% of its employees. The negotiations with the largest of these organizations, a coalition of the Brotherhood Railroad Carmen and the Transport Workers Union, are currently in mediation. The outcome of these negotiations cannot be predicted at this time. If the NMB eventually concludes that its efforts to resolve the dispute will not be successful, it will proffer binding arbitration. If either side refuses to arbitrate, there is a 30-day "cooling-off" period during which the NMB may make a finding that the dispute threatens "substantially to interrupt interstate commerce to a degree such as to deprive any section of the country of essential transportation service." Such finding is then presented to the President of the United States who has the option of appointing an Emergency Board to investigate the dispute. If the President does not appoint an Emergency Board, the parties are free to resort to self help at the conclusion of the above-mentioned cooling-off period.

If the President does appoint an Emergency Board, the Board has 30 days to investigate the dispute and report its findings. The Emergency Board's findings are non-binding. Although the parties must maintain the status quo for a period of 30 days following the issuance of the Board's report, any party which rejects the Board's findings may thereafter resort to self help. In the event of a strike, Congress has the power to resolve the dispute by enacting legislation, including legislation imposing a labor contract in accordance with the findings of the Emergency Board.

In Conrail's negotiations with four other organizations representing approximately 4% of its employees, the parties have not invoked mediation.

Under a decision by the United States Supreme Court on April 28, 1987, rail unions have the right, under the Railway Labor Act and other federal laws, to engage in secondary picketing against any railroad. As a result, a labor dispute between one railroad and a union can cause a strike to spread to any other railroad, or to all other railroads, whether or not the union has a collective bargaining agreement or a dispute with such other railroads. There is also the potential that railroads may be subject to secondary picketing in the event of a strike in the airline industry, which, like the railroad industry, is subject to the Railway Labor Act.

Should Conrail or its subsidiaries be the subject of a strike or secondary picketing, Conrail's rail operations could be stopped or severely curtailed.

GOVERNMENT REGULATION. Conrail is subject to environmental, safety, and other regulations generally applicable to all businesses, and its rail operations are also regulated by the DOT, the Federal Railroad Administration ("FRA"), state Departments of Transportation and some state and local regulatory agencies.

The DOT has jurisdiction over, among other things, rates charged for certain traffic movements, service levels and freight car rents. It also has jurisdiction over the situations and terms under which one railroad may gain access to another railroad's traffic or facilities, extension or abandonment of rail lines, consolidation, merger, or acquisition of control of rail common carriers and of other carriers by rail common carriers, and labor protection provisions in connection with the foregoing.

Under the Staggers Act, federal regulation of rates and services was reduced. The regulatory scheme, now administered by the Surface Transportation Board, continues the ICC's prior deregulation of rates for intermodal traffic, most boxcar traffic and a series of miscellaneous commodities, including steel and automobiles. In addition, railroads are free to negotiate contracts with shippers setting rates, service standards and the terms for movements of other kinds of traffic. As a result, railroads have greater flexibility in adjusting rates and services to meet revenue needs and competitive conditions. For further discussion of the abolition of the ICC and the effect of the transfer of its regulatory authority to DOT, see "Competition."

The FRA has jurisdiction over safety and railroad equipment standards.

Conrail's rail operations are also subject to a variety of governmental laws and regulations relating to the protection of the environment. In addition to being involved as a potentially responsible party at numerous Superfund sites (see Item 3 - "Legal Proceedings"), Consolidated Rail Corporation is subject to increasing regulation of its transportation and handling of certain hazardous and non-hazardous commodities and waste which has resulted in additional administrative and operating costs. Also, on February 11, 1997, the United States Environmental Protection Agency published in the Federal Register Proposed Rule "Emission Standards for Locomotives and Locomotive Engines". According to the Proposed Rule, locomotive engines (other than those defined as new or remanufactured) may be regulated by the states. Additional investments will likely be required to bring other than new locomotives into compliance, although the timing and amount of the investments will not be determinable until the Rule is adopted. Compliance with existing laws and regulations relating to the protection of the environment has not had a material effect on Conrail's capital expenditures, earnings or competitive condition. (See "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Environmental Matters," and Note 13 to the Consolidated Financial Statements included elsewhere in this Annual Report.)

Item 3. Legal Proceedings. References to Conrail in "Item 3. Legal Proceedings" shall denote Consolidated Rail Corporation unless otherwise expressly noted.

Occupational Disease Litigation. Conrail has been named as a defendant in lawsuits filed pursuant to the provisions of the Federal Employers' Liability Act ("FELA") by persons alleging (1) personal injury or death caused by exposure to asbestos in connection with railroad employment (2) complete or partial loss of hearing caused by exposure to excessive noise in the course of railroad employment; (3) repetitive motion injury in connection with railroad employment; and (4) personal injury or death caused by exposure to deleterious substances (mixed dusts, fumes, chemicals, etc.) As of December 31, 1996, Conrail was a defendant in 559 pending asbestos suits, 545 pending hearing loss suits, 1,318 repetitive motion injury suits and 374 pending deleterious substance suits, and had notice of 1,293 potential asbestosis claims, 2,734 potential hearing loss claims, 2,112 potential repetitive motion injury claims and 56 deleterious substance claims.

Conrail expects to be named as a defendant in a significant number of occupational disease cases in the future.

Norfolk Southern Corp., et al. v. Conrail Inc. On October 23, 1996, Norfolk filed a Complaint for Declaratory and Injunctive Relief (as amended on October 30, 1996, the "Complaint"), with respect to the transactions contemplated by the Merger Agreement, in the United States District Court for the Eastern District of Pennsylvania. Norfolk named CSX, Conrail and certain directors of Conrail as defendants. The Complaint in its currently amended form alleges, among other things, violations of: (1) fiduciary duties by the Conrail Board; (2) Conrail's Articles of Incorporation and By-Laws; and (3) Pennsylvania statutory law.

In addition, Norfolk alleges that the CSX tender offer is coercive and unfair to Conrail shareholders; that certain provisions in the Merger Agreement prohibiting Conrail from changing its recommendation of the transaction or agreeing to a competing transaction, is *ultra vires* and a breach of the Conrail Board's fiduciary duties; and that Conrail and CSX violated disclosure provisions of the federal securities laws relating to tender offers and proxy solicitations through the misrepresentation and omission of material facts.

Norfolk has requested preliminary and permanent injunctive and declaratory relief including, without limitation, an injunction to prevent defendants from: (1) continuing a tender offer for the Conrail shares, (2) taking any action to enforce certain provisions of the Merger Agreement, and (3) failing to take actions necessary to exempt Norfolk's proposal to acquire Conrail from certain provisions of Pennsylvania statutory law.

Conrail believes that the claims set forth by Norfolk are entirely without merit, and on November 12, 1996, Conrail filed a motion to dismiss Norfolk's complaint in its entirety. The Federal District Court and the Third Circuit Court of Appeals have denied Norfolk's requests for the preliminary injunctions.

Punitive Damage Awards in Ohio Crossing Accident Cases. Consolidated Rail Corporation has recently received adverse jury verdicts in three separate crossing accident cases in Ohio: Garrett and Gollihue v. Consolidated Rail Corp.; Wightman v. Consolidated Rail Corp.; and Moore, et al. v. Consolidated Rail Corp. In each case, the jury awarded substantial punitive damages in connection with property damage resulting from the accidents. Collectively, the total punitive damage awards total approximately $30 million, based on property damage that totals less than $5,000. Conrail believes that, ultimately, these awards should not be sustainable due to their failure to bear a reasonable relationship to the amount of physical property damage involved, and has appealed. Ohio law prohibits the award of punitive damages in connection with a wrongful death action.

Structure and Crossing Removal Disputes in Connection With Lines Abandoned Under NERSA. Conrail may be responsible, in whole or in part, for the costs of removal of several hundred overhead and underpass crossings located on railroad lines it has abandoned under NERSA (and, in some instances, responsible for the removal of the lines of railroad themselves as well as appurtenant structures). Conrail's liability for the removal of such lines, crossings and structures will be determined on a case-by-case basis, and is dependent upon the circumstances under which each was constructed, the nature of Conrail's property interest with respect to such structures, the existence of contracts pertaining to such crossings and structures, and applicable federal and state law. Some states have imposed upon Conrail the obligation to remove certain crossings.

Engelhart v. Conrail. In connection with the Special Voluntary Retirement Program offered to certain employees in late 1989 and early 1990, Conrail used surplus funds in its over-funded Supplemental Pension Plan ("Plan") to fund certain aspects of that program. In December 1992, certain former Conrail employees brought suit challenging the use of surplus Plan funds (a) to pay administrative Plan expenses previously paid by Conrail, (b) to fund the Special Voluntary Retirement Program, and (c) to pay life insurance and medical insurance premiums of former employees as improper and unlawful, and alleging that employees who have made contributions to the Plan or its predecessor plans are entitled to share in the surplus assets of the Plan. In August, 1993, the court granted Conrail's Motion to Dismiss the majority of the counts in the complaint, but refused to dismiss the issue of Conrail's use of Plan assets to pay administrative expenses of the Plan, which are estimated to be approximately $40 million at December 31, 1996. Conrail believes that the use of surplus Plan assets for this purpose was lawful and proper. On September 16, 1996, the Judge granted Conrail's motion for summary judgment on all of the claims except for one individual participant claim. Plaintiffs have appealled those claims as to which they received an adverse ruling.

Environmental Litigation. Conrail is subject to various federal, state and local laws and regulations regarding environmental matters. In certain instances, Conrail has received notices of violations of such laws and regulations and either has taken or plans to take appropriate steps to address the problems cited or to contest the allegations of violation. As of December 31, 1996, Conrail had received inquiries from governmental agencies or had been identified, together with other companies, as a potentially responsible party for cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 135 locations throughout the country. However, Conrail, through its own investigations and assessments, believes it may have some potential responsibility at only 61 of these sites. The amounts Conrail has accrued with respect to the proceedings listed below are included in its $55 million accrual for estimated future environmental expenses. (See Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations - Environmental Matters" and Note 13 to the Consolidated Financial Statements included elsewhere in this Annual Report.) The significant environmental proceedings, including Superfund sites, are discussed below.

United States v. Southeastern Pennsylvania Transportation Authority ("SEPTA"), National Railroad Passenger Corporation ("Amtrak"), and Consolidated Rail Corporation. In March 1986, the United States Environmental Protection Agency ("EPA") filed an action in the United States District Court for the Eastern District of Pennsylvania for cost recovery, injunctive relief, and a declaratory judgment against the Company, Southeastern Pennsylvania Transportation Authority ("SEPTA") and National Railroad Passenger Corp. ("Amtrak") under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA" or "Superfund Law"), as amended. In 1990, the Pennsylvania Department of Environmental Resources intervened as a plaintiff. Suit is based on the release or threatened release at the Paoli Railroad Yard, Paoli, Chester County, Pennsylvania, of polychlorinated biphenyls ("PCBs"), a listed hazardous substance under CERCLA.

Pursuant to a series of partial preliminary consent decrees, defendants have performed a series of cleanup actions both on and off-site and have conducted a Remedial Investigation/Feasibility Study ("RI/FS"). Those costs have been shared equally among the three defendants but are subject to reallocation.

The estimated cost of the Company's portion of a remedy proposed by the parties was included in the 1991 special charge and subsequent adjustments to accruals. EPA and the railroad parties have entered into a tentative settlement agreement regarding EPA's claim for past costs, as well as federal and state natural resource damages. As part of the settlement, Amtrak, SEPTA and Conrail have committed to perform the on-site remedy for the rail yard.

United States v. Conrail. The EPA has listed Conrail's Elkhart Yard on the National Priorities List. The EPA contends that chemicals have migrated from the yard and contaminated drinking wells in the area. On February 14, 1990, EPA filed a civil action against Conrail in the U.S. District Court for the Northern District of Indiana seeking recovery of approximately $345,000 for costs incurred in protecting the water supply. In addition, EPA seeks a declaratory judgment against Conrail for all future costs incurred in responding to the release or threatened release of hazardous substances from the site. Conrail believes it is not the sole source and may not be a contributing source to the contamination alleged by EPA.

Conrail filed a third-party action joining Penn Central as a defendant. Conrail and Penn Central have negotiated an interim cost sharing arrangement for the cost of implementing the EPA's 1992 interim record of decision, which is substantially complete. On May 15, 1995 EPA issued an Administrative Order to Conrail and Penn Central requiring the extension of public water hook-up to an additional 700 - 1,000 residences and businesses in the site area. Conrail and Penn Central have agreed that each company would comply with the Order. The cost for providing public water to the remaining residences is estimated to be in excess of $6 million, which will be apportioned between Penn Central and Conrail according to the interim cost sharing arrangement that has been negotiated. Conrail and Penn Central are attempting to negotiate a final settlement with EPA of the matter.

United States v. Consolidated Rail Corp., et al (Berks Superfund Site). Conrail has been identified as the fifth largest generator of waste oil at the Berks Associates Superfund site in Douglasville, Pennsylvania. In addition, Conrail has become aware that it and its predecessor, Penn Central, owned a small portion of land that was leased to the operator of the Berks site. As such, Conrail's liability could increase due to its questionable status as both an owner and a generator. In August 1991, the EPA issued an administrative order against Conrail and thirty-five other entities mandating the implementation of an approximately $2 million partial remedy and filed a complaint in the U.S. District Court for the recovery of approximately $8 million in costs incurred by the government. The parties have negotiated an administrative order with the EPA and have filed an answer to the civil action. A group of potentially responsible parties (including Conrail) undertook compliance with the administrative order. Conrail and the 35 other defendants have filed a third-party complaint against approximately 630 entities seeking contribution for the costs of the remedy and government costs. Conrail, along with other defendants, is negotiating a settlement with the EPA. On June 30, 1993, the EPA issued another administrative order against Conrail and 33 other entities, mandating the remediation of the southern portion of the site. The EPA has requested a feasibility study for the implementation of a less expensive remedy for the southern portion of the site, which remedy would range from approximately $10-$12 million. Conrail's share of such a remedy has not yet been determined. In addition, the PADER has filed a complaint for the recovery of natural resource damages.

United Scrap Lead - Troy, OH. Conrail is a potentially responsible party, along with more than 50 other parties, in the United Scrap Lead federal Superfund action in Troy, Ohio, where substantial quantities of batteries were disposed of over a period of several years. EPA sued Conrail and nine other parties in August 1991 for the recovery of approximately $2,000,000 in past costs. Conrail and other PRP's have commissioned treatability studies. The parties are negotiating over the nature of the remediation to be undertaken at the site. EPA has selected a preferred alternative with an estimated total cost of $33 million, which the PRP group is challenging. Conrail's estimated share of any remedial costs is 8%.

Commonwealth of Massachusetts v. Conrail (Locomotive Emission). On April 21, 1992, the Massachusetts Attorney General filed suit in state court alleging Conrail's violation of the Massachusetts Clean Air Act by allowing diesel engines to idle unnecessarily and/or in excess of thirty (30) minutes. On May 4, 1992, the court entered a preliminary injunction, the terms of which are substantially those embodied in Conrail's existing idling policy. The Attorney General has filed a complaint alleging Conrail's violation of the preliminary injunction. On February 2, 1993, the parties entered into a partial settlement agreement; however, the Attorney General has alleged that Conrail has failed to comply with certain provisions of the settlement. Conrail continues to attempt to settle the matter with the Attorney General's office.

New York State Department of Environmental Conservation Order On Consent (Selkirk Yard). On July 31, 1996, the New York State Department of Environmental Conservation (NYSDEC) served Conrail with a revised draft Order on Consent requiring the payment of a penalty of $250,000 in connection with its inspection of Selkirk Yard. A revised Order was received by Conrail on August 6, 1996, requiring the payment of fines in connection with the 1991 inspection and mandates assessment and remediation of the facility. Conrail is negotiating the terms of the order with NYSDEC.

New York State Department of Environmental Conservation Order on Consent (DeWitt Yard). On November 3, 1994, NYSDEC served Conrail with a Consent Order in connection with the alleged discharge of waste water from DeWitt Yard, Onondaga County, New York into New York state waters. On June 17, 1996, a revised Consent Order was issued to Conrail which added American Financial Group (Penn Central Corp.) as a named responsible party for the payment of penalties and preparation of a Site Assessment and Remediation Plan. Conrail and American Financial Group are negotiating the terms of the Order with NYSDEC.

In the Matter of Conrail, Ashtabula, OH. On September 21, 1994, the EPA filed an Administrative Complaint against Conrail seeking civil penalties of $125,000 for certain alleged violations of its National Pollutants Discharge Emissions System permit. On November 27, 1995, EPA filed a separate Administrative Complaint seeking civil penalties for alleged violations of regulatory requirements pertaining to on-site petroleum storage. Conrail has reached agreement with EPA to jointly settle these matters for $150,000.

Conway Yard, Pittsburgh. In 1991, Conrail received Notices of Violation ("NOV") from the Pennsylvania DER ("PADER") alleging violations of the Clean Streams Act for discharges of oil into the Ohio River. In September 1993, PADER sent to Conrail a draft Consent Order and Agreement requiring a comprehensive site remediation for soil, ground water, surface waters and sediments at the Conway Railyard and requiring the payment of civil fines in connection with violations at the yard. Conrail and PADER continue to negotiate the extent of the investigation and remediation to be undertaken at the yard.

Other. In addition to the above proceedings, Conrail has been named in various legal proceedings arising out of its activities as an employer and as an operator of a freight railroad, including personal injury actions brought by its employees under FELA, as well as administrative proceedings with and investigation by government agencies.

In view of the inherent difficulty of predicting the outcome of legal proceedings, particularly in certain matters described above in which substantial damages are or may be sought, Conrail cannot state what the eventual outcomes of such legal proceedings will be. Certain of these matters, if determined adversely to Conrail, could result in the imposition of substantial damage awards against, or increased costs to, Conrail that could have a material adverse effect on Conrail's results of operations and financial position. Conrail's management believes, however, based on current knowledge, that such legal proceedings will not have a material adverse effect on Conrail's financial position.

Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of security holders during the fourth quarter of 1996.

Executive Officers of the Registrant.

Conrail's officers are elected annually by the Board of Directors at its first meeting held after the meeting of shareholders at which directors are elected, and they hold office until their successors are elected. There are no family relationships among the officers or directors, nor any arrangement or understanding between any officer and any other person pursuant to which the officer was selected. The following table sets forth certain information, as of March 1, 1997, relating to the executive officers of Conrail and Consolidated Rail Corporation. An asterisk (*) indicates that such individual is an officer of Consolidated Rail Corporation only:

Name, Age, Present Position	Business Experience During Past 5 Years
David M. LeVan, 51, Chairman, President and Chief Executive Officer	Present position since May 1996. Served as President and Chief Executive Officer between March 1995 and May 1996. Served as President and Chief Operating Officer between September 1994 and March 1995. Served as Executive Vice President between November 1993 and September 1994. Served as Senior Vice President - Operations between July 1992 and November 1993. Served as Senior Vice President-Operating Systems and Strategies between November 1991 and July 1992.

Cynthia A. Archer, 43, Senior Vice President - Intermodal Service Group	Present position since May 1995. Served as General Manager - Transportation and Customer Service of the Harrisburg Division between February 1994 and May 1995. Served as Assistant Vice President - Food and Agriculture between September 1993 and January 1994. Served as Director - Intermodal Business Development between September 1991 and August 1993.
Ronald J. Conway, 53, Senior Vice President - Operations	Present position since November 1994. Served as Vice President - Operations between September 1994 and November 1994. Served as Vice President - Transportation between July 1994 and September 1994. Served as Vice President - Intermodal Service Group between November 1993 and July 1994. Served as Assistant Vice President - Petrochemicals and Minerals between April 1992 and November 1993.
Timothy P. Dwyer, 47, Senior Vice President - Unit Train Service Group	Present position since November 1994. Served as Vice President - Unit Train Service Group between November 1993 and November 1994. Served as General Manager - Philadelphia Division between April 1992 and November 1993.
John A. McKelvey, 45, Senior Vice President - Finance	Present position since February 1997. Served as Vice President-Service Delivery between January 1996 and February 1997. Served as Vice President - Materials and Purchasing between April 1994 and January 1996. Served as Vice President - Controller between May 1993 and March 1994. Served as Vice President - Treasurer between 1988 and May 1993.

Frank H. Nichols, 50, Senior Vice President - Organizational Performance	Present position since May 1995. Served as Vice President - Human Resources between February 1993 and May 1995. Served as Assistant Vice President - Finance between November 1988 and February 1993.
Timothy T. O'Toole, 41, Senior Vice President - Law and Government Affairs	Present position since February 1997. Served as Senior Vice President-Finance between April 1996 and February 1997. Served as Vice President and Treasurer between April 1994 and April 1996. Served as Vice President and General Counsel between May 1989 and April 1994.
Lester M. Passa, 43, Senior Vice President - Automotive Service Group	Present position since February 1997. Served as Vice President-Logistics and Corporate Strategy between March 1995 and February 1997. Served as Assistant Vice President - Corporate Strategy between February 1993 and March 1995. Served as Director - Intermodal Planning between October 1991 and January 1993.
John P. Sammon, 46, Senior Vice President - CORE Service Group	Present position since November 1994. Served as Vice President - Intermodal between July 1994 and November 1994. Served as Assistant Vice President- Intermodal between January 1988 and July 1994.
George P. Turner, 55, Senior Vice President - Merger Transition	Present position since February 1997. Served as Senior Vice President-Automotive Service Group between November 1994 and February 1997. Served as Vice President - Automotive Service Group between November 1993 and November 1994. Served as Assistant Vice President - Automotive between April 1992 and November 1993.

Bruce B. Wilson, 61, Senior Vice President - Merger	Present position since February 1997. Served as Senior Vice President - Law between April 1987 and February 1997.
Lucy S.L. Amerman, 46, Vice President - Risk Management*	Present position since July 1994. Served as Assistant Vice President - Claims and Litigation between April 1994 and July 1994. Served as General Counsel - Litigation between March 1990 and March 1994.
Dennis A. Arouca, 45, Vice President - Labor Relations*	Present position since May 1994. Served as Partner in the law firm of Pepper Hamilton & Scheetz between February 1986 and May 1994.
Gerald T. Gates, 43, Vice President - Customer Support*	Present position since January 1996. Served as Vice President - Transportation between November 1994 and January 1996. Served as Vice President - Mechanical between December 1993 and November 1994. Served as Assistant Vice President - Operations Planning and Administration between July 1992 and November 1993. Served as General Manager - Indianapolis Division between September 1990 and July 1992.
Hugh J. Kiley, 44, Vice President - Service Design & Planning*	Present position since January 1996. Served as Assistant Vice President - Performance and Process Management between November 1994 and January 1996. Served as Assistant Vice President - Program Management between May 1994 and November 1994. Served as General Manager - National Customer Service Center between November 1990 and May 1994.
Craig R. MacQueen, 44, Vice President - Corporate Communications*	Present position since June 1995. Served as Assistant Vice President - Public Affairs between September 1992 and June 1995. Served as Executive Director - Public Affairs between November 1990 and August 1992.

Donald W. Mattson, 54, Vice President - Controller	Present position since April 1994. Served as Vice President - Treasurer between May 1993 and April 1994. Served as Vice President - Controller between August 1988 and May 1993.
Thomas J. McFadden, 42, Treasurer*	Present position since May 1996. Served as Assistant Treasurer - Investor Relations and Finance between June 1994 and May 1996. Served as Director - Project Financing between July 1990 and June 1994.
James D. McGeehan, 48, Corporate Secretary	Present position since May 1996. Served as Assistant Corporate Secretary between December 1980 and May 1996.
William B. Newman, Jr., 46, Vice President and Washington Counsel*	Present position since 1981.
Albert M. Polinsky, 50, Vice President - Information Systems*	Present position since April 1994. Served as Assistant Vice President - Program Management between December 1993 and March 1994. Served as Assistant Vice President - Marketing Services between April 1992 and December 1993.
John M. Samuels, 53, Vice President - Operating Assets*	Present position since January 1996. Served as Vice President - Mechanical between November 1994 and January 1996. Served as Vice President - Engineering between April 1992 and November 1994.
Gary M. Spiegel, 46, Vice President - Service Delivery*	Present position since February 1997. Served as Assistant-Vice President - Train Operations between August 1994 and February 1997. Served as General Manager-Transportation and Customer Service between April 1992 and August 1994.

PART II

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

Conrail's common stock is listed for trading on the New York Stock Exchange and the Philadelphia Stock Exchange. The number of holders of record of Conrail common stock on March 1, 1997 was 18,377. For the high and low sales prices of Conrail's common stock on the New York Stock Exchange and the frequency and amount of cash dividends for 1996 and 1995, see Note 14 to the Consolidated Financial Statements included elsewhere in this Annual Report.

Item 6. Selected Financial Data.

The selected consolidated financial data included in the following tables have been derived from Conrail's Consolidated Financial Statements. The consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1996 and the consolidated balance sheets as of December 31, 1996 and 1995 appear elsewhere in this Annual Report and have been audited by the Company's independent accountants, as indicated in their report thereon. For purposes of the following selected consolidated financial data, references to Conrail reflect the consolidated entities of Consolidated Rail Corporation for periods prior to July 1, 1993 and Conrail Inc. for subsequent periods.

The selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements and related notes and other financial information included elsewhere in this Annual Report.

	Years ended December 31,				
	1996	1995	1994	1993(4)	1992
	(In Millions Except Per Share Amounts)				
STATEMENT OF INCOME DATA:					
Revenues	$3,714	$3,686	$3,733	$3,453	$3,345
Operating expenses (before one-time charges)(1)	2,978	2,945	3,043	2,862	2,811
One-time charges (1),(2) and (3)	135	285	84		
Income from operations	601	456	606	591	534
Interest expense	(182)	(194)	(192)	(185)	(172)
Loss on disposition of subsidiary (5)				(80)	
Other income, net	112	130	118	114	98
Income before income taxes and the cumulative effect of changes in accounting principles	531	392	532	440	460
Income taxes (2)	189	128	208	206	178
Income before the cumulative effect of changes in accounting principles	342	264	324	234	282
Cumulative effect of changes in accounting principles				(74)	
Net income	$ 342	$ 264	$ 324	$ 160	$ 282
Income per common share before the cumulative effect of changes in accounting principles					
Primary	$4.25	$3.19	$3.90	$2.74	$3.28
Fully diluted	3.89	2.94	3.56	2.51	2.99
Cumulative effect of changes in accounting principles					
Primary				(.92)	
Fully diluted				(.81)	
Net income per common share (6)					
Primary	4.25	3.19	3.90	1.82	3.28
Fully diluted	3.89	2.94	3.56	1.70	2.99
Dividends per common share (6)	1.80	1.60	1.40	1.20	1.00

	Years ended December 31,				
	1996	1995	1994	1993	1992
	(In Millions)				
BALANCE SHEET DATA:					
Cash, cash equivalents and temporary cash investments	$ 30	$ 73	$ 43	$ 38	$ 40
Working capital (deficit)	25	36	(76)	(13)	(489)
Total assets	8,402	8,424	8,322	7,948	7,315
Other noncurrent liabilities (net of current maturities of debt)	2,379	2,444	2,480	2,433	2,075
Deferred income taxes	1,478	1,393	1,203	1,081	644
Special income tax obligation	346	440	513	575	569
Stockholders' equity	3,107	2,977	2,925	2,784	2,748

NOTES TO SELECTED FINANCIAL DATA

1. Included in 1996 operating expenses is a charge of $135 million (before tax benefits of $52 million) consisting of $102 million in termination benefits to be paid to non-union employees participating in the voluntary retirement and separation programs ("voluntary separation programs") and losses of $33 million on non-cancelable leases for office space no longer required as a result of the reduction in the Company's workforce. Over 840 applications were accepted from eligible employees under both programs. Approximately $90 million of the termination benefits are being paid from the Company's overfunded pension plan. Also included in 1996 operating expenses are expenses of $16 million (before tax benefits of $6 million) incurred by Conrail as a result of the proposed merger with CSX Corporation. Without these items, net income for 1996 would have been $435 million ($5.45 per share, primary and $4.96 per share, fully diluted). (See Notes 3 and 2, respectively to the Consolidated Financial Statements included elsewhere in this Annual Report.)

2. Included in 1995 operating expenses is an asset disposition charge of $285 million, which reduced net income by $176 million. The asset disposition charge resulted from a review of the Company's route system and other operating assets to determine those that no longer effectively and economically support current and expected operations. The Company identified and has committed to sell 1,800 miles of rail lines that are expected to provide proceeds substantially less than net book value. In addition, other assets, principally yards and side tracks, identified for disposition have been written down to estimated net realizable value. Also, in 1995, as a result of a decrease in a state income tax rate enacted during the second quarter of 1995, income tax expense was reduced by $21 million representing the effect of adjustment for the rate decrease as required by Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Without these items, net income for 1995 would have been $419 million ($5.16 per share, primary and $4.69 per share, fully diluted). (See Notes 10 and 7, respectively, to the Consolidated Financial Statements included elsewhere in this Annual Report.)

3. In 1994, Conrail recorded a charge of $51 million (after tax benefits of $33 million) for a non-union employee voluntary early retirement program and related costs. The majority of the cost of the early retirement program is being paid from Conrail's overfunded pension plan. Without this one-time charge, net income would have been $375 million ($4.54 per share, primary and $4.13 per share, fully diluted). (See Note 11 to the Consolidated Financial Statements included elsewhere in this Annual Report.)

4. Conrail adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("SFAS 106"), and SFAS 109 effective January 1, 1993. As a result, in the first quarter of 1993, Conrail recorded cumulative after-tax charges of $22 million and $52 million, respectively. In addition, as a result of the increase in the federal corporate income tax rate from 34% to 35%, effective January 1, 1993, income tax expense includes $34 million of a retroactive nature, primarily for the effects of adjusting deferred income taxes and the special income tax obligation for the rate increase as required under SFAS 109.

5. In 1993, Conrail committed to a plan for disposition of its investment in Concord Resources Group, Inc. ("Concord"). Pursuant to this plan, Conrail recorded an estimated loss of $80 million for the disposition of its investment, including $19 million for operating losses expected to be incurred during the phase-out period and disposition costs. Conrail also recorded estimated federal tax benefits of $30 million relating to the disposition. In June 1995, the Company completed the disposition of the last two major waste disposal facilities of Concord. The disposition had no financial statement impact.

6. Net income and dividends per common share include the effects of a 1992 two-for-one common stock split. The calculations of income per common share for 1996, 1995 and 1994 are shown in Exhibit 11, Part IV included elsewhere in this Annual Report.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

Conrail's net income for 1996 was $342 million, compared with $264 million for 1995 and $324 million for 1994. Results for 1996 include a one-time charge of $83 million (net of $52 million of tax benefits) related to voluntary separation programs and related costs and merger-related expenses of $10 million (net of $6 million of tax benefits) incurred in connection with the proposed merger with CSX Corporation ("CSX") (see Notes 3 and 2, respectively, to the Consolidated Financial Statements included elsewhere in this Annual Report). Without these charges, net income for 1996 would have been $435 million.

The results for 1995 include the effects of a $285 million asset disposition charge ($176 million after income taxes) and the recognition of a $21 million reduction in income taxes related to a decrease in a state tax rate (see Notes 10 and 7, respectively, to the Consolidated Financial Statements included elsewhere in this Annual Report). Results for 1994 include a one-time charge of $51 million (net of tax benefits of $33 million) for a non-union early retirement program and related costs (see Note 11 to the Consolidated Financial Statements included elsewhere in this Annual Report). Absent the one-time items, Conrail's net income for 1995 and 1994 would have been $419 million and $375 million, respectively.

Traffic volumes and operating revenues increased 2.1% and .8%, respectively, in 1996 compared with 1995. Lower than anticipated revenue growth and higher than expected operating expenses resulted in an operating ratio (operating expenses as a percent of revenues) of 83.8%. Excluding the voluntary separation programs charge and merger-related costs, Conrail's operating ratio was 79.7% compared with the Company's 1996 operating ratio goal of 77.5%. The difficult operating conditions caused by severe weather experienced over most of the Company's service area during the first quarter of 1996, higher fuel prices and declines in equipment utilization all contributed to the increase in operating expenses in 1996 as compared with those that were planned for 1996. The 1995 operating ratio, excluding the asset disposition charge, was 79.9%.

For 1995 versus 1994, traffic volume and operating revenues decreased 5.4% and 1.3%, respectively, while operating expenses, excluding one-time charges, decreased 3.2%.

Proposed Merger

On October 14, 1996, Conrail, CSX Corporation ("CSX") and a subsidiary of CSX entered into an Agreement and Plan of Merger (as amended, the

"Merger Agreement"), pursuant to which Conrail was to be merged with a subsidiary of CSX in a merger-of-equals transaction.

On October 24, 1996, Norfolk Southern Corporation ("Norfolk") commenced an unsolicited tender offer for all outstanding Conrail voting stock at $100 per share in cash. Norfolk has since increased its offer to $115 per share in cash.

On November 20, 1996, CSX concluded its first tender offer and purchased approximately 19.9% of Conrail's outstanding shares for $110 per share.

On December 18, 1996, CSX and Conrail entered into a second amendment to the Merger Agreement (the "Second Amendment") that would, among other things, (i) increase the consideration payable pursuant to the merger, (ii) accelerate the consummation of the merger to immediately following the receipt of applicable shareholder approvals and prior to the Surface Transportation Board ("STB") approval and (iii) extend until December 31, 1998 an exclusivity period during which the Conrail Board agreed not to withdraw or modify its recommendations of the CSX transactions, approve or recommend any takeover proposal or cause Conrail to enter into any agreement related to any takeover proposal.

On January 13, 1997, Norfolk issued a press release announcing that it would offer to purchase shares representing 9.9% of the outstanding Shares for $115 per share, in the event that Conrail shareholders did not approve a proposal to opt out of a Pennsylvania statute (the "Opt Out Proposal") at the meeting of shareholders to be held on January 17, 1997 (the "Special Shareholders Meeting").

On January 17, 1997, Conrail shareholders voted at the Special Shareholders Meeting against the Opt Out Proposal.

On February 4, 1997, the amended Norfolk tender offer expired, and Norfolk subsequently purchased approximately 8.2 million Shares pursuant thereto.

On March 7, 1997, Conrail and CSX entered into a Third Amendment (the "Third Amendment") to the Merger Agreement. Pursuant to the Third Amendment, (i) the price per share has been increased from $110 to $115, and the number of shares to be purchased in the tender offer has been increased to all outstanding shares. The tender offer is scheduled to close April 18, 1997 (subject to extension by CSX to June 2, 1997 whether or not the conditions have been satisfied), (ii) the consideration paid per share in the merger for all remaining outstanding shares following consummation of the offer has been increased to $115 in cash and (iii) the conditions to the offer relating to certain provisions of Pennsylvania law becoming inapplicable to Conrail and relating pending governmental actions or proceedings have been deleted.

The Third Amendment also provides that CSX will have sole control over the regulatory approval process and will be free to conduct by itself discussions with other railroads, including Norfolk, relating to competitive issues raised by the CSX transactions, and to enter into any resulting agreement. It is anticipated that CSX and Norfolk will negotiate an appropriate division of Conrail's assets; however, neither the pending CSX tender offer nor the merger is conditioned on CSX's reaching an agreement with Norfolk.

Pursuant to the Third Amendment, three members of Conrail's Board of Directors approved by CSX shall be invited to join the CSX Board of Directors and a transition team will be established, the leadership of which will include senior executive officers of CSX and Conrail to ensure the orderly operation of Conrail during the regulatory approval process and an orderly transition thereafter.

Under the Third Amendment, Conrail and CSX agreed to reduce from December 31, 1998 to December 31, 1997 the period of time during which the Conrail Board is prohibited from (i) withdrawing or modifying, or publicly proposing to withdraw or modify, its approval or recommendation of the CSX transactions, in a manner adverse to CSX, (ii) approving or recommending, or publicly proposing to approve or recommend, any competing proposal or (iii) causing Conrail to enter into any agreement related to any such competing proposal.

Under the Merger Agreement as amended, Conrail may terminate the Merger Agreement in the event that after June 2, 1997, CSX fails to consummate the tender offer for any reason other than the non-occurrence of any condition to the tender offer. In the event that CSX fails to consummate the tender offer under such circumstances, Conrail will be entitled to exercise any additional remedies it may have.

The full terms and conditions of the CSX and Norfolk offers and Conrail's position with respect to the CSX and Norfolk offers are set forth in documents filed by Conrail with the Securities and Exchange Commission.

1997 Outlook

Conrail expects the economy to grow in 1997 at about the same growth rate experienced in 1996. Conrail's 1997 plans are based on assumptions of 2.2% growth in real gross domestic product and 3.4% growth in industrial production. Conrail's outlook for 1997 includes line haul revenue growth of between 2.5% and 3.5%. Conrail's operating ratio goal for 1997 is 78.5%.

Voluntary Separation Programs

During the second quarter of 1996, the Company recorded a charge of $135 million (before tax benefits of $52 million) consisting of $102 million in termination benefits to be paid to non-union employees participating in the voluntary retirement and separation programs ("voluntary separation programs") and losses of $33 million on non-cancelable leases for office space no longer required as a result of the reduction in the Company's workforce. Over 840 applications were accepted from eligible employees under the voluntary separation programs. Approximately $90 million of the termination benefits are being paid from the Company's overfunded pension plan.

Results of Operations

1996 Compared with 1995

Net income for 1996 was $342 million ($4.25 per share, primary and $3.89 per share, fully diluted) compared with 1995 net income of $264 million ($3.19 per share, primary and $2.94 per share, fully diluted). Excluding the unusual items (see "Overview") in both years, Conrail's net income would have been $435 million ($5.45 per share, primary and $4.96 per share, fully diluted) for 1996 and $419 million ($5.16 per share, primary and $4.69 per share, fully diluted) for 1995.

Operating revenues (primarily freight line haul revenues, but also including switching, demurrage and incidental revenue) increased $28 million, or .8%, to $3,714 million in 1996 from $3,686 million in 1995. A 2.1% increase in traffic volume in units (freight cars and intermodal trailers and containers) resulted in a $74 million increase in revenues. Average revenue per unit decreased revenues by $42 million due to an unfavorable traffic mix. A traffic volume increase of 7.6% was experienced by the Intermodal Service Group while traffic volume for the Unit Train Service Group remained unchanged. The Automotive and CORE service groups experienced traffic volume declines of 1.7% and 1.6%, respectively. Within the CORE Service Group, traffic volume declines were experienced by three of the four commodity groups: Forest and Manufactured Products, 5.3%; Food and Agriculture, 2.8%; and Petrochemicals, 2.5%. Metals experienced a traffic increase of 4.0%.

Operating expenses (including one-time charges and merger-related costs in 1996 and the asset disposition charge in 1995) decreased $117 million, or 3.6%, from $3,230 million in 1995 to $3,113 million in 1996. The following table sets forth the operating expenses for the two years:

(In Millions)	1996	1995	Increase (Decrease)
Compensation and benefits	$1,206	$1,249	$(43)
Fuel	202	168	34
Material and supplies	175	167	8
Equipment rents	382	355	27
Depreciation and amortization	283	293	(10)
Casualties and insurance	176	175	1
Other	554	538	16
Voluntary separation programs	135		135
Asset disposition charge		285	(285)
	$3,113	$3,230	$(117)

Compensation and benefits decreased $43 million, or 3.4%, as a result of reductions in employment levels and other employee-related costs. These decreases were partially offset by increased wage rates due to new labor agreements, increased train crew costs and overtime caused by adverse weather conditions experienced during the first quarter of 1996. Compensation and benefits as a percent of revenues was 32.5% in 1996 as compared with 33.9% in 1995.

Fuel costs increased $34 million, or 20.2%, due mostly to higher fuel prices.

Equipment rents increased $27 million, or 7.6%, primarily as a result of declines in equipment utilization and increased car hire rates.

Other operating expenses increased $16 million, or 3.0%, primarily due to $16 million of costs incurred in connection with the proposed merger with CSX (see Note 2 to the Consolidated Financial Statements included elsewhere in this Annual Report).

Conrail recorded a one-time pre-tax charge of $135 million in 1996 for the voluntary separation programs and related costs (see Note 3 to the Consolidated Financial Statements included elsewhere in this Annual Report) and an asset disposition charge of $285 million in 1995 (see Note 10 to the Consolidated Financial Statements included elsewhere in this Annual Report).

Conrail's operating ratio was 83.8% for 1996, compared with 87.6% for 1995. Without the one-time charges recorded in 1996 and 1995 and the merger-related costs incurred in 1996, the operating ratios would have been 79.7% and 79.9%, respectively.

Other income decreased $18 million, or 13.8%, from $130 million in 1995 to $112 million in 1996 primarily due to decreases in rental income and lesser gains from sales of property.

The Company's effective income tax rate for 1996 was 35.6% compared with 32.7% for 1995. The lower effective rate in 1995 is primarily caused by a $21 million reduction in income taxes as a result of a decrease in state income taxes (see Note 7 to the Consolidated Financial Statements included elsewhere in this Annual Report).

1995 Compared with 1994

Net income for 1995 was $264 million ($3.19 per share, primary and $2.94 per share, fully diluted) compared with 1994 net income of $324 million ($3.90 per share, primary and $3.56 per share, fully diluted). Excluding the one-time charges (see "Overview") in both years and the one-time tax benefit in 1995, Conrail's net income would have been $419 million ($5.16 per share, primary and $4.69 per share, fully diluted) for 1995 and $375 million ($4.54 per share, primary and $4.13 per share, fully diluted) for 1994.

Operating revenues decreased $47 million, or 1.3%, from $3,733 million in 1994 to $3,686 million in 1995. A 5.4% decrease in traffic volume in units resulted in a $191 million decrease in revenues which was partially offset by an increase in average revenue per unit that increased revenues by $140 million. The improvement in average revenue per unit resulted from increases in average rates, $117 million, and a favorable traffic mix, $23 million. Traffic volume decreases were experienced by three of the four service groups, with only Automotive showing a slight volume increase of .8%. Traffic volume declines for the other service groups were as follows: Intermodal, 7.3%; Unit Train, 5.4%; and CORE, 5.1%. Within the CORE Service Group, traffic volume declines were also experienced by each of the commodity groups: Food and Agriculture, 8.2%; Petrochemicals, 4.6%; Metals, 4.0%; and Forest and Manufactured Products, 3.9%.

Operating expenses increased $103 million, or 3.3%, from $3,127 million in 1994 to $3,230 million in 1995. The following table sets forth the operating expenses for the two years:

(In Millions)	1995	1994	Increase (Decrease)
Compensation and benefits	$1,249	$1,260	$(11)
Fuel	168	188	(20)
Material and supplies	167	203	(36)
Equipment rents	355	381	(26)
Depreciation and amortization	293	278	15
Casualties and insurance	175	184	(9)
Other	538	549	(11)
Asset disposition charge	285		285
Early retirement program		84	(84)
	$3,230	$3,127	$103

Compensation and benefits costs decreased $11 million, or .9%, as a result of a 5.3% reduction in employment levels, which exceeded the increases in wage rates and fringe benefit costs. Compensation and benefits as a percent of revenues was 33.9% in 1995 compared with 33.7% in 1994.

Fuel costs decreased $20 million, or 10.6%, as a result of greater use of newer fuel efficient locomotives, lower average fuel prices and lower traffic volume.

The decrease of $36 million, or 17.7%, in material and supplies costs was primarily attributable to a lower level of repair and maintenance expenditures related to lower traffic volume.

Equipment rents decreased $26 million, or 6.8%, primarily as a result of fewer foreign cars on Conrail's lines and improved equipment utilization, partially offset by the increased costs associated with new operating leases for equipment.

Depreciation and amortization increased $15 million, or 5.4%, due to asset additions and increased depreciation rates for track structure as a result of a depreciation study required by the former Interstate Commerce Commission.

Conrail recorded an asset disposition charge of $285 million in 1995 (see Note 10 to the Consolidated Financial Statements included elsewhere in this Annual Report) and a one-time pre-tax charge of $84 million in 1994 for the non-union voluntary early retirement program and related costs (see Note 11 to the Consolidated Financial Statements included elsewhere in this Annual Report).

Conrail's operating ratio was 87.6% for 1995, compared with 83.8% for 1994. Without the $285 million asset disposition charge in 1995 and the $84 million charge for the early retirement program in 1994, the operating ratios for 1995 and 1994 would have been 79.9% and 81.5%, respectively.

Other income, net, increased $12 million, or 10.2%, primarily due to an $8 million gain from a property sale completed during the second quarter of 1995.

The Company's effective income tax rate for 1995 was 32.7% compared with 39.1% for 1994. The lower rate reflects the effect of a $21 million reduction in income taxes resulting from a decrease in a state income tax rate enacted during the second quarter of 1995 (see Note 7 to the Consolidated Financial Statements included elsewhere in this Annual Report).

Liquidity and Capital Resources

Conrail's cash and cash equivalents decreased $43 million, from $73 million at December 31, 1995 to $30 million at December 31, 1996. Cash generated from operations, principally from its wholly-owned subsidiary, Consolidated Rail Corporation ("CRC"), and borrowings are Conrail's principal sources of liquidity and are used primarily for capital expenditures, debt service, and dividends. Operating activities provided cash of $669 million in 1996, compared with $773 million in 1995 and $697 million in 1994. In 1996, loans from and redemptions of insurance policies provided cash of $95 million and issuance of long-term debt provided cash of $26 million. The principal uses of cash in 1996 were for property and equipment acquisitions, $387 million, payment of long-term debt including capital lease and equipment obligations, $184 million, cash dividends on preferred and common stock, $171 million, and the repurchase of common stock, $156 million.

Working capital (current assets less current liabilities)of $25 million existed at December 31, 1996, compared with $36 million at December 31, 1995. Management believes that Conrail's financial position allows it sufficient access to credit sources on investment grade terms, and, if necessary, additional intermediate or long-term debt could be issued for additional working capital requirements.

In April 1995, the Company's Board of Directors approved a $250 million multi-year stock repurchase program. During 1996, the Company acquired 2,225,738 shares for $156 million under this program. As a result of the proposed merger agreement with CSX (see Note 2 to the Consolidated Financial Statements included elsewhere in this Annual Report), the Company will not make any additional stock repurchases under this program.

During 1996, CRC issued an additional $139 million of commercial paper and repaid $129 million. Of the $199 million outstanding at December 31, 1996, $100 million is classified as long-term debt since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by the $500 million uncollateralized bank credit agreement.

At December 31, 1996, $312 million remains available to Conrail and CRC under a 1993 shelf registration statement whereby CRC can issue debt securities and Conrail can issue both convertible debt and equity securities.

In April 1996, CRC issued $50 million of Pass-Through Certificates at a rate of 6.96% to finance equipment. Although the certificates are not direct obligations of, or guaranteed by CRC, amounts payable under related capital leases will be sufficient to pay principal and interest on the certificates.

In July 1996, CRC issued $26 million of 1996 Equipment Trust Certificates, Series A, with interest rates ranging from 6.0% to 7.48%, maturing annually from 1997 to 2011. The certificates were issued to finance approximately 85% of the purchase price of twenty locomotives.

In June 1996, CRC borrowed $69 million against the cash surrender value of the company-owned life insurance policies which it maintains on certain of its non-union employees. The Company also redeemed the remaining excess cash surrender value of $26 million. Both transactions resulted in an increase of $95 million in cash in 1996.

Capital Expenditures

Capital expenditures totaled $478 million, $494 million and $508 million in 1996, 1995 and 1994, respectively. Of these totals, Conrail directly financed $108 million in 1996, $126 million in 1995 and $57 million in 1994.

Capital expenditures for 1997 are expected to be approximately $550 million.

Inflation

Generally accepted accounting principles require the use of historical costs in preparing financial statements. This approach does not consider the effects of inflation on the costs of replacing assets. The replacement cost of Conrail's property and equipment is substantially higher than its historical cost basis. Similarly, depreciation expense on a replacement cost basis would be substantially in excess of the amount recorded under generally accepted accounting principles.

Environmental Matters

Conrail's operations and property are subject to various federal, state and local laws regulating the environment. CRC is a party to numerous proceedings brought by regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. As of December 31, 1996, CRC had received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 135 locations throughout the country. However, based on currently available information, Conrail believes CRC may have some potential responsibility at only 61 of these sites. Due to the number of parties involved at many of these sites, the wide range of costs of the possible remediation alternatives, changing technology and the length of time over which these matters develop, it is not always possible to estimate CRC's liability for the costs associated with the assessment and remediation of contaminated sites. At December 31, 1996, Conrail had accrued $55 million for estimated future environmental expenses. Although Conrail's operating results and liquidity could be significantly affected in any quarterly or annual reporting period in which CRC was held principally liable in certain of these actions, Conrail believes the ultimate liability for these matters will not materially affect its financial condition. (See Note 13 to the Consolidated Financial Statements included elsewhere in this Annual Report).

Conrail spent $11 million, $14 million and $8 million in 1996, 1995 and 1994, respectively, for environmental remediation and related costs and anticipates spending an amount comparable to that spent in 1996 during 1997. In addition, Conrail's capital expenditures for environmental control and abatement projects were approximately $6 million in 1996 and 1995, and $5 million in 1994, and are anticipated to be approximately $10 million in 1997.

Conrail has an Environmental Quality Department, the mission of which is to institute and promote compliance with environmentally sound operating practices and to monitor and assess the status of sites where liability under environmental laws may exist.

Other Matters

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements that involve risks and uncertainties that may cause actual results to differ, including but not limited to the effect of economic conditions, competition, regulation and weather on Conrail's operations, customers, service and prices, and other factors discussed elsewhere in this report and, from time to time, in other reports filed with the Securities and Exchange Commission.

Item 8. Financial Statements and Supplementary Data.

Report of Independent Accountants

The Stockholders and Board of Directors
Conrail Inc.

In our opinion, the consolidated financial statements listed in the index appearing under Item 14 (a) 1. and 2. present fairly, in all material respects, the financial position of Conrail Inc. and subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Price Waterhouse LLP
Thirty South Seventeenth Street
Philadelphia, PA 19103

January 21, 1997,
except as to Note 2, which is as of March 7, 1997

CONRAIL INC.
CONSOLIDATED STATEMENTS OF INCOME

($ In Millions Except Per Share Data)	1996	1995	1994
	Years ended December 31,		
Revenues	$3,714	$3,686	$3,733
Operating expenses			
Way and structures	462	485	499
Equipment	803	766	815
Transportation	1,385	1,324	1,379
General and administrative	328	370	350
Voluntary separation programs (Note 3)	135		
Asset disposition charge (Note 10)		285	
Early retirement program (Note 11)			84
Total operating expenses	3,113	3,230	3,127
Income from operations	601	456	606
Interest expense	(182)	(194)	(192)
Other income, net (Note 12)	112	130	118
Income before income taxes	531	392	532
Income taxes (Note 7)	189	128	208
Net income	$ 342	$ 264	$ 324
Net income per common share (Note 1)			
Primary	$ 4.25	$ 3.19	$ 3.90
Fully diluted	3.89	2.94	3.56
Ratio of earnings to fixed charges (Note 1)	3.19x	2.51x	3.19x

See accompanying notes.

CONRAIL INC.
CONSOLIDATED BALANCE SHEETS

($ In Millions)	December 31, 1996	December 31, 1995
ASSETS		
Current assets		
Cash and cash equivalents	$ 30	$ 73
Accounts receivable	630	614
Deferred tax assets (Note 7)	293	333
Material and supplies	139	158
Other current assets	25	28
Total current assets	1,117	1,206
Property and equipment, net (Note 4)	6,590	6,408
Other assets	695	810
Total assets	$8,402	$8,424
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short-term borrowings	99	89
Current maturities of long-term debt (Note 6)	130	181
Accounts payable	135	113
Wages and employee benefits	143	183
Casualty reserves	141	110
Accrued and other current liabilities (Note 5)	444	494
Total current liabilities	1,092	1,170
Long-term debt (Note 6)	1,876	1,911
Casualty reserves	190	217
Deferred income taxes (Note 7)	1,478	1,393
Special income tax obligation (Note 7)	346	440
Other liabilities	313	316
Total liabilities	5,295	5,447
Commitments and contingencies (Note 13)		
Stockholders' equity (Notes 2 and 9)		
Preferred stock (no par value; 15,000,000 shares authorized; no shares issued)		
Series A ESOP convertible junior preferred stock (no par value; 10,000,000 shares authorized; 7,303,920 and 9,770,993 shares issued and outstanding, respectively)	211	282
Unearned ESOP compensation	(222)	(233)
Common stock ($1 par value; 250,000,000 shares authorized; 87,768,428 and 85,392,392 shares issued, respectively; 82,244,973 and 82,094,675 shares outstanding, respectively)	88	85
Additional paid-in capital	2,404	2,187
Employee benefits trust, at market (3,394,988 and 4,706,665 shares, respectively)	(384)	(329)
Retained earnings	1,357	1,176
	3,454	3,168
Treasury stock, at cost (5,523,455 and 3,297,717 shares, respectively)	(347)	(191)
Total stockholders' equity	3,107	2,977
Total liabilities and stockholders' equity	$8,402	$8,424

See accompanying notes.

CONRAIL INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

($ In Millions Except Per Share Data)	Series A Preferred Stock	Unearned ESOP Compensation	Common Stock	Additional Paid-in Capital	Employee Benefits Trust	Retained Earnings	Treasury Stock
Balance, January 1, 1994	$286	$(253)	$80	$1,819		$ 857	$ (5)
Amortization		10					
Net income						324	
Common dividends, $1.40 per share						(111)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(94)
Exercise of stock options				14			
Other	(3)			15		7	
Balance, December 31, 1994	283	(243)	80	1,848		1,056	(99)
Amortization		10					
Net income						264	
Common dividends, $1.60 per share						(129)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(92)
Exercise of stock options				6			
Establishment of employee benefits trust			5	245	$(250)		
Employee benefits trust transactions, net				84	(79)		
Other	(1)			4		6	
Balance, December 31, 1995	282	(233)	85	2,187	(329)	1,176	(191)
Amortization		11					
Net income						342	
Common dividends, $1.80 per share						(146)	
Preferred dividends, $2.165 per share						(20)	
Common shares acquired							(156)
Exercise of stock options				29	53		
Employee benefits trust transactions, net				128	(116)		
Effects of voluntary separation programs	(8)				8		
Effects of CSX tender offer (Note 2)	(63)		3	60			
Other						5	
Balance, December 31, 1996	$211	$(222)	$88	$2,404	$(384)	$1,357	$(347)

See accompanying notes.

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CONRAIL INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

($ In Millions)	1996	1995	1994
	Years ended December 31,		
Cash flows from operating activities			
Net income	$ 342	$ 264	$ 324
Adjustments to reconcile net income to net cash provided by operating activities:			
Voluntary separation programs	135		
Asset disposition charge		285	
Early retirement program			84
Depreciation and amortization	283	293	278
Deferred income taxes	183	108	150
Special income tax obligation	(94)	(73)	(62)
Gains from sales of property	(24)	(27)	(18)
Pension credit	(46)	(43)	(46)
Changes in:			
Accounts receivable	(16)	32	(2)
Accounts and wages payable	(18)	8	41
Settlement of tax audit	(39)		
Other	(37)	(74)	(52)
Net cash provided by operating activities	669	773	697
Cash flows from investing activities			
Property and equipment acquisitions	(387)	(415)	(490)
Proceeds from disposals of properties	34	38	32
Other	(46)	(59)	(23)
Net cash used in investing activities	(399)	(436)	(481)
Cash flows from financing activities			
Repurchase of common stock	(156)	(92)	(94)
Net proceeds from (repayments of) short-term borrowings	10	(23)	33
Proceeds from long-term debt	26	85	114
Payment of long-term debt	(184)	(134)	(158)
Loans from and redemptions of insurance policies	95		
Dividends on common stock	(146)	(129)	(111)
Dividends on Series A preferred stock	(25)	(21)	(16)
Proceeds from stock options and other	67	7	21
Net cash used in financing activities	(313)	(307)	(211)
Increase(decrease) in cash and cash equivalents	(43)	30	5
Cash and cash equivalents			
Beginning of year	73	43	38
End of year	$ 30	$ 73	$ 43

See accompanying notes.

CONRAIL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. **Summary of Significant Accounting Policies**

Industry

Conrail Inc. ("Conrail") is a holding company of which the principal subsidiary is Consolidated Rail Corporation ("CRC"), a freight railroad which operates within the northeast and midwest United States and the Province of Quebec.

Principles of Consolidation

The consolidated financial statements include Conrail and majority-owned subsidiaries. Investments in 20% to 50% owned companies are accounted for by the equity method.

Cash Equivalents

Cash equivalents consist of commercial paper, certificates of deposit and other liquid securities purchased with a maturity of three months or less, and are stated at cost which approximates market value.

Material and Supplies

Material and supplies consist mainly of fuel oil and items for maintenance of property and equipment, and are valued at the lower of cost, principally weighted average, or market.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided using the composite straight-line method. The cost (net of salvage) of depreciable property retired or replaced in the ordinary course of business is charged to accumulated depreciation and no gain or loss is recognized.

Asset Impairment

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Expected future cash flows from the use and disposition of long-lived assets are compared to the current carrying amounts to determine the potential impairment loss.

Revenue Recognition

Revenue is recognized proportionally as a shipment moves on the Conrail system from origin to destination.

Earnings Per Share

Primary earnings per share are based on net income adjusted for the effects of preferred dividends net of income tax benefits, divided by the weighted average number of shares outstanding during the period, including the dilutive effect of stock options. Fully diluted earnings per share assume conversion of Series A ESOP Convertible Junior Preferred Stock ("ESOP Stock") into Conrail common stock. Net income amounts applicable to fully diluted earnings per share have been adjusted by the increase, net of income tax benefits, in ESOP-related expenses assuming conversion of all ESOP Stock to common stock. Shares in the Conrail Employee Benefits Trust are not considered outstanding for computing earnings per share. The weighted average number of shares of common stock outstanding during each of the most recent three years are as follows:

	1996	1995	1994
Primary weighted average shares	77,628,825	78,733,947	79,674,781
Fully diluted weighted average shares	87,325,575	88,702,712	89,562,721

Ratio of Earnings to Fixed Charges

Earnings used in computing the ratio of earnings to fixed charges represent income before income taxes plus fixed charges, less equity in undistributed earnings of 20% to 50% owned companies. Fixed charges represent interest expense together with interest capitalized and a portion of rent under long-term operating leases representative of an interest factor.

New Accounting Standards

During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (SFAS 121) and SFAS No. 123, "Accounting for Stock-Based Compensation"(SFAS 123), which are both effective in 1996. The Company has decided to adopt only the disclosure provisions of SFAS 123 in 1996 and continues to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and related interpretations in accounting for its stock-based compensation plans. The Company adopted SFAS 121 in the first quarter of 1996 and determined that it did not have a material effect on its financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Proposed Merger

On October 14, 1996, Conrail, CSX Corporation ("CSX") and a subsidiary of CSX entered into an Agreement and Plan of Merger (as amended, the "Merger Agreement"), pursuant to which Conrail was to be merged with a subsidiary of CSX in a merger-of-equals transaction.

On October 24, 1996, Norfolk Southern Corporation ("Norfolk") commenced an unsolicited tender offer for all outstanding Conrail voting stock at $100 per share in cash. Norfolk has since increased its offer to $115 per share in cash.

On November 20, 1996, CSX concluded its first tender offer and purchased approximately 19.9% of Conrail's outstanding shares for $110 per share.

On December 18, 1996, CSX and Conrail entered into a second amendment to the Merger Agreement (the "Second Amendment") that would, among other things, (i) increase the consideration payable pursuant to the merger, (ii) accelerate the consummation of the merger to immediately following the receipt of applicable shareholder approvals and prior to the Surface Transportation Board ("STB") approval and (iii) extend until December 31, 1998 an exclusivity period during which the Conrail Board agreed not to withdraw or modify its recommendations of the CSX transactions, approve or recommend any takeover proposal or cause Conrail to enter into any agreement related to any takeover proposal.

On January 13, 1997, Norfolk issued a press release announcing that it would offer to purchase shares representing 9.9% of the outstanding shares for $115 per share, in the event that Conrail shareholders did not approve a proposal to opt out of a Pennsylvania statute (the "Opt Out Proposal") at the meeting of shareholders to be held on January 17, 1997 (the "Special Shareholders Meeting").

On January 17, 1997, Conrail shareholders voted at the Special Shareholders Meeting against the Opt Out Proposal.

On February 4, 1997, the amended Norfolk tender offer expired, and Norfolk subsequently purchased approximately 8.2 million shares pursuant thereto.

On March 7, 1997, Conrail and CSX entered into a Third Amendment (the "Third Amendment") to the Merger Agreement. Pursuant to the Third Amendment, (i) the price per share has been increased from $110 to $115, and the number of shares to be purchased in the tender offer has been increased to all outstanding shares. The tender offer is scheduled to close April 18, 1997 (subject to extension by CSX to June 2, 1997 whether or not the conditions have been satisfied), (ii) the consideration paid per share in the merger for all remaining outstanding shares following consummation of the offer has been increased to $115 in cash and (iii) the conditions to the offer relating to certain provisions of Pennsylvania law becoming inapplicable to Conrail and relating pending governmental actions or proceedings have been deleted.

The Third Amendment also provides that CSX will have sole control over the regulatory approval process and will be free to conduct by itself discussions with other railroads, including Norfolk, relating to competitive issues raised by the CSX transactions, and to enter into any resulting agreement. It is anticipated that CSX and Norfolk will negotiate an appropriate division of Conrail's assets; however, neither the pending CSX tender offer nor the merger is conditioned on CSX's reaching an agreement with Norfolk.

Pursuant to the Third Amendment, three members of Conrail's Board of Directors approved by CSX shall be invited to join the CSX Board of Directors and a transition team will be established, the leadership of which will include senior executive officers of CSX and Conrail to ensure the orderly operation of Conrail during the regulatory approval process and an orderly transition thereafter.

Under the Third Amendment, Conrail and CSX agreed to reduce from December 31, 1998 to December 31, 1997 the period of time during which the Conrail Board is prohibited from (i) withdrawing or modifying, or publicly proposing to withdraw or modify, its approval or recommendation of the CSX transactions, in a manner adverse to CSX, (ii) approving or recommending, or publicly proposing to approve or recommend, any competing proposal or (iii) causing Conrail to enter into any agreement related to any such competing proposal.

Under the Merger Agreement as amended, Conrail may terminate the Merger Agreement in the event that after June 2, 1997, CSX fails to consummate the tender offer for any reason other than the non-occurrence of any condition to the tender offer. In the event that CSX fails to consummate the tender offer under such circumstances, Conrail will be entitled to exercise any additional remedies it may have.

The full terms and conditions of the CSX and Norfolk offers and Conrail's position with respect to the CSX and Norfolk offers are set forth in documents filed by Conrail with the Securities and Exchange Commission.

Pending approval by the Surface Transportation Board ("STB"), 100% of Conrail's voting stock will be held by CSX in a voting trust. The combination of the railroad operations of the two companies is contingent upon the approval of the merger by the STB.

3. **Voluntary Separation Programs**

During the second quarter of 1996, the Company recorded a charge of $135 million (before tax benefits of $52 million) consisting of $102 million in termination benefits to be paid to non-union employees participating in the voluntary retirement and separation programs ("voluntary separation programs") and losses of $33 million on non-cancelable leases for office space no longer required as a result of the reduction in the Company's workforce. Over 840 applications were accepted from eligible employees under the voluntary separation programs. Approximately $90 million of the termination benefits are being paid from the Company's overfunded pension plan.

4. **Property and Equipment**

	December 31, 1996	December 31, 1995
	(In Millions)	
Roadway	$ 7,021	$ 6,828
Equipment	1,231	1,213
Less: Accumulated depreciation	(1,654)	(1,572)
Allowance for disposition	(408)	(439)
	6,190	6,030
Capital leases (primarily equipment)	908	908
Accumulated amortization	(508)	(530)
	400	378
	$ 6,590	$ 6,408

Conrail acquired equipment and incurred related long-term debt under various capital leases of $82 million in 1996, $71 million in 1995 and $8 million in 1994. In 1995 (Note 10) and 1991, the Company recorded allowances for disposition for the sale or abandonment of certain under-utilized rail lines and other facilities.

5. **Accrued and Other Current Liabilities**

	December 31, 1996	December 31, 1995
	(In Millions)	
Freight settlements due others	$ 48	$ 54
Equipment rents (primarily car hire)	74	71
Unearned freight revenue	79	56
Property and corporate taxes	49	66
Other	194	247
	$444	$494

6. **Long-Term Debt**

Long-term debt outstanding, including the weighted average interest rates at December 31, 1996, is composed of the following:

	December 31, 1996	December 31, 1995
	(In Millions)	
Capital leases	$ 491	$ 489
Medium-term notes payable, 6.70%, due 1997 to 1999	109	208
Notes payable, 9.75%, due 2000	250	250
Debentures payable, 7.88%, due 2043	250	250
Debentures payable, 9.75%, due 2020	544	544
Equipment and other obligations, 6.55%	262	251
Commercial paper, 5.53%	100	100
	2,006	2,092
Less current portion	(130)	(181)
	$1,876	$1,911

Using current market prices when available, or a valuation based on the yield to maturity of comparable debt instruments having similar characteristics, credit rating and maturity, the total fair value of the Company's long-term debt, including the current portion, but excluding capital leases, is $1,685 million and $1,870 million at December 31, 1996 and 1995, respectively, compared with carrying values of $1,515 million and $1,603 million at December 31, 1996 and 1995, respectively.

The Company's noncancelable long-term leases generally include options to purchase at fair value and to extend the terms. Capital leases have been discounted at rates ranging from 3.09% to 14.26% and are collateralized by assets with a net book value of $400 million at December 31, 1996.

Minimum commitments, exclusive of executory costs borne by the Company, are:

	Capital Leases	Operating Leases
	(In Millions)	
1997	$ 107	$115
1998	96	104
1999	86	87
2000	64	76
2001	57	68
2002 - 2017	273	523
Total	683	$973
Less interest portion	(192)	
Present value	$ 491	

Operating lease rent expense was $127 million in 1996, $130 million in 1995 and $118 million in 1994.

In June 1993, the Company and CRC filed a shelf registration statement on Form S-3 to enable CRC to issue up to $500 million in debt securities or the Company to issue up to $500 million in convertible debt and equity securities. The remaining balance under this shelf registration was $312 million at December 31, 1996.

In April 1996, CRC issued $50 million of Pass-Through Certificates at a rate of 6.96% to finance equipment. Although the certificates are not direct obligations of, or guaranteed by CRC, amounts payable under related capital leases will be sufficient to pay principal and interest on the certificates.

In July 1996, CRC issued $26 million of 1996 Equipment Trust Certificates, Series A, with interest rates ranging from 6.0% to 7.48%, maturing annually from 1997 to 2011. The certificates were used to finance approximately 85% of the purchase price of twenty locomotives.

In June 1996, CRC borrowed $69 million against the cash surrender value of the company-owned life insurance policies which it maintains on certain of its non-union employees.

Equipment and other obligations mature in 1997 through 2043 and are collateralized by assets with a net book value of $253 million at December 31, 1996. Maturities of long-term debt other than capital leases and commercial paper are $65 million in 1997, $46 million in 1998, $46 million in 1999, $266 million in 2000, $17 million in 2001 and $975 million in total from 2002 through 2043.

CRC had $199 million of commercial paper outstanding at December 31, 1996. Of the total amount outstanding, $100 million is classified as long-term since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by the long-term credit facility mentioned below.

CRC maintains a $500 million uncollateralized bank credit agreement with a group of banks which is used for general corporate purposes and to support CRC's commercial paper program. The agreement matures in 2000 and requires interest to be paid on amounts borrowed at rates based on various defined short-term rates and an annual maximum fee of .125% of the facility amounts. The agreement contains, among other conditions, restrictive covenants relating to a debt ratio and consolidated tangible net worth. During 1996, CRC had no borrowings under this agreement.

Interest payments were $170 million in 1996, $177 million in 1995 and $174 million in 1994.

7. **Income Taxes**

The provisions for income taxes are composed of the following:

	1996	1995	1994
		(In Millions)	
Current			
Federal	$ 90	$ 78	$104
State	10	15	16
	100	93	120
Deferred			
Federal	151	110	125
State	32	(2)	25
	183	108	150
Special income tax obligation			
Federal	(80)	(61)	(53)
State	(14)	(12)	(9)
	(94)	(73)	(62)
	$189	$128	$208

In conjunction with the public sale in 1987 of the 85% of the Company's common stock then owned by the U.S. Government, federal legislation was enacted which resulted in a reduction of the tax basis of certain of the Company's assets, particularly property and equipment, thereby substantially decreasing tax depreciation deductions and increasing future federal income tax payments. Also, net operating loss and investment tax credit carryforwards were canceled. As a result of the sale-related transactions, a special income tax obligation was recorded in 1987 based on an estimated effective federal and state income tax rate of 37.0%.

As a result of a decrease in a state income tax rate enacted during 1995, income tax expense for that year was reduced by $21 million representing the effects of adjusting deferred income taxes and the special income tax obligation for the rate decrease as required by SFAS 109, "Accounting for Income Taxes".

In November 1996, the Company reached a settlement with the Internal Revenue Service related to the audit of the Company's consolidated federal income tax returns for the fiscal years 1990 through 1992. The Company made a payment of $39 million pending resolution of the final interest determination related to the settlement. Federal and state income tax payments were $145 million in 1996 (excluding tax settlement), $109 million in 1995 and $80 million in 1994.

Reconciliations of the U.S. statutory tax rates with the effective tax rates are as follows:

	1996	1995	1994
Statutory tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.4	3.5	3.9
Effect of state tax decrease on deferred taxes		(5.3)	
Other	(2.8)	(.5)	.2
Effective tax rate	35.6%	32.7%	39.1%

Significant components of the Company's special income tax obligation and deferred income tax liabilities and (assets) are as follows:

	December 31, 1996	December 31, 1995
	(In Millions)	
Current assets (primarily accounts receivable)	$ (9)	$ (27)
Current liabilities (primarily accrued liabilities and casualty reserves)	(245)	(265)
Tax benefits related to disposition of subsidiary	(30)	(30)
Net operating loss carryforwards	(9)	(11)
Current deferred tax asset, net	$ (293)	$ (333)
Noncurrent liabilities:		
Property and equipment	1,939	1,936
Other long-term assets (primarily prepaid pension asset)	92	67
Miscellaneous	98	66
	2,129	2,069
Noncurrent assets:		
Nondeductible reserves and other liabilities	(174)	(144)
Tax benefit transfer receivable	(36)	(33)
Alternative minimum tax credits		(38)
Miscellaneous	(95)	(21)
	(305)	(236)
Special income tax obligation and deferred income tax liabilities, net	$1,824	$1,833

8. Employee Benefits

Pension Plans

The Company and certain subsidiaries maintain defined benefit pension plans which are noncontributory for all non-union employees and generally contributory for participating union employees. Benefits are based primarily on credited years of service and the level of compensation near retirement. Funding is based on the minimum amount required by the Employee Retirement Income Security Act of 1974.

Pension credits include the following components:

	1996	1995	1994
	(In Millions)		
Service cost - benefits earned during the period	$ 9	$ 8	$ 8
Interest cost on projected benefit obligation	51	51	48
Return on plan assets - actual	(138)	(254)	(10)
- deferred	47	167	(77)
Net amortization and deferral	(15)	(15)	(15)
	$ (46)	$(43)	$(46)

The funded status of the pension plans and the amounts reflected in the balance sheets are as follows:

	1996	1995
	(In Millions)	
Accumulated benefit obligation ($655 million and $603 million vested, respectively)	$ 661	$ 609
Market value of plan assets	1,187	1,168
Projected benefit obligation	(734)	(726)
Plan assets in excess of projected benefit obligation	453	442
Unrecognized prior service cost	36	50
Unrecognized transition net asset	(90)	(120)
Unrecognized net gain	(231)	(157)
Net prepaid pension cost	$ 168	$ 215

The assumed weighted average discount rates used in 1996 and 1995 are 7.5% and 7.0%, respectively, and the rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation as of December 31, 1996 and 1995 is 6.0%. The expected long-term rate of return on plan assets (primarily equity securities) in 1996 and 1995 is 9.0%.

Savings Plans

The Company and certain subsidiaries provide 401(k) savings plans for union and non-union employees. Under the Non-union ESOP, 100% of employee contributions are matched in the form of ESOP Stock for the first 6% of a participating employee's base pay. There is no Company match provision under the union employee plan. Savings plan expense was $4 million in 1996 and 1995, and $5 million in 1994.

In connection with the Non-union ESOP, the Company issued 9,979,562 of the authorized 10 million shares of its ESOP Stock to the Non-union ESOP in exchange for a 20 year promissory note with interest at 9.55% from the Non-union ESOP in the principal amount of $288 million. In addition, unearned ESOP compensation of $288 million was recognized as a charge to stockholders' equity coincident with the Non-union ESOP's issuance of its $288 million promissory note to the Company. The debt of the Non-union ESOP was recorded by the Company and offset against the promissory note from the Non-union ESOP. Unearned ESOP compensation is charged to expense as shares of ESOP Stock are allocated to participants. Approximately 2.7 million ESOP shares have been cumulatively allocated to participants through December 31, 1996, and a portion of these shares have been tendered to CSX (Note 2). An amount equivalent to the preferred dividends declared on the ESOP Stock partially offsets compensation and interest expense related to the Non-union ESOP.

In 1994, the ESOP's promissory note to the Company was refinanced. As part of the refinancing, the interest rate was decreased to 8.0%, from the original 9.55%, and accrued interest of $21 million was capitalized as part of the principal balance of the promissory note.

The Company is obligated to make dividend payments at a rate of 7.51% on the ESOP Stock and additional contributions in an aggregate amount sufficient to enable the Non-union ESOP to make the required interest and principal payments on its note to the Company.

Interest expense incurred by the Non-union ESOP on its debt to the Company was $24 million in 1996 and 1995, and $30 million in 1994. Compensation expense related to the Non-union ESOP was $11 million in 1996, and $10 million in 1995 and 1994. Preferred dividends of $20 million were declared in 1996, and $21 million in 1995 and 1994. Preferred dividend payments of $25 million, $21 million and $16 million were made in 1996, 1995 and 1994, respectively. The Company received debt service payments from the Non-union ESOP of $40 million in 1996, $31 million in 1995 and $21 million in 1994.

Postretirement Benefits Other Than Pensions

The Company provides health and life insurance benefits to certain retired non-union employees. Certain non-union employees are eligible for retiree medical benefits, while substantially all non-union employees are eligible for retiree life insurance benefits. Generally, company-provided health care benefits terminate when individuals reach age 65.

Retiree life insurance plan assets consist of a retiree life insurance reserve held in the Company's group life insurance policy. There are no plan assets for the retiree health benefits plan.

The following sets forth the plans' funded status reconciled with amounts reported in the Company's balance sheets:

	1996		1995	
	Medical Plan	Life Insurance Plan	Medical Plan	Life Insurance Plan
	(In Millions)			
Accumulated postretirement benefit obligation:				
Retirees	$44	$20	$38	$19
Fully eligible active plan participants	1		5	1
Other active plan participants		3		5
Accumulated benefit obligation	45	23	43	25
Market value of plan assets		(10)		(7)
Accumulated benefit obligation in excess of plan assets	45	13	43	18
Unrecognized gains and (losses)	(1)	2	1	(1)
Accrued benefit cost recognized in the Consolidated Balance Sheet	$44	$15	$44	$17
Net periodic postretirement benefit cost, primarily interest cost	$ 3	$ 1	$ 4	$ 1

An 8 percent rate of increase in per capita costs of covered health care benefits was assumed for 1997, gradually decreasing to 6 percent by the year 2007. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1996 by $2 million and would have an immaterial effect on the net periodic postretirement benefit cost for 1996. Discount rates of 7.5% and 7.0% were used to determine the accumulated postretirement benefit obligations for both the medical and life insurance plans in 1996 and 1995, respectively.

The assumed rate of compensation increase was 6.0% in 1996 and 5.0% in 1995.

Retiree medical benefits are funded by a combination of Company and retiree contributions. Retiree life insurance benefits are provided by insurance companies whose premiums are based on claims paid during the year.

9. **Capital Stock**

Preferred Stock

The Company is authorized to issue 25 million shares of preferred stock with no par value. The Board of Directors has the authority to divide the preferred stock into series and to determine the rights and preferences of each.

The Company cannot pay dividends on its common stock unless full cumulative dividends have been paid on its ESOP Stock, and no distributions can be made to the holders of common stock upon liquidation or dissolution of the Company unless the holders of the ESOP Stock have received a cash liquidation payment of $28.84375 per share, plus unpaid dividends up to the date of such payment. The ESOP Stock is convertible into an equivalent number of shares of common stock based on their respective market values at the date of conversion. The ESOP Stock is entitled to one vote per share, voting together as a single class with common stock on all matters.

As a result of the CSX tender offer related to the proposed merger (Note 2), 2.2 million shares of ESOP Stock have been converted to common shares as a result of being removed from the Non-union ESOP 401(k) savings plan.

Employee Benefits Trust

In 1995, the Company issued approximately 4.7 million shares of its common stock to the Conrail Employee Benefits Trust (the "Trust") in exchange for a promissory note of $250 million at an interest rate of 6.9%. The Trust is being used to fund certain employee benefits and other forms of compensation over its fifteen-year term. The amount representing unearned employee benefits is recorded as a deduction from stockholders' equity and is reduced as benefits and compensation are paid through the release of shares from the Trust. The shares owned by the Trust are valued at the closing market price as of the end of each reporting period, with corresponding changes in the balance of the Trust reflected in additional paid-in capital. The Trust has sold shares of Conrail common stock in connection with the CSX and Norfolk tender offers (Note 2) and has used the proceeds to repurchase shares of Conrail common stock in the open market. Shares held by the Trust are not considered outstanding for earnings per share computations until released by the Trust, but do have voting and dividend rights.

Common Stock Repurchase Program

In April 1995, the Board of Directors approved a $250 million multi-year stock repurchase program. During 1996, the Company acquired 2,225,738 shares for approximately $156 million under

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this program. At December 31, 1996, approximately $93 million remained available from this authorization; however, as a result of the proposed merger with CSX Corporation (Note 2), the Company will not make any additional stock repurchases under this program.

The activity and status of treasury stock follow:

	1996	1995	1994
Shares, beginning of year	3,297,717	1,789,164	83,745
Acquired	2,225,738	1,508,553	1,705,419
Shares, end of year	5,523,455	3,297,717	1,789,164

Stock Plans

The Company's stock-based compensation plans as of December 31, 1996 are described below. The Company applies APB 25 and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans. SFAS 123 was issued in 1995 and, if fully adopted, would change the method of recognition of costs on plans similar to those of the Company. Adoption of SFAS 123 is optional; however, the required pro forma disclosures as if the Company had adopted the cost recognition requirements under SFAS 123 in 1996 and 1995 are presented below.

The Company's 1987 and 1991 Long-Term Incentive Plans authorize the granting to officers and key employees of up to 4 million and 6.6 million shares of common stock, respectively, through stock options, stock appreciation rights, phantom stock and awards of restricted or performance shares. A stock option is exercisable for a specified term commencing after grant at a price not less than the fair market value of the stock on the date of grant. The vesting of awards made pursuant to these plans is contingent upon one or more of the following: continued employment, passage of time or financial and other performance goals.

Effective November 1996, the Company's Board of Directors authorized the automatic vesting of all unvested stock options outstanding in connection with the Merger Agreement between CSX and the Company (Note 2).

The activity and status of stock options under the incentive plans follow:

	Non-qualified Stock Options	
	Option Price Per Share	Shares Under Option
Balance, January 1, 1994	$14.000 - $60.500	1,966,321
Granted	$52.188 - $66.938	23,988
Exercised	$14.000 - $51.375	(507,450)
Canceled	$42.625 - $60.500	(118,904)
Balance, December 31, 1994	$14.000 - $66.938	1,363,955
Granted	$50.688 - $68.563	516,757
Exercised	$14.000 - $53.875	(200,940)
Canceled	$42.625 - $53.875	(123,560)
Balance, December 31, 1995	$14.000 - $68.563	1,556,212
Granted	$68.563 - $96.063	551,038
Exercised	$14.000 - $73.250	(1,268,085)
Canceled	$42.625 - $70.031	(3,984)
Balance, December 31, 1996	$14.000 - $96.063	835,181
Exercisable, December 31, 1996	$14.000 - $74.188	831,481
Available for future grants December 31, 1995		1,188,193
December 31, 1996		3,969,317

The weighted average exercise prices of options granted during 1996 and 1995 are $70.130 per share and $51.204 per share, respectively. The weighted average exercise prices of options exercised during 1996 and 1995 are $48.32 per share and $31.16 per share, respectively. The average remaining maximum terms of options is not considered meaningful given the events that have occurred as a result of the proposed merger with CSX (Note 2).

The fair value of each option granted during 1996 is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: (1) dividend yield of 2.43%, (2) expected volatility of 25.25%, (3) risk-free interest rate of 5.51%, and (4) expected life of 4 years. The weighted average fair value of options granted during 1996 and 1995 is $16.00 per share and $13.12 per share, respectively.

Had the compensation cost for the Company's 1996 and 1995 grants for stock-based compensation plans been determined consistent with SFAS 123, the Company's net income, primary earnings per share and fully diluted earnings per share for 1996 and 1995 would approximate the pro forma amounts below ($ in millions except per share data):

	1996	1995
Net income as reported	$ 342	$ 264
Net income pro forma	335	262
Primary earnings per share	$4.25	$3.19
Primary earnings per share pro forma	4.16	3.16
Fully diluted earnings per share	$3.89	$2.94
Fully diluted earnings per share pro forma	3.81	2.92

The Company has granted phantom shares and restricted stock under its non-union employee bonus plans to eligible employees who elect to defer all or a portion of their annual bonus in a given year. The number of shares granted depends on the length of the deferral period. Grants are made at the market price of the Company's common stock at the date of grant. The Company has granted 148,749 shares and 337,329 shares of phantom and restricted stock, respectively, under its non-union employee bonus plans through December 31, 1996. The Company has also granted 73,344 performance shares under its 1991 Long-Term Incentive Plan through December 31, 1996. Compensation expense related to these plans was $2 million in 1996 and $3 million in 1995. The weighted-average fair value for the phantom shares and restricted stock granted during 1996 and 1995 was $68.02 per share and $52.88 per share, respectively.

Stock Rights

In 1989, the Company declared a dividend of one common share purchase right (the "Right") on each outstanding share of common stock. The Rights are not exercisable or transferable apart from the common stock until the occurrence of certain events arising out of an actual or potential acquisition of 10% or more of the Company's common stock, and would at such time provide the holder with certain additional entitlements. However, under the terms of the Merger Agreement (Note 2) the CSX tender offer does not constitute an event that would result in the Rights becoming exercisable. In 1995, a dividend of one Right for each share of ESOP Stock was declared and paid. The exercise price of the Rights is $205. The Rights may be redeemed by the Company prior to becoming exercisable at one-half cent ($.005) per Right and have no voting or dividend rights.

10. Asset Disposition Charge

Included in 1995 operating expenses is an asset disposition charge of $285 million, which reduced net income by $176 million. The asset disposition charge resulted from a review of the Company's route system and other operating assets to determine those that no longer effectively and economically supported current and expected operations. The Company identified and has committed to sell 1,800 miles of rail lines that are expected to provide proceeds substantially less than net book value. In addition, other assets, principally yards and side tracks, identified for disposition were written down to estimated net realizable value (See Note 1 "Asset Impairment").

11. 1994 Early Retirement Program

During 1994, the Company recorded a charge of $84 million, which reduced net income by $51 million, for a non-union employee voluntary early retirement program and related costs. The majority of the cost of the early retirement program is being paid from the Company's overfunded pension plan.

12. Other Income, Net

	1996	1995	1994
		(In Millions)	
Interest income	**$ 29**	$ 33	$ 34
Rental income	**50**	57	53
Property sales	**23**	27	18
Other, net	**10**	13	13
	$112	$130	$118

13. Commitments and Contingencies

Environmental

The Company is subject to various federal, state and local laws and regulations regarding environmental matters. CRC is a party to various proceedings brought by both regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. At December 31, 1996, CRC has received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 135 locations. However, based on currently available information, the Company believes CRC may have some potential responsibility at only 61 of these sites. Due to the number of parties involved at many of these sites, the wide range of costs of possible remediation alternatives, the changing technology and the length of time over which these matters develop, it is often not possible to estimate CRC's liability for the costs associated with the assessment and remediation of contaminated sites.

Although the Company's operating results and liquidity could be significantly affected in any quarterly or annual reporting period if CRC were held principally liable in certain of these actions, at December 31, 1996, the Company had accrued $55 million, an amount it believes is sufficient to cover the probable liability and remediation costs that will be incurred at Superfund sites and other sites based on known information and using various estimating techniques. The Company believes the ultimate liability for these matters will not materially affect its consolidated financial condition.

The Company spent $11 million in 1996, $14 million in 1995 and $8 million in 1994 for environmental remediation and related costs and anticipates spending an amount comparable to that spent in 1996 during 1997. In addition, the Company's capital expenditures for environmental control and abatement projects were approximately $6 million in 1996 and 1995, and $5 million in 1994, and are anticipated to be approximately $10 million in 1997.

The Environmental Quality Department is charged with promoting the Company's compliance with laws and regulations affecting the environment and instituting environmentally sound operating practices. The department monitors the status of the sites where the Company is alleged to have liability and continually reviews the information available and assesses the adequacy of the recorded liability.

Other

The Company is involved in various legal actions, principally relating to occupational health claims, personal injuries, casualties, property damage and damage to lading. The Company has recorded liabilities on its balance sheet for amounts sufficient to cover the expected payments for such actions.

The Company may be contingently liable for approximately $63 million at December 31, 1996 under indemnification provisions related to sales of tax benefits.

CRC had an average of 20,761 employees in 1996, approximately 87% of whom are represented by 14 different labor organizations and are covered by 22 separate collective bargaining agreements. The Company was engaged in collective bargaining at December 31, 1996 with labor organizations representing approximately 22% of its labor force.

In 1994, Locomotive Management Services, a general partnership of which CRC holds a fifty percent interest, issued $96 million of Equipment Trust Certificates to fund the purchase price of 60 new locomotives. While principal and interest payments on certificates will be fully guaranteed by CRC, through a sharing agreement with its partner, CRC's portion of the guarantee is reduced to approximately $48 million, effective January 1, 1997, with the Company's purchase of twenty of the locomotives.

CRC has received three adverse jury verdicts related to railroad crossing accidents in Ohio that include significant punitive damage awards that collectively approximate $30 million. CRC believes the punitive damage awards in those cases are improper and that it has meritorious defenses, which it plans to pursue on appeal. The Company is not presently able to reasonably estimate the ultimate outcome of these cases, and accordingly, no expense for such awards has been recorded as of December 31, 1996.

As part of the Merger Agreement (Note 2), the Company may be a party to certain stock purchase options or, under certain circumstances, be required to pay substantial termination fees.

14. Condensed Quarterly Data (Unaudited)

	First		Second		Third		Fourth	
	1996	1995	1996	1995	1996	1995	1996	1995
	($ In Millions Except Per Share)							
Revenues	$889	$889	$949	$923	$933	$923	$943	$951
Income (loss) from operations	69	114	54	180	235	208	243	(46)
Net income (loss)	31	55	26	123	138	116	147	(30)
Net income (loss) per common share:								
Primary	.36	.66	.30	1.52	1.74	1.44	1.86	(.43)
Fully diluted	.35	.61	.29	1.37	1.58	1.31	1.70	(.43)
Ratio of earnings to fixed charges	1.75x	2.39x	1.57x	3.42x	4.77x	4.02x	4.91x	-
Dividends per common share	.425	.375	.425	.375	.475	.425	.475	.425
Market prices per common share (New York Stock Exchange)								
High	77 1/4	57 5/8	73 1/4	56 1/4	74 5/8	70 1/4	100 7/8	74 3/8
Low	67 5/8	50 1/2	66 1/4	51 1/8	63 3/4	55 1/8	68 1/2	65 1/2

During the second quarter of 1996, the Company recorded a one-time charge of $135 million for the non-union employee voluntary early retirement and separation programs and related costs, which reduced net income by $83 million (Note 3). Without this charge, net income would have been $109 million for the quarter ($1.37 and $1.25 per share, primary and fully diluted, respectively).

As a result of a decrease in a state income tax rate enacted during the second quarter of 1995, income tax expense was reduced by $21 million representing the effects of adjusting deferred income taxes and the special income tax obligation for the rate decrease as required under SFAS 109 (Note 7). Without this one-time tax benefit, the Company's net income for the quarter would have been $102 million ($1.25 and $1.14 per share, primary and fully diluted, respectively). During the fourth quarter of 1995, an asset disposition charge reduced income from operations by $285 million and adversely affected the quarter's net income by $176 million (Note 10). Without the asset disposition charge, net income would have been $146 million ($1.82 and $1.65 per share, primary and fully diluted, respectively) for the fourth quarter of 1995. After the asset disposition charge, earnings were insufficient by $58 million to cover fixed charges for the quarter.

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

None.

Item 10. Directors and Executive Officers of the Registrant.

The information regarding executive officers called for by Item 401 of Regulation S-K is included in Part I under "Executive Officers of the Registrant."

CLASS I DIRECTORS - TERM EXPIRING 1997:

Name, Business Experience and Other Directorships	Prior Service As Conrail Director
H. Furlong Baldwin Chairman and Chief Executive Officer of Mercantile Bankshares Corporation since prior to January 1991. Director, Mercantile Bankshares Corporation, Baltimore Gas & Electric Company, GRC International, Inc. and USF&G Corporation. Age 65.	Since 1988
David M. LeVan Chairman, President and Chief Executive Officer of Conrail since May 1996. Served as President and Chief Executive Officer between March 1995 and May 1996. President and Chief Operating Officer of Conrail between September 1994 and March 1995. Executive Vice President between November 1993 and September 1994. Senior Vice President - Operations between July 1992 and November 1993. Senior Vice President - Operating Systems and Strategies between November 1991 and June 1992. Age 51.	Since 1994
Gail J. McGovern Executive Vice President, Consumer Markets of AT&T since January 1997. Executive Vice President, Business Markets of AT&T between November 1995 and January 1997. Vice President, Business Services of AT&T between April 1994 and November 1995. Vice President, Strategy of AT&T between August 1993 and April 1994. Vice President, 800 Service of AT&T between January 1992 and August 1993. Age 45.	Since 1996

Name, Business Experience and Other Directorships	Prior Service As Conrail Director
David H. Swanson President and Chief Executive Officer of Countrymark Cooperative, Inc., a farm supply and marketing cooperative, since December 1995. Chairman, President and Chief Executive Officer of Explorer Nutritional Group, an animal nutrition company, and Chairman of Premiere Agri-Technologies, Inc., an international agricultural business, between January 1995 and December 1995. Chief Executive Officer of Premiere Agri-Technologies, Inc. between January 1994 and January 1995. Chairman, President and Chief Executive Officer of Central Soya Company, Inc. between 1986 and January 1994. Director, Fiduciary Trust International. Age 54.	Since 1989
CLASS II DIRECTORS - TERM EXPIRING 1998:	
Kathleen Foley Feldstein President of Economics Studies, Inc., a private consulting firm, since prior to January 1, 1991. Director, Bank America Corporation, Digital Equipment Corporation and John Hancock Mutual Life Insurance Company. Age 56.	Since 1993
David B. Lewis Chairman of Lewis, Clay & Munday, P.C., a law firm, since prior to January 1991. Director, LG&E Energy Corp., Comerica Bank, and TRW, Inc. Lewis, Clay & Munday provided legal services to Conrail in 1996. Age 52.	Since 1989
John C. Marous Retired in July 1990 from Westinghouse Electric Corporation where he held the position of Chairman and Chief Executive Officer between January 1988 and July 1990. Director, Mellon Bank, N.A. Age 71.	Since 1991
Raymond T. Schuler Retired in September 1990 from the Business Council of New York State, Inc., where he held the positions of Vice Chairman, President and Chief Executive Officer. Director, Oneida, Ltd., Northeast Savings and NAMICVSA. Age 67.	Since 1981

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CLASS III DIRECTORS - TERM EXPIRING 1999:

Name, Business Experience and Other Directorships	Prior Service As Conrail Director
Claude S. Brinegar Vice Chairman of Unocal Corp., a high technology earth resources company, from August 1989 to June 1995. Retired from Unocal Corp. in May 1992, where he held the position of Executive Vice President - Administration and Planning, since 1989. Director, Maxicare Health Plans, Inc., and a visiting scholar at Stanford University. Age 70.	Since 1990
Daniel B. Burke Chairman and Owner, Portland, Maine Baseball Inc., 1994 to present. Retired in February 1994 from Capital Cities/ABC, Inc. where he held the positions of President and Chief Executive Officer since June 1990. Director, Capital Cities/ABC, Inc., Rohm and Haas Co., Avon Products, Inc., Morgan Stanley Group Incorporated and Darden Restaurants. Age 68.	1981 to 1986 and since 1987
Roger S. Hillas Retired in January 1993 from Meritor Savings Bank where he held the positions of Chairman and Chief Executive Officer between July 1988 and December 1992. Director, P.H. Glatfelter Company, Toll Bros., Inc., The Bon-Ton Stores, Inc. and VF Corporation. Age 69.	Since 1981
E. Bradley Jones Retired in December 1984 from LTV Steel Company where he held the positions of Chairman and Chief Executive Officer and Group Vice President of LTV Corporation. Director, TRW, Inc., Cleveland-Cliffs, Inc., Birmingham Steel Corporation and RPM, Inc.; Trustee, First Union Real Estate Equity and Mortgage Investments and Trustee, Fidelity Group of Funds. Age 69.	Since 1987

Item 11. Executive Compensation.

COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

Directors' Compensation. Directors who are not officers of Conrail receive an annual fee of $25,000 and a fee of $1,000 for each Board and Board committee meeting they attend. Each such director who is a chairman of a Board Committee receives an additional annual fee of $2,000, except the chairman of the Audit Committee who receives an additional annual fee of $2,500. Directors who are officers of Conrail are not paid any fees for service on the Board or on any Board Committees.

Conrail maintains a Retirement Plan for Non-Employee Directors that provides each director who is not an employee or former employee of Conrail with a retirement benefit equal to the product of (1) one-twelfth of his or her annual retainer fee from Conrail in effect at the time the director ceases to serve as a member of the Board and (2) the number of full months, up to 120, he or she served on the Board, including service on the Board of Consolidated Rail Corporation prior to July 1, 1993.

Benefits are payable in cash, from Conrail's general assets, in equal monthly installments over the ten-year period beginning with the month following the later of (1) the month in which the director ceases to serve on the Board or (2) the month in which the director attains age 65. Notwithstanding the foregoing, (1) the benefits of directors who cease to serve on the Board on account of disability commence with the month following the month in which the director ceases to serve on the Board, and (2) after a director's death, his or her benefits shall be paid to the director's designated beneficiary, or in the absence of a written designation, to the director's estate, in a lump sum, as soon as practicable following the director's death.

Benefits are forfeited in the event the director, before he or she attains age 65, is removed from the Board for cause or voluntarily resigns from the Board, unless the resignation is approved by the Board on account of a conflict between the interests of the director and the interests of Conrail.

Conrail also maintains a Board of Directors Charitable Contributions Program pursuant to which Conrail has purchased life insurance policies of $1 million on the life of each director. Upon the death of an individual director, Conrail will donate $1 million in five annual installments of $200,000 each to one or more qualifying educational or charitable organizations designated by the director, and will be reimbursed by the life insurance proceeds. Individual directors derive no financial benefit from the program; all charitable deductions accrue solely to Conrail. In 1996, a donation of $200,000 was made under the program on behalf of the late Ann F. Friedlaender.

Compensation of Executive Officers. The following table provides certain summary information concerning compensation awarded to, earned by or paid in 1996 to Conrail's Chairman, President and Chief Executive Officer, David M. LeVan, and each of the four other most highly compensated executive officers of Conrail (determined as of the end of the last fiscal year (December 31, 1996) and hereafter referred to as the "named executive officers") for all services rendered in all capacities to Conrail and its subsidiaries during the fiscal years ended December 31, 1994, 1995 and 1996.

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation Awards		
(a)	(b)	(c)	(d)	(f)	(g)	(i)
Name and Principal Position	Year	Salary ($)	Bonus ($)	Restricted Stock Award(s) ($)	Securities Underlying Options/SARS (#)	All Other Compensation ($)(1)
D. M. LeVan	1996	594,522	0	0(2)	33,000	9,000
Chairman, President & CEO	1995	514,519	24,759	509,976(3)	30,746	9,000
R. J. Conway	1996	257,031	0	0(2)	9,000	9,000
Sr. Vice President-Operations	1995	223,889	101,367	27,425 (3)	9,000	9,000
	1994	166,940	88,023	0		9,000
B. B. Wilson	1996	251,840	0	0(2)	9,000	9,000
Sr. Vice President-Merger	1995	253,026	114,792	27,425 (3)	9,000	9,000
	1994	245,040	122,500	0		9,000
J.P. Sammon	1996	217,720	0	0(2)	9,000	9,000
Sr. Vice President-CORE Service Group	1995	198,334	90,104	27,425(3)	9,000	9,000
	1994	135,187	54,207	0		9,000
T.P. Dwyer	1996	197,819	0	0(2)	9,000	9,000
Sr. Vice President-Unit Train Service Group	1995	198,882	33,736	106,340(3)	9,000	9,000
	1994	150,446	65,178	0		9,000

(1) These amounts represent Conrail's matching contribution in the form of Conrail Preferred Stock of amounts deferred by the named executive officers through a 401(k) plan during 1996, 1995 and 1994. The shares are allocated based on the per share price set at the time the shares were purchased by the plan.

(2) As of December 31, 1996, Messrs. LeVan, Conway, Wilson, Sammon and Dwyer held, respectively, 15,273, 2,061, 1,230, 0 and 2,212 restricted shares of Conrail Common Stock worth $940,411, $146,513, $122,539, $0 and $124,473, respectively, net of the payments which such officers would have been entitled to receive absent their elections to take restricted shares instead of cash

bonuses. Valuation is based on the closing price of Conrail Common Stock on December 31, 1996 ($99.625).

(3) This figure represents the following: (i) full market value as of the January 31, 1996 grant date of restricted shares of Conrail Common Stock awarded to the named executive officer as a result of a 1995 bonus deferral, and is composed of the amount of the 1995 bonus which such officer elected to defer ($277,546 and $56,368 for Messrs. LeVan and Dwyer, respectively) plus a matching contribution by Conrail in the amount of 50%; and (ii) the value of shares of Conrail Common Stock awarded on January 22, 1996 in settlement of performance shares granted on January 1, 1995 based on Conrail's having met certain predetermined financial performance goals (computed at a fair market value of $68.5625). The number of shares of restricted stock was determined by the fair market value of Conrail Common Stock on January 31, 1996 ($70.3125). Dividends are paid on all restricted shares.

The following table contains information concerning the grant of stock options made to the named executive officers during the fiscal year ended December 31, 1996.

Option/SAR Grants in Last Fiscal Year

	Individual Grant				Grant Date Value
(a)	(b)	(c)	(d)	(e)	(f)
Name	Number of Securities Underlying Options/SARs Granted (#)	% of Total Options/SARs Granted to Employees in Fiscal Year	Exercise or Base Price ($/sh)	Expiration Date	Grant Date Present Value ($) (2)
D. M. LeVan	33,000 (1)	6.9%	$70.0313	January 1, 2006	521,730
R.J. Conway	9,000(1)	1.9%	$70.0313	January 1, 2006	142,290
B.B. Wilson	9,000(1)	1.9%	$70.0313	January 1, 2006	142,290
J.P. Sammon	9,000(1)	1.9%	$70.0313	January 1, 2006	142,290
T.P. Dwyer	9,000(1)	1.9%	$70.0313	January 1, 2006	142,290

(1) Exerciseable as of November, 1996.

(2) Based on modified Black-Scholes Option Pricing Model assuming a four year term and that dividends are compounded quarterly and risk-free rates are compounded continuously over the expected option term. Dividend yield for the options is 2.43%, and the risk free rate of return is 5.34%, using daily volatility rates of 25.30%.

The following table provides information concerning the exercise of stock options during the fiscal year ended December 31, 1996, by each of the named executive officers and the value of unexercised stock options held by each such officer as of December 31, 1996.

Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option/SAR Values

(a)	(b)	(c)	(d)		(e)	
			Number of Securities Underlying Unexercised Options/SARs at FY-End (#)		Value of Unexercised In-the-Money Options/SARs at FY-End ($)	
Name	Shares Acquired On Exercise (#)	Value Realized ($)	Exercisable/ Unexercisable		Exercisable/ Unexercisable(1)	
D. M. LeVan	0	0	E	98,896	E	4,357,479
			U	0	U	0
R. J. Conway	0	0	E	27,375	E	1,242,867
			U	0	U	0
B. B. Wilson	65,716	3,654,824	E	0	E	0
			U	0	U	0
J.P. Sammon	17,375	562,867	E	18,125	E	739,226
			U	0	U	0
T.P. Dwyer	30,500	1,314,437	E	0	E	0
			U	0	U	0

(1) This valuation is based on the fair market value of Conrail Common Stock on December 31, 1996 ($99.6875).

Long-Term Incentive Plans —Awards in Last Fiscal Year

(a)	(b)	(c)	(d)	(e)	(f)
			Estimated Future Payouts under Non-Stock Price-Based Plans		
Name	Number of Shares, Units or Other Rights (#)(1)	Performance or Other Period Until Maturation or Payout	Threshold (#)	Target (#)	Maximum(#)
D. M. LeVan	4,400	January 1999	3,960	4,400	4,400
R. J. Conway	1,200	January 1999	1,080	1,200	1,200
B. B. Wilson	1,200	January 1999	1,080	1,200	1,200
J.P. Sammon	1,200	January 1999	1,080	1,200	1,200
T.P. Dwyer	1,200	January 1999	1,080	1,200	1,200

(1) Represents performance shares granted to the named executive officers in 1996. Shares will vest proportionately in January 1999 if Conrail has met 90% or more of a three-year, cumulative cash flow goal.

Pension Plan Table and Related Disclosure

The following table shows estimated annual retirement benefits payable under the Supplemental Pension Plan of Consolidated Rail Corporation.

	Years of Service				
Remuneration	15 YRS	20 YRS	25 YRS	30 YRS	35 YRS
$ 125,000	$ 20,928	$ 27,905	$ 34,881	$ 41,857	$ 48,833
150,000	26,178	34,905	43,631	52,357	61,083
175,000	31,428	41,905	52,381	62,857	73,333
200,000	36,678	48,905	61,131	73,357	85,583
225,000	41,928	55,905	69,881	83,857	97,833
250,000	47,178	62,905	78,631	94,357	110,083
300,000	57,678	76,905	96,131	115,357	134,583
400,000	78,678	104,905	131,631	157,357	183,583
450,000	89,178	118,905	148,631	178,357	208,083
500,000	99,678	132,905	166,131	199,357	232,583
600,000	120,678	160,905	201,131	241,357	281,583
700,000	141,678	188,905	236,131	283,357	330,583
750,000	152,178	202,905	253,631	304,357	355,083
1,250,000	257,178	342,905	428,631	514,357	600,083
1,500,000	309,678	412,905	516,131	619,357	722,583

Messrs. LeVan, Conway, Wilson, Sammon and Dwyer have 18, 27, 17, 17 and 24 years of credited service, respectively. Compensation covered by the Pension Plan consists of an employee's wages for federal income tax purposes (see column (c) to the Summary Compensation Table plus any bonus paid in 1996; column (d) reflects bonuses earned in the stated year, but not paid in such year), excluding reimbursements, fringe benefits, gains from the exercise of employee stock options, and contributions to deferred compensation plans other than employee deferrals under Conrail's Matched Savings Plan. In 1996, the covered compensation of Messrs. LeVan, Conway, Wilson, Sammon and Dwyer was $625,826, $260,636, $308,554, $210,455, and $233,707, respectively. The table above shows estimated annual retirement benefits, after application of the Pension Plan's railroad retirement offset, payable to participants as a straight life annuity under the Pension Plan upon normal retirement at age 65 based upon final average compensation and years of Conrail service. The table does not reflect statutory limits on benefits under tax-qualified plans.

Employment Agreements and Termination of Employment and Change in Control Arrangements

To ensure that Conrail would have the continued dedicated service of certain executives notwithstanding the possibility, threat or occurrence of changes in control, in 1995, Conrail entered into severance agreements with its officers and certain key employees, including the officers named in the Summary Compensation Table ("Change of Control Contracts"). The agreements generally provide that if the executive is Terminated other than for Cause within three years after a Change in Control, or within two years of regulatory approval of such Change in Control, each as defined in the agreement, such executive is entitled to receive severance benefits. Such benefits would be equal to a lump sum payment equal to all previously accrued cash compensation, three times the sum of the then-current base salary and highest annual bonus earned within the previous three calendar years, together with certain other payments and benefits, including continuation of employee welfare benefits and an additional payment to compensate the executive for certain excise taxes imposed upon payments under such agreements. In addition, such Termination would result in the acceleration of vesting or lapse of restricted periods on previously granted stock-based incentive awards.

In connection with the proposed merger with CSX Corporation, CSX has agreed to pay to Mr. LeVan, in lieu of any stay bonus and severance or termination benefits, a lump sum equal to the economic value of the employment agreement (as reasonably determined by the parties in good faith) which CSX and Mr. LeVan had entered into in connection with the Conrail-CSX merger as originally proposed. Company executives (other than Mr. LeVan) will be paid the value of their Change of Control Contracts in accordance with the terms thereof if their employment is terminated under certain specified circumstances or if they remain employed until May 31, 1998.

CSX Corporation has agreed to honor all obligations under employment agreements and employee benefit plans, programs and policies and arrangements of Conrail in accordance with the terms of the Merger Agreement and to provide benefits to those employees of Conrail transferred to CSX or another entity. Severance or supplemental retirement benefits will be provided to non-union employees (other than executive level employees) who are terminated within three years following the regulatory approval of the merger, equal to between six months and 24 months of salary (depending upon an employee's service). Medical coverage will also be continued for these employees for specified periods. A stay bonus program will also be established that provides a lump sum cash payment to non-union employees who remain employed until regulatory approval of the merger with additional payments made to those employees who remain employed for up to six months thereafter.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

Outstanding Shares. As of the close of business on March 3, 1997, there were issued and outstanding 83,144,397 shares of Conrail Common Stock and 6,358,470 shares of Conrail Preferred Stock. To Conrail's knowledge, the only persons (or "group" as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) who, as of March 3, 1997, owned beneficially more than 5% of any class of Conrail's voting securities are listed in the following table:

Title of Class	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Conrail Common Stock	Green Acquisition Corp., a wholly-owned subsidiary of CSX Corp. One James Center 901 E. Cary Street Richmond, VA 23219	17,775,124 (of which: sole voting power - 17,775,124; shared voting power - 0; sole dispositive power - 17,775,124; shared dispositive power - 0) (1)	21.4%
Conrail Common Stock	Atlantic Acquisition Corp., a wholly-owned subsidiary of Norfolk Southrn Corp. Three Commercial Place Norfolk, VA 23510	8,200,100 (of which: sole voting power - 8,200,100; shared voting power - 0; sole dispositive power - 8,200,100; shared dispositive power - 0) (2)	9.9%
Conrail Preferred Stock	Fidelity Management Trust Co. 82 Devonshire Street Boston, MA 02109	4,825,000 shares, not individually, but solely in its capacity as Trustee of the ESOP (3)	75.9%

1. Held in trust by Deposit Guaranty National Bank, One Deposit Guaranty Plaza, Jackson, Mississippi. These shares represent 19.9% of Conrail's total voting securities (Common Stock and Preferred Stock voting as one class). CSX also beneficially owns an additional 15,955,477 shares of Conrail Common Stock pursuant to a Conrail Stock Option Agreement dated as of October 14, 1996 between Conrail and CSX, pursuant to which CSX currently has the right to purchase up to that number of additional shares at a price of $92.50 per share. These option shares, together with the 17,775,124 shares referred to above, represent approximately 37.7% of Conrail's total voting securities.

2. Held in trust by First American National Bank, 300 Union Street, Nashville, Tennessee. These shares represent 9.2% of Conrail's total voting securities.

3. Shares of Conrail Preferred Stock are convertible into shares of Conrail Common Stock at any time on a share-for-share basis, subject to certain antidilution adjustments. As a result, ownership of shares of Conrail Preferred Stock is deemed to be ownership of an equal number of shares of Conrail Common Stock. These 4,825,000 shares of Conrail Preferred Stock represent 5.4% of Conrail's total voting securities.

Ownership by Management of Equity Securities. The following table sets forth the beneficial ownership, as of March 3, 1997, of Conrail

Common Stock and Conrail Preferred Stock of each director and nominee, each of the executive officers named in the Summary Compensation Table and all directors and executive officers as a group. Unless otherwise indicated, each such person has sole voting and investment power with respect to such shares of Conrail Common Stock and sole voting power with respect to such shares of Conrail Preferred Stock. The ESOP Trustee holds sole investment power with respect to all shares of Conrail Preferred Stock. As of March 3, 1997, all Conrail directors and officers as a group owned less than one percent (1%) of the aggregate outstanding Conrail Common Stock and Conrail Preferred Stock.

Title of Class	Name and Title of Beneficial Owner	Amount and Nature of Beneficial Ownership
Conrail Common Stock	H. Furlong Baldwin Director	2,000
	Claude S. Brinegar Director	1,000
	Daniel B. Burke Director	2,000
	Kathleen Foley Feldstein Director	700
	Roger S. Hillas Director	2,362
	E. Bradley Jones Director	1,000
	David B. Lewis Director	919
	John C. Marous Director	612
	Gail J. McGovern Director	0
	Raymond T. Schuler Director	6,070
	David H. Swanson Director	452
	David M. LeVan Director, Chairman, President and Chief Executive Officer	138,896(1)

Bruce B. Wilson Senior Vice President - Merger	28,166(1)
Ronald J. Conway Senior Vice President - Operations	33,481(1)
John P. Sammon Senior Vice President - CORE Service Group	23,839(1)
Timothy P. Dwyer Senior Vice President - Unit Train Service Group	12,252(1)
All Directors and Executive Officers as a group(2)	577,760

(1) For Messrs. LeVan, Wilson, Conway, Sammon and Dwyer, respectively, includes options exercisable within 60 days to acquire 98,896, 0, 27,375, 18,125 and 0 shares of Conrail Common Stock and 1,968, 1,700, 1,903, 1,673 and 1,665 shares of Conrail Preferred Stock allocated to the accounts of the named officers pursuant to the ESOP. Shares of Conrail Preferred Stock are convertible into shares of Conrail Common Stock at any time on a share-for-share basis, subject to certain antidilution adjustments. As a result, ownership of shares of Conrail Preferred Stock is deemed to be ownership of an equal number of shares of Conrail Common Stock.

(2) Includes options exercisable within 60 days to acquire 356,560 shares of Conrail Common Stock and 35,842 shares of Conrail Preferred Stock allocated to the accounts of individual officers pursuant to the ESOP. This number also includes shares held by all officers of Consolidated Rail Corporation.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act and the rules and regulations promulgated thereunder require that certain officers, directors and 10% beneficial owners of Conrail Common Stock file with the Securities and Exchange Commission, within specified time periods, reports concerning transactions in Conrail securities. Based on its review of the filed forms or written representations that, in certain instances, no filing is required, Conrail believes that all Section 16(a) filing requirements during 1996 were complied with, except that, due to administrative error, one timely-filed report of each of Bruce B. Wilson, Senior Vice President-Merger, and Lucy S.L. Amerman, Vice President-Risk Management, disclosed an incorrect number of shares sold in a tender offer and stock options granted, respectively.

and

Item 13. Certain Relationships and Related Transactions.

None except as disclosed in Item 10.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

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

1. Financial Statements:

2. Financial Statement Schedules:

The following financial statement schedules should be read in connection with the financial statements listed in Item 14(a)1 above.

Index to Financial Statement Schedules

Schedules other than those listed above are omitted for reasons that they are not required, are not applicable, or the information is included in the financial statements or related notes.

3. Exhibits:

Exhibit No.

2.1 Agreement and Plan of Merger among Consolidated Rail Corporation, Conrail Inc. and Conrail Subsidiary Corporation dated as of February 17, 1993, filed as Appendix A to the Proxy Statement of Consolidated Rail Corporation, dated April 16, 1993 and incorporated herein by reference.

2.2 Agreement and Plan of Merger dated October 14, 1996 among Conrail Inc., CSX Corporation and Green Acquisition Corp. (the "Merger Agreement") (incorporated by reference to Exhibit (c)(1) to the Solicitation/Recommendation Statement on Schedule 14D-1, originally filed with the Securities and Exchange Commission ("SEC") on October 16, 1996 (the "CSX 14D-1")).

2.3 First Amendment to the Merger Agreement, dated as of November 5, 1996 (incorporated by reference to Exhibit (c)(7) to the CSX 14D-1).

2.4 Second Amendment to the Merger Agreement, dated as of December 18, 1996 (the "Second Amendment") (incorporated by reference to Exhibit (c)(10) to the CSX 14D-1).

2.5 Third Amendment to the Merger Agreement, dated as of March 7, 1997 (the "Third Amendment") (incorporated by reference to Exhibit (c)(12) to the CSX 14D-1).

3.1 Articles of Incorporation of the Registrant filed as Appendix B to the Proxy Statement of Consolidated Rail Corporation, dated April 16, 1993 and incorporated herein by reference.

3.2 Amended and Restated Bylaws of the Registrant filed as Exhibit 3 to the Registrant's Report on Form 10-Q for the quarterly period ended September 30, 1996 and incorporated herein by reference.

4.1 Articles of Incorporation of the Registrant filed as Appendix B to the Proxy Statement of Consolidated Rail Corporation, dated April 16, 1993 and incorporated herein by reference.

4.2 Form of Certificate of Common Stock, par value $1.00 per share, of the Registrant, filed as Exhibit 3.4(i)(c) to the Registrant's Form 8-B dated July 13, 1993 and incorporated herein by reference.

4.3 Form of Certificate of Series A ESOP Convertible Junior Preferred Stock, no par value, of the Registrant filed as Exhibit 3.4(i)(d) to the Registrant's Form 8-B dated July 13, 1993 and incorporated herein by reference.

4.4 Rights Agreement dated as of July 19, 1989, between Consolidated Rail Corporation and First Chicago Trust Company of New York, together with Form of Right Certificate and Summary of Rights to Purchase Common Shares as exhibits thereto, filed as Exhibit 1 to Consolidated Rail Corporation's Form 8-K dated July 31, 1989 and incorporated herein by reference.

4.5 Amendment to Rights Agreement dated as of March 21, 1990, filed as Exhibit 4.5 to Consolidated Rail Corporation's Report on Form 8-K dated March 27, 1990 and incorporated herein by reference.

4.6 Amendment, Assignment and Assumption Agreement, dated as of February 17, 1993, with respect to the Rights Agreement, filed as Exhibit 3.4(i)(g) to the Registrant's Form 8-B dated July 13, 1993 and incorporated herein by reference.

4.7 Amendment to Rights Agreement dated as of October 19, 1994 filed as Exhibit 4.1 to the Registrant's Report on Form 10-Q for the quarter ended September 30, 1994 and incorporated herein by reference.

4.8 Amendment to Rights Agreement of the Registrant dated as of September 20, 1995, filed as Exhibit 3.4(i)(i) to the Registrant's Form 8-B/A dated as of September 25, 1995 and incorporated herein by reference.

4.9 Form of Indenture between Consolidated Rail Corporation and The First National Bank of Chicago, as Trustee, with respect to the issuance of up to $1.25 billion aggregate principal amount of Consolidated Rail Corporation's debt securities, filed as Exhibit 4 to Consolidated Rail Corporation's Registration Statement on Form S-3 (Registration No. 33-34040) and incorporated herein by reference.

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

10.1 Second Amended and Restated Northeast Corridor Freight Operating Agreement dated October 1, 1986 between National Railroad Passenger Corporation and

Consolidated Rail Corporation, filed as Exhibit 10.1 to Consolidated Rail Corporation's Registration Statement on Form S-1 (Registration No. 33-11995) and incorporated herein by reference.

10.2 Letter agreements dated September 30, 1982 and July 19, 1986 between Consolidated Rail Corporation and The Penn Central Corporation, filed as Exhibit 10.5 to Consolidated Rail Corporation's Registration Statement on Form S-1 (Registration No. 33-11995) and incorporated herein by reference.

10.3 Letter agreement dated March 16, 1988 between Consolidated Rail Corporation and Penn Central Corporation relating to hearing loss litigation, filed as Exhibit 19.1 to Consolidated Rail Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 1988 and incorporated herein by reference.

10.4 Conrail Stock Option Agreement, dated as of October 14, 1996 (incorporated by reference to Exhibit (c)(2) of the CSX 14D-1).

Management Compensation Plans and Contracts

10.5 Consolidated Rail Corporation 1993 Annual Performance Achievement Reward Plan, filed as Exhibit 3.10(v) to the Registrant's Form 8-B dated July 13, 1993 and incorporated herein by reference.

10.6 Consolidated Rail Corporation 1994 Annual Performance Achievement Reward Plan for Officers, filed as Exhibit 10.7 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference.

10.7 Consolidated Rail Corporation 1995 Annual Performance Achievement Reward Plan for Officers, filed as Exhibit 10.6 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 and incorporated herein by reference.

10.8 Consolidated Rail Corporation 1996 Annual Performance Achievement Reward Plan for Officers.

10.9 Retirement Plan for Non-employee Directors, as amended February 21, 1990, filed as Exhibit 10.10 to Consolidated Rail Corporation's Annual Report on Form 10-K for the year ended December 31, 1989 and included herein by reference.

10.10	Conrail 1987 Long-Term Incentive Plan, filed as Exhibit 4.4 to Consolidated Rail Corporation's Registration Statement on Form S-8 (Registration No. 33-19155) and incorporated herein by reference.
10.11	Conrail 1991 Long-Term Incentive Plan, amended and restated as of May 15, 1996, filed as Appendix A to the Registrant's Proxy Statement dated April 3, 1996 and incorporated herein by reference.
10.12	Conrail Senior Executive Performance Plan, filed as Appendix A to the Registrant's Proxy Statement for the 1995 Annual Meeting of Shareholders, dated April 3, 1995, and incorporated herein by reference.
10.13	Form of Severance Agreement between the Registrant and each of the officers of Consolidated Rail Corporation, dated as of August 1, 1995, filed as Exhibit 10.1 to the Registrant's Report on Form 10-Q for the quarterly period ended September 30, 1995 and incorporated herein by reference.
11	Statement of earnings per share computations.
12	Computation of the ratio of earnings to fixed charges.
21	Subsidiaries of the Registrant, filed as Exhibit 21 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 1993 and incorporated herein by reference.
23	Consent of Independent Accountants.
24	Each of the officers and directors signing this Annual Report on Form 10-K has signed a power of attorney, contained on page 86 hereof, with respect to amendments to this Annual Report.
27	Financial Data Schedule.

(b) Reports on Form 8-K.

October 22, 1996, in connection with Merger Agreement between CSX Corporation and Consolidated Rail Corporation.

(c) Exhibits.

The Exhibits required by Item 601 of Regulation S-K as listed in Item 14(a)3 are filed herewith or incorporated herein by reference.

(d) Financial Statement Schedules.

Financial statement schedules and separate financial statements specified by this Item are included in Item 14(a)2 or are otherwise omitted for reasons that they are not required or are not applicable.

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POWER OF ATTORNEY

Each person whose signature appears below under "SIGNATURES" hereby authorizes Timothy T. O'Toole and John A. McKelvey, or either of them, to execute in the name of each such person, and to file, any amendment to this report and hereby appoints Timothy T. O'Toole and John A. McKelvey, or either of them, as attorneys-in-fact to sign on his or her behalf, individually and in each capacity stated below, and to file any and all amendments to this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act 1934, Conrail Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CONRAIL INC.

Date: March 19, 1997

By David M. LeVan
David M. LeVan
Chairman, President and Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on this 19th day of March, 1997, by the following persons on behalf of Conrail Inc. and in the capacities indicated.

Signature	Title
David M. LeVan David M. LeVan	Chairman, President and Chief Executive Officer and Director (Principal Executive Officer)
John A. McKelvey John A. McKelvey	Senior Vice President-Finance (Principal Financial Officer)
Donald W. Mattson Donald W. Mattson	Vice President-Controller (Principal Accounting Officer)

H. Furlong Baldwin	Director
Claude S. Brinegar	Director
Daniel B. Burke	Director
Kathleen Foley Feldstein	Director
Roger S. Hillas	Director
E. Bradley Jones	Director
David B. Lewis	Director
John C. Marous	Director
Gail J. McGovern	Director
Raymond T. Schuler	Director
David H. Swanson	Director

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EXHIBIT INDEX

Exhibit No.

Exhibit No.	
10.8	Consolidated Rail Corporation 1996 Annual Performance Achievement Reward Plan for Officers
11	Statement of earnings per share computations
12	Computation of the ratio of earnings to fixed charges
23	Consent of Independent Accountants
27	Financial Data Schedule

Exhibits 2.1, 2.2, 2.3, 2.4, 2.5, 3.1, 3.2, 4.1, 4.2, 4.3, 4.4, 4.5, 4.6, 4.7, 4.8, 4.9, 10.1, 10.2, 10.3, 10.4, 10.5, 10.6, 10.7, 10.9, 10.10, 10.11, 10.12, 10.13 and 21 are incorporated herein by reference. Powers of attorney with respect to amendments to this Annual Report are contained on page 86.

CONSOLIDATED RAIL CORPORATION

ANNUAL PERFORMANCE ACHIEVEMENT REWARD PLAN FOR 1996

FOR OFFICERS

1. Definitions

When used in this document, the following terms shall have the meanings set forth below:

Board means the Board of Directors of Conrail.

Conrail means the Consolidated Rail Corporation.

The Company means Conrail Inc.

Operating Ratio means the percentage determined by dividing (a) operating expenses by (b) revenues, as shown on Conrail's consolidated financial statements.

Cost of Risk Ratio means the percentage determined by dividing (a) the sum of the cost of risk elements (as designated by the Risk Management Department) by (b) Conrail's railroad operating revenues.

Participant means an officer of Conrail who participates in the Plan in accordance with Section 3.

Plan means the Consolidated Rail Corporation Annual Performance Achievement Reward Plan for 1996, as set forth in this document and as may be amended from time to time.

Salary means the salary earned by a Participant in 1996 from employment with Conrail. For purposes of this Plan, Salary shall include salary earned pursuant to any holiday, vacation, or sick leave policy of Conrail, salary deferred pursuant to the Consolidated Rail Corporation Matched Savings

Plan, and salary contributed pursuant to the Consolidated Rail Corporation Flexible Benefits Plan. Except as otherwise provided in the preceding sentence, Salary shall not include any amount payable pursuant to receipt of a Spot Award or a 1995 Selective Cash Award paid in 1996 or to an employee benefit or incentive compensation plan. .

2. Introduction

The Board has approved the implementation of this Plan. The Board expects that the Plan will provide an incentive for enhanced individual and corporate performance and aid Conrail in attracting and retaining capable employees.

3. Eligibility

Each officer of Conrail, who is employed during 1996, shall participate in the Plan.

4. Prerequisite for Award

Anything in this Plan to the contrary notwithstanding, no award shall be payable under the Plan in the event actual operating income for 1996, as shown on Conrail's consolidated financial statements, is less than $690 million.

5. Amount of Award

(a) Under the Plan, a Participant may earn an award equal to a percentage (or percentages) of his/her Salary. This award may consist of two parts, the Annual Performance Achievement Reward ("APAR") and the Annual Performance Achievement Reward Plus ("APAR Plus"). The APAR percentage(s) shall depend upon the position held by the Participant and the performance of Conrail, measured by the relationship of (i) the Operating Ratio for 1996, to (ii) the Operating Ratio goal set by the Board (or its delegate) for purposes of the Plan and the relationship of (iii) the Cost of Risk Ratio for 1996 to (iv) the Cost of Risk Ratio goal set by the Board (or its delegate) for purposes of the Plan, both as certified by Conrail's chief financial officer, after taking into account any amounts payable pursuant to the Plan that are not taken into account in the Operating Ratio goal set by the Board (or its delegate) for purposes of the Plan. The percentage(s) shall be determined in accordance with one of three schedules.

The APAR Plus percentage shall depend upon the performance of Conrail, as measured by the relationship of (i) the Operating Ratio for 1996 to (ii) the Operating Ratio goal set by the Board (or its delegate) for purposes of the Plan.

Conrail shall furnish each Participant with a copy of the schedule(s) of awards applicable to him/her.

(b) A Participant's award shall be pro-rated, as provided in Section 8, in the event he/she participates in the Plan for less than all of 1996 or moves into a position covered under a different schedule of awards. The Participant's award shall equal the sum of the partial awards computed by multiplying (i) the Salary earned by the Participant while covered under a schedule of awards, by (ii) the percentage of Salary determined in accordance with such schedule.

(c) Anything to the contrary in this Section 5 notwithstanding, a Participant's award may be reduced by up to 50 percent by Conrail's President and Chief Executive Officer (or his delegate(s)) on the basis of individual or group performance.

6. <u>Election to Defer Awards</u>

(a) Each Participant shall be entitled to elect irrevocably to defer, for a period of one, two, three, four, or five years, all or a portion of any APAR award payable to him/her pursuant to this Plan. The minimum deferral permitted is 10 percent and a deferral may be made in any percentage above this minimum. A Participant who so elects shall receive his/her APAR award in the form of whole shares of Conrail Inc. restricted common stock, recorded in electronic book entry at First Chicago Trust Company of New York which shares shall be forfeited (except as otherwise provided in the Plan) in the event the Participant terminates employment with Conrail during the applicable periods of deferral, as described in Section 7, and prior to the receipt of a certificate(s) for the shares. Such elections must be made no later than July 27, 1996, on forms provided by Conrail's Assistant Vice President-Compensation and Benefits for this purpose.

(b) A Participant who elects to receive an APAR award in Conrail Inc. common stock shall be granted shares of such stock equal in value to the amount of his/her deferred award (the "Deferred Shares"), plus additional shares of such stock equal in value to 10 percent (10%) of his/her deferred award times the period of deferral selected, up to a maximum of fifty percent (50%) (the "Bonus Shares"). The number of shares so awarded shall be determined as of the date the non-deferred portions of awards are or would have been paid.

(c) Deferred Shares and Bonus Shares shall be issued as restricted shares pursuant to the Consolidated Rail Corporation 1991 Long-Term Incentive Plan, as amended. Each such share shall entitle the Participant to the same dividend and voting rights as one share of Conrail Inc. common stock.

(d) The APAR Plus award shall not be eligible for deferral.

7. Time and Form of Payments

(a) In the case of a Participant who has made an election to defer, the certificates for the Participant's Deferred Shares and for the Participant's Bonus Shares, shall be paid in the form of Conrail Inc. common stock, recorded in electronic book entry at First Chicago Trust Company of New York, the Company's transfer agent, as soon as practicable after expiration of the deferral period chosen by the Participant. Any portion of an APAR award not deferred by a Participant shall be paid to him/her in cash during the first quarter of 1997.

(b) In the case of a Participant who has made no election to defer, the Participant's award shall be paid to him/her in cash in a single installment during the first quarter of 1997.

8. Special Payment Rules

Anything in this Plan to the contrary notwithstanding, a Participant who is dismissed for cause prior to receipt of any portion of his/her award shall forfeit such portion of the award. A Participant who resigns from Conrail during 1996 shall receive a prorated portion of his/her APAR and APAR Plus awards. The amount of the prorated award shall be determined by applying a fraction to the Participant's Salary determined up until his/her date of termination. The numerator of this fraction is the number of days of the year until the termination occurred and the denominator is 366, the number of days in the year. A Participant who resigns from Conrail after December 31, 1996, but before the date in the first quarter of 1997 on which payments are made under the Plan, shall receive a full APAR and APAR Plus award. If the Participant has elected to defer his/her award, such election is void and the prorated or full award will be paid in cash in the first quarter of 1997. If the Participant resigns during the deferral period the Participant forfeits both the Deferred and Bonus Shares.

If a Participant who has elected to defer all or a portion of his/her APAR award in the form of Deferred and Bonus Shares retires with the right to an immediate pension under the Supplemental Pension Plan of Consolidated Rail

Corporation (the "Pension Plan") prior to receipt of any such shares, the restriction on such shares shall be lifted and the Participant shall receive shares of Conrail Inc. common stock representing the Participant's deferred APAR award recorded in electronic book entry at First Chicago Trust Company of New York. The matching or Bonus Shares shall be prorated on the basis of a fraction, the denominator of which shall be the number of days from the date of the award through the end of the elected deferral period and the numerator shall be the number of days from the date of the award through the last day of employment. This proration factor shall be multiplied by the number of Bonus Shares and the resulting number of Bonus Shares shall be distributed to the Participant. The balance of the Bonus Shares shall be forfeited on the last day of the Participant's employment.

If during 1996, a Participant is force reduced, goes on a leave of absence, becomes disabled or dies, such Participant's award shall be prorated in the first quarter of 1997 on the basis of a fraction applied to the Participant's Salary, the numerator of which is the number of days of the year until the event occurred and the denominator of which is 366, the number of days in the year. The amount of the award shall be paid in cash.

A Participant who is force reduced or goes on a leave of absence after the end of 1996, but before payments under the Plan are made shall receive a full APAR and APAR Plus award. If the Participant has elected to defer his or her APAR award, the election is void and the APAR award is payable in cash. A Participant who becomes disabled or dies after the end of 1996, but before payments under the Plan are made shall receive a full APAR and APAR Plus award. If the Participant has elected to defer his/her APAR award, such award will be paid in cash to the Participant or his/her beneficiary(ies) or estate.

If, after the APAR award is made in the first quarter of 1997, a Participant is force reduced, becomes disabled or dies, his/her Deferred and Bonus Shares shall be distributed in full to him/her or to his/her beneficiary(ies) or estate in the form of Conrail Inc. common stock recorded in electronic book entry at First Chicago Trust Company of New York. If after the APAR award is made in the first quarter of 1997 a Participant goes on a leave of absence, his/her Deferred and

Bonus shares shall be retained in the Plan and distributed in the form of Conrail Inc. common stock recorded in electronic book entry at First Chicago Trust Company of New York at the end of the deferral period selected by the Participant.

9. Acceleration of Awards Upon a Change of Control

Notwithstanding any provision of the Plan to the contrary, upon the occurrence of a Change of Control, as defined below, all terms and conditions with respect to Deferred and Bonus Shares then outstanding shall be deemed satisfied as of the date of the Change of Control for all purposes hereunder, and such Deferred and Bonus Shares shall be payable to Participants as soon as practicable following the Change of Control.

A Change of Control hereunder shall be deemed to have occurred on the earliest of the following dates: (i) the date any entity, person or group (within the meaning of Section 13(d)(3) or Section 14(d)(2) of the Securities Exchange Act of 1934, as amended) other than the Company or any of its subsidiaries, shall have become the beneficial owner of, or shall have obtained voting control over, outstanding securities issued by the Company entitled to cast 20% or more of the votes which all outstanding securities issued by the Company are entitled to cast in an election of directors of the Company; (ii) the date the shareholders of the Company and the shareholders of the other constituent corporations have approved a definitive agreement to merge or consolidate the Company with or into another corporation other than in either case, a merger or consolidation of the Company in which holders of shares of common stock of Conrail Inc. immediately prior to the merger or consolidation, which common stock is then held in the same proportion as such holders' ownership of common stock of Conrail Inc. immediately before the merger or consolidation; (iii) the date the shareholders of the Company approve a definitive agreement to sell or otherwise dispose of substantially all the assets of the Company; or (iv) the date there shall have been a change in the composition of the Company's Board such that a majority of the Company's Board shall have been members thereof for less than twelve (12) months, unless the nomination for election of each new director who was not a director at the beginning of such twelve (12) month period was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of such period.

To the extent a Participant hereunder is a party to an agreement with the Company as authorized by its Board on June 21, 1995, awards hereunder shall be subject to the terms of such agreement, in addition to the foregoing provisions of this Section 9. In resolving any conflict between the terms of such agreement and the terms of the Plan, the provisions which are most favorable to the Participant shall prevail.

10. Withholding for Taxes

Payments pursuant to this Plan shall be reduced by amounts sufficient to satisfy any Federal, state, and/or local tax withholding requirements. With respect to payments in the form of stock, an amount of stock shall be withheld from the award that is sufficient to enable Conrail to satisfy any Federal, state, and/or local tax withholding requirements.

11. Designation of Beneficiary

A Participant may designate a beneficiary(ies) to receive any payment pursuant to the Plan that has not been made prior to the Participant's death. Such designation must be submitted to Conrail's Assistant Vice President-Compensation and Benefits, on a form provided for this purpose. Such form is available upon request from the Administrator-APAR/APAR Plus, 18-B 2001 Market Street, Philadelphia, PA 19101-1418. In the absence of such a designation, a Participant's most recent designation of beneficiary(ies) pursuant to a prior annual performance achievement reward plan maintained by Conrail shall be treated as his/her designation for purposes of this Plan.

12. Duration, Amendment, and Termination of Plan

The Plan shall take effect on January 1, 1996. Conrail, by action of the Board, may amend or terminate the Plan at any time. In addition, Conrail's President and Chief Executive Officer may amend the eligibility requirements and/or the schedules of awards under the Plan, in connection with a re-assessment of positions or changes in organization or staffing. The Plan shall terminate automatically as of January 1, 1997, unless terminated earlier by Conrail; provided, however, that such termination shall not preclude the subsequent payment of awards earned under the Plan.

CONRAIL INC.

EARNINGS PER SHARE COMPUTATIONS

($ In Millions Except Per Share)

	Years ended December 31,		
	1996	1995	1994
Primary			
Net income	$342	$264	$324
Dividends declared on Series A ESOP convertible junior preferred stock (ESOP Stock), net of tax benefits	(12)	(13)	(13)
Adjusted net income	$330	$251	$311
Fully Diluted			
Net income	342	264	324
Nondiscretionary adjustment (1)	(2)	(3)	(5)
Adjusted net income	$340	$261	$319

Page 1 of 3

CONRAIL INC.

EARNINGS PER SHARE COMPUTATIONS

($ In Millions Except Per Share)

	Years ended December 31,		
	1996	1995	1994
Weighted average number of shares (2)			
Primary			
Weighted average number of common shares outstanding	76,903,665	78,144,694	79,089,464
Effect of shares issuable under employee stock compensation plans	725,160	589,253	585,317
	77,628,825	78,733,947	79,674,781
Fully diluted			
Weighted average number of common shares outstanding	76,903,665	78,144,694	79,089,464
ESOP Stock	9,393,275	9,799,611	9,887,940
Effect of shares issuable under employee stock compensation plans	1,028,635	758,407	585,317
	87,325,575	88,702,712	89,562,721
Net income per common share			
Primary	$4.25	$3.19	$3.90
Fully diluted	3.89	2.94	3.56

CONRAIL INC.

EARNINGS PER SHARE COMPUTATIONS

Notes: 1. Represents the increase, net of income tax benefits, in ESOP-related expenses assuming conversion of all ESOP Stock to common stock.

2. Shares held by the Employee Benefits Trust (the "Trust") are not considered outstanding for earnings per share computations until issued by the Trust.

Exhibit 12

CONRAIL INC.

COMPUTATION OF THE RATIO OF EARNINGS TO FIXED CHARGES

($ In Millions)

	Quarters Ended March 31,		Quarters Ended June 30,		Quarters Ended September 30,		Quarters Ended December 31,		Years Ended December 31,		
	1996	1995	1996	1995	1996	1995	1996	1995(1)	1996	1995	1994
Earnings											
Pre-tax income (loss)	$ 50	$ 91	$38	$165	$216	$188	$227	$(52)	$531	$392	$532
Add:											
Interest expense	47	48	46	50	44	49	45	47	182	194	192
Rental expense interest factor	14	14	14	16	12	12	11	11	51	53	42
Less equity in undistributed earnings of 20-50% owned companies	(4)	(5)	(4)	(5)	(5)	(4)	(8)	(6)	(21)	(20)	(17)
Earnings available for fixed charges	$107	$148	$94	$226	$267	$245	$275	$ -	$743	$619	$749
Fixed Charges											
Interest expense	47	48	46	50	44	49	45	47	182	194	192
Rental expense interest factor	14	14	14	16	12	12	11	11	51	53	42
Capitalized interest											1
Fixed charges	$ 61	$ 62	$60	$ 66	$ 56	$ 61	$ 56	$ 58	$233	$247	$235
Ratio of earnings to fixed charges	1.75x	2.39x	1.57x	3.42x	4.77x	4.02x	4.91x	-	3.19x	2.51x	3.19x

Note: For the purpose of computing the ratio of earnings to fixed charges, earnings represent income before income taxes plus fixed charges, less equity in undistributed earnings of 20% to 50% owned companies. Fixed charges represent interest expense together with interest capitalized and a portion of rent under long-term operating leases representative of an interest factor.

(1) In the fourth quarter of 1995, the Company recorded an asset disposition charge of $176 million (after tax benefits of $109 million). After this charge, earnings were insufficient by $58 million to cover fixed charges for the quarter.

Exhibit 23

Consent of Independent Accountants

We hereby consent to the incorporation by reference in the Prospectuses constituting part of the Registration Statements on Form S-3 (Nos. 33-64670 and 33-62929) and in the Registration Statements on Form S-8 (Nos. 33-19155, 33-44140, 33-57717, 33-60445 and 333-6513) of Conrail Inc. and subsidiaries of our report dated January 21, 1997, except as to Note 2, which is as of March 7, 1997, included in this Form 10-K.

Price Waterhouse LLP

PRICE WATERHOUSE LLP
Thirty South Seventeenth Street
Philadelphia, PA 19103
March 24, 1997

CONRAIL INC.
FINANCIAL DATA SCHEDULE
($ In Millions Except Per Share)

THIS SCHEDULE CONTAINS SUMMARY INFORMATION EXTRACTED FROM FORM 10-K AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FORM 10-K.

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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]

For the fiscal year ended December 31, 1996

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the Transition Period from ________________ to ____________________

Commission File No. 1-9064

CONSOLIDATED RAIL CORPORATION
(Exact name of registrant as specified in its charter)

Pennsylvania	23 1989084
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2001 Market Street, Two Commerce Square Philadelphia, Pennsylvania	19101-1417
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (215) 209-4000

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

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

Aggregate market value of voting stock held by non-affiliates of the Registrant (as of March 3, 1997): $0.

Shares of Common Stock Outstanding (as of March 3, 1997): 100 Shares, all of which are held by the parent of the Registrant

DOCUMENTS INCORPORATED BY REFERENCE: NONE

REGISTRANT MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION (I)(1)(a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH THE REDUCED DISCLOSURE FORMAT.

TABLE OF CONTENTS

PART I

Item 1. Business.

GENERAL. Consolidated Rail Corporation ("the Company") is a Pennsylvania corporation incorporated on February 10, 1976 to acquire, pursuant to the Regional Rail Reorganization Act of 1973, the rail properties of many of the railroads in the northeast and midwest region of the United States which had gone bankrupt during the early 1970's, the largest of which was the Penn Central Transportation Company ("Penn Central").

On July 1, 1993 Conrail Inc. ("Conrail") became the holding company of the Company. The Company is Conrail Inc.'s only significant subsidiary and primary asset. Conrail Inc.'s common stock is listed on the New York and Philadelphia Stock Exchanges.

Reports on Form 10-K for years prior to 1993 were filed by Consolidated Rail Corporation, and historic data presented herein and therein reflect the results of Consolidated Rail Corporation for those time periods.

PROPOSED MERGER. On October 14, 1996, Conrail, CSX Corporation ("CSX") and a subsidiary of CSX entered into an Agreement and Plan of Merger (as amended, the "Merger Agreement"), pursuant to which Conrail was to be merged with a subsidiary of CSX in a merger-of-equals transaction.

On October 24, 1996, Norfolk Southern Corporation ("Norfolk") commenced an unsolicited tender offer for all outstanding Conrail voting stock at $100 per share in cash. Norfolk has since increased its offer to $115 per share in cash.

On November 20, 1996, CSX concluded its first tender offer and purchased approximately 19.9% of Conrail's outstanding shares for $110 per share.

On December 18, 1996, CSX and Conrail entered into a second amendment to the Merger Agreement (the "Second Amendment") that would, among other things, (i) increase the consideration payable pursuant to the merger, (ii) accelerate the consummation of the merger to immediately following the receipt of applicable shareholder approvals and prior to the Surface Transportation Board ("STB") approval and (iii) extend until December 31, 1998 an exclusivity period during which the Conrail Board agreed not to withdraw or modify its recommendations of the CSX transactions, approve or recommend any takeover proposal or cause Conrail to enter into any agreement related to any takeover proposal.

On January 13, 1997, Norfolk issued a press release announcing that it would offer to purchase shares representing 9.9% of the outstanding shares for $115 per share, in the event that Conrail shareholders did not approve a proposal to opt out of a Pennsylvania statute (the "Opt Out Proposal") at the meeting of shareholders to be held on January 17, 1997 (the "Special Shareholders Meeting").

On January 17, 1997, Conrail shareholders voted at the Special Shareholders Meeting against the Opt Out Proposal.

On February 4, 1997, the amended Norfolk tender offer expired, and Norfolk subsequently purchased approximately 8.2 million shares pursuant thereto.

On March 7, 1997, Conrail and CSX entered into a Third Amendment (the "Third Amendment") to the Merger Agreement. Pursuant to the Third Amendment, (i) the price per share has been increased from $110 to $115, and the number of shares to be purchased in the tender offer has been increased to all outstanding shares. The tender offer is scheduled to close April 18, 1997 (subject to extension by CSX to June 2, 1997 whether or not the conditions have been satisfied), (ii) the consideration paid per share in the merger for all remaining outstanding shares following consummation of the offer has been increased to $115 in cash and (iii) the conditions to the offer relating to certain provisions of Pennsylvania law becoming inapplicable to Conrail and relating pending governmental actions or proceedings have been deleted.

The Third Amendment also provides that CSX will have sole control over the regulatory approval process and will be free to conduct by itself discussions with other railroads, including Norfolk, relating to competitive issues raised by the CSX transactions, and to enter into any resulting agreement. It is anticipated that CSX and Norfolk will negotiate an appropriate division of Conrail's assets; however, neither the pending CSX tender offer nor the merger is conditioned on CSX's reaching an agreement with Norfolk.

Pursuant to the Third Amendment, three members of Conrail's Board of Directors approved by CSX shall be invited to join the CSX Board of Directors and a transition team will be established, the leadership of which will include senior executive officers of CSX and Conrail to ensure the orderly operation of Conrail during the regulatory approval process and an orderly transition thereafter.

Under the Third Amendment, Conrail and CSX agreed to reduce from December 31, 1998 to December 31, 1997 the period of time during which the Conrail Board is prohibited from (i) withdrawing or modifying, or publicly proposing to withdraw or modify, its approval or recommendation of the CSX transactions, in a manner adverse to CSX, (ii) approving or recommending, or publicly proposing to approve or recommend, any competing proposal or (iii) causing Conrail to enter into any agreement related to any such competing proposal.

Under the Merger Agreement as amended, Conrail may terminate the Merger Agreement in the event that after June 2, 1997, CSX fails to consummate the tender offer for any reason other than the non-occurrence of any condition to the tender offer. In the event that CSX fails to consummate the tender offer under such circumstances, Conrail will be entitled to exercise any additional remedies it may have.

The full terms and conditions of the CSX and Norfolk offers and Conrail's position with respect to the CSX and Norfolk offers are set forth in documents filed by Conrail with the Securities and Exchange Commission.

RAIL OPERATIONS. The Company provides freight transportation services within the northeast and midwest United States. The Company interchanges freight with other United States and Canadian railroads for transport to destinations within and outside the Company's service region. The Company operates no significant line of business other than the freight railroad business and does not provide common carrier passenger or commuter train service.

The Company serves a heavily industrial region that is marked by dense population centers which constitute a substantial market for consumer durable and non-durable goods, and a market for raw materials used in manufacturing and by electric utilities. The Company's traffic levels are substantially affected by its ability to compete with trucks and other railroads, the economic strength of the industries and metropolitan areas that produce and consume the freight the Company hauls, and the traffic generated by the Company's connecting railroads. The Company remains dependent on non-bulk traffic, which tends to generate higher revenues than bulk commodities, but also involves higher costs and is more vulnerable to truck competition.

Item 2. Properties.

As of December 31, 1996, the Company (excluding subsidiaries) maintained 16,970 miles of track including track for crossovers, turnouts, second main, other main, passing and switch track, on its 10,543 mile route system. Of total route miles, 8,459 are owned, 87 are leased or operated under contract and 1,997 are operated under trackage rights, including approximately 300 miles operated pursuant to an easement over Amtrak's Northeast Corridor. As of December 31, 1996, virtually all track over which at least 10 million gross tons moved annually (5,923 track miles) was heavy-weight rail of at least 127 pounds per yard, and 100% of such track had continuous welded rail. Continuous welded rail reduces track maintenance costs and, in general, permits trains to travel at higher speeds. As of December 31, 1996, the Company had 8,804 miles of continuous welded rail on track it maintained.

As of December 31, 1996, 83% of the 3,814 track miles maintained for fast freight traffic had a maximum operating speed of 50 MPH or more, and 70% had a maximum operating speed of at least 60 MPH. As of December 31, 1996, approximately 96% of the track over which at least 10 million gross tons moved annually was governed by automatic signal systems. In all, as of December 31, 1996, 7,656 miles of track were controlled by automatic signal systems.

The Company is engaged in an ongoing process to identify certain under-utilized rail lines and other underperforming assets to avoid future capital costs and to improve its return on assets. The Company recorded a $283 million charge in 1995 to cover the expected losses upon disposition of approximately 1,800 miles of lines and other assets not required to support the Company's service. See Note 11 to the Consolidated Financial Statements elsewhere in this Annual Report.

The Company owns (or uses subject to capitalized leases) 2,006 locomotives with an average age of 15.6 years and 45,988 freight cars of various types (including 21,435 freight cars under operating leases) with an average age of 22 years.

GOVERNMENT REGULATION. The Company is subject to environmental, safety, and other regulations generally applicable to all businesses, and its rail operations are also regulated by the Department of Transportation ("DOT"), the Federal Railroad Administration ("FRA"), state Departments of Transportation and some state and local regulatory agencies.

The DOT has jurisdiction over, among other things, rates charged for certain traffic movements, service levels and freight car rents. It also has jurisdiction over the situations and terms under which one railroad may gain access to another railroad's traffic or facilities, extension or abandonment of rail lines, consolidation, merger, or acquisition of control of rail common carriers and of other carriers by rail common carriers, and labor protection provisions in connection with the foregoing.

Under The Staggers Rail Act of 1980, federal regulation of rates and services was reduced. The regulatory scheme, now administered by the Surface Transportation Board, continues the ICC's prior deregulation of rates for intermodal traffic, most boxcar traffic and a series of miscellaneous commodities, including steel and automobiles. In addition, railroads are free to negotiate contracts with shippers setting rates, service standards and the terms for movements of other kinds of traffic. As a result, railroads have greater flexibility in adjusting rates and services to meet revenue needs and competitive conditions.

The FRA has jurisdiction over safety and railroad equipment standards.

The Company's rail operations are also subject to a variety of governmental laws and regulations relating to the protection of the environment. In addition to being involved as a potentially responsible party at numerous Superfund sites (see Item 3 - "Legal Proceedings"), the Company is subject to increasing regulation of its transportation and handling of certain hazardous and non-hazardous commodities and waste which has resulted in additional administrative and operating costs. Also, on February 11, 1997, the United States Environmental Protection Agency published in the Federal Register Proposed Rule "Emissions Standards for Locomotives and Locomotive Engines." According to the Proposed Rule, locomotive engines (other than those defined as new or remanufactured) may be regulated by the states. Additional investments will likely be required to bring other than new locomotives into compliance, although the timing and amount of the investments will not be determinable until the legislation is adopted. Compliance with existing laws and regulations relating to the protection of the environment has not had a material effect on the Company's capital expenditures, earnings or competitive condition. (See Note 14 to the Consolidated Financial Statements included elsewhere in this Annual Report.)

Item 3. Legal Proceedings.

Occupational Disease Litigation. The Company has been named as a defendant in lawsuits filed pursuant to the provisions of the Federal Employers' Liability Act ("FELA") by persons alleging (1) personal injury or death caused by exposure to asbestos in connection with railroad employment (2) complete or partial loss of hearing caused by exposure to excessive noise in the course of railroad employment; (3) repetitive motion injury in connection with railroad employment; and (4) personal injury or death caused by exposure to deleterious substances (mixed dusts, fumes, chemicals, etc.) As of December 31, 1996, the Company was a defendant in 559 pending asbestos suits, 545 pending hearing loss suits, 1,318 repetitive motion injury suits and 374 pending deleterious substance suits, and had notice of 1,293 potential asbestosis claims, 2,734 potential hearing loss claims, 2,112 potential repetitive motion injury claims and 56 deleterious substance claims.

The Company expects to be named as a defendant in a significant number of occupational disease cases in the future.

Norfolk Southern Corp., et al. v. Conrail. On October 23, 1996, Norfolk filed a Complaint for Declaratory and Injunctive Relief (as amended on October 30, 1996, the "Complaint"), with respect to the transactions contemplated by the Merger Agreement, in the United States District Court for the Eastern District of Pennsylvania. Norfolk named CSX, Conrail and certain directors of Conrail as defendants. The Complaint in its currently amended form alleges, among other things, violations of: (1) fiduciary duties by the Conrail Board; (2) Conrail's Articles of Incorporation and By-Laws; and (3) Pennsylvania statutory law.

In addition, Norfolk alleges that the CSX tender offer is coercive and unfair to Conrail shareholders; that certain provisions in the Merger Agreement prohibiting Conrail from changing its recommendation of the transaction or agreeing to a competing transaction, is *ultra vires* and a breach of the Conrail Board's fiduciary duties; and that Conrail and CSX violated disclosure provisions of the federal securities laws relating to tender offers and proxy solicitations through the misrepresentation and omission of material facts.

Norfolk has requested preliminary and permanent injunctive and declaratory relief including, without limitation, an injunction to prevent defendants from: (1) continuing a tender offer for the Conrail shares, (2) taking any action to enforce certain provisions of the Merger Agreement, and (3) failing to take actions necessary to exempt Norfolk's proposal to acquire Conrail from certain provisions of Pennsylvania statutory law.

Conrail believes that the claims set forth by Norfolk are entirely without merit, and on November 12, 1996, Conrail filed a motion to dismiss Norfolk's complaint in its entirety. The Federal District Court and the Third Circuit Court of Appeals have denied Norfolk's requests for the preliminary injunctions.

Punitive Damage Awards in Ohio Crossing Accident Cases. The Company has recently received adverse jury verdicts in three separate crossing accident cases in Ohio: Garrett and Gollihue v. Consolidated Rail Corp.; Wightman v. Consolidated Rail Corp.; and Moore, et al. v. Consolidated Rail Corp. In each case, the jury awarded substantial punitive damages in connection with property damage resulting from the accidents. Collectively, the total punitive damage awards total approximately $30 million, based on property damage that totals less than $5,000. The Company believes that, ultimately, these awards should not be sustainable due to their failure to bear a reasonable relationship to the amount of physical property damage involved, and has appealed. Ohio law prohibits the award of punitive damages in connection with a wrongful death action.

Structure and Crossing Removal Disputes in Connection With Lines Abandoned Under NERSA. The Company may be responsible, in whole or in part, for the costs of removal of several hundred overhead and underpass crossings located on railroad lines it has abandoned under NERSA (and, in some instances, responsible for the removal of the lines of railroad themselves as well as appurtenant structures). The Company's liability for the removal of such lines, crossings and structures will be determined on a case-by-case basis, and is dependent upon the circumstances under which each was constructed, the nature of the Company's property interest with respect to such structures, the existence of contracts pertaining to such crossings and structures, and applicable federal and state law. Some states have imposed upon the Company the obligation to remove certain crossings.

Engelhart v. Conrail. In connection with the Special Voluntary Retirement Program offered to certain employees in late 1989 and early 1990, the Company used surplus funds in its over-funded Supplemental Pension Plan ("Plan") to fund certain aspects of that program. In December 1992, certain former Company employees brought suit challenging the use of surplus Plan funds (a) to pay administrative Plan expenses previously paid by the Company, (b) to fund the Special Voluntary Retirement Program, and (c) to pay life insurance and medical insurance premiums of former employees as improper and unlawful, and alleging that employees who have made contributions to the Plan or its predecessor plans are entitled to share in the surplus assets of the Plan. In August, 1993, the court granted the Company's Motion to Dismiss the majority of the counts in the complaint, but refused to dismiss the issue of the Company's use of Plan assets to pay administrative expenses of the Plan, which are estimated to be approximately $40 million at December 31, 1996. The Company believes that the use of surplus Plan assets for this purpose was lawful and proper. On September 16, 1996, the Judge granted the Company's motion for summary judgment on all of the claims except for one individual participant claim. Plaintiffs have appealled those claims as to which they received an adverse ruling.

Environmental Litigation. The Company is subject to various federal, state and local laws and regulations regarding environmental matters. In certain instances, the Company has received notices of violations of such laws and regulations and either has taken or plans to take appropriate steps to address the problems cited or to contest the allegations of violation. As of December 31, 1996, the Company had received inquiries from governmental agencies or had been identified, together with other companies, as a potentially responsible party for cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 135 locations throughout the country. However, the Company, through its own investigations and assessments, believes it may have some potential responsibility at only 61 of these sites. The amounts the Company has accrued with respect to the proceedings listed below are included in its $55 million accrual for estimated future environmental expenses. (See Note 14 to the Consolidated Financial Statements included elsewhere in this Annual Report.) The significant environmental proceedings, including Superfund sites, are discussed below.

United States v. Southeastern Pennsylvania Transportation Authority ("SEPTA"), National Railroad Passenger Corporation ("Amtrak"), and Consolidated Rail Corporation. In March 1986, the United States Environmental Protection Agency ("EPA") filed an action in the United States District Court for the Eastern District of Pennsylvania for cost recovery, injunctive relief, and a declaratory judgment against the Company, Southeastern Pennsylvania Transportation Authority ("SEPTA") and National Railroad Passenger Corp. ("Amtrak") under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA" or "Superfund Law"), as amended. In 1990, the Pennsylvania Department of Environmental Resources intervened as a plaintiff. Suit is based on the release or threatened release at the Paoli Railroad Yard, Paoli, Chester County, Pennsylvania, of polychlorinated biphenyls ("PCBs"), a listed hazardous substance under CERCLA.

Pursuant to a series of partial preliminary consent decrees, defendants have performed a series of cleanup actions both on and off-site and have conducted a Remedial Investigation/Feasibility Study ("RI/FS"). Those costs have been shared equally among the three defendants but are subject to reallocation.

The estimated cost of the Company's portion of a remedy proposed by the parties was included in the 1991 special charge and subsequent adjustments to accruals. EPA and the railroad parties have entered into a tentative settlement agreement regarding EPA's claim for past costs, as well as federal and state natural resource damages. As part of the settlement, Amtrak, SEPTA and the Company have committed to perform the on-site remedy for the rail yard.

United States v. Conrail. The EPA has listed the Company's Elkhart Yard on the National Priorities List. The EPA contends that chemicals have migrated from the yard and contaminated drinking wells in the area. On February 14, 1990, EPA filed a civil action against the Company in the U.S. District Court for the Northern District of Indiana seeking recovery of approximately $345,000 for costs incurred in protecting the water supply. In addition, EPA seeks a declaratory judgment against the Company for all future costs incurred in responding to the release or threatened release of hazardous substances from the site. The Company believes it is not the sole source and may not be a contributing source to the contamination alleged by EPA.

The Company filed a third-party action joining Penn Central as a defendant. The Company and Penn Central have negotiated an interim cost sharing arrangement for the cost of implementing the EPA's 1992 interim record of decision, which is substantially complete. On May 15, 1995 EPA issued an Administrative Order to the Company and Penn Central requiring the extension of public water hook-up to an additional 700 - 1,000 residences and businesses in the site area. The Company and Penn Central have agreed that each company would comply with the Order. The cost for providing public water to the remaining residences is estimated to be in excess of $6 million, which will be apportioned between Penn Central and the Company according to the interim cost sharing arrangement that has been negotiated. The Company and Penn Central are attempting to negotiate a final settlement with EPA of the matter.

United States v. Consolidated Rail Corp., et al (Berks Superfund Site). The Company has been identified as the fifth largest generator of waste oil at the Berks Associates Superfund site in Douglasville, Pennsylvania. In addition, the Company has become aware that it and its predecessor, Penn Central, owned a small portion of land that was leased to the operator of the Berks site. As such, the Company's liability could increase due to its questionable status as both an owner and a generator. In August 1991, the EPA issued an administrative order against the Company and thirty-five other entities mandating the implementation of an approximately $2 million partial remedy and filed a complaint in the U.S. District Court for the recovery of approximately $8 million in costs incurred by the government. The parties have negotiated an administrative order with the EPA and have filed an answer to the civil action. A group of potentially responsible parties (including the Company) undertook compliance with the administrative order. The Company and the 35 other defendants have filed a third-party complaint against approximately 630 entities seeking contribution for the costs of the remedy and government costs. The Company, along with other defendants, is negotiating a settlement with the EPA. On June 30, 1993, the EPA issued another administrative order against the Company and 33 other entities, mandating the remediation of the southern portion of the site. The EPA has requested a feasibility study for the implementation of a less expensive remedy for the southern portion of the site, which remedy would range from approximately $10-$12 million. The Company's share of such a remedy has not yet been determined. In addition, the PADER has filed a complaint for the recovery of natural resource damages.

United Scrap Lead - Troy, OH. The Company is a potentially responsible party, along with more than 50 other parties, in the United Scrap Lead federal Superfund action in Troy, Ohio, where substantial quantities of batteries were disposed of over a period of several years. EPA sued the Company and nine other parties in August 1991 for the recovery of approximately $2,000,000 in past costs. The Company and other PRP's have commissioned treatability studies. The parties are negotiating over the nature of the remediation to be undertaken at the site. EPA has selected a preferred alternative with an estimated total cost of $33 million, which the PRP group is challenging. The Company's estimated share of any remedial costs is 8%.

Commonwealth of Massachusetts v. Conrail (Locomotive Emission). On April 21, 1992, the Massachusetts Attorney General filed suit in state court alleging the Company's violation of the Massachusetts Clean Air Act by allowing diesel engines to idle unnecessarily and/or in excess of thirty (30) minutes. On May 4, 1992, the court entered a preliminary injunction, the terms of which are substantially those embodied in the Company's existing idling policy. The Attorney General has filed a complaint alleging the Company's violation of the preliminary injunction. On February 2, 1993, the parties entered into a partial settlement agreement; however, the Attorney General has alleged that the Company has failed to comply with certain provisions of the settlement. The Company continues to attempt to settle the matter with the Attorney General's office.

New York State Department of Environmental Conservation Order On Consent (Selkirk Yard). On July 31, 1996, the New York State Department of Environmental Conservation (NYSDEC) served the Company with a revised draft Order on Consent requiring the payment of a penalty of $250,000 in connection with its inspection of Selkirk Yard.

A revised Order was received by the Company on August 6, 1996, requiring the payment of fines in connection with the 1991 inspection and mandates assessment and remediation of the facility. The Company is negotiating the terms of the order with NYSDEC.

New York State Department of Environmental Conservation Order on Consent (DeWitt Yard). On November 3, 1994, NYSDEC served the Company with a Consent Order in connection with the alleged discharge of waste water from DeWitt Yard, Onondaga County, New York into New York state waters. On June 17, 1996, a revised Consent Order was issued to the Company which added American Financial Group (Penn Central Corp.) as a named responsible party for the payment of penalties and preparation of a Site Assessment and Remediation Plan. The Company and American Financial Group are negotiating the terms of the Order with NYSDEC.

In the Matter of Conrail, Ashtabula, OH. On September 21, 1994, the EPA filed an Administrative Complaint against the Company seeking civil penalties of $125,000 for certain alleged violations of its National Pollutants Discharge Emissions System permit. On November 27, 1995, EPA filed a separate Administrative Complaint seeking civil penalties for alleged violations of regulatory requirements pertaining to on-site petroleum storage. The Company has reached agreement with EPA to jointly settle these matters for $150,000.

Conway Yard, Pittsburgh. In 1991, the Company received Notices of Violation ("NOV") from the Pennsylvania DER ("PADER") alleging violations of the Clean Streams Act for discharges of oil into the Ohio River. In September 1993, PADER sent to the Company a draft Consent Order and Agreement requiring a comprehensive site remediation for soil, ground water, surface waters and sediments at the Conway Railyard and requiring the payment of civil fines in connection with violations at the yard. The Company and PADER continue to negotiate the extent of the investigation and remediation to be undertaken at the yard.

Other. In addition to the above proceedings, the Company has been named in various legal proceedings arising out of its activities as an employer and as an operator of a freight railroad, including personal injury actions brought by its employees under FELA, as well as administrative proceedings with and investigation by government agencies.

In view of the inherent difficulty of predicting the outcome of legal proceedings, particularly in certain matters described above in which substantial damages are or may be sought, the Company cannot state what the eventual outcomes of such legal proceedings will be. Certain of these matters, if determined adversely to the Company, could result in the imposition of substantial damage awards against, or increased costs to, the Company that could have a material adverse effect on the Company's results of operations and financial position. The Company's management believes, however, based on current knowledge, that such legal proceedings will not have a material adverse effect on the Company's financial position.

Item 4. Submission of Matters to a Vote of Security Holders.

Information omitted in accordance with General Instruction I(2)(c).

PART II

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

All of the common stock of the Company is held by Conrail. Accordingly, there is no market for the Company's common stock. See Note 4 to the Consolidated Financial Statements elsewhere in this Annual Report for information with respect to dividends paid by the Company.

Item 6. Selected Financial Data.

Information omitted in accordance with General Instruction I(2)(a).

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

See General Instruction I (2) (a).

Results of Operations

1996 Compared with 1995

Net income for 1996 was $335 million, compared with $256 million for 1995. Results for 1996 include a one-time charge of $83 million (net of $52 million of tax benefits) related to voluntary separation programs and related costs and merger-related expenses of $10 million (net of $6 million of tax benefits) incurred in connection with the proposed merger with CSX Corporation ("CSX") (see Notes 3 and 2, respectively, to the Consolidated Financial Statements included elsewhere in this Annual Report). Without these charges, net income for 1996 would have been $428 million.

The results for 1995 include the effects of a $283 million asset disposition charge ($175 million after income taxes) and the recognition of a $21 million reduction in income taxes related to a decrease in a state tax rate (see Notes 11 and 8, respectively, to the Consolidated Financial Statements included elsewhere in this Annual Report).

Operating revenues (primarily freight line haul revenues, but also including switching, demurrage and incidental revenue) increased $16 million, or .4%, to $3,684 million in 1996 from $3,668 million in

1995. A 2.1% increase in traffic volume in units (freight cars and intermodal trailers and containers) resulted in a $74 million increase in revenues. Average revenue per unit decreased revenues by $42 million due to an unfavorable traffic mix. A traffic volume increase of 7.6% was experienced by the Intermodal Service Group while traffic volume for the Unit Train Service Group remained unchanged. The Automotive and CORE service groups experienced traffic volume declines of 1.7% and 1.6%, respectively. Within the CORE Service Group, traffic volume declines were experienced by three of the four commodity groups: Forest and Manufactured Products, 5.3%; Food and Agriculture, 2.8%; and Petrochemicals, 2.5%. Metals experienced a traffic increase of 4.0%.

Operating expenses (including one-time charges and merger-related costs in 1996 and the asset disposition charge in 1995) decreased $127 million, or 4.0%, from $3,213 million in 1995 to $3,086 million in 1996. The following table sets forth the operating expenses for the two years:

(In Millions)	1996	1995	Increase (Decrease)
Compensation and benefits	$1,204	$1,247	$ (43)
Fuel	202	168	34
Material and supplies	175	167	8
Equipment rents	382	355	27
Depreciation and amortization	282	293	(11)
Casualties and insurance	179	178	1
Other	527	522	5
Voluntary separation programs	135		135
Asset disposition charge		283	(283)
	$3,086	$3,213	$(127)

Compensation and benefits decreased $43 million, or 3.4%, as a result of reductions in employment levels and other employee-related costs. These decreases were partially offset by increased wage rates due to new labor agreements, increased train crew costs and overtime caused by adverse weather conditions experienced during the first quarter of 1996. Compensation and benefits as a percent of revenues was 32.7% in 1996 as compared with 34.0% in 1995.

Fuel costs increased $34 million, or 20.2%, due mostly to higher fuel prices.

Equipment rents increased $27 million, or 7.6%, primarily as a result of declines in equipment utilization and increased car hire rates.

The Company recorded a one-time pre-tax charge of $135 million in 1996 for the voluntary separation programs and related costs (see Note 3 to the Consolidated Financial Statements included elsewhere in this

Annual Report) and an asset disposition charge of $283 million in 1995 (see Note 11 to the Consolidated Financial Statements included elsewhere in this Annual Report).

The Company's operating ratio (operating expenses as a percent of revenues) was 83.8% for 1996, compared with 87.6% for 1995. Without the one-time charges recorded in 1996 and 1995 and the merger-related costs of $16 million incurred in 1996, the operating ratios would have been 79.7% and 79.9%, respectively.

Other income decreased $19 million, or 17.1%, from $111 million in 1995 to $92 million in 1996 primarily due to decreases in rental income and lesser gains from sales of property.

The Company's effective income tax rate for 1996 was 35.1% compared with 32.8% for 1995. The lower effective rate in 1995 is primarily caused by a $21 million reduction in income taxes as a result of a decrease in state income taxes (see Note 8 to the Consolidated Financial Statements included elsewhere in this Annual Report).

Item 8. Financial Statements and Supplementary Data.

Report of Independent Accountants

The Stockholder and Board of Directors
Consolidated Rail Corporation

In our opinion, the consolidated financial statements listed in the index appearing under Item 14 (a) 1. and 2. present fairly, in all material respects, the financial position of Consolidated Rail Corporation and subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Price Waterhouse LLP
Thirty South Seventeenth Street
Philadelphia, PA 19103

January 21, 1997,
except as to Note 2, which is as of March 7, 1997

CONSOLIDATED RAIL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

($ In Millions Except Per Share Data)	1996	1995	1994
	Years ended December 31,		
Revenues	$3,684	$3,668	$3,716
Operating expenses			
Way and structures	463	486	500
Equipment	803	767	816
Transportation	1,361	1,311	1,366
General and administrative	324	366	347
Voluntary separation programs (Note 3)	135		
Asset disposition charge (Note 11)		283	
Early retirement program (Note 12)			84
Total operating expenses	3,086	3,213	3,113
Income from operations	598	455	603
Interest expense	(174)	(185)	(178)
Other income, net (Note 13)	92	111	101
Income before income taxes	516	381	526
Income taxes (Note 8)	181	125	207
Net income	$ 335	$ 256	$ 319
Ratio of earnings to fixed charges (Note 1)	3.20x	2.52x	3.29x

See accompanying notes.

CONSOLIDATED RAIL CORPORATION
CONSOLIDATED BALANCE SHEETS

($ In Millions)	December 31, 1996	December 31, 1995
ASSETS		
Current assets		
Cash and cash equivalents	$ 17	$ 58
Accounts receivable	629	624
Deferred tax assets (Note 8)	285	325
Material and supplies	139	158
Other current assets	22	26
Total current assets	1,092	1,191
Property and equipment, net (Note 5)	6,590	6,408
Other assets	671	788
Total assets	$8,353	$8,387
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities		
Short-term borrowings	99	89
Current maturities of long-term debt (Note 7)	130	181
Accounts payable	160	126
Wages and employee benefits	143	182
Casualty reserves	138	107
Accrued and other current liabilities (Note 6)	445	492
Total current liabilities	1,115	1,177
Long-term debt (Note 7)	1,876	1,911
Casualty reserves	190	217
Deferred income taxes (Note 8)	1,484	1,401
Special income tax obligation (Note 8)	346	440
Other liabilities	307	312
Total liabilities	5,318	5,458
Commitments and contingencies (Note 14)		
Stockholder's equity (Note 10)		
Preferred stock (no par value; 25,000,000 shares authorized; 1 share issued)		
Common stock ($1 par value; 250,000,000 shares authorized; 100 shares issued and outstanding)		
Additional paid-in capital	2,151	2,130
Note receivable from ESOP	(294)	(305)
Retained earnings	1,178	1,104
Total stockholder's equity	3,035	2,929
Total liabilities and stockholder's equity	$8,353	$8,387

See accompanying notes.

CONSOLIDATED RAIL CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY

($ In Millions Except Per Share Data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Note Receivable From ESOP	Retained Earnings
Balance, January 1, 1994	$ -	$ -	$2,123	$(308)	$ 928
Net income					319
Common dividends (Note 4)					(170)
Other			5	(4)	
Balance, December 31, 1994	-	-	2,128	(312)	1,077
Net income					256
Common dividends (Note 4)					(229)
Other			2	7	
Balance, December 31, 1995	-	-	2,130	(305)	1,104
Net income					335
Common dividends (Note 4)					(261)
Other			21	11	
Balance, December 31, 1996	$ -	$ -	$2,151	$(294)	$1,178

See accompanying notes.

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CONSOLIDATED RAIL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

($ In Millions)	Years ended December 31, 1996	1995	1994
Cash flows from operating activities			
Net income	$ 335	$ 256	$ 319
Adjustments to reconcile net income to net cash provided by operating activities:			
Voluntary separation programs	135		
Asset disposition charge		283	
Early retirement program			84
Depreciation and amortization	282	293	278
Deferred income taxes	180	108	150
Special income tax obligation	(94)	(73)	(62)
Gains from sales of property	(24)	(27)	(18)
Pension credit	(46)	(43)	(46)
Changes in:			
Accounts receivable	(5)	26	1
Accounts and wages payable	(5)	17	22
Settlement of tax audit	(39)		
Other	(62)	(116)	(94)
Net cash provided by operating activities	657	724	634
Cash flows from investing activities			
Property and equipment acquisitions	(387)	(415)	(490)
Proceeds from disposals of properties	34	37	32
Other	(46)	(45)	(18)
Net cash used in investing activities	(399)	(423)	(476)
Cash flows from financing activities			
Net proceeds from (repayments of) short-term borrowings	10	(23)	33
Proceeds from long-term debt	26	85	114
Payment of long-term debt	(184)	(133)	(158)
Loans from and redemptions of insurance policies	95		
Dividends on common stock	(261)	(229)	(170)
Other	15	26	28
Net cash used in financing activities	(299)	(274)	(153)
Increase(decrease) in cash and cash equivalents	(41)	27	5
Cash and cash equivalents			
Beginning of year	58	31	26
End of year	$ 17	$ 58	$ 31

See accompanying notes.