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September 27, 2006

BY HAND DELIVERY

The Honorable Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

ENTERED
Office of Proceedings

217651 SEP 28 2006
Part of
Public Record

Re: STB Finance Docket No. 34922
*Keokuk Junction Railway Co. – Feeder Line Application – South
Plains Switching, Ltd. Co.*

Dear Secretary Williams:

Enclosed, pursuant to the Board's decisions served on August 16 and 18, 2006, are an original and eleven copies of the expanded competing application of Keokuk Junction Railway Co. to acquire the lines of railroad that are also the subject of the expanded "All-SAW" application filed by Pyco Industries, Inc., in Finance Docket No. 34890.

Also enclosed is a check for \$2,600.00 to cover the filing fee for a feeder line application. If the enclosed filing is not regarded as a new application and is instead viewed as a supplement to KJRY's previously filed application in the above-referenced proceeding, then KJRY submits that no additional filing fee from KJRY should be required. In that event, KJRY asks the Board to kindly return the enclosed check. KJRY is submitting an additional filing fee in an abundance of caution.

Please acknowledge the receipt and filing of the enclosed application by time stamping the eleventh copy and returning it to the courier for delivery to me. If there are any questions about this matter, please contact me directly, either by telephone: (202) 663-7823 or by e-mail: wmullins@bakerandmiller.com.

Respectfully submitted,

William A. Mullins
Attorney for Keokuk Junction Railway Co.

cc: All Parties of Record
All Parties Listed in 49 CFR 1151.2(a)

217651

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

**KEOKUK JUNCTION RAILWAY CO.
— FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

EXPANDED COMPETING FEEDER LINE APPLICATION



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Attorneys for Keokuk Junction Railway Co.

DATED: September 27, 2006

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

**KEOKUK JUNCTION RAILWAY CO.
— FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

EXPANDED COMPETING FEEDER LINE APPLICATION

By decision served on August 17, 2006 (“August 17 Decision”), the Surface Transportation Board (“STB” or “Board”) accepted the competing feeder line application (“FLA”) of Keokuk Junction Railway Co. (“KJRY”). KJRY’s competing feeder line application accepted by the Board involved the so-called “Alternative Two” lines and was filed in response to a FLA filed by PYCO Industries, Inc. (“PYCO”) in STB Finance Docket No. 34890.¹ After KJRY filed its competing application for Alternative Two, the Board accepted PYCO’s expanded feeder line application covering all of the lines of South Plains Switching, Ltd. Co. (“SAW”) in a decision served on August 16, 2006—the so-called “All-SAW” option. In that decision, the Board afforded KJRY the opportunity to expand its application to encompass the entirety of SAW’s rail lines, and directed KJRY to file its All-SAW valuation evidence by August 28, 2006. The deadline for KJRY’s submission of All-SAW evidence was extended until September 27, 2006, pursuant to a Board decision served on August 18, 2006. In accordance

¹ While KJRY’s FLA is being filed in F.D. No. 34922, KJRY requests the Board to incorporate the record in all related proceedings, including F.D. No.’s 34890 and 34802, into this docket and vice-a-versa consistent with 49 CFR § 1112.7. As the Board has copies of the record in those proceedings, KJRY requests that it not be required to provide copies in accordance with the rule.

with the various decisions, KJRY hereby expands its Alternative Two FLA to encompass all of the lines owned and operated by South Plains Switching, Ltd. Co. and files this All-SAW FLA.

APPLICATION

(1) Identification of the line to be purchased including:

(i) The name of the owning carrier;

South Plains Switching, Ltd. Co.
P.O. Box 64299
Lubbock, TX 79464-4299

and

(ii) The exact location of the line to be purchased including milepost designations, origin and termination points, stations located on the line, and cities, counties, and States traversed by the line.

KJRY relies upon the description of the lines contained in SAW's September 15, 2006 "Statement in Response to PYCO's Feeder Line Application to Acquire 'All-SAW'" ("SAW Statement"), Verified Statement of Edward J. Landreth at 4 and Attachment 1 (collectively, all of the lines referred to in the SAW Statement will be known as the "Lines"). Relying on a recent SAW inventory, Mr. Landreth states that SAW owns a total of 133,884 feet of track. The Lines are all located in Lubbock County, TX. KJRY specifically adopts those descriptions and seeks to acquire the Lines contained within the SAW Statement.

(2) Identification of applicant including:

(i) The applicant's name and address;

Keokuk Junction Railway Co.
1318 South Johanson Road
Peoria, IL 61607

(ii) The name, address, and phone number of the representative to receive correspondence concerning this application;

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(iii) A description of applicant's affiliation with any railroad;

KJRY is a Class III railroad subsidiary of Pioneer Railcorp ("Pioneer"), a non-carrier railroad holding company. KJRY is an experienced short line operator. The company operates approximately 147 miles of rail line in Iowa and Illinois. KJRY was the successful feeder line applicant in Keokuk Junction Railway Co. – Feeder Railroad Development Application – Line Of Toledo, Peoria & Western Railway Corporation Between La Harpe And Hollis, IL, STB Finance Docket No. 34335 (STB served Feb. 7, 2005) ("KJRY-Feeder Line"), aff'd sub nom. Toledo, Peoria & W. Ry. v. Surface Transp. Bd., No. 05-1920, ___ F.3d ___ (7th Cir., Decided Sept. 7, 2006). KJRY has been safely operating the rail line acquired as a result of KJRY-Feeder Line for 20 months and in doing so has restored service to those who had lost it and recruited new shippers as well.

As set forth in the Verified Statement of J. Michael Carr, President, CEO, and Chief Financial Officer of Pioneer and President and CEO of KJRY, attached hereto as Exhibit A ("V.S. Carr"), KJRY is an experienced and capable rail carrier with good safety and service records. In fact, KJRY, doing business as Peoria & Western Railway, will add another 42.1 miles to its system once it is permitted to exercise its exemption authority (currently the subject of an STB-imposed "housekeeping stay") to lease and operate additional rail lines in Illinois.

See Keokuk Junction Railway Co. d/b/a Peoria & Western Railway – Lease and Operation

Exemption – BNSF Railway Company, STB Finance Docket No. 34918.

Pioneer's other rail subsidiaries, and the approximate number of miles of track each operates, are as follows:

Alabama Railroad CO. (ALAB)	60 miles
Alabama & Florida Railway Co. (AF)	43 miles
Decatur Junction Railway Co. (DT)	38 miles
Elkhart & Western Railroad Co. (EWR)	10 miles
Fort Smith Railroad Co. (FSR)	18 miles
Garden City Western Railway Company (GCW)	40 miles
Gettysburg & Northern Railroad Company (GET)	25 miles
Indiana Southwestern Railway Co. (ISW)	23 miles
Kendallville Terminal Railway Co. (KTR)	1.1 miles
Michigan Southern Railroad Co. (MSO)	14 miles
Mississippi Central Railroad Co. (MSCI)	51 miles
Shawnee Terminal Railway Company (STR)	2.5 miles
Vandalia Railroad Company (VRRC)	3.5 miles
West Michigan Railroad Co. (WMI)	15 miles

Applicant and all of its affiliated railroad companies are Class III railroads.

Pioneer Railroad Equipment Co., Ltd., Pioneer Railroad Services, Inc., Pioneer Resources, Inc., and Pioneer Air, Inc., are wholly-owned, noncarrier subsidiaries of Pioneer, each of which provides corporate support operations to Pioneer's subsidiary railroads.²

² Neither Pioneer nor any of KJRY's corporate affiliates are applicants or parties to this proceeding.

and

(iv) If the applicant is a corporation, the names and addresses of its officers and directors.

Officer	Officer's Address	Director	Director's Address
J. Michael Carr, President, CEO, and CFO	1318 South Johanson Road Peoria, IL 61607	J. Michael Carr	1318 South Johanson Road Peoria, IL 61607
		Guy L. Brenkman	1318 South Johanson Road Peoria, IL 61607
		Orvel Cox	1318 South Johanson Road Peoria, IL 61607

(3) Information sufficient to demonstrate that the applicant is a financially responsible person. In this regard, the applicant must demonstrate its ability:

(i) To pay the higher of the net liquidation value (NLV) or going concern value (GCV) of the line;

As explained in detail below and in the Verified Statement of William J. Brennan, PhD, attached hereto as Exhibit B, ("V.S. Brennan"), KJRY has determined that the Lines have a going concern value ("GCV") of \$2,712,370.00 if one includes a factor for projected growth in traffic volumes and \$2,486,779.00 if traffic volumes remain at their historic averages. As also explained in the Verified Statement of Roger Stice, KJRY's Track Foreman, attached hereto as Exhibit C ("V.S. Stice"), the Lines need very little rehabilitation and can be operated safely and efficiently as a going concern under standard maintenance practices. Mr. Stice's agrees that the GCV exceeds the net liquidation value ("NLV"). Therefore, KJRY must, and will, demonstrate that it has the financial ability to pay the Lines' GCV.

Pioneer has obtained a commitment letter from National City Bank of Michigan/Illinois in the amount of \$3 million for the specific purpose of funding KJRY's acquisition and operation of the Lines. See Exhibit 1 to the attached V.S. Carr. Pioneer will loan those funds to KJRY for

KJRY's exclusive use in acquiring and operating the Lines. KJRY will repay those funds through operating revenues.

and

(ii) To cover expenses associated with providing services over the line (including, but not limited to, operating costs, rents, and taxes) for at least the first 3 years after acquisition of the line.

PYCO's All-Saw FLA did not include evidence that PYCO, or its designated operator, could operate the Lines for the first 3 years after acquiring them. PYCO did not include any projected pro-formas or other financial information to meet this statutory criteria. The most that can be said is that PYCO's own witness showed that there would be a positive cash flow for post-acquisition operations. See F.D. No. 34844, May 5 Feeder Line Application, R.L. Banks Study, Exhibit C, Tables 7 and 14; see also PYCO June 14 Revised Application at 8 (the "system's operating revenues exceed its costs, the necessary cash reserve for [post-acquisition] operation is essentially nil.")(internal footnotes omitted). KJRY accepts PYCO's comments and evidence that the Lines will have a positive operating cash flow.³

Furthermore, KJRY's own valuation and analysis confirms that the Lines can be operated on a going concern basis. As Mr. Carr states:

[B]ased upon my railroad financial experience, my review of the traffic and financial information provided by SAW, my review of the expert testimony presented by PYCO and SAW, and my consultations with KJRY's witnesses, I am convinced that SAW's lines, as a whole, can be operated profitably into the future and that extensive rehabilitation is not needed to maintain the kind of service required of a shortline that serves a number of customers in a relatively confined area. My analysis establishes that SAW will operate on a positive cash

³ PYCO's FLA seems to suffer from an inconsistency. If the lines are in such bad shape that adding the rehabilitation costs means the lines only have a net liquidation value, then PYCO has not shown, through pro-formas or otherwise, that PYCO can both pay for that rehabilitation, which it claims is necessary for continued operations, and operate the lines for a three year period as required by the statute. On the other hand, if PYCO believes the lines in fact can be operated on a profitable basis going forward, which PYCO's own witness says, then the lines have a going concern value. Yet PYCO presented no GCV values.

flow basis providing more than sufficient funds to cover the debt payments and continuing operations. The fact that the All-SAW Alternative can be operated on a going concern basis and generate sufficient cash flow to make the operations profitable without the need for subsidy is consistent with PYCO's own testimony which postulates profitable operations without the need for substantial rehabilitation. This conclusion is also consistent with the testimony of Mr. Brennan, who has shown that SAW possesses a going concern value based on SAW's projected positive cash flow.

V.S. Carr at 4.

Given PYCO's own expert testimony, Mr. Carr's analysis, and Mr. Brennan's view that SAW's lines have a going concern basis, it is not necessary to provide further evidence or commentary that the lines can be operated for "at least the first 3 years after acquisition of the line[s]." Nonetheless, to demonstrate that KJRY's operation of SAW would meet the statutory requirement, Mr. Carr has composed a three-year pro forma balance sheet that accurately takes into account KJRY's prospective revenues from owning and operating the SAW lines as well as the costs of owning the line and providing service over it. See V.S. Carr, Exhibit 2. These pro-formas are consistent with PYCO's views regarding their ability to operate the lines profitably and with the data prepared by Mr. Brennan. Accordingly, KJRY expects a positive operating cash flow, and does not expect to need to subsidize their operation from other available funds. Should such a subsidy for some reason become necessary, however, KJRY has adequate funds to cover any shortfall.

(4) An estimate of the NLV and the GCV of the line and evidence in support of these estimates.

"Under 49 U.S.C. 10907(b)(1), we set the purchase price of a line at its constitutional minimum value, which is defined in 49 U.S.C. 10907(b)(2) as 'not less than the net liquidation value of such line, or the going concern value of such line, whichever is greater.'" KJRY-Feeder Line, STB Finance Docket No. 34335 (served Oct. 28, 2004). As stated in the Board's initial

decision in that proceeding, a feeder line applicant must provide estimates of both NLV and GCV, even if that applicant believes that one or the other is clearly the higher value. KJRY-Feeder Line, STB Finance Docket No. 34335 (served May 9, 2003), slip op. at 4. KJRY provides estimates of both NLV and GCV, even though GCV is the higher value.

NLV Estimate

“In the absence of a higher going-concern value for continued rail use, the proper valuation standard in proceedings for offers to purchase under section 10904 is the NLV of the rail properties for their highest and best nonrail use. Chicago and North Western Transp. Co.—Abandonment, 363 I.C.C. 956, 958 (1981) (Lake Geneva Line), aff’d sub nom. Chicago and North Western Transp. Co. v. U.S., 678 F.2d 665 (7th Cir. 1982). NLV includes the value of the underlying real estate plus the [net salvage value] of track and track materials.” Greenville County Economic Development Corporation – Abandonment And Discontinuance Exemption – In Greenville County, SC, STB Docket No. AB-490 (Sub-No. 1X) (served March 16, 2006), slip op. at 2.

“For purposes of computing NLV, [the Board assigns] value only to land to which a railroad holds marketable title. Marketable title generally means that held by warranty or quitclaim deed without restrictions or reversionary language. Thus, property that is subject to a reversion, if no longer used for rail purposes, or if held by easement for railroad purposes, is not included in determining real estate NLV. Southern Pacific Transportation Company—Abandonment Exemption—Sacramento and El Dorado Counties, CA, Docket No. AB-12 (Sub-No. 159X) (ICC served Oct. 20, 1994) (Southern Pacific).” San Pedro Railroad Operating Company, LLC—Abandonment Exemption—In Cochise County, AZ, STB Docket No. AB-1081X (served April 13, 2006), slip op. at 5.

In its original application under STB Docket No. 34844, PYCO has estimated the NLV of the Lines at \$2,094,000. PYCO's STB Docket No. 34844 Application at 19.⁴ SAW maintains that the Line's NLV is \$6 million. See Saw Statement at 22-23. SAW's evidence confirms that most of the rail is 90# or lighter. See SAW Statement, V.S. Landreth, Attachment 2 (numbered page 22). SAW's evidence also indicates that the materials comprising the Lines are for the most part worn, but suitable for their current use.

SAW's \$6 million estimate, which it relies upon for NLV and as a floor for GCV, is flawed and unreliable. The estimate is not based on application of the Board's NLV methodology, but rather on previously made, *preliminary* purchase offers which appear to have included more than just the SAW physical plant. In that sense, SAW's NLV evidence, if accurate, would show a going concern value, not NLV. But SAW's evidence is not accurate and cannot be used to establish NLV. Under SAW's test, the best evidence is that presented in an executed sale contract or in an unqualified purchase offer for the line. See SAW Statement at 4-5. Here, SAW has provided no executed sale contract (it clearly does not have any) nor has it presented evidence of an unqualified purchase offer.

One of the alleged offers put forth by SAW as establishing NLV was made by Pioneer itself. The problem with SAW's argument is that Pioneer's offer was not "unqualified" and included much more than the Lines. It is true that at one time Pioneer had extended an offer to SAW, but that offer was done on a going concern basis, was preliminary, was conditioned upon Pioneer conducting due diligence, and included assets far beyond the physical plant and real

⁴ To the best of KJRY's knowledge, PYCO has not submitted new NLV estimates for the entire SAW system since its original application was filed on May 5, 2006, in Finance Docket No. 34844. The NLV figures from that proceeding were incorporated by reference into PYCO's Alternative Two application filed in STB Docket No. 34890. See Pyco Industries, Inc. – Feeder

estate. See Verified Statement of Daniel A. LaKemper, attached hereto as Exhibit D (“V.S. LaKemper”). That offer, in addition to covering additional SAW assets, was a highly qualified offer, and therefore cannot represent a valid NLV.

SAW also relies upon a voluntary offer to purchase all of SAW’s lines by US Rail Partners, Ltd. (“USRP”) (SAW Statement at 22, V.S. Wisener, Appendix DW-2, Verified Statement of John K. Howell – “V.S. Howell”). To the best of KJRY’s knowledge, however, USRP’s offer appears to have been withdrawn in connection with the pending feeder line proceedings, and so is of questionable ongoing relevance. Furthermore, SAW’s evidence does not indicate whether USRP’s offer, which very likely was modeled upon Pioneer’s, included all business assets of SAW, instead of just its physical plant, or whether USRP’s offer was also conditioned upon completion of due diligence by USRP, as it most likely was.

There is no evidence of USRP’s financial wherewithal to complete such a transaction. Mr. Howell’s verified statement indicates that he has had discussions with a lender, which has advised that the offer “meets the bank’s lending guidelines for the transaction” (V.S. Howell at 4 of 6), but there is no written commitment letter from that bank. Moreover, there is no evidence USRP’s offer has ever tendered a formal written offer. USRP indicated that it intended to furnish SAW with a “formal purchase offer” (*id.*) but no copy of that offer – which would have been highly relevant to assessing the reliability and merit of Mr. Howell’s statement and SAW’s reliance upon it – accompanies Mr. Howell’s statement. Instead, Mr. Howell merely attaches to his statement an email from USRP’s lawyer indicating that USRP would offer SAW \$6 million.

The evidence simply does not establish that USRP ever made, let alone still has in place, an unqualified offer to purchase SAW. Even the value of USRP’s purported offer is

questionable, since it is based on a partial up-front cash payment at closing. For these reasons, neither Pioneer's preliminary offer to buy SAW nor USRP's purported offer is a valid or reliable basis for establishing either NLV or GCV.

In support of its NLV figures, KJRY offers the expert testimony of Mr. Roger Stice. Based on his experience in the railroad business, his personal inspection of the Lines, his review of PYCO's net salvage and real estate values reports, and his review of the SAW Statement, Mr. Stice explains that PYCO's NLV calculation of \$2,094,000 is a realistic liquidation value for the Lines. As explained in his verified statement, Mr. Stice bases his NLV conclusions, in part, on the willingness of PYCO's track valuation witness to make assumptions favorable to SAW about the value of certain assets, such as his decision to attribute reroll quality to rail that could be treated as scrap. Exhibit B to PYCO's STB Docket No. 34844 Application at ¶7. Similarly, the assessment by PYCO's witness that most of the ties in the Lines as scrap appears to Mr. Stice to be sensible, considering Mr. Stice's personal assessment of SAW's physical plant, although the ties can support continued operations as long as they are replaced on a regular maintenance schedule. Accordingly, consistent with its expert witness' testimony, KJRY accepts PYCO's evidence, as confirmed and substantiated by Mr. Stice, of an NLV of \$2,094,000 for purposes of this proceeding.

GCV Estimate

When a line can be operated by its owner at a profit, "the only fair way to value this line" is at its GCV (assuming that GCV is established with reliable evidence). Caddo Antoine and Little Missouri Railroad Company-Feeder Line Acquisition-Arkansas Midland Railroad Company Line Between Gurdon and Birds Mill, AR, 4 S.T.B. 326 (1999) ("Caddo"), rev'd in

(STB served Aug. 16, 2006) slip op. at 5.

part 4 S.T.B. 610 (2000) at 14. “GCV is defined as what a line is worth as an operating business, not its break-up value.” Id. It is the line’s worth to the seller, not its projected value to the buyer, which is determinative. Id., citing United States v. Miller, 317 U.S. 369, 375 (1942). GCV is calculated by applying a multiplier based on the railroad industry’s pre-tax cost of capital⁵ to the net revenues⁶ earned from operating the line. Id., at 15.

Both PYCO and SAW present GCV calculations for the Lines. PYCO (through the statement of its witness Charles H. Banks, Exhibit C to PYCO’s May 5 Feeder Line Application - “V.S. Banks”) maintains that the Lines have a negative GCV. Mr. Banks’ conclusion rests in large part on alleged substantial rehabilitation costs, which if undertaken and accounted for in calculating operating costs, lowers the GCV below the NLV. SAW, on the other hand, claims that the Lines have a maximum GCV of \$8,537,903. SAW Statement at 23. Of course the problem with SAW’s GCV estimate is that it actually presents a range of GCV estimates. SAW’s witness, Joseph J. Plaistow, assumes differing surcharge and traffic scenarios, rather than embracing just one set of facts, and as a result presents a GCV for All-SAW ranging from a high of \$8,537,903 to a low of \$3,958,547. See SAW Statement, Verified Statement of Joseph J. Plaistow (“V.S. Plaistow”) at 36.

In assessing the GCV of the Lines, KJRY retained the expert services of William J. Brennan, Managing Director of Transportation Economics, Inc., who has offered verified testimony on SAW’s GCV (attached hereto as Exhibit B). Mr. Brennan has reviewed the SAW and PYCO GCV estimates, and finds problems with both. As explained more fully in his statement, Mr. Brennan concludes that the GCV of the Lines is \$2,712,370.00 if one includes a

⁵ Specifically, 100/rail industry pre-tax cost of capital established by the Board in Ex Parte No. 558.

⁶ Gross revenues less variable costs, less fixed costs (if any). Caddo Antoine at 16.

factor for projected growth in traffic volumes and \$2,486,779.00 if traffic volumes remain at their historic averages.

As Mr. Brennan discusses in his statement, there are significant problems with the GCV calculations by both PYCO and SAW. As to PYCO, its witness Mr. Banks incorrectly calculates SAW's revenues in two ways. First, he overstates the number of cars SAW can expect to move on an ongoing basis by using an inflated traffic base which was a result of a one year bumper crop. Second, he improperly assumes that all of SAW's rock movements, approximately 3,500 carloads, moved at \$142.72 per car when it is likely that 2,769 of the 3,500 rock carloads moved at the \$45.67 rate. Together, these two errors explain why his "preliminary" GCV is far too high.

Mr. Plaistow, SAW's witness, also grossly exaggerates SAW's GCV. First, he also bases the GCV on the abnormally large 2005 traffic base. Second, he includes revenues from an alleged surcharge in his GCV calculation, but the record does not reflect that such a surcharge is being imposed and collected on all shipments included in Mr. Plaistow's analysis. Third, and equally troubling, he assumes that the imposition of this "phantom" surcharge will have no effect on the quantity demanded. Finally, he does not use the Uniform Rail Costing System ("URCS") to calculate operating expenses as required by Board precedent. Combined, these errors by Mr. Plaistow greatly overstate the Lines' GCV.

As noted, both SAW and PYCO commit a fundamental error by assuming that the 2005 cotton harvest in Texas approximates the going forward volumes of traffic, which increases revenues substantially more than can be justified. As Mr. Brennan, a former economist with the United States Department of Agriculture as well as the STB, establishes, the 2005 harvest was tremendously large and represented a significant aberration in comparison to past years. For that

reason, Mr. Brennan does not use 2005 traffic figures as his baseline for projected future traffic volumes. Mr. Brennan explains that reliance on 2005 traffic as the baseline for future traffic is flawed and grossly overstates the Lines' GCV. Mr. Brennan further explains in detail how he has relied upon extensive USDA data to formulate a reliable estimate for future traffic on the Lines. His GCV estimate therefore brings into balance the significant fluctuations in regional agricultural output occasioned by a variety of factors, including planted acreage and rainfall.

Mr. Brennan also explains why the substantial surcharge that SAW factors into its future revenue projections is either not being charged to all of the traffic as witness Plaistow assumes, or if it were charged, would result in traffic diversions. In contrast, SAW relies on a Texas jury verdict favoring SAW's imposition of a surcharge as evidence that no diversion would occur. SAW claims that, by virtue of the verdict, one can infer that, "in effect," the traffic diversion issue has been resolved once and for all as a matter of law and economics. That is patently not the case.

SAW attaches a copy of the decision on appeal, which summarizes the case presented to the jury. V.S. Wisener, Appendix DW-5. There is absolutely no indication in the appeals court decision that the jury found that no traffic diversion would occur. In fact, SAW's evidence indicates that the traffic diversion question was not specifically presented to the jury, but was instead merely a factor among many in determining whether or not BNSF's disapproval of the surcharge was unreasonable. On the basis of the evidence SAW has provided, it would be grossly inaccurate even to *infer* that the jury specifically found that no traffic would be diverted. In short, when compared to SAW's multiple estimates, KJRY's calculation of GCV is not only consistent with agency precedent, but it also relies on much more reliable traffic projections.

While Mr. Brennan's testimony also discusses other issues related to why both Mr. Banks and Mr. Plaistow overstate revenues, he does not focus solely on the revenue side. Mr. Brennan also discusses why SAW's GCV calculations did not accurately reflect Board precedent and methodology with respect to operating costs. In Caddo Antoine, the Board set the constitutional minimum value for a portion of that line using GCV. In so doing, the Board compared the revenues that the GCV segment could capture against the *variable* costs associated with serving that traffic. Mr. Banks employs that process here; Mr. Plaistow does not. Instead, Mr. Plaistow has taken SAW's tax returns and other financial statements and converted them into profit and loss statements. The Board should view these reports with some skepticism as they are clearly made-for-litigation documents. It is not clear, for example, why Mr. Plaistow did not rely on the actual profit and loss statements that SAW undoubtedly prepared in the course of business. Rather than rely on documents whose accuracy the Board cannot verify directly, the Board should – as it has done in the past – rely on URCS to estimate the operating expenses for this feeder line application.

As explained by Mr. Brennan, the use of URCS is not only consistent with Board precedent, but is also the most appropriate methodology. Using variable costs enables the Board to determine SAW's *economic*, not its accounting, value because the comparison of revenues and variable costs is a cleaner and more appropriate comparison of the future flow of revenues and expenses. In addition, using variable costs *increases* the constitutional minimum value and ensures that the selling entity receives a more favorable settlement. Including other costs would lower the stream of cash flows and reduce GCV. Like Mr. Banks, and in keeping with Board precedent, KJRY's witness Brennan has used URCS variable costs to calculate the expense side of the GCV calculation.

Finally, as to the issue of track rehabilitation costs, PYCO claims that the new operator would have to invest roughly \$1.18 to \$2.13 million up front in track rehabilitation. According to PYCO, once one takes these costs into consideration, the Lines cannot be operated on a profitable basis; thereby reducing the GCV to below the NLV. According to SAW, on the other hand, "there is no justification whatsoever for reducing GCV of All-SAW by any amount for rehabilitation, let alone by the huge amounts in Mr. Banks' Table 8." SAW Statement at 11. SAW's witness Landreth establishes that the trackage complies with FRA Class I track standards. SAW also attaches an October 2005 inspection report by FRA that confirms this analysis. In fact, SAW submits approximately seven pages of argument and an extensive report by Landreth detailing why the Lines do not need rehabilitation.

KJRY's witnesses Carr and Stice have reviewed SAW's evidence and believe that it represents the best evidence of record on this issue and do not dispute it. In fact, as Mr. Stice's testimony shows, and as is also discussed in Dr. Brennan's statement, the Lines do not need substantial rehabilitation to be operated safely. However, Mr. Stice does believe the Lines (including three rail-highway crossings) could use some relatively minor rehabilitation in the amount of \$77,215. After this rehabilitation, Mr. Stice is convinced that the standard maintenance practices as used by KJRY would be sufficient to sustain operations safely. See *Stice V.S.* at 2, 4.

PYCO's insistence upon extensive rehabilitation of the Lines is not consistent with either SAW's or KJRY's evidence and should be rejected. PYCO position is also not consistent with Board precedent or with economic principles. As Dr. Brennan discusses, no new carrier (certainly not KJRY) would spend so much on rehabilitating Lines when spending that much would prevent the carrier from ever making a profit. As such, why would PYCO be seeking to

even acquire the Lines? Instead, it must be that PYCO realizes that the Lines can be operated safely and efficiently on a going concern basis with little, if any, rehabilitation needed. Indeed, the fact that the Lines were capable of handling PYCO's 2005 record traffic amounts, shows that the Lines do not need substantial rehabilitation. The most rational economic decision, which was confirmed by Mr. Carr's previous verified statement and Mr. Stice's attached statement, is to take a gradual approach to rehabilitation and maintenance, making investments as necessary to serve the shippers and to maintain safety. This is far more practical than a huge upfront capital project that insures perpetual unprofitability. KJRY August 4 Feeder Line Application, V.S. Carr at 37. This is the approach KJRY intends to take. It is consistent with past practices and SAW's evidence of record. Mr. Banks' rehabilitation assumptions, on the other hand, are not.

In summary, there are problems with both PYCO's and SAW's GCV calculations. However, except for Mr. Banks' assumptions about rehabilitation expenditures and his overly optimistic revenue projections, PYCO's methodology is certainly more consistent with Board precedent for calculating GCV. On the other hand, SAW's calculations are not only based upon unrealistic revenue assumptions, but they also fail to accurately reflect operating expenses in accordance with Board precedent. KJRY, through its witness Dr. Brennan, develops a GCV estimate for the Lines based upon realistic traffic assumptions, using URCS to develop operating expenses, and adopting most of SAW's evidence regarding rehabilitation. This is consistent with Board precedent and should be accepted.

(5) An offer to purchase the line at the higher of the two estimates submitted pursuant to paragraph (a)(4) of this section.

KJRY hereby offers to purchase the Lines at the higher of the two above estimates; namely, the GCV estimate of \$2,712,370.00 if the Board presumes some modest growth in traffic count, and a GCV of \$2,486,779.00 if one assumes that the traffic levels will remain at

historic averages with little or no growth. Pioneer and KJRY have an arrangement in place with the Bank to fund the acquisition. KJRY is ready, willing, and able to pay GCV for the entire SAW property, and to close within 30 days.

(6) The dates for the proposed period of operation of the line covered by the application.

KJRY requests that the Board order closing on KJRY's purchase of the Lines to occur no less than 60 days of the service date of the Board's order granting KJRY's application. KJRY will close on the purchase at the earliest possible time within that period and will make every effort to close within 30 days of the Board's order. After closing, KJRY intends to operate the lines for a minimum of three years, and in all likelihood, for considerably longer.

(7) An operating plan that identifies the proposed operator; attaches any contract that the applicant may have with the proposed operator; describes in detail the service that is to be provided over the line, including all interline connections; and demonstrates that adequate transportation will be provided over the line for at least 3 years from the date of acquisition.

All interested parties agree that one carrier should own and operate all of SAW's lines. For that reason, KJRY embraces the All-SAW arrangement contained in this application, rather than the Alternative Two scenario set forth in its hastily-composed initial application. As set forth in the Verified Statement of Shane Cullen, attached hereto as Exhibit E, ("V.S. Cullen"), KJRY, an experienced rail operator, can operate the All-SAW lines both safely and at the same or better service levels than those being currently provided on the Lines. KJRY intends to operate the lines itself, and, in so doing, would interchange with BNSF Railway Company ("BNSF"), the only major carrier with a direct connection to the lines. KJRY will provide service that meets the needs described by shippers in PYCO's original FLA and in the related alternative service order proceeding.

It appears that SAW has operated the Lines on a five-day-per-week basis (with occasional weekend operations). See V.S. Wisener, Appendix DW-5; PYCO May 5 Feeder Line

Application at 21 (“WTL currently operates alternative service five days per week, with additional service on weekends as needed.”). KJRY anticipates providing service on a five-day-per-week basis, utilizing two train crews, a track crew and a general manager. KJRY would accept applications from any SAW employees who would be laid off as a direct result of the grant of KJRY’s application, and would give those persons priority consideration for hiring as specified below under heading 15. KJRY anticipates providing office and support services through its existing personnel and those of Pioneer Railroad Services, though if it were necessary to add to that level of staffing, KJRY would do so.

To handle the volume of traffic currently moving on the Lines, KJRY would provide three or four locomotives available for immediate use. Car supply, as KJRY understands it, is handled by BNSF, and KJRY anticipates that arrangement would continue. KJRY would coordinate its interchange and other operational matters with BNSF, the linehaul movement provider for most or all of the traffic moving to or from the lines. KJRY anticipates being able to work with BNSF to resolve any and all operating issues. Indeed, KJRY and BNSF have good relations and have only recently entered into an agreement whereby KJRY will lease 42.1 miles of BNSF Railway line. See Keokuk Junction Railway Co. d/b/a Peoria & Western Railway – Lease and Operation Exemption – BNSF Railway Company, STB Finance Docket No. 34918. The bottom line is that BNSF and KJRY have experience working together and can resolve any operational concerns and issues.

In light of the information concerning traffic levels, rates, and divisions that is contained in KJRY’s expert testimony attached hereto, KJRY estimates that its operation of the Lines will be self-sustaining financially. KJRY would fund any non-standard rehabilitation through

KJRY's operating net income in the event that such costs cannot be supported by current cash flow from operating the line. V.S. Carr at 3.

(8) A description of the liability insurance coverage carried by applicant or any proposed operator. If trackage rights are requested, the insurance must be at a level sufficient to indemnify the owning railroad against all personal and property damage that may result from negligence on the part of the operator in exercising the trackage rights.

Pioneer maintains insurance covering KJRY. This insurance covers claims arising from personal injury and property damage in the event of derailments or other accidents or occurrences. Certificates of insurance coverage in the amount of \$25 million for personal injury and \$1.5 million for property damage, listing KJRY as a named insured, were attached as Appendix 3 to KJRY's Alternative Two FLA and are specifically incorporated herein.

(9) Any preconditions (such as assuming a share of any subsidy payments) that will be placed on shippers in order for them to receive service, and a statement that if the application is approved, no further preconditions will be placed on shippers without Board approval. (This Statement Will Be Binding Upon Applicant if the Application is Approved.)

Absent Board approval, no preconditions will be placed upon shippers in order to receive service. KJRY is not seeking Board approval for any such conditions at this time.

(10) The name and address of any person(s) who will subsidize the operation of the line.

As stated above, KJRY anticipates that its operation of the Lines will be self-supporting. Accordingly, there is no need for any entity to subsidize the operation of the lines. However, should unforeseen need arise, KJRY will provide the needed subsidy by drawing down on its \$3 million line of credit. As set forth in Mr. Carr's previous verified statement filed on August 4, KJRY also has \$1.5 million of free cash flow that it could use to provide any needed subsidy or unexpected expense.

(11) A statement that the applicant will seek a finding by the Board that the public convenience and necessity permit or require acquisition, or a statement that the line is currently in category 1 or 2 of the owning railroad's system diagram map.

KJRY seeks a finding that the public convenience and necessity permit or require acquisition of the lines.

(i) If the applicant seeks a finding of public convenience and necessity, the application must contain detailed evidence that permits the Board to find that:

(A) The rail carrier operating the line refused within a reasonable time to make the necessary efforts to provide adequate service to shippers who transport traffic over the line; [and]

(B) The transportation over the line is inadequate for the majority of shippers who transport traffic over the line;

The lines involved in this application have been the subject of an ongoing service dispute between PYCO and SAW for over a year. The Board found that SAW's service to PYCO was so severely deficient that the Board issued an alternative service order, Pyco Industries, Inc.—Alternative Rail Service—South Plains Switching, Ltd. Co., STB Finance Docket No. 34802 (served Jan. 26, 2006), replacing SAW temporarily as the carrier serving PYCO. In so doing, the Board found that:

PYCO is a rail-dependent shipper with two plants from which it ships annually more than 6,000 carloads of cottonseed oil and related products. Moreover, PYCO is served only by SAW. Here, the daily shortfall of 14 carloads for switching at Plant No. 1 (more than half of the 26 carloads that PYCO previously could load there), the continued lack of delivery of sufficient boxcars to serve Plant No. 2, and the period in November 2005 during which SAW performed no switching at all at Plant No. 2 indicate a serious deterioration in SAW's service to PYCO. PYCO has demonstrated through ample, credible evidence that, as a consequence of these service inadequacies, it will soon run out of storage capacity for its cottonseed oil and related products, and will be forced to curtail or close operations. Consequently, we find that PYCO has shown, as to itself, "a substantial, measurable deterioration or other demonstrated inadequacy in rail service provided by the incumbent carrier." 49 CFR 1146.1(a).

(Footnotes omitted.)

Even after issuance of the alternative service order, multiple disputes between PYCO and SAW have arisen, requiring a series of decisions by the Board to referee between the warring parties. The particulars of these disputes are set forth in some additional detail in KJRY's application filed on August 4.

Clearly, PYCO's many filings with the Board, combined with the supporting comments of other shippers on the lines, show that SAW's service has been inadequate to meet the needs of shippers. The Board's acceptance of PYCO's All-SAW application further confirms this. In addition, although not admitting that it has provided inadequate service, SAW does not oppose a Board finding that the public convenience and necessity permits the sale of the Lines. See SAW Statement at 2. KJRY hereby adopts the Board's findings and PYCO's evidence.

(C) The sale of the line will not have a significantly adverse financial effect on the rail carrier operating the line;

The sale of the lines will not have a significant adverse financial effect on SAW because, by paying the GCV of the lines, SAW will be fully compensated. The purpose of valuing a feeder line based on the higher of GCV or NLV is to give the carrier the highest value it can establish that it would lose as a result of transferring the line. In particular, purchase of the line at GCV would compensate the carrier for the lost opportunity to profit from continued operations. KJRY's application offers to pay SAW the Lines' GCV, which would make SAW whole for the loss of the business opportunity to continue operating the Lines.

(D) The sale of the line will not have an adverse effect on the overall operational performance of the rail carrier operating the line;

The All-SAW option KJRY proposes would entirely eliminate any potential for an adverse effect on SAW's operations. Granting KJRY's application would not force SAW to suffer any operational difficulties.

and

(E) The sale of the line will be likely to result in improved railroad transportation for shippers who transport traffic over the line.

As indicated by KJRY in its Alternative Two FLA, acquisition and operation of only a portion of SAW's lines could create coordination challenges that would make it difficult to provide improved service. For those reasons, an All-SAW arrangement would ensure improved service for shippers.

Moreover, KJRY is poised to deliver improved service. KJRY has both the resources and the expertise to operate SAW's lines efficiently and cost-effectively. In addition, KJRY will provide service to all of the shippers in a fair and non-discriminatory manner. Unlike PYCO, which is a shipper on the line and which would through its proposed feeder line application control service to a competing shipper, KJRY would be an independent carrier. Unlike PYCO, KJRY would have no motivation to discriminate in favor of or against any customers. Again, unlike Pyco, which, given a choice between meeting its schedules and desires, and those of a small unaffiliated shipper, might well decide to neglect the latter, KJRY has a demonstrated history of serving the needs of both large and small shippers. As neutral third party, KJRY is in the best position to return the operation of the Lines to a normal operating footing, leading to vastly improved service for all the shippers who are currently caught up in the vortex of out-of-control litigation.

PYCO is neither a rail carrier nor does it have experience owning or operating a railroad. If PYCO were to acquire the lines, PYCO has claimed that it would hire the West Texas & Lubbock Railway Company ("WT&L") as its operator. Yet PYCO has presented no information regarding WT&L's safety record, its financial ability to operate the line for the mandated three

year period, or a proposed operating plan. KJRY's application does not suffer from those deficiencies.

(ii) If the applicant seeks a finding that the line is currently in category 1 or 2 of the owning carrier's system diagram map, the relevant portion of the current map must be attached to the application.

Not applicable.

(12) A statement detailing applicant's election of exemption from the provisions of Title 49, United States Code, and a statement that if the application is approved, no further exemptions will be elected. (This Statement Will Be Binding Upon the Applicant if the Application is Approved.)

KJRY does not choose to be exempt from of Title 49 of the U.S. Code pursuant to authority available under 49 U.S.C. Section 10907(g).

(13) A description of any trackage rights sought over the owning railroad that are required to allow reasonable interchange or to move power equipment or empty rolling stock between noncontiguous feeder lines operated by the applicant, and an estimate of the reasonable compensation for such rights, including full explanation of how the estimate was reached. The description of the trackage rights shall include the following information: Milepost or other identification for each segment of track; the need for the trackage rights (interchange of traffic, movement of equipment, etc.); frequency of operations; times of operation; any alternative to the use of trackage rights; and any other pertinent data. Trackage rights that are necessary for the interchange of traffic shall be limited to the closest point to the junction with the owning railroad's line that allows the efficient interchange of traffic. A statement shall be included that the applicant agrees to have its train and crew personnel take the operating rules examination of the railroad over which the operating rights are exercised.

No such rights are requested.

(14) If applicant requests Board prescribed joint rates and divisions in the feeder line proceeding, a description of any joint rate and division agreement that must be established. The description must contain the following information:

- (i) The railroad(s) involved;*
- (ii) The estimated revenues that will result from the division(s);*
- (iii) The total costs of operating the line segment purchased (including any trackage rights fees).*
- (iv) Information sufficient to allow the Board to determine that the line sought to be acquired carried less than 3 million gross ton-miles of traffic per mile in the preceding calendar year; and*
- (v) Any other pertinent information.*

KJRY does not request the establishment of joint rates and divisions at this time.

(15) The extent to which the owning railroad's employees who normally service the line will be used.

KJRY anticipates that, if its application is granted, it will need to hire additional operating employees in roughly the same number as otherwise would be displaced by the transaction. KJRY will give priority consideration to any current SAW employees that otherwise would be displaced as a direct result of the transaction. KJRY would welcome employment applications from former SAW employees and would accord such applicants priority over other, equally-qualified applicants. To be hired, applicants must be qualified by training and other capabilities to fill an available position and be willing to accept employment under the terms and conditions available to KJRY's employees. If any track rehabilitation is required, KJRY expects to use outside contractors.

(16) A certificate stating that the service requirements of Sec. 1151.2(a) have been met.

Such requirements have been met.⁷ See Certificate of Service attached hereto. KJRY is also serving a copy of its application on all shippers identifiable from either PYCO's application or from Appendix DW-1 to V.S. Wisener, *except that* KJRY has not been able to locate through internet or telephone records any entity named Dodson Lumber, listed on Appendix DW-1. In addition, KJRY is also serving a copy of its application on all parties of record listed on the Board's website.

RESPONSE TO BNSF'S AUGUST 31 PETITION FOR LEAVE TO INTERVENE

On August 31, 2006, BNSF filed a petition for leave to intervene in these proceedings. BNSF requests that, if either KJRY's or PYCO's All-SAW application is approved, the Board condition such approval on BNSF being able to operate at Lubbock efficiently and without undue interference. Toward that end, BNSF requests that the Board require the successful applicant to enter in to an operating protocol with BNSF, with the Board resolving any disputes arising from negotiation of such an agreement. KJRY does not object to this request. If KJRY is the successful feeder line applicant, KJRY would work with all affected carriers in Lubbock, especially BNSF, to ensure the smoothest practicable local operations. KJRY expects that other carriers will also work toward that objective.

BNSF's petition also includes a request that its right of first refusal to purchase the Lines, which it apparently retained when it sold the Lines to SAW in the first instance, be preserved in the event that the Board grants one or more of the feeder line applications. BNSF's request seems to cover two possible scenarios. The first, and the more understandable of the two, would involve the preservation of BNSF's right of first refusal *subsequent to* a feeder line applicant's acquisition of the Lines. Under such a scenario, the successful feeder line applicant would acquire the Lines subject to BNSF's right. As such, BNSF would be able to exercise a right of first refusal in accordance with the terms of its sale agreement if and when the successful feeder line applicant attempted to sell the line back to SAW or to another entity. KJRY does not object to BNSF's request under such a scenario.

⁷ Amtrak does not operate on this line and therefore has not been served a copy of the application. To the best of KJRY's knowledge, SAW's employees are not unionized; therefore, copies of this application have not been served on offices of national railway unions.

Under another scenario, however, BNSF might attempt to assert a right of first refusal to preempt PYCO's or KJRY's acquisition of the Lines pursuant to Board authority. In other words, BNSF appears to be arguing that notwithstanding what the Board rules, BNSF shall have the right to step in, before a FLA applicant purchases the line, and exercise its right to get the line back pursuant to its agreement. The Board should not uphold BNSF's asserted rights under this scenario. There is no such provision in the statutory process. In fact, such a reservation of a right of first refusal would entirely negate the processes set forth in Section 10907, and potentially could make both KJRY's and PYCO's respective pursuits of the Lines through the FLA processes entirely pointless. As KJRY's witness, Mr. Brennan, explains, preservation of BNSF's right also would have a chilling effect upon would-be feeder line applicants in future cases, and would be contrary to the objectives of the feeder line provisions and the Rail Transportation Policy ("RTP") at 49 U.S.C. 10101.

BNSF relies upon Milford-Bennington Railroad Company, Inc. – Feeder Line Acquisition – Boston and Maine Corporation Hillsborough Branch, Finance Docket No. 31701 (ICC served Oct. 16, 1991) ("Milford-Bennington") in arguing that it may disrupt the transfer of the Lines to an otherwise successful feeder line applicant. But that case is factually distinguishable. Milford-Bennington did not involve a right of first refusal, nor did the line's owner (or, more to the point, a prior owner) threaten to undermine the feeder line applicant's ability to acquire the line. Rather, in that case, the Interstate Commerce Commission, the Board's predecessor, found that the feeder line applicant acquirer would have to take the target line subject to the rights of an existing tenant operating over the line, much like the first scenario discussed immediately above to which KJRY does not object. Thus, requiring the successful feeder line applicant to acquire the Lines subject to BNSF's *subsequent* right would be consistent

with Milford-Bennington. The “encumbrance” in that case would not have undermined the transaction.

On the other hand, allowing BNSF to exercise a right of first refusal to acquire the lines out from under a successful feeder line applicant would render the statutory process, as well as the applicant’s efforts, potentially meaningless, and would be inconsistent with Milford-Bennington and Railroad Ventures⁸ as well. BNSF’s expansive interpretation of Milford-Bennington would frustrate the objectives of the feeder line provisions entirely.

Expanding application of Milford-Bennington would not just be bad law, it would also be bad economic policy. Economic theory clearly demonstrates that allowing BNSF to trump the feeder line process by invoking its right of first refusal would have a serious chilling effect upon would-be feeder line applicants in future cases. As Mr. Brennan explains in the attached verified statement, game theory reveals that, if a third party is entitled to invoke a pre-existing right of first refusal upon the occasion of a feeder-line induced sale, the best choice for the feeder line applicant would have been not to proceed at all. V.S. Brennan at 26-30. If this is the case, the purpose of the feeder line statute would be frustrated. A railroad could simply avoid application of the statute in the future by including a right of first refusal in any agreement covering lines that it sells. For these reasons, BNSF’s right of first refusal may be permitted to survive KJRY’s purchase of the Lines, but, in the interests of the Rail Transportation Policy at 49 U.S.C. 10101 and the principles behind the feeder line statute, BNSF’s asserted right must not be permitted to preempt that sale.⁹

⁸ Railroad Ventures, Inc.—Acquisition and Operation Exemption—Youngstown & Southern Railroad Company, STB Finance Docket No. 33385 (STB served Oct. 4, 2000), aff’d, Railroad Ventures, Inc. v. STB, 299 F.3d 5223 (6th Cir. 2003).

⁹ If BNSF’s contractual right does take precedence over the statute, then BNSF, once it has reacquired SAW at whatever price is set forth in its contract, should immediately be required to

CONCLUSION

KJRY's GCV calculations for the Lines are more reliable and better substantiated than either PYCO's or SAW's. KJRY's estimated GCV provides a higher and more realistic value for the Lines than PYCO has done in arguing that the Lines possess a positive NLV and a negative GCV. Moreover, KJRY's expert witnesses show that SAW's GCV calculations are based on flawed assumptions that severely overstate SAW's minimum constitutional value. KJRY has shown that it has ample financial resources available to purchase the Lines and to operate them for at least three years.

KJRY is an experienced rail operator whose ultimate objective is to provide improved service to all shippers on the Lines. Accordingly, granting KJRY's application will serve the public convenience and would put an end to the PYCO and SAW feud, by replacing SAW with a neutral, experienced carrier. The Board should grant KJRY's application and set the constitutional minimum value of the Lines at \$2,712,370.00 if the Board presumes some modest growth in traffic count or \$2,486,779.00 if one assumes that the traffic levels will remain at historic averages with little or no growth. If the Board determines that PYCO's All-SAW application should be granted also, the Board should, consistent with 49 CFR 1151.4(c) and Board precedent, grant both applications and allow the incumbent carrier to choose between the two applicants.¹⁰

sell SAW to the successful feeder line applicant at the Board established price. In this sense, BNSF would be taking back the SAW lines burdened by the Board's decision and subject to the Board's decision. This would also be consistent with Milford-Bennington.

¹⁰ Cheney Railroad Company-Feeder Line Acquisition-CSX Transportation, Inc. Line Between Greens and Ivalee, AL; Tyson Foods, Inc.--Feeder Line Application-CSX Transportation, Inc. Line at Ivalee, AL, 5 I.C.C2d 250, 1989 ICC LEXIS 19 at *60, ordering paragraph 3, aff'd sub nom. Cheney Railroad v. I.C.C., 902 F.2d 66 (D.C. Cir.); cert den. 498 U.S. 985 (1990).

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'William A. Mullins', written over a horizontal line.

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Attorneys for Keokuk Junction Railway Co.

September 27, 2006

CERTIFICATE OF SERVICE

I, Robert A. Wimbish, hereby certify that on September 27, 2006, I caused a copy of the foregoing Expanded Competing Feeder Line Application of Keokuk Junction Railway Co., to be served by first class mail, postage prepaid, or by more expeditious service upon each of the following persons or entities, as required by 49 C.F.R. § 1151.2(a):

(1) Owning Railroad

South Plains Switching, Inc.
c/o Thomas F. McFarland, Esq.
208 South LaSalle Street
Suite 1890
Chicago, IL 60604-1112

(2) Shippers:

Farmrail System, Inc.
1601 West Gary Boulevard
Clinton, OK 73601

PYCO Industries, Inc.
P.O. Box 841
Lubbock, TX 79408

PYCO Industries, Inc.
c/o Charles H. Montange, Esq.
426 NW 162nd Street
Seattle, WA 98177

Teinert Metals, Inc.
1802 East 50th Street
P.O. Box 3217
Lubbock, TX 79452

Russell E. Womack
1300 E. 42nd Street
Lubbock, TX 79404

84 Lumber
102 E. 50th Street
Lubbock, TX 79404

Wilkerson Storage
500 East 50th
P.O. Box 2525
Lubbock, TX 79408

Vulcan Construction Materials LP
Regional Sales Office
3509 Hulen Street, Suite 102
Ft. Worth, TX 76107

Acme Brick
2301 Ave. A
Lubbock, TX 79404

Robertson Bonded Warehouse, Inc.
833 E. 40th Street
Lubbock, TX 79404

Stock Building Supply
801 E. 40th Street
Lubbock, TX 79404

Pantex
1116 E. 42d Street
Lubbock, TX 79404

BlueLinx Holdings, Inc.
4300 Wildwood Parkway
Atlanta, GA 30339

International Fiber Packaging
704 E. 42d St.
Lubbock, TX 79404

Ron Harkey, President
Farmers Cooperative Compress
3800 Southeast Drive
Lubbock, TX 79404

Lehmer Dunn, Vice President
Attebury Grain, L.L.C
4909 Canyon Drive
Amarillo, TX 79110

Southern Cotton Oil Company
C/O Goldstein, Andrew P.
Mccarthy, Sweney & Harkaway, P.C.
2175 K Street, N. W., Suite 600
Washington, DC 20037

Hanson Aggregate
8505 Freeport Parkway North, Suite 300
Irving, TX 75063

Brite Trucking Co, Inc.
P.O. Box 537
Lubbock, TX 79408

ABC Supply Co. Inc.
404 34th Street
Lubbock, TX 79404

Dynamic Foods
1001 E. 33rd Street
Lubbock, TX 79404

South Plains Food Bank, Inc.
d/b/a Breedlove Hydrated Foods
1818 North Martin Luther King, Jr., Blvd.
Lubbock, TX 74903

Calvin Kidwell, General Manager
Hi-Plains Bas and Bagging Company
707 East 44th Street
Lubbock, TX 79404

David C. Weaver Grain Company
P.O. Box 94582
Lubbock, TX 79493

John Goetz
Goetz and Sons, Incorporated
P.O. Box 740635
Dallas, TX 75374-0635

ADM
2300 E. 50th
Lubbock, TX 79404

Georgia Pacific
702 E. 44th Street
Lubbock, TX 79404

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Penny-Newman Grain
2591 S. Cedar Avenue
Fresno, CA 93725

Sheila Bracken
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P.O. Box 3254
Cordova, TN 38088-3254

Rhonda Lambert
Logistics Coordinator
Cargill Cotton
1212 13th Street, Suite 200
Lubbock, TX 79401

Mr. O.E. Floyd
Floyd Trucking, Inc.
P.O. Box 3456
Lubbock, TX 79452

(3)

State Agency:

Texas Governor's Office of Budget and Planning
P.O. Box 12428
Austin, TX 78711

Texas Department of Transportation Rail Division
Dewitt C. Greer State Highway Building
125 East 11th Street
Austin, TX 78701-2483

(4)

County Governments:

Honorable Tom Head
Lubbock County Judge
904 Broadway
Lubbock, TX 79401

(5) **National Railroad Passenger Corporation (if operates on the line):**

Amtrak's website says Amtrak serves no station within 150 miles of this location.

(6) **National offices of rail unions with employees on the line:**

KJRY is informed that there are no unionized employees on SAW.

Other

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Robert A. Wimbish

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

EXHIBIT A

VERIFIED STATEMENT

OF

J. MICHAEL CARR

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

**KEOKUK JUNCTION RAILWAY CO.
— FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

EXPANDED COMPETING FEEDER LINE APPLICATION

VERIFIED STATEMENT OF J. MICHAEL CARR

My name is J. Michael Carr, and I am the President, CEO, and Chief Financial Officer of Keokuk Junction Railway Co. ("KJRY"), and the other railroad subsidiaries of Pioneer Railcorp ("Pioneer").

I have been Chief Financial Officer of Pioneer and its subsidiaries since 1993; CFO of KJRY since 1996; and President of Pioneer's subsidiaries, including KJRY, since early 2005. I am a Certified Public Accountant. During the past 13 years I have been involved in many railroad acquisition projects, including the acquisition of KJRY itself (in 1996), and the KJRY Feeder Line acquisition of the "west end" of the Toledo, Peoria & Western Railroad ("TP&W"). My qualifications as a witness on the topics I discuss below were previously set forth in my verified statement accompanying KJRY's feeder line application to acquire the so-called "Alternative Two" lines filed in this proceeding on August 4, 2006.

KJRY has been in business since 1981. KJRY originally operated 4.5 miles of former Rock Island trackage in/near Keokuk, Iowa. KJRY acquired the line from Keokuk to LaHarpe, Illinois, from the Atchison, Topeka & Santa Fe Railroad in 1987. Pioneer acquired a majority

interest in KJRY in March, 1996, and subsequently acquired all of KJRY's outstanding stock. In 2001, KJRY acquired the line from LaHarpe to Lomax (including trackage rights over BNSF to Fort Madison, Iowa) from the TP&W, and in February, 2005, acquired the line from LaHarpe to Hollis, Illinois ("TP&W's West End") through a feeder line proceeding. KJRY currently handles approximately 2,000 cars a month and operates over lines extending from Keokuk and Fort Madison to East Peoria, Illinois (including trackage rights over BNSF between Fort Madison and Lomax, Illinois, and over Union Pacific Railroad and Tazewell & Peoria Railroad ("T&P"), between Hollis and the T&P yard in East Peoria), a total of approximately 141 miles.

Other Pioneer subsidiaries operate common carrier rail lines in Kansas, Arkansas, Mississippi, Tennessee, Alabama, Pennsylvania, Indiana, Michigan, and Illinois. One of those carriers, the Fort Smith Railroad Co. ("FSR"), has operated over a complex set of tracks and switching operations in/near Fort Smith, Arkansas since 1991. FSR handles approximately 10,000 cars per year for about 17 customers. The FSR operations are substantially similar to those of South Plains Switching, Ltd. Co. ("SAW").

Given our experience with FSR and our other railroads, I have extreme confidence that our experienced and knowledgeable railroad personnel at KJRY will have no problems operating the SAW lines. Indeed, KJRY has both the resources and the expertise to operate SAW's lines efficiently and cost-effectively. In addition, KJRY will provide service to all of the shippers in a fair and non-discriminatory manner. Unlike Pyco Industries, Inc. ("PYCO"), which is a shipper on the line and which would through its proposed feeder line application control service to a competing shipper, KJRY would be an independent carrier. Unlike PYCO, KJRY would have no motivation to discriminate for/against any customers. Again, unlike Pyco, which, given a choice between meeting its schedules and desires, and those of a small unaffiliated shipper,

might well decide to neglect the latter, KJRY has a demonstrated history of serving the needs of both large and small shippers.

I have reviewed the Verified Statements of Roger Stice, Shane Cullen, Daniel LaKemper, and William Brennan, all of which are offered here in support of KJRY's expanded application to acquire the entire SAW system. I agree with each of these statements, and the conclusions expressed therein.

KJRY has the financial resources to acquire and operate the entire SAW system. In the past, Pioneer secured a loan from National City Bank ("Bank") to finance KJRY's feeder line acquisition of TP&W's West End. The Bank has now committed to providing a least \$3 million to Pioneer to finance the acquisition and operation of SAW. Pioneer will in turn provide this money to KJRY, its wholly owned subsidiary, for KJRY's exclusive use. As evidence of KJRY's ability to purchase SAW trackage, I attach as Exhibit 1 a copy of a commitment letter from the Bank evidencing its agreement to fund KJRY's acquisition of SAW. The loan amount exceeds KJRY's estimate of SAW's going concern value ("GCV"), which, according to Mr. Brennan, is \$2,712,370.00 with projected growth and \$2,486,779.00 without traffic growth. This is precisely the sort of loan arrangement that KJRY utilized to acquire TP&W's West End.

Given this \$3 million line of credit to Pioneer, which is being provided to KJRY for KJRY exclusive use, KJRY has more than sufficient funds to acquire the lines and plenty of surplus funds to draw upon in the event there are unforeseen operating problems. In addition to this loan commitment, KJRY has adequate cash flow from its continuing operations to cover any unanticipated shortfalls in revenue over at least the next three years, although, as explained immediately below, no such shortfall should occur. Therefore, KJRY has access to several funding sources to ensure that it will provide adequate transportation for SAW's shippers for a

period of not less than 3 years: its own operating funds from its existing operations, positive cash flow from operating SAW, and if need be, the ability to draw additional funds from the \$3 million line of credit.

In fact, based upon my railroad financial experience, my review of the traffic and financial information provided by SAW, my review of the expert testimony presented by PYCO and SAW, and my consultations with KJRY's witnesses, I am convinced that SAW's lines, as a whole, can be operated profitably into the future and that extensive rehabilitation is not needed to maintain the kind of service required of a shortline that serves a number of customers in a relatively confined area. My analysis establishes that SAW will operate on a positive cash flow basis providing more than sufficient funds to cover the debt payments and continuing operations. The fact that the All-SAW Alternative can be operated on a going concern basis and generate sufficient cash flow to make the operations profitable without the need for subsidy is consistent with PYCO's own testimony which postulates profitable operations without the need for substantial rehabilitation. This conclusion is also consistent with the testimony of Mr. Brennan, who has shown that SAW possesses a going concern value based on SAW's projected positive cash flow.

Given PYCO's own expert testimony and Mr. Brennan's view that SAW's lines have a going concern basis, it is not necessary to provide further evidence or commentary as to whether or not the Lines could be operated for three years. The Lines will be self-sustaining. Nonetheless, to further demonstrate that KJRY's operation of SAW would be self-sufficient, I have composed a three-year pro forma balance sheet that accurately takes into account KJRY's prospective revenues from owning and operating the SAW lines as well as the costs of owning the line and providing service over it. See Exhibit 2, attached hereto. These pro-formas are

consistent with PYCO's views regarding their ability to operate the lines profitably and with the data prepared by Mr. Brennan.

As to the issue of whether or not substantial rehabilitation of the lines is necessary, I agree with SAW's assertion that extensive rehabilitation of its lines, as proposed by PYCO, is unnecessary. This conclusion was confirmed by KJRY's witness, Roger Stice. Mr. Stice has personally inspected the lines and the safety and maintenance records produced by SAW. As detailed in Mr. Stice's statement, the lines require little, if any, rehabilitation. Rather, routine maintenance should be sufficient to maintain the operating characteristics of the railroad. Accordingly, based upon the fact that extensive rehabilitation is not needed, it is also my belief that GCV is the correct basis for valuation of the property.

In fact, given the relatively modest profit margins of the SAW system on a going concern basis, if the lines truly need the type of rehabilitation suggested by PYCO, I question how PYCO can operate the SAW lines profitably. In my opinion, this is the problem with PYCO's application. If the lines are in such bad shape that adding the rehabilitation costs means the lines only have a net liquidation value, then PYCO has not shown, through pro-formas or otherwise, that PYCO can both pay for that rehabilitation, which it claims is necessary for continued operations, and operate the lines for a three year period as required by the statute. On the other hand, if PYCO believes the lines in fact can be operated on a profitable basis going forward, which PYCO's own witness says, then the lines have a going concern value for which PYCO has not adequately accounted for. KJRY's application does not suffer from such incongruities. In the end, based on the evidence KJRY has filed in connection with this expanded feeder line application to acquire and operate all of SAW's lines, KJRY has concluded that SAW has a GCV of \$2,712,370.00 if the Board presumes some modest growth in traffic count and a GCV of

\$2,486,779.00 if one assumes that the traffic levels remain at historic averages with no growth. I concur with these figures and, as stated above, KJRY has an arrangement in place with the Bank to fund the acquisition. Accordingly, KJRY hereby offers to pay up to \$2,712,370.00 for the All-SAW system. As President and CEO of Pioneer and President of KJRY, it is within my authority to make this offer. KJRY is ready, willing, and able to pay GCV for the entire SAW property, and to close within 30 days.

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

VERIFIED STATEMENT

OF

J. MICHAEL CARR

EXHIBIT 1

September 22, 2006

Mr. J. Michael Carr
Pioneer Railcorp
1318 S. Johanson Rd.
Peoria, IL 61607

Dear Mike:

National City Bank ("Bank") is pleased to make the following credit facility available to Pioneer Railcorp ("Borrower").

Terms not specifically covered or made definitive in this commitment are subject to mutual agreement between Bank and Borrower. This commitment will be subject to the attached terms and conditions, which supersede all prior oral or written understanding between Bank and Borrower with regard to the transactions provided for herein.

If this commitment is accepted by Borrower but not consummated, this commitment, at Bank's option, may be considered canceled. Borrower will still be liable for all out of pocket expenses incurred by Bank in preparation for the closing.

Third parties should in no way rely on this letter and Bank is not liable for any actions taken by a third party because of their reliance on this letter.

Please indicate acceptance of the stated terms of this commitment by executing this financing commitment and returning the same to us on or before October 31, 2006. If acceptance is not received by this date, this commitment will be considered canceled and void. Any revisions to this commitment letter must be approved by Bank in writing. Closing of this commitment is to take place no later than December 31, 2006 or as soon thereafter as considered reasonable.

Sincerely,



Michael A. Zeller
Senior Vice President

National City.

Financing Commitment

National City Bank ("Bank") is pleased to provide the following commitment to Pioneer Railcorp ("Borrower") subject to the terms and conditions contained herein.

Pioneer Railcorp ("Borrower")

TERM LOAN:

Borrower:	Pioneer Railcorp
Amount & Facility:	A \$3,000,000 secured term loan.
Guarantor:	All railroad subsidiaries of Pioneer Railcorp and Pioneer Railroad Equipment Co., Ltd.
Purpose:	For Keokuk Junction Railway Co. to purchase assets of South Plains Switching, LTD.
Pricing:	Subject to a grid based upon Total Leverage. Initial pricing to be set at 30-day LIBOR + 275 basis points.
Collateral:	Blanket lien on all non-real estate assets acquired from the South Plains Switching, LTD, as well as a negative pledge on any acquired real estate. Blanket lien on all business assets (primarily steel, rail, ties, ballast) of all Pioneer Railcorp railroad subsidiaries, as well as a negative pledge on all real estate owned by the railroads. Pledge of stock of the subsidiary railroads. Cross collateralized and cross-defaulted with other National City debt.
Amortization:	Monthly principal plus interest payments based on a ten year amortization with payments scheduled to approximate a modified mortgage payment.
Maturity:	5 years from closing.

Tuesday, September 26, 2006

National City.

OTHER TERMS AND CONDITIONS

This commitment will be subject to mutually agreed upon terms and conditions of a loan agreement.

Further, this commitment is subject to satisfactory completion of usual and customary due diligence by the Bank.

The undersigned hereby accepts the foregoing commitment from National City and the terms and conditions set forth herein, this
_____ day of _____.

Pioneer Railcorp

BY: _____
J. Michael Carr, President

DATE: _____

National City Bank

BY: _____

Michael A. Zeller, Senior Vice President

Tuesday, September 26, 2006

National City.

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

VERIFIED STATEMENT

OF

J. MICHAEL CARR

EXHIBIT 2

SAW

	Year 1	Year 2	Year 3
<u>OPERATING REVENUES</u>	\$ 1,332,234	\$ 1,385,523	\$ 1,440,944
<u>OPERATING EXPENSES</u>			
<u>MAINTENANCE OF WAY</u>			
WAGES, MOW - Employees 2	\$ 99,840	\$ 103,834	\$ 107,987
INS., BENEFITS & TAXES, MOW	34,944	36,342	37,795
FUEL/OIL, MOW (Truck)	-	-	-
TRACK MATERIALS	48,000	50,400	52,920
REPAIRS & MAINTENANCE, MOW (WASH OUTS)	-	-	-
WEED CONTROL, MOW	19,500	20,475	21,499
BRUSH CUTTING	19,500	20,475	21,499
SIGNAL MAINTENANCE, MOW	9,984	10,483	11,007
TOTAL MAINTENANCE OF WAY:	\$231,768	\$242,009	\$252,707
<u>MAINTENANCE OF EQUIPMENT</u>			
WAGES, MOE	\$ 40,000	\$ 41,600	\$ 43,264
INS., BENEFITS & TAXES, MOE	14,000	14,560	15,142
FUEL/OIL, MOE	0	0	0
REPAIRS & MAINTENANCE, MOE	0	0	0
CAR REPAIR PARTS	0	0	0
MECHANICAL PARTS & SUPPLIES	0	0	0
TOTAL MAINT. OF EQUIPMENT:	\$54,000	\$56,160	\$58,406
<u>TRANSPORTATION EXPENSES</u>			
WAGES, TRANS.	\$ 176,800	\$ 183,872	\$ 191,227
INS., BENEFITS & TAXES, TRANS	61,880	64,355	66,929
FUEL, TRANSPORTATION 1 LOCO 24 HOURS A DAY	187,000	194,480	202,259
OIL TRANSPORTATION 1 LOCO 24 HOURS A DAY - 4 BARRELS M	14,400	14,976	15,575
COLD WEATHER LOCOMOTIVE IDLING	-	-	-
LOCOMOTIVE SUPPLIES	9,750	10,140	10,546
LOCOMOTIVE LEASE	85,200	85,200	85,200
CAR HIRE EXPENSES	24,000	24,000	24,000
OTHER EXPENSES - TRACK LEASE	-	-	-
TOTAL TRANSPORTATION EXP.:	\$559,030	\$577,023	\$595,736
<u>ADMINISTRATIVE EXPENSES</u>			
SALARIES, MANAGEMENT	\$ 60,000	\$ 62,400	\$ 64,896
INS., BENEFITS & TAXES, ADMIN.	21,000	21,840	22,714
MARKETING ALLOCATION & EXP.	-	-	-
TRAVEL (BY CORPORATE OFFICE)	-	-	-
PROFESSIONAL FEES (CPA)	-	-	-
DIRECT EDI EXPENSES \$3 PER CAR	21,000	21,000	21,000
INSURANCE, LIABILITY	30,000	30,000	30,000
INSURANCE, PROPERTY	-	-	-
INSURANCE, VEHICLES	-	-	-
UTILITIES	4,800	5,232	5,703
MISC. OFFICE SUPPLIES/EXPENSES	-	-	-
OTHER LICENSES/FEES	-	-	-
MANAGEMENT FEE TO RAILROAD	-	-	-
REAL ESTATE/PROPERTY TAXES	-	-	-
TOTAL ADMINISTRATIVE EXP.:	\$136,800	\$140,472	\$144,312
TOTAL OPERATING EXPENSES	\$981,598	\$1,015,664	\$1,051,162
Cash Flow	\$350,636	\$369,860	\$389,782
Less Interest Payments on Debt	\$209,250	\$209,250	\$209,250
Profit	\$141,386	\$160,610	\$180,532

VERIFICATION

I, J. Michael Carr, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 27th day of September, 2006.

A handwritten signature in black ink, reading "J. Michael Carr". The signature is written in a cursive style with a large, stylized initial "J" and a long, sweeping underline.

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

EXHIBIT B

VERIFIED STATEMENT

OF

WILLIAM J. BRENNAN, PhD

Before the Surface Transportation Board
STB Finance Docket 34922
Keokuk Junction Railway Company – Feeder Line Application –
Lines of South Plains Switching, Ltd. Co.

Verified Statement
Of
William J. Brennan, PhD

I. Introduction

I am William J. Brennan, Managing Director of Transportation Economics, Inc. (“TEI”), an economic consulting firm. The Keokuk Junction Railway Co. (“KJRY”) engaged me to prepare this Verified Statement. KJRY has asked me to review the testimony of other witnesses in this proceeding and, in light of the evidence of record, the testimony of other witnesses, and my own calculations, set forth an appropriate going concern value (“GCV”) for South Plains Switching Ltd., Co., (“SAW”). KJRY has also asked me to analyze, from an economic perspective, the likely effects on the feeder line application process if BNSF (or any third-party) retains a right-of first refusal. My qualifications are detailed in Exhibit 1.

II. SAW's Going Concern Value

To determine SAW's GCV, I will review the GCV estimates that PYCO Industries, Inc. ("PYCO") and SAW have presented to the Board for the entirety of SAW's assets and operations in the Lubbock, TX, area, and I present and explain my own GCV estimate. I also briefly comment upon the estimated net liquidation value ("NLV") of the entire SAW system, understanding that KJRY will include additional evidence on the NLV issue through the testimony of other witnesses.

Central to my testimony here, I estimate that SAW's GCV is \$2,718,100 as I will explain more fully below. Because I concur that the NLV of SAW is \$2,059,800, I conclude that GCV is greater than the NLV. Therefore, GCV is the constitutional minimum value that the Board must set for SAW's rail lines.

To calculate a firm's going concern value ("GCV"), one must assess its ability to produce a stream of cash flows into the future; the greater that cash flow, the higher the GCV. One can calculate GCV in a number of different ways. For example, Mr. Joseph Plaistow, SAW's GCV witness, forecasts after-tax revenues and expenses over a 10-year horizon, at which point he uses a perpetuity formula to calculate a terminal value. The difference between each year's revenues and expenses (the cash flow) are discounted using the after-tax cost of capital and then summed to find GCV. Alternatively, Mr. Charles Banks, PYCO's witness, calculates the pre-tax cash flow for SAW in 2005, and then capitalizes that flow using the pre-tax cost of capital of 14.1 percent.

For his part, Mr. Plaistow places great stock in his argument that value is a forward looking concept.¹ I agree, but am puzzled that Mr. Plaistow fails to recognize that not only are the two approaches both valid, but that they will also yield equivalent results. Consider for example a perpetual cash flow of \$1 per year with a discount rate of 50 percent. Under Mr. Plaistow's approach we would obtain present values of \$1, \$0.50, \$0.25, \$0.125, and so forth. Summing this over an infinite horizon, we obtain a net present value of \$2. Alternatively, equivalently, and much more directly, we could use Mr. Bank's approach and divide \$1 by 0.5 and obtain \$2.

This equivalency is a standard result described in many microeconomics and finance textbooks.² If an asset generates a stream of identical cash flows at the end of each period, the value of the asset is the present value of the perpetuity. Thus, if we designate a stream of cash flows, C , and the discount rate as i , then we can describe the present value (PV) problem mathematically as follows:

$$PV_{\text{Perpetuity}} = C + \frac{C}{(1+i)} + \frac{C}{(1+i)^2} + \dots + \frac{C}{(1+i)^n} = \frac{C}{i}$$

Of course, if we expect a stream of cash flows to grow over time, say at a constant rate g (such that $g < i$, to ensure the solution is bounded), then this formula needs to be modified slightly to reflect the growth in cash flows. The growing perpetuity formula is simply $C/(i-g)$. Because there are reasons to believe that SAW's cash flows will grow over time, I will apply this formula, though I will also present the steady-state version the Board has applied in the past.

¹ See SAW Statement in Response to PYCO's Feeder Line Application, Plaistow V.S., at 6.

² See, for example, Robert S. Pindyck and Daniel L. Rubenfield, *Microeconomics*, 6th Edition, 2005, p. 550.

Please note that Mr. Plaistow himself calculates the terminal value of the SAW using this very formula.³³ Thus, both the approach employed by Mr. Banks and the slightly modified approach I have employed are every bit as “forward looking” as the one employed by Mr. Plaistow; and much simpler. In fact, my approach is *identical* to that presented by Mr. Plaistow, except that I apply the appropriate formula from the first rather than go through the complicated and unnecessary efforts needed to separately calculate cash flows for each of the years 2007-2015.

Similar techniques were presented to the Board in the *Caddo Antoine and Little Missouri Railroad Company – Feeder Line Application – Arkansas Midland Railroad Company Line Between Gurdon and Bird Mill Arkansas (Caddo)*, decided August 10, 1999 and subsequently published in the STB Reports at 4 S.T.B. 326. There the Board employed the one-year method virtually identical to the one presented by Mr. Banks. In keeping with that decision, I also have employed the same one-year approach here, though I have modified the formula as needed to properly account for growth over time. Thus, the real question confronting the Board is not whether PYCO’s approach to GCV is valid or whether SAW’s approach is better. Rather, the key factor behind either approach is whether PYCO or SAW employ appropriate underlying assumptions. To calculate GCV, all the Board needs to do is properly identify the base year cash flow, the discount rate, and (if necessary), a growth rate.

As it turns out, the witnesses for both PYCO and SAW rely upon assumptions in developing GCV that are not valid, as I will explain further. Beyond assessing the shortcomings of PYCO’s and SAW’s GCV estimates, I have supplied here a thorough description of the data and methods I have used to calculate the SAW’s GCV.

³³ See SAW Statement in Response to PYCO’s Feeder Line Application at 17-18.

Traffic Volumes

Cotton Traffic

According to PYCO's original feeder line application, SAW moved 5,050 cars on behalf of BNSF in 2003; 5,329 in 2004; and 12,747 cars in 2005.⁴ PYCO's witness Charles Banks presents similar numbers in his testimony, stating that SAW moved 12,928 cars in 2005.⁵ By contrast, Mr. Plaistow reports higher traffic levels of 14,048 carloads. It is not clear why these car counts differ from one another.

However, as I shall show, both Mr. Banks and Mr. Plaistow assume that 2005 traffic volumes were typical of what SAW could expect to generate in the future. In fact, 2005 was not a representative year for SAW, as the statement of Delilah Wisener, owner/operator of SAW, makes perfectly clear.

In 2005, SAW's total traffic jumped *139 percent* from 2004 levels. Nearly all of this can be attributed to movements to PYCO (a producer of cottonseed oil), Compress (a cotton-farmer cooperative), and Southern Cotton Oil (also a producer of cottonseed oil). Lubbock was blessed with a bumper cotton crop in 2005. As Mrs. Wisener states, "[P]rivate trackage ... was inadequate to accommodate the number of railcars that would be required to be shipped each day in the event of a large cotton crop in the area. *It turned out that there was such a crop in 2005.* PYCO wanted to ship 24 cars per day from its Plant No. 1, but its private tracks at that Plant could accommodate only 13 cars at a time."⁶ (Emphasis added).

⁴ See PYCO May 5 Feeder Line Application at 36.

⁵ See PYCO May 5 Feeder Line Application, Banks V.S. at 6 and 19.

⁶ See SAW Statement in Opposition to Revised Feeder Line Application, Wisener V.S. at 3.

When I served as the lead freight railroad expert for the U.S. Department of Agriculture (USDA) during the mid-1990s, I learned that small changes in weather, soil, and pest conditions can cause crop yields to vary widely from location to location; and, as yields in local agricultural markets vary, so will the demand for railroad transportation in these local markets. Statistics from USDA confirm Mrs. Wisener's testimony. The September 13, 2006 edition of USDA's *Cotton and Wool Outlook* shows not only that U.S. cotton production reached an all-time high in 2005 (24 million bales) but also that this record was driven in large part by yields of upland cotton in Texas.⁷

Not only was the Texas cotton crop of 2005 a record, but the local yields in the Lubbock area seem, if anything, to have risen even more dramatically than the state-wide averages. (I base this observation on the 139-percent increase in SAW's traffic volumes; no doubt, on a percentage basis, its cotton traffic increased by an even larger amount). It is, therefore, totally inappropriate to base projections of future cotton traffic on 2005 levels that are well above trend. Indeed, the preliminary figures from 2006 suggest that the cotton crop in Texas will fall below normal. In fact, USDA reports that "drought conditions in the region have led to large abandonment expectations and the lower crop estimate."⁸ It is, therefore, of no consequence that SAW's cotton traffic year-to-date is running even with its 2005 levels because all expectations are that the harvest will be significantly lower than last year's bumper crop. This demonstrates the danger in assuming that the future flow of revenues SAW can capture should be tied directly to the 2005 level. Assuming that 2005 was a normal year vastly overstates SAW's GCV. Instead, one must first calculate what a "normal" year would look like.

⁷ USDA's most recent *Cotton and Wool Outlook* can be found on the internet at: <http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-09-13-2006.pdf>

⁸ See *Cotton and Wool Outlook*, September 13, 2006, p. 2.

To estimate a “normal” base year for 2006 traffic, I employed two alternative approaches. First, I calculated what the simple 5-year average for SAW’s traffic, using the higher car counts from SAW.

Table 1: SAW’s Annual Carloads, 2001-2005

Year	SAW Carloads
2001	7,857
2002	8,616
2003	6,330
2004	6,541
2005	14,048
5-year Average (2001-2005)	8,678

As Table 1 show, a five-year average of 8,678 cars would better reflect the SAW’s future traffic volumes than relying on the clearly abnormal 2005 traffic levels.

Alternatively, I calculated what a normal cotton harvest would be for SAW. Using USDA data (all of which is readily available in Excel worksheets on USDA’s website), I ran the following regression for the years 1965 to 2005 to determine the size of a “normal” cotton crop for Texas in 2006.⁹ With the benefit of USDA data, my projection is based on the following equation:

$$Bales = \beta_1 + \beta_2(Acres) + \beta_3(Year),$$

where *Bales* is bales produced, *Acres* is acres planted, and *Year* is the crop year. β_1 , β_2 , and β_3 are the estimated coefficients.

⁹ See Table A-1 for the relevant data and A-2 for the regression results.

We would expect both *Acres* and *Year* to be significant and positive. Naturally, *Acres* should be positive (the more we plant, the more we expect to harvest). *Year* is also expected to be positive as agricultural productivity improves over time. As Table 2 shows, not only are *Acres* and *Year* positive, as expected, but they are also statistically significant at the 99-percent confidence interval.

Table 2: Regression Results for Texas Upland Cotton Yields

	<i>Coefficients</i>	<i>Standard Error</i>	<i>T Stat</i>
<i>Intercept</i>	313819.3995	1015643.361	0.308985823
<i>Acres</i>	511.2623747	185.6855499	2.753377281
<i>Year</i>	46566.02806	13980.56545	3.330768575

Holding constant *Acres* at its 2005 level (5.9 million acres), it is possible to estimate the conditional mean or expected value of the 2006 Texas Upland Cotton Crop. This equation can be written as follows:

$$E(\text{Bales} | \text{Acres}, \text{Year}) = \beta_1 + \beta_2(\text{Acres}_{2005}) + \beta_3(\text{Year}_{2006}).$$

As Table 3 shows, an estimate of 5.286 million bales is a much better estimate of the “normal” size of the Texas cotton crop given current planting levels. The 2004 and 2005 harvests both exceeded this level, but one would have to go back to 1981, when considerably more acreage was planted, to find a larger crop of Texas cotton.

Table 3: Calculating the Normal 2006 Crop

Independent Variable	Estimated Coefficient	Value of Variable	Bales
Intercept	313.819	1.000	313.819
Acres	0.511	5,900	3,016.448
Year	46.566	42	1,955.773
Normal 2006 Crop	--	--	5,286.041

Note: Because USDA reports bales harvested and acres planted by the thousand. Thus, the 5,286 bales reported here represent 5.286 million bales. For *Year*, 1965 equals one; 1966 equals two; etc. Thus, 2006 equals 42. Transformations of this kind do not influence the conditional mean

Rather than projecting future yields from a single point that lies far from any underlying trend-line, I adjusted SAW's 2005 traffic levels to reflect more "normal" levels. Without more specific data on yields in the Lubbock area, I returned SAW's cotton traffic to its long-term trend line by dividing the "normal" Texas crop (5.286 million bales) by the 2005 harvest (7.8 million bales). The resulting figure is 0.6777. I call this figure the *Cotton Adjustment Factor* and I will apply it against the cotton revenues and cotton expenses to "normalize" the SAW's cash flows.

I first applied the Cotton Adjustment Factor to SAW's 2005 cotton carloads, as reported by Mr. Banks. Rather than the basing SAW's future traffic volumes on the assumption that it will originate 8,033 carloads of cotton traffic annually, I find that SAW would only have produced 5,444 carloads.¹⁰ Accordingly, SAW's total traffic volumes are reduced to 10,339 carloads.

This adjustment is heavily biased in favor of SAW. My "normal" traffic volumes greatly exceed the 2001-2005 average, as reported by SAW. My approach overstates the SAW's cotton traffic because I reduced these levels to reflect the normal Texas crop. But

¹⁰ See Table A-3.

yields in the local Lubbock area must have vastly exceeded their long-term averages if we are to account for the 139 percent growth in overall traffic. Nevertheless, to ensure that the SAW obtains the benefit of doubt in this feeder line application, I set its *normal* traffic levels at 10,339 carloads even though it greatly exceeds the 2001-2005 average traffic volume.

Both Mr. Plaistow and Mr. Banks base their projections of the SAW's traffic on the 2005 levels, without making any adjustment to reflect the extraordinary volumes that SAW enjoyed in that year. By itself, this is a mistake large enough to warrant the rejection of their evidence.

Non-Cotton Traffic

I am not aware of any deviation in SAW's 2005 non-cotton traffic from its expected or usual levels. Consequently, I have not made any adjustment to SAW's non-cotton traffic volumes for GCV purposes.

Revenues

Haulage Revenue

According to SAW's witness Plaistow, SAW's haulage revenues are subject to a multiple-tiered pricing structure.¹¹ The normal per-car charge is \$142.72. There are, however, two forms of discount. First, per-car revenue is reduced to \$125.60 after it moves 5,000 cars. Second, SAW collects \$45.67 per car for traffic that move in blocks of

¹¹ See SAW Statement in Opposition to Revised Feeder Line Application Plaistow V.S. at 7.

27 cars or more. However, 27-car blocks are not counted among the first 5,000 cars for purposes of the 5,000 car line haul reduction mentioned above.

This pricing scheme encourages higher volumes and more efficient movements. Applying this revenue information to my (lower) projections of SAW's traffic volumes, I find SAW's annual haulage revenues would be \$1,118, 963.¹²

Unfortunately, Mr. Banks does not apply the pricing system detailed above. For example, he states that SAW moved 3,500 carloads of rock, for which he assumes that SAW received \$499,520.¹³ By simple division, one can verify that Mr. Banks assumes that *all* rock traffic moved at the \$142.72 per car rate. But Mr. Banks' assumption is not logical. As Mr. Banks acknowledges, the *average* block size for rock traffic is 25 cars. A profit-maximizing firm, however, would not permit all such shipments to take place in 25-car blocks when an enormous discount of nearly \$100 per car would be captured by shipping in blocks just two cars larger than that. Moreover, SAW's Mr. Plaistow shows that a large number of shipments moved under the 27-car block discount. It is logical to assume that the majority of these were rock movements.¹⁴ In fact, as I show in my work papers, it is reasonable to assume that 2,769 of the 3,500 rock carloads moved at the \$45.67 rate.

Because he fails to apply the appropriate discounts to SAW's traffic, Mr. Banks overstates the total annual revenues he reports on Table 14 of his May 5, 2006 testimony. Indeed, correcting the revenues from rock traffic reduces SAW's revenues by nearly \$300,000. Once this correction to Mr. Bank's revenue estimates is made, his "preliminary" GCV falls by nearly \$2.1 million.

¹² See Table A-6 for details.

¹³ See PYCO May 5 Feeder Line Application, Banks V.S. at Tables 8 and 14.

¹⁴ See SAW Statement in Opposition to Revised Feeder Line Application, Plaistow V.S. at 10.

As mentioned above, SAW's Mr. Plaistow employs a different technique to calculate GCV than the one Board employed in *Caddo Antoine*. There, the Board considered and rejected Mr. Plaistow's approach. In any event, Mr. Plaistow's analysis is flawed because he bases his future traffic estimates on USDA's projection for Upland Cotton Production *for the nation as a whole*. As we have seen, however, Texas Upland Cotton production was at an all-time high in 2005, and the downward adjustment Mr. Plaistow makes is, therefore, far too small.

Non-Haulage Revenues

As Mr. Plaistow reports, SAW earns modest sums performing track jobs and storing cars.¹⁵ In particular, Mr. Plaistow states that SAW earned revenues of \$34,505 for track jobs and \$131,890 for car storage. Revenues of this nature are normal for a Class III carrier and can be expected to continue at these levels into the future.

I have also included in my non-haulage revenues fees that SAW collect on BNSF's movement to Jarvis Metals at Burris, Texas. SAW asserts these movements generate \$75 per car in fees, even though it admits it provides no transportation services at Burris. KJRY is not familiar with this movement or with the underlying arrangement permitting SAW to obtain payments from BNSF for this traffic. Nevertheless SAW asserts these revenues will be part of its revenue stream henceforward, and there is no evidence to the contrary, so I have included them in my calculations. SAW states that BNSF moved 625 carloads to Jarvis Metals at Burris, TX in 2005. At \$75 per car, this

¹⁵ See SAW Statement in Opposition to Revised Feeder Line Application, Plaistow V.S., Exhibit 17.

amounts to an additional revenue stream of \$46,875. SAW's total non-haulage revenues therefore amount to \$213,270.

Surcharge Revenues

In addition to the haulage revenues obtained via the divisions specified in the line sale agreement, SAW imposed a "surcharge" on certain traffic in 2005, and proposes to apply that surcharge to all of its traffic. Specifically, SAW asserts that it will impose an additional charge of \$40 per car for blocks of 27 or more cars and \$60 per car charge for all other traffic. Every dollar raised via a surcharge has a nearly *eight-fold* impact on SAW's GCV. This is so because each dollar raised via a surcharge flows directly into SAW's cashflow. Thus, after a \$1 increase in cash flow is divided through by the growth-adjusted costs of capital (14.1 percent less 1.2 percent), GCV rises by \$7.75. ($\$1/(0.141-0.012) = \7.75). Application of this surcharge to all of SAW's traffic increases SAW's GCV by *\$4.3 million*.¹⁶ The proper treatment of these surcharges is thus of paramount importance to the outcome of this case.

Over the past few years, fuel prices have risen sharply. Many carriers – including both BNSF and KJRY – have imposed fuel surcharges to reflect the higher costs of operations. To the best of my knowledge, BNSF does not share any of the additional revenues it obtains via its surcharges with SAW, even though, due to the typically lower

¹⁶ With 4,224.1 cars (adjusted for normal cotton yields), SAW's \$20/car charge to PYCO alone generates an \$84,482/year increase in SAW's revenue. At a pre-tax growth-adjusted cost of capital of 12.9%, this added revenue increases SAW's GCV by \$654,889. If one applies the full surcharge of \$60 per car and \$40 for movements of large blocks, we obtain $7,020.9 \times \$60 + 3318 \times \40 , then additional \$553,977 in cash flows would increase GCV by \$4,294,550. See Table A-4.

overhead and labor costs of a smaller carrier, fuel represents a larger proportion of a Class III carrier's expenses than it does for a Class I carrier.

KJRY has informed me that, if it were to acquire SAW, it would impose a fuel surcharge that is similar, if not identical, to the one utilized by other carriers in its corporate family. Accordingly, KJRY will impose a surcharge that is linked to a widely publicized fuel index, and that regularly adjusts to reflect the changes in that index.

The question, then, is what impact the imposition of such a fuel surcharge would have on SAW's GCV? The answer is that such an appropriate surcharge tied to increased fuel costs will have *no effect* on the SAW's GCV. To see why this is so, bear in mind two points. First, surcharges are typically imposed in response to a particular event, such as a sudden and unanticipated increase in the price of fuel. In addition, surcharges are generally designed to recoup these unanticipated operating cost increases. It is inappropriate to assume that the conditions that justify a temporary surcharge will persist into the future (and thus be part of the future stream of revenues embedded in a GCV analysis). Second, because KJRY's surcharge would be adjusted to reflect changes in fuel prices, the net effect of the surcharge on SAW's cash flows will be neutral. That is, as KJRY's fuel expenses rise, its surcharge revenue will rise; as KJRY's fuel expenses fall, so too would its surcharge revenue. The imposition of a surcharge tied to fuel prices – such as the one KJRY would implement post acquisition – therefore should have no effect on SAW's cash flow or GCV.

SAW might also have justified a surcharge in response to the extraordinary traffic volumes it experienced in 2005. Traffic increased 139 percent in 2005, largely as a result of a bumper cotton harvest in the Lubbock area. If this increase in demand strained

SAW's ability to provide adequate service, then a temporary surcharge could have been used to ration capacity and ensure that SAW properly served those shippers whose demand for its services was greatest. Yet, the bumper traffic conditions of 2005 were highly unusual and unlikely to be repeated. If surcharges are intended to ration capacity in the face of a temporary shift in demand, the resulting revenues are not part of the SAW's expected cash flows over time and ought not to be included in its GCV.

Similarly, SAW might have justified a surcharge on the customers served by the West Texas & Lubbock Railway Company ("WTL") if it possessed economies of scope and the presence of a second carrier on its property raised its costs. An offsetting surcharge might be appropriate, but such a justification is self-limiting; the loss of economies of scope would last only as long as the WTL remains on SAW's property. A surcharge on these grounds would not be part of the SAW's expected revenues or cash flows.

In each of these cases – rising fuel costs, capacity constraints, and operational interference – a surcharge would have no long term effect on GCV. The associated surcharges revenues are of a temporary nature and simply offset higher costs. They have no effect on the "normal" or expected cash flows that SAW is likely to capture over time.

The Board should exclude SAW's surcharges from the GCV calculations for yet another reason. By its own admission, SAW has not applied the surcharges it says it has the "authority" to implement; nor has SAW explained why it has not done so. Its failure to assess these higher charges is highly puzzling. Because SAW is presumably profit-maximizing firm, the opportunity to apply a surcharge would be eagerly seized. Yet, until SAW actually imposes these "phantom" surcharges, the Board should view its

announcement in the same category as the “vapor-ware” announcements of software firms, a form of “cheap talk” designed to advance the firm’s strategic goals.

Unless SAW is not operating as a rational, profit-maximizing firm, something must account for its reluctance to impose these surcharges. Perhaps the reason is quite simple: application of SAW’s surcharge is likely to profoundly alter the market for rail transportation in the Lubbock area.

Let us suppose that, SAW’s haulage revenues account for 15 percent of the total shipping bill of its customers (not an atypical division for a Class III switching carrier). In that case, the total haulage revenues for the traffic handled by SAW totals \$7,459,758. Assuming no change in quantity demanded, application of the surcharge would raise these revenues to \$8,013,734, an increase of 7.4 percent.

But the assumption that a price increase of this magnitude would not have an effect on the quantity demanded is absurd. Basic economic theory informs us that demand curves slope down. As one raises prices, the quantity demanded falls. This relationship is called the Law of Demand; it is the most important relationship in all of economics. To suggest, as SAW does, that it has been established “as a matter of fact and law” that the Board should ignore the central finding of economics, is silly. We are here to establish the proper GCV of a feeder-line application in the real world, not the GCV that might prevail if the laws of economics were, somehow, suspended.

Economic theory strongly suggests that firms do not produce in the *inelastic* portion of their demand curves; it also suggests that the responsiveness of shippers to an increase in prices only increases over time. Therefore, we can predict with confidence that a 7.4 percent increase in price will generate a greater than 7.4 percent decrease in the

quantity of traffic tendered. In fact, empirical studies of the transportation industry suggest that the long-term own-price elasticity of demand is -1.9.¹⁷ That is, for every 1 percent increase in prices, the quantity demand falls 1.9 percent. Thus, a 7.4 percent increase in prices should result in a 14.1 percent reduction in the SAW's traffic volumes.

Yet, Mr. Plaistow's revenue and expense estimates fail to account for the surcharge's impact on quantity demanded. Considered in this light, maybe it is not so strange that SAW has apparently not imposed its surcharge. Not only would this have a large effect on rail shippers in the Lubbock region, it would result in a large loss in revenues (and profits) for SAW's interline partner, the BNSF. One doubts that BNSF would be pleased to see such a large reduction in the traffic it moves from the Lubbock region. Perhaps this explains SAW's reticence to apply the surcharge it has announced.

So, what strategic goal might SAW have in mind that when it made its "phantom" surcharge announcement? The obvious candidate is that, anticipating this proceeding would result in a forced transfer of its lines, SAW has announced these surcharges in a naked attempt to inflate projected revenues and boost the railroad's GCV in this proceeding. A surcharge on these grounds would blatantly manipulate the Board's feeder line application process and the Board should not permit it.

Finally, SAW has announced that it has imposed a \$20 surcharge on one customer, PYCO. KJRY has not included these revenues in its GCV calculations. It appears that the imposition of this surcharge was a form of retaliation by SAW. Certainly, the Board should not permit SAW to capture a higher constitutional minimum

¹⁷ See M.R. Baye, D. W. Jansen, and J. W. Lee, "Advertising Effects in Complete Demand Systems," *Applied Economics* 24 (1992), pp. 1087-1096.

by improperly retaliating against the very shipper who first initiated this proceeding. In addition, if the Board were to accept and apply this surcharge for setting GCV, the Board would not only endorse its continued use, but it would also effectively ensure that a successful feeder line applicant would assess the charge to justify its purchase of the lines. KJRY informs me that it does not intend to apply a “surcharge” on PYCO. However, I suspect that if the Board accepts the PYCO surcharge, KJRY’s fiduciary responsibilities would compel it to impose on PYCO a surcharge consistent with its obligations to maximize profits and shareholder value.

Nevertheless, should the Board decide to include the PYCO surcharge in its GCV calculations, it should make an appropriate adjustment in the quantity PYCO demands. As discussed above, the Board should apply the long-run, own-price elasticity of demand of -1.9 on both the costs and revenues associated with PYCO’s traffic.

To conclude, there are many reasons that would properly justify the application of a surcharge, but there is no reason to believe that such charges should be included here. By contrast, there are strong arguments to exclude such charges, not least of which is the potential to manipulate the outcome of a feeder line proceeding. Certainly, the Board should not permit the SAW to obtain a GCV on a “phantom” surcharge that it has not yet and may never impose. Nor should the Board allow SAW to achieve a higher constitutional minimum by retaliating against the very shipper who initiated this process in the first place.

Total Revenues

In calculating the total revenues that SAW can anticipate, PYCO's witness Mr. Banks incorrectly calculates the SAW's revenues in two ways. First, he overstates the number of cars SAW can expect to move on an ongoing basis. Second, he improperly assumes that all of SAW's rock movements move at the small block rate. Together, these two errors explain why his "preliminary" GCV is far too high. By contrast, Mr. Plaistow, SAW's witness, grossly exaggerates SAW's GCV. First, he bases the GCV on the abnormally large 2005 traffic base. Second, he includes the revenues obtained from the "phantom" surcharge in his GCV calculation. Third, and equally troubling, he assumes that the imposition of this "phantom" surcharge will have no effect on the quantity demanded. Yet, this violates the most important relationship in all of economics, the Law of Demand, which states that as the price of a good rises, the quantity demanded falls.

As Table A-4 shows, once one properly forecasts the 2006 traffic volumes and applies them to the applicable pricing system, SAW's "normalized" revenue for 2006 totals \$1,332,234.

Operating Expenses

URCS is the Appropriate Tool to Generate Operating Expenses

Developing operating expenses is much more difficult than identifying revenues. In fact, it is impossible to determine precisely the exact costs associated with moving a particular railroad shipment. However, many tools and methods exist to estimate these costs. In a regulatory setting, however, the data used in these costing models should be

uniform and consistent to allow meaningful comparisons, not just between railroad firms, but between different time *periods*. It is also important that costing data used in regulatory proceedings be sanctioned and monitored by the government to ensure data integrity.

In *Caddo Antoine*, the Board set the constitutional minimum value for a portion that line at GCV. In so doing, the Board compared the revenues that the GCV-segment could capture against the *variable* costs associated with serving that traffic. Mr. Banks employs that process here; Mr. Plaistow does not. Instead, Mr. Plaistow has taken SAW's tax returns and other financial statements and converted them into profit and loss statements. The Board should view these reports with some skepticism as they are clearly made-for-litigation documents. It is not clear, for example, why Mr. Plaistow did not rely on the actual profit and loss statements that SAW undoubtedly prepared in the on-going course of business. Rather than rely on documents whose accuracy the Board cannot verify directly, the Board should – as it has done in the past – rely on its Uniform Rail Costing System (“URCS”) to estimate the operating expenses for this feeder line application.

URCS is the general purpose costing system that the Board uses for all regulatory costing purposes. As the Board's web-site states:

URCS is used by the STB for a variety of statutory and non statutory functions. URCS is statutorily required for making the jurisdictional determination in railroad maximum rate reasonableness proceedings. URCS is also used to develop variable costs for making cost determinations in abandonment proceeding; to provide the railroad industry and shipper with a standardized costing model; costing the STB Car Load Waybill Sample to develop industry cost information; and to provide interested parties with basic cost information.¹⁸

¹⁸ See <http://www.stb.dot.gov/stb/industry/urcs.html>

Using URCS in a feeder line application is a logical and reasonable extension of the Board's current practices. Indeed, in a comparable setting where the Board must use variable costs, 49 U.S.C. 10707(d)(1)(B), states:

variable costs for a rail carrier shall be determined *only* by using such carrier's unadjusted costs, calculated using the Uniform Rail Costing System cost finding methodology (or an alternative methodology adopted by the Board in lieu thereof) and indexed quarterly to account for current wage and price levels in the region in which the carrier operates, with adjustments specified by the Board (emphasis added).

Using variable costs enables the Board to determine SAW's *economic*, not its accounting, value because the comparison of revenues and variable costs is a cleaner and more appropriate comparison of the future flow of revenues and expenses. In addition, using variable costs *increases* the constitutional minimum value and ensures that the selling entity receives a more favorable settlement. Including other costs would lower the stream of cash flows and reduce GCV.

Mr. Plaistow criticizes the use of URCS on several grounds. For example, he suggests that "URCS... is only relevant for determining the costs of individual traffic movements."¹⁹ Yet, just as a firm's revenues are the sum of many individual movements, a firm's total variable costs are the sum of individual movements. Mr. Plaistow also notes that PYCO and KJRY "exclude the variable depreciation, rent and lease costs and return on investment costs that are typically included in URCS computations."²⁰

Ironically, PYCO and KJRY have made this assumption in order to be as conservative as possible. Including these costs would *reduce* SAW's cash flow and *reduce* its GCV.

Moreover, this approach is consistent with the Board's decision in *Caddo*, where the Board stated "We have not included fixed costs... Fixed costs, by definition are those

¹⁹ 4 S.T.B. 342.

²⁰ SAW Statement in Response to PYCO's Feeder Line Application at 11.

that do not vary with volume. Thus we have not included fixed costs in determining GCV.”²¹

Like Mr. Banks, and in keeping with Board precedent, I believe that URCS variable costs should be used to calculate SAW’s expenses. Mr. Banks’ variable cost analysis offers a reasonable starting point for determining SAW’s 2006 expenses. In particular, his basic cost estimates are appropriate because they are highly conservative. By excluding some of the items that normally are a part of the URCS process, PYCO has increased the cash flow and GCV SAW can expect. I think this was a prudent decision on PYCO’s part, and so I have adopted it as well. However, because Mr. Banks has overstated the amount of traffic that SAW will generate, it remains necessary to reduce these costs using the Cotton Adjustment Factor described above.

Rehabilitation Expenses

Mr. Banks incorrectly assumes that SAW is in need of extensive rehabilitation, and, relying on asserted rehabilitation costs, calculates a “preliminary” GCV that takes these costs into account. I have been informed from KJRY’s witnesses Carr and Stice that such expenses are neither necessary nor prudent. Because SAW’s track structure was capable of handling its bumper 2005 traffic volumes, there should no question but that it can handle the normal traffic volumes SAW can expect. It may be that PYCO has included these expenses in order to reduce artificially SAW’s GCV. Just as the Board must reject the attempts by SAW to increase GCV by including its surcharges in its

²¹ 4 S.T.B. 342.

calculations, the Board must also reject PYCO's effort to reduce GCV by including a large and unnecessary rehabilitation expense.

Total Operating Expenses

Using Mr. Banks cost figures, but adjusting them downward to reflect a lower level of traffic, I estimate SAW's 2006 expenses at \$981,598.²²

IV. Growth Factor

To estimate traffic growth over time, Mr. Plaistow relies on a combination of USDA and Energy Information Administration (EIA) forecasts of railroad ton-miles. Certainly, the EIA forecast is consistent with Board findings that Class I carriers, through mergers and marketing opportunities, have increased their respective lengths of haul.²³ It must be noted, however, that even if traffic originating or terminating on the SAW actually move greater distances on average, BNSF will capture these increases, not SAW, whose lines have in no way been enlarged through mergers. Thus, Mr. Plaistow's projections of future growth are likely to be overly optimistic.

Nevertheless, in order to minimize the differences between KJRY and SAW, I accept the long-term growth rate that Mr. Plaistow uses to calculate his terminal value. Mr. Plaistow explains in his August 2, 2006 statement that he used "the percentage increase of 2015 cash flows over 2014 cash flows" for his expected growth rate.²⁴ Applying the same technique here, looking at Exhibit 50 of his September 18 statement,

²² See Table A-11.

²³ See Surface Transportation Board, Office of Economics, Environmental Analysis, and Administration, "Rail Rates Continue Multi-Year Decline," December 2000. This report is available on the internet at: <http://www.stb.dot.gov/stb/docs/RI.pdf>. Table A-4 presents information on lengths of haul.

²⁴ See Verified Statement of Joseph Plaistow, August 2, 2006, p. 25

one can see that Mr. Plaistow estimates 2015 cash flows at \$850,011. 2014 cash flows are estimated at \$840,158. It follows that the rate of growth is 1.2 percent which – like Mr. Plaistow – I deduct from the cost of capital in order to calculate the appropriate net present value.

V. Determining the Constitutional Minimum

We now have all of the necessary information to calculate SAW's GCV and establish the appropriate constitutional minimum value.

Going Concern Value

Using revenue figures that are favorable to SAW (because they are based on an initial level of 10,339 cars, not the 8,678 cars SAW has average over the past five years), I find SAW's revenues to be a little more than \$1.3 million. Using variable costs that are also favorable to SAW, because they exclude certain fixed costs and other expenses typically included in URCS, I find expenses are nearly \$1.0 million. The resulting net revenues, or cash flows, are a generous representation of the cash flows SAW can expect on an on-going basis. Armed with this information, it is now possible to calculate SAW's GCV. Table 4 details the calculations.

Table 4: SAW's Going Concern Value

	Amount
Revenues	\$1,332,236
Variable Costs	\$981,600
Net Revenues	\$350,636
Pre-Tax Cost of Capital	14.1%
Growth Rate	1.2%
Growth Adjusted Multiplier	12.9%
Going Concern Value (w/ Growth)	\$2,712,379
Going Concern Value (w/o Growth)	\$2,486,779

Please note that the figures here do not include the 2005 cost of capital which the Board released on Wednesday, September 20, 2006. I have excluded the latest figures to facilitate the comparison of KJRY's statement with SAW's statement. (SAW submitted its testimony prior to the Board's decision). Naturally, we expect that when the Board makes its final determination it will make the appropriate adjustment to reflect the 2005 cost of capital.

Net Liquidation Value

I understand that KJRY has designated Mr. Roger Stice to provide a verified statement addressing SAW's net liquidation value. I also understand that Mr. Stice concludes that his evaluation of SAW's lines leads him to conclude that PYCO's NLV estimate of \$2,059,000 is appropriate. In determining whether the Board should use NLV or GCV to set the constitutional minimum value for SAW, I will use the \$2,059,000 NLV as the correct point of reference.

Constitutional Minimum

The constitutional minimum is set at the higher of NLV or GCV. The GCV of \$2,712,379 is therefore the constitutional minimum here.

VI. A Right of Refusal Has a Chilling Effect on Feeder Line Applications

BNSF has asked the Board to preserve its contractual right-of-first refusal in the event of a sale of SAW, including a sale of SAW's lines through the feeder line process. In typical commercial transactions, a right of first refusal would not frustrate the public policy goals of the Board. Indeed, it is easy to understand why BNSF would reserve a right of first refusal for itself in a line sale agreement; such an arrangement promotes efficiency and cooperation.

In the context of a feeder-line process, however, a third-party right-of-first refusal can frustrate the Board's wider public policy goals, and can have a chilling effect on would-be participants in the feeder line process. To explain why that is, however, I will review and then apply concepts from non-cooperative game theory.

Here, BNSF wants to have the Board clarify that it can wait until the Board determines the SAW lines' constitutional minimum value and then choose whether to exercise its asserted right of first refusal. In game theory terms, we therefore have a sequential (as opposed to simultaneous) game. In sequential games, the second player, BNSF, observes how the first player (KJRY) has "moved" before BNSF makes its own decision. The information BNSF obtains from the first player's move matters significantly.

By contrast, if we were to assume, hypothetically, that the feeder line applicants and BNSF all know with perfect certainty the “true” value of a feeder line’s GCV – then the feeder line applicants would have every incentive to reveal their valuation of the feeder line. The Board would also be assured that it can correctly arrive at the true and appropriate GCV.²⁵ This would seem a highly desirable outcome, but it depends entirely on the assumption that the parties have perfect and certain information.

The assumption that parties possess perfect and certain information is, however, untenable. Moreover, the absence of perfect and certain information radically changes the strategies and actions of the players, as I next explain.

In a feeder line case, each applicant develops, and argues in support of, an estimate of the appropriate GCV. In so doing, applicants incur significant costs. Applicants must submit document requests, evaluate the responses, conduct a physical inspection of the rail lines in question, and interview key individuals (customers, railroad workers, interline partners, etc.). Only after all this work is done can an applicant develop a valuation of the targeted assets.

It is highly unlikely that any of the applicants would develop identical valuations. It is also unlikely that any one of the applicants has correctly arrived at the “true” valuation, which will only be revealed by nature over time. Generally, the assumptions each player relied upon will be tested and revealed as inaccurate. Future events may disclose that a key customer is going out of business, or that a new business may locate their facilities along the line. The feeder line’s infrastructure may need more rehabilitation than expected. Floods, fire or a recession may affect the value of the line.

²⁵In a case of perfect and certain information, consider what would happen if an applicant presented evidence and persuaded the Board that a feeder line’s GCV was less than its “true” value: BNSF would exercise its right of first refusal and capture a windfall profit.

In short, the future is always full of unexpected and unanticipated twists that no one can predict *ex ante*. Thus, far from possessing perfect and certain information, parties possess asymmetric and uncertain information.

Still, it is likely that even if none of the applicants predicted the true *ex post* valuation, their forecasting errors are still clustered in the neighborhood of the “true” value.²⁶ Thus, the revelation of the private knowledge possessed by feeder line applicants gives the second mover a significant advantage; the second mover can reevaluate his own valuation in light of the applicants’ estimates.

In fact, a second mover will revise his expectations in the direction of the applicant’s valuation. Thus, if the applicant’s valuation is lower than BNSF’s, BNSF will lower its estimate of the true valuation. Similarly, if the applicant’s valuation is higher, BNSF will raise its valuation. In either case, BNSF’s revised valuation is more likely to be closer to the “true” estimate than either its original estimate or the feeder line applicant’s. (This outcome is certainly more plausible than the assumption that both BNSF and the applicant possess perfect and certain information about a feeder line’s GCV).

A simple, 2 x 2 matrix reveals the *ex post* outcomes of such a game.

		BNSF	
		Exercise Right	Declines Right
Applicant	Bid	(- , +)	(- , 0)
	No Bid	(0 , 0)	(0 , 0)

Note: (Payoffs to Applicant, Payoffs to BNSF)

²⁶ It is this phenomenon that supports the view that consensus forecasts are often more accurate than individual forecasts. In his fascinating book, *The Wisdom of Crowds*, James Surowiecki points out that in many cases it is possible to aggregate this information effectively.

So, what happens after BNSF revises its valuation? If BNSF believes that the applicant has undervalued the feeder line's GCV, it exercises its right of first refusal. As shown in the matrix cell (Bid, Exercise Right), the applicant incurs a loss (-) because of the costs it incurs developing and presenting the information that supported its application. BNSF gains a positive profit (+).

By contrast, when BNSF believes the applicant has overvalued the feeder line's GCV, it does not exercise its right of first refusal. As the matrix cell (Bid, Declines Right) shows, the applicant is now likely to suffer a loss (-) because it overpaid for the feeder line. This is known as the "winner's curse." Because BNSF did not exercise its right of first refusal, it earns zero (0) profit. In either case, if the feeder line applicant bids, it loses.

This illustration shows why preserving a third party's right of first refusal in the context of a feeder line-induced sale is likely to deter feeder line applicants and have a chilling effect on the entire feeder line remedy. In this case, only BNSF could capture positive profits and the feeder line applicant's dominant strategy would be *not to bid*.²⁷ As a matter of policy, permitting BNSF (or any third-party) an unfettered right of first refusal creates an unbalanced "heads, I win; tails, you lose" playing field. No matter how meritorious a feeder line applicant's objectives may be or how much shippers may suffer under the inadequate service of an incumbent railroad, game theory shows that a would-be feeder line applicant's financial best interest is not to initiate the feeder line process in the face of a non-applicant third-party's right of first refusal. Such disincentive frustrates

²⁷ A strategy is dominant if it is a player's strictly best response to any strategy that other player might pick. Here, no matter what BNSF does a feeder line applicant is better off not bidding.

the wider goals of the Board and is contrary to the Rail Transportation Policy of 49 U.S.C. 10101.

List of Appended Tables

Table	Page
A-1: USDA Data on Texas Upland Cotton.....	32
A-2: Regression Results.....	33
A-3: Adjusted Traffic Levels.....	34
A-4: Revenue per Car.....	34
A-5: SAW Carloads.....	35
A-6: Movements in Blocks of 27 Cars or More.....	35
A-7: Movements in Blocks of Less than 27 Cars.....	36
A-8: SAW Revenues.....	36
A-9: Per Car Expenses for Cotton Traffic.....	37
A-10: Southern Expenses.....	37
A-11: SAW Expenses.....	38
A-12: Growth Rate.....	38
A-13: Going Concern Value.....	39

Table A-1: USDA Data on Texas Upland Cotton

Bales Harvested (in 1,000s) 1/	Acres Planted 2/	Year (Year 1 = 1965)
4,632,000	5,822	1
3,156,000	4,236	2
2,740,000	3,936	3
3,499,000	4,426	4
2,831,000	5,148	5
3,191,000	5,225	6
2,579,000	5,230	7
4,246,000	5,570	8
4,673,000	5,400	9
2,462,000	5,200	10
2,382,000	4,350	11
3,307,000	4,800	12
5,465,000	6,650	13
3,792,000	6,950	14
5,515,000	7,700	15
3,320,000	7,850	16
5,645,000	7,460	17
2,700,000	5,800	18
2,380,000	4,000	19
3,680,000	5,350	20
3,910,000	5,000	21
2,535,000	4,850	22
4,635,000	4,700	23
5,215,000	5,600	24
2,870,000	4,650	25
4,965,000	5,500	26
4,710,000	6,300	27
3,265,000	5,500	28
5,095,000	5,550	29
4,915,000	5,450	30
4,460,000	6,400	31
4,345,000	5,700	32
5,140,000	5,500	33
3,600,000	5,650	34
5,050,000	6,150	35
3,940,000	6,400	36
4,260,000	6,000	37
5,040,000	5,600	38
4,330,000	5,600	39
7,740,000	5,850	40
7,800,000	5,900	41

Notes:

1. 1/ Data Source for Bales – USDA Cotton and Wool Yearbook, Table 7 – <http://usda.mannlib.cornell.edu/usda/ers/89004/table07uplandproduction.xls>
2. 2/ Data Source for Acres – USDA Cotton and Wool Yearbook, Table 4 – <http://usda.mannlib.cornell.edu/usda/ers/89004/table04uplandplantedacreage.xls>

Table A-2: Regression Results

<i>Regression Statistics</i>					
Multiple R	0.630				
R Square	0.397				
Adjusted R Square	0.365				
Standard Error	1,024.114				
Observations	41.000				

ANOVA					
	<i>Df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	2.000	26,204,969.773	13,102,484.887	12.493	0.000
Residual	38.000	39,854,730.714	1,048,808.703		
Total	40.000	66,059,700.488			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>
<i>Intercept</i>	313.819	1,015.643	0.309	0.759	-1,742.243	2,369.882
<i>Acres</i>	0.511	0.186	2.753	0.009	0.135	0.887
<i>Year</i>	46.566	13.981	3.331	0.002	18.264	74.868

Conditional Mean or Expected Yield		
	Coefficient	Point Estimate
<i>Intercept</i>	313.819	313.819
<i>Acres</i>	0.511	3,016.448
<i>Year</i>	46.566	1,955.773
Conditional Mean		5,286.041
Expected 2006 Crop as a % of 2005 Harvest		67.770%

Table A-3: Adjusted Traffic Levels

Customer Type	Carloads	Adjusted Cars
Cotton Customers		
PYCO 1/	6,233	4,224.1
Farmers Compress 1/	900	609.9
Southern 2/	900	609.9
	8,033	5,444.0
Non-Cotton Customers		
Attebury 1/	495	495.0
All Other 2/	4,400	4,400.0
	4,895	4,895.0
Total	12,928	10,339.0

Notes:

1. 1/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 1.
2. 2/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 8.
3. Note also that the Cotton Traffic is adjusted by multiplying the number of 2005 Cotton carloads by the Cotton Adjustment Factor, 0.6777.

Table A-4: Revenue per Car

First 5000 Cars	\$142.72
Cars after 5000	\$125.60
Cars in Blocks of 27 or More	\$45.67

Notes:

1. Source: SAW Statement in Opposition to Revised Feeder Line Application, Plaistow V.S. at 7.
2. Cars moving at the \$45.67 do not count towards the 5000-car discount.

Table A-5: SAW Carloads**Total Carloads**

Cotton Customers	Adjusted Cars
PYCO	4224.1
Farmers Compress	609.9
Southern	609.9
	5444.0
Non-Cotton Customers	Cars
Attebury	495.0
All Other	4400.0
	4895.0
Total Cars	10339.0

Notes:

1. Source: Table A-3

Table A-6: Movements in Blocks of 27 Cars or More**Customer Type**

Cotton Customers	No. of Cars
PYCO	54.0
Farmers Compress	0.0
Southern	0.0
	54.0
Non-Cotton Customers	No. of Cars
Attebury	495.0
All Other	2769.0
	3264.0
Total in Blocks of 27 or more	3318.0

Notes:

1. Source: SAW Statement in Opposition to Revised Feeder Line Acquisition, Plaistow V.S. at 10.
2. Mr. Plaistow's NEW carrier carried 549 cars in blocks of 27 cars or more. Since all of Attebury Grain's trains move in large blocks, this leaves 54 cars (2 trains of 27 cars), which I attributed to PYCO.

Table A-7: Movements in Blocks of Less than 27 Cars

Customer Type		
Cotton Customers		No. of Cars
PYCO		4170.1
Farmers Compress		609.9
Southern		609.9
		<u>5390.0</u>
Non-Cotton Customers		No. of Cars
Attebury		0.0
All Other		1631.0
		<u>1631.0</u>
Total in Blocks of Less than 27 Cars		7021.0

Notes:

1. Source: Table A-5 and Table A-6

Table A-8: SAW Revenues

Haulage Revenues	Cars	Revenue Per Car	Revenue
First 5000 Cars	5,000.0	\$142.72	\$713,600.00
Cars After 5000	2,021.0	125.60	<u>253,833.09</u>
Cars in Blocks of Less than 27	7,021.0		\$967,433.09
Cars in Blocks of 27 or more	3,318.0	\$45.67	<u>\$151,533.06</u>
Total Haulage Revenues	10,339.0		\$1,118,966.15
Non-Haulage Revenues			
Track Jobs			\$34,505.00
Car Storage			131,890.00
Jarvis Metals Settlement			<u>46,875.00</u>
Total Non-Haulage Revenues			\$213,270.00
Total SAW Revenues			\$1,332,236.15

Table A-9: Per Car Expense for Cotton Traffic

Cotton Traffic on a Per Car Basis

PYCO and Compress

Expenses 1/	\$684,520.00
Carloads 2/	7,133.00
Expense per Car	\$95.97

Notes:

1. 1/ Source: PYCO May 5 Feeder Line Application, Banks V.S., Table 14.
2. 2/ Source: PYCO May 5 Feeder Line Application, Banks V.S., Table 1.

Table A-10: Southern Expenses¹

All Other Rail Customers 2/	\$151,949.00
 Southern Carloads 3/	 900
Per Car Cotton Expense 4/	\$95.97
Southern Expense	\$86,368.71
 All Other Rail Customers	 151,949.00
Less Southern	-\$86,368.71
All other Rail Customers (less Southern)	\$65,580.29

Notes:

1. Southern is a Cotton Shipper that Mr. Banks has included in his all other rail customer category. In order to properly reflect the "normalized" 2005 operating expenses, Southern's expenses must be reduced appropriately.
2. 2/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 14.
3. 3/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 8.
4. 4/ Source: Table A-9.

Table A-11: SAW Expenses

Cotton Cars 1/	5,444.0
Per Car Cotton Expense 2/	95.97
Cotton Expenses	\$522,431.28
Non-Cotton Expenses	
Attebury 3/	\$20,550.00
Rock Movements 3/	242,783.00
All Other Rail Customers (less Southern) 4/	65,580.29
Total Non-Cotton	\$328,913.29
Total SAW Expenses	\$851,344.57
Index Cost Adjustment 3/	1.153
2006 SAW Operating Expenses	\$981,600.29

Notes:

1. 1/ Source: Table A-3
2. 2/ Source: Table A-9
3. 3/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 14
4. 4/ Source: Table A-10

Table A-12: Growth Rate

2015 SAW Cash Flow 1/	\$850,011.00
2014 SAW Cash Flow 1/	\$840,158.00

Percentage Growth Rate (2005 Cash Flow over 2004 Cash Flow) 1.2%

Notes:

1. 1/ Source: PYCO Statement in Response to PYCO's Feeder Line Application to Acquire "All-SAW," V.S. Plaistow at Exhibit 50.

Table A-13: Going Concern Value

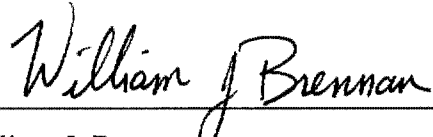
SAW Revenues 1/	\$1,332,236.15
SAW Expenses 2/	981,600.29
SAW Cash Flows	<u>\$350,635.86</u>
2004 Pre-Tax Cost of Capital	14.1%
Percentage Growth Rate 3/	1.2%
Growth-Adjusted Cost of Capital / Multiplier Factor	12.9%
Going Concern Value (w/ Growth)	\$2,712,379.00
Going Concern Value (w/o Growth)	\$2,486,779.17

Notes:

1. 1/ Source: Table A-8
2. 2/ Source: Table A-11
3. 3/ Source: Table A-12

VERIFICATION

I, William J. Brennan, PhD, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 27th day of September, 2006.



William J. Brennan

Exhibit 1

Qualifications of William Brennan, Ph.D.

William Brennan is a co-founder and Managing Director of Transportation Economics, Inc., an economic consulting firm whose principal office is located at 6122 Mountain Springs Lane, Clifton, VA 20124.

Dr. Brennan graduated from the College of William and Mary in 1985 with a Bachelor of Arts in Economics. In 1995 he graduated from Virginia Tech with a Masters Degree in Economics. In 2006, he graduated from George Mason University with a Doctorate of Philosophy in Economics. He is a member of the American Economic Association and the Association for Law, Logistics, and Policy.

Dr. Brennan founded Transportation Economics in 2005. Dr. Brennan advises clients on range of business and regulatory issues. Before founding Transportation Economics, he served as an economist for the U.S. Surface Transportation Board (Board). At the Board, Dr. Brennan worked on primarily on rate reasonableness cases, railroad mergers, and other policy matters. Dr. Brennan worked at the Surface Transportation Board from 1999 to 2005.

Prior to joining the Surface Transportation Board, Dr. Brennan worked for the U.S. Department of Agriculture (USDA) from 1997 to 1999. He served as USDA's lead analyst for freight railroad issues and was responsible for briefing and preparing testimony for Secretary Glickman and other senior leaders at the Department on transportation issues.

Dr. Brennan also worked for Association of American Railroads (AAR) from 1992 to 1997. At the AAR, Dr. Brennan analyzed regulatory and legislative proposals. Dr. Brennan served in similar capacity for the Association of Manufacturing Technology (previously, the National Machine Tool Builders Association), from 1987 to 1992. He has worked as an economist for 19 years, the last 14 of which have been spent in and around the U.S. freight railroad industry.

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

EXHIBIT C

VERIFIED STATEMENT

OF

ROGER STICE

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

**KEOKUK JUNCTION RAILWAY CO.
— FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

EXPANDED COMPETING FEEDER LINE APPLICATION

**VERIFIED STATEMENT
OF
ROGER STICE**

My name is Roger Stice, and I am the track foreman of Keokuk Junction Railway Co. ("KJRY"), and a qualified track inspector. I have been the track foreman of KJRY since 1986, and before that was a track laborer for Burlington Northern Railroad for eleven years. I am familiar with all railroad maintenance, repair, rehabilitation, and construction.

I will comment upon two aspects of the feeder line proceedings currently being reviewed by the Board: (1) the extent to which the lines of South Plains Switching, Ltd. Co. ("SAW") are in need of rehabilitation; and (2) my views regarding the net liquidation value ("NLV") of the lines. To answer these questions, I made an on-site inspection of SAW's rail lines on August 30, 2006. I have also reviewed the record in these proceedings, including the September 15, 2006 "Statement In Response To PYCO's

Feeder Line Application To Acquire 'All-SAW'" ("SAW Statement"), and I have discussed my findings with KJRY's President and CEO, J. Michael Carr.

I do not agree with PYCO's assertions the lines need substantial rehabilitation in order to operate them safely and efficiently at Class I FRA standards. Instead, my inspection confirms SAW's conclusions in the SAW Statement concerning track conditions and confirms the study done by Landreth Engineering on SAW's behalf. I believe that SAW's lines can be operated safely at existing service levels with very little rehabilitation. The most the SAW system would require is a regularly scheduled maintenance program.

As both PYCO and SAW indicate, and as my inspection confirmed, SAW consists mostly of 85 to 90 lb. rail with some larger rail (100/112). Ties in general are in good condition, although I would recommend replacing 2,000 to 3,000 ties on a regular maintenance schedule to maintain Class I condition overall, but this could be done gradually as needed and does not need to be done in order to operate the lines at FRA Class I standards. Alignment of curves and tangent track meets Class I standards. Turn outs are in good shape and do not need to be replaced, although again, I believe there should be a regularly scheduled maintenance program to replace some of the switch ties. OTM is in good usable condition, including plates, angle bars and switch parts. I did not find any gauge that would not meet Class I track standards.

Surface is sand and gravel for ballast. This is adequate for conditions. Track surface is good. I would recommend that KJRY adopt a regularly scheduled maintenance program to do some spot tamping, but again, this does not need to be done now in order to operate the railroad.

I do not believe that any of the crossings need to be replaced. Three of the crossings require some minor surface work; one of which needs mud rails or flangeways put in. The estimated cost of rehabilitating these crossings is \$20,900.

Overall, SAW has good Class I track, which is the level needed for its operations. I would not recommend upgrading the track above Class I, as speeds above 10 mph would not be safe in SAW's operating environment. Therefore, no substantial work needs to be done beyond normal and consistent maintenance. However, the rail on the old mainline does show some signs of shelling on the rail head. Therefore, I would recommend relaying 1,000 track feet, and use the good rail out of that 1,000 feet to change out other mainline rail on a spot basis. I would estimate that the cost of relaying this rail would be \$56,315, with \$46,784 of that for track materials, \$4,806 in labor costs, and \$4,725 in equipment costs. Combined with the crossing repairs discussed above, all of which I recommend be done before KJRY begins operations, the total rehabilitation cost would be \$77,215.

I have also been asked to comment upon the net liquidation value of the line. As I understand the concept, the NLV of a line is calculated by adding up the gross value of the real estate (assuming the railroad has ownership of the right-of-way), the track, switches, ties, and other track materials and then subtracting the cost of salvaging those materials and selling the property. The end product should give you the NLV of the line.

I have not performed an itemized study of each and every asset owned by SAW nor have I calculated a net salvage value for each individual asset. On the other hand, I have reviewed PYCO's and SAW's evidence regarding NLV. I cannot agree with SAW that the NLV of the line is \$6 million. That estimate is based upon what SAW claims to

have been unqualified offers to purchase the lines. While I have no first hand knowledge of these alleged unqualified offers, my review of the line and of the evidence in the proceeding clearly indicates that the line would not have a NLV of \$6 if one were to follow the methodology of determining value as I have discussed above.

Reviewing Exhibit B to PYCO's original May 5, 2006 feeder line application, I believe the calculations and methodologies employed by Mr. Sneed are accurate and consistent with industry practice. I note that Mr. Sneed has made several assumptions favorable to SAW about the value of certain assets, such as his decision to attribute reroll quality to rail that could be treated as scrap. I also share his view that most of the ties in the lines have scrap value rather than relay or landscape value. However, I believe the ties are of sufficient condition to support continued operations as long as they are replaced on a regular maintenance schedule. I do not share his treatment of the rail as being all 90 pound rail. As noted above, some of the rail is 100 lb or 112 lb rail.

Finally, I believe that Mr. Sneed has used the correct methodology and has sourced his prices to the right sources, i.e. steel mills and industry publications. I would only note that the prices would have to be updated to reflect current market conditions. I believe he may have also overstated the profit margin retained by salvage companies and the freight costs.

I make no independent judgment regarding the scope of the real estate owned by SAW and whether that real estate is owned by SAW or simply used by SAW under easement rights. I accept Mr. Sneed's opinions on this matter, although I believe the better evidence is that presented by the Blosser Appraisal and the Crawford analysis presented in Exhibit D to PYCO's feeder line application.

In summary, I do not share PYCO's conclusions that the lines need substantial rehabilitation. With minor upfront costs, I believe that KJRY can operate the lines safely and efficiently as a going concern under standard maintenance practices. On the other hand, I share PYCO's conclusions regarding NLV, although I would make some minor adjustments to account for changes in price that have occurred during the course of this proceeding, the weight of rail, and other miscellaneous changes.

Having reviewed Dr. Brennan's statement regarding going concern value, I can say unequivocally that even if you made the adjustments that I suggest, and assuming the real estate values presented by PYCO are valid, that the NLV would not surpass the GCV as calculated by Dr. Brennan. Nonetheless, based on my experience in the railroad business, my personal inspection of the lines, my review of PYCO's net salvage and real estate values reports, and my review of the SAW's Statement, I believe PYCO's NLV calculation of \$2,094,000 is a realistic liquidation value for the Lines.

VERIFICATION

I, Roger Stice, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 26th day of August, 2006.

A handwritten signature in cursive script, reading "Roger Stice", positioned above a horizontal line.

Roger Stice

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

EXHIBIT D

VERIFIED STATEMENT

OF

DANIEL A. LAKEMPER

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

**KEOKUK JUNCTION RAILWAY CO.
— FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

EXPANDED COMPETING FEEDER LINE APPLICATION

VERIFIED STATEMENT OF DANIEL A. LaKEMPER

My name is Daniel A. LaKemper and I am the General Counsel of Keokuk Junction Railway Co. and Pioneer Railcorp ("PRC").

On Page 22 of the Statement in Response to Pyco's Feeder Line Application to Acquire "ALL-SAW", South Plains Switching, Ltd. Co. ("SAW"), makes the statement that SAW received an unqualified offer from Pioneer Railcorp to purchase All-SAW for \$6 Million".

This statement is inaccurate.

PRC did, indeed, make an offer to purchase "All-SAW" for \$6 Million, but the offer was by no means "unqualified" and it was not a liquidation offer. The offer was to purchase SAW as a going concern. More importantly, it was, as is stated in the e-mail included in the SAW filing, subject to due diligence. It was also to include all of SAW's assets, including locomotives, vehicles, materials, tools, files, and all other assets of SAW, not just the rail line.

The offer contemplated a negotiated sale. Such an arrangement would include various warranties by SAW; the cooperation of SAW personnel in the transition of operation and on-going matters; and various other provisions common to negotiated sale agreements.

Further, a negotiated purchase could have been concluded with considerably less cost and uncertainty, as opposed to a Feeder Line acquisition.

PRC's offer of \$6 Million may well have ultimately been reduced, based upon a due diligence review, or part of the purchase price escrowed to meet contingencies (as PRC has done in the past). PRC, however, never got beyond the initial offer stage because SAW's acceptance of the offer was withdrawn before a Letter of Intent could be reduced to writing.

In fact, I personally made the offer to SAW's Attorney, Thomas McFarland, who accepted on behalf of SAW. I was preparing a draft Agreement when Mr. McFarland called me a few days later and withdrew SAW's acceptance, because SAW made the decision not to oppose the "All-SAW" feeder line application.

I do not quarrel with much of the remainder of the paragraph concerning PRC's offer. It was an arms-length offer submitted in good faith. There is no affiliation of any kind between PRC and SAW. The offer was not solicited by SAW. I contacted Attorney McFarland initially and inquired as whether SAW's owners would be interested in selling the entire entity. The response was "absolutely".

SAW admits that the offer had express contingencies of "due diligence and regulatory approval". It is somewhat misleading, however, to state that the offer was "conditioned solely" on those items. While those were the expressed contingencies of the offer, a final agreement was never negotiated. I have personally been involved in the negotiation of dozens of railroad purchase agreements. They can run into dozens of pages, including exhibits and ancillary agreements, and, until finally signed, there is no assurance that the parties will agree on all of the provisions. It is not uncommon for the parties to reach an impasse and deals fall apart long after initial offers have been accepted and letters of intent have been signed. Although PRC's offer was made in good faith, and with every intention of closing a purchase, there is no guarantee that had SAW not withdrawn its acceptance; the sale would actually have closed.

VERIFICATION

I, Daniel A. LaKemper, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 27th day of September, 2006.

A handwritten signature in black ink, appearing to read "Daniel A. LaKemper", written in a cursive style.

Daniel A. LaKemper

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34922

KEOKUK JUNCTION RAILWAY CO.

— FEEDER LINE APPLICATION —

LINES OF SOUTH PLAINS SWITCHING, LTD. CO.

EXPANDED COMPETING FEEDER LINE APPLICATION

EXHIBIT E

VERIFIED STATEMENT

OF

SHANE CULLEN

VERIFIED STATEMENT OF SHANE CULLEN

My name is Shane Cullen, and I am the Superintendent of Transportation of Keokuk Junction Railway Co. ("KJRY").

I have been the Superintendent of Transportation of KJRY and Pioneer Railcorp's other railroad subsidiaries since October, 2003, and before that was an Operations Analyst, beginning in June, 2001. I hold a B.S. in Business Management from Bradley University and various F.R.A. certifications.

I have reviewed the statements of Roger Stice, and J. Michael Carr and I agree with them. I am confident, based upon my experience, that KJRY can operate the lines of South Plains Switching, Ltd. Co. ("SAW") safely and profitably, and provide a level of service that meets or exceeds the customers' needs.

KJRY has an excellent working relationship with BNSF Railway Company ("BNSF"), and has crews that are qualified to operate over BNSF mainline trackage, and interchange in BNSF yards. I anticipate that we would have no trouble working efficiently and amicably with BNSF at Lubbock.

KJRY currently serves the needs of a variety of shippers, including major industrial shippers, agricultural shippers, and small occasional shippers. Likewise, I believe KJRY can successfully manage the needs of the diverse shipper base that SAW has, and do so fairly and without discrimination.

I would anticipate that we would need 3-4 locomotives, which KJRY has immediate access to, and could ship within 48 hours. I would anticipate that we would need two train crews, a track crew, and a general manager. The operation would be very similar to operations I currently manage for KJRY at Keokuk, Iowa and on the Fort Smith Railroad Co. at Fort Smith, Arkansas.

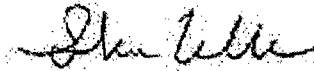
KJRY has adequate "back office" personnel to perform all support functions.

KJRY would provide service Monday-Friday, and weekends as needed.

KJRY has both the expertise; the financial resources; and the equipment to successfully assume operation of SAW's lines without any appreciable disruption of service.

VERIFICATION

I, Shane Cullen, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 27th day of September, 2006.

A handwritten signature in cursive script, appearing to read "Shane Cullen", is positioned above a horizontal line.

Shane Cullen