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October 12, 2006

VIA ELECTRONIC FILING

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

RE: STB Finance Docket Nos. 34890, *PYCO Industries, Inc. — Feeder Line Application — Lines Of South Plains Switching, Ltd. Co.*

Reply of Keokuk Junction Railway Co. To The Amended Valuation Evidence Of Pyco Industries, Inc.

Dear Secretary Williams:

Pursuant to the Board's decision in this proceeding served on August 16, 2006, as amended by the Board's decision of August 18, 2006, I am enclosing herewith an original and eleven copies of the "Reply Of Keokuk Junction Railway Co. To The Amended Valuation Evidence Of Pyco Industries, Inc."

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

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34890

**PYCO INDUSTRIES, INC. — FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

**REPLY OF KEOKUK JUNCTION RAILWAY CO.
TO AMENDED VALUATION EVIDENCE
OF PYCO INDUSTRIES, INC.**

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Attorneys for Keokuk Junction Railway Co.

DATED: October 12, 2006

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SURFACE TRANSPORTATION BOARD**

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**PYCO INDUSTRIES, INC. — FEEDER LINE APPLICATION —
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**REPLY OF KEOKUK JUNCTION RAILWAY CO.
TO AMENDED VALUATION EVIDENCE
OF PYCO INDUSTRIES, INC.**

On September 28, 2006, PYCO Industries, Inc. (“PYCO”) filed what it has entitled as a “Modification to Valuation of Assets of South Plains Switching, Ltd.” (“Modified Valuation”) in connection with its feeder line application (“FLA”) to acquire all of the rail assets of South Plains Switching, Ltd. Co. (“SAW”) in Lubbock, TX. Pursuant to the Board’s decisions in this proceeding served on August 16 and 18, 2006, any party may file a reply to PYCO’s amended valuation evidence within 14 days, in this case, by October 12, 2006. In accordance with the Board’s decisions, Keokuk Junction Railway Co. (“KJRY”) hereby submits its comments.¹

AS KJRY will discuss in detail below, PYCO’s application to acquire all of the SAW’s assets (“All-SAW”) is fundamentally flawed and should not be granted. In particular, PYCO has not met its statutory obligation to show that it is a “financially responsible person” capable of paying the constitutional minimum value (“CMV”) and assuring that adequate transportation will be provided over SAW’s lines for at least 3 years. PYCO also continues to rely on valuation

¹ Other than today’s filing date, the Board’s procedural schedule provided KJRY with no other date for filing comments on whether PYCO is a “financially responsible person.” Thus, today’s filing is KJRY’s first and only opportunity to address that issue, as well as “replying” to PYCO’s amended valuation evidence.

estimates based upon unsupported rehabilitation costs that are not credible and do not reflect SAW's true CMV. For these reasons, the Board should deny PYCO's FLA.

ARGUMENT

For any FLA to be granted, a party must show that it is a "financially responsible person." See 49 U.S.C. 10907(a); Keokuk Junction Railway Company – Feeder Line Acquisition – Line of Toledo, Peoria and Western Railway Corporation Between La Harpe and Hollis, IL, STB Finance Docket No. 34335 (STB Served Oct. 28, 2004) ("KJRY-TPW"), slip op. at 20; Valley Feed Company – Feeder Line Application – Greater Shenandoah Valley Development Company d/b/a Shenandoah Valley Railroad Company Line in Augusta County, VA, Finance Docket No. 32331 (ICC served Feb. 14, 1994), 1994 ICC LEXIS 12 at *3-*4.. To be a "financially responsible person" under the feeder line provisions and the associated regulations, PYCO must show that it is – (1) capable of paying the CMV of All-SAW, and (2) able to assure that adequate transportation will be provided over All-SAW for not less than 3 years. See 49 U.S.C. 10907(a); 49 CFR 1151.3(a)(3) and (7). PYCO has not met this test.

PYCO has provided very limited, vague evidence in support of its ability to acquire All-SAW at what PYCO contends is the line's CMV of \$2,274,000 and has not shown that it has sufficient funds available to undertake what PYCO claims is substantial required rehabilitation. Likewise, as explained below, even if PYCO has enough funds to acquire All-SAW at its proposed NLV price, PYCO has utterly failed to establish that it (or its proposed contractor) can assure that adequate transportation will be provided over All-SAW for at least 3 years.

As these proceedings have unfolded, PYCO has had numerous opportunities to buttress its FLA by supplying supporting information (including a 3-year *pro forma* balance sheet) in order to conform its application to precedent and the statutory requirements. PYCO has not done

so. PYCO has failed in its last opportunity to resolve the problems with its FLA discussed in detail below. PYCO cannot now, at this stage of the proceeding and in its rebuttal, provide such evidence.² PYCO's FLA must stand or fall on its own merits, and the Board's findings with respect to PYCO's financial responsibility, should be based upon PYCO's evidence only.

I. PYCO HAS NOT ESTABLISHED THAT IT HAS SUFFICIENT FUNDS TO ACQUIRE AND REHABILITATE ALL-SAW

Throughout its filings in both its original (Board-rejected) FLA in STB Finance Docket No. 34844 and its renewed efforts in STB Finance Docket No. 34890, PYCO has argued that it has the ability to fund its proposed acquisition of SAW's lines at their estimated net liquidation value ("NLV"). PYCO relies on its NLV figures as the best evidence of the CMV of All-SAW, which PYCO now says is \$2,274,000. PYCO asserts in its Modified Valuation that All-SAW has a pre-rehabilitation going concern value ("GCV") ranging from \$1,131,102 to \$3,032,745, depending upon assumptions about SAW's traffic levels and revenue projections. PYCO discounts from these GCV values what it insists are necessary rehabilitation costs of between \$4,072,000 and \$6,605,000, which gives All-SAW a negative GCV under any scenario. PYCO states that rehabilitation, though necessary, "would not be feasible in one year, but would need to be spread over several years,"³ and that its rehabilitation cost estimates reflect their "present value."

² See, e.g., Texas Municipal Power Agency v. The Burlington Northern & Santa Fe Railway Company, STB Docket No. 42056 (STB served Mar. 24, 2003) slip op. at 142 (a party may not introduce new evidence on rebuttal); CSX Transportation, Inc. – Discontinuance – At Memphis, In Shelby County, TN, STB Docket No. AB-55 (Sub-No. 618) (STB served Oct. 28, 2002) slip op. at 7 n.19 (the Board will not consider new evidence submitted on rebuttal).

³ PYCO proposes a seven-year plan for the extensive rehabilitation that it says is needed. See Modified Valuation, Exhibit C, V.S. Davis at 4-5. PYCO does not indicate, however, the per-year costs for this 7-year program.

Although PYCO's CMV for All-SAW is invalid as it substantially overstates rehabilitation costs, KJRY will assume for the sake of discussion here that PYCO's NLV figure of \$2,274,000 is correct. (KJRY submits that the totality of PYCO's feeder line application must be assessed as a whole, and should be granted or denied on the basis of its own evidence.) If \$2,274,000 is the correct NLV figure, and, by extension, the appropriate CMV for All-SAW, then PYCO's total up-front outlay to acquire the line and rehabilitate it⁴ for operation for at least three years would be at least \$6,346,000 (NLV of \$2,274,000 plus present value for rehabilitation of \$4,072,000) or as much as \$8,879,000 (NLV of \$2,274,000 plus present value for rehabilitation of \$6,605,000). Accordingly, to be financially responsible, PYCO must demonstrate its ability to fund the acquisition *and operation* of All-SAW to the tune of \$6,346,000-\$8,879,000.

As it happens, PYCO has never shown that it has that kind of money. According to PYCO's original FLA, filed on May 5, 2006, in STB Finance Docket No. 34844 ("PYCO Original FLA"), incorporated by reference into PYCO's FLA filed on June 14, 2006, in STB Finance Docket No 34890:

PYCO Industries is a large cottonseed oil and cotton byproducts producer with plants in Lubbock and in Mississippi. PYCO attaches a letter from Co-Bank (Exhibit E) attesting that Co-Bank will provide loan funding sufficient to pay a value greater than the estimated NLV or GCV *plus operating capital*.

PYCO Original FLA at 19 (emphasis added).

This original Co-Bank letter upon which PYCO relied upon to establish its financial wherewithal to undertake the proposed transaction (which would include the present value of

⁴ KJRY assumes here the ability to obtain an upfront outlay of these funds for both acquisition and rehabilitation because PYCO's witness for GCV does the same. See Modified Valuation, Exhibit B, V.S. Banks at 22 (Table 6). PYCO also claims that the rehabilitation is necessary to operate the line; thereby making rehabilitation costs a necessary component of PYCO's FLA.

PYCO's proposed rehabilitation) states that "PYCO has the financial resources to devote as much as \$5,000,000 towards rail acquisition and operation." PYCO Original FLA at Exhibit E (Co-Bank Letter). Yet, according to its own evidence, PYCO needs between \$6,346,000 and \$8,879,000 to acquire and operate All-SAW. As such, under the original Co-Bank letter, PYCO is between \$1,346,000 and \$3,879,000 short on funds.

This original Co-Bank letter itself is problematic. In fact, a careful reading of that letter shows that Co-Bank is not committing to lend PYCO any money in connection with the proposed line acquisition, even though Co-Bank states that it is PYCO's "primary lender." The letter merely says that PYCO has financial resources available to it, not that Co-Bank will loan any money to PYCO. As such, the Co-Bank letter simply speaks to the "financial resources" that PYCO has available to "devote" to such a transaction. PYCO's supporting evidence thus leaves unclear what resources are available to it and whether or not Co-Bank is willing to lend PYCO the money it may need.

Perhaps realizing the deficiency of its original evidence, on June 13, 2006 in its Revised Feeder Line Application, PYCO submitted another letter from Co-Bank, as well as PYCO's 2005 Annual Report. This Co-Bank letter again falls short. As relevant the letter states (emphasis added):

The purpose of this letter is to confirm CoBank's existing loan commitment to PYCO Industries, Inc. for up to \$15 million *to meet capital expenditures requirements*, including expenditures related to the acquisition of the aforementioned Feeder Line. In addition we provide other credit facilities to meet *ongoing working capital and term credit needs*, including additional expenses associated with operating the feeder line.

Again, a careful reading shows that the \$15 million is dedicated to all of PYCO's capital expenditures. A portion of that may "include expenditures related" to the acquisition of All-SAW, but the Board does not know, nor does the record reflect, how much of the \$15 million is

“included” for the acquisition and operation of All-SAW. PYCO’s ongoing capital needs for its existing operations may in fact require \$14 million of that available capital expenditure money. Likewise, the record does not reflect how much of PYCO’s ongoing working capital is available for operations, including rehabilitation. Indeed, as set forth in the attached Verified Statement of J. Michael Carr, Exhibit C, who is a qualified CPA, there are significant questions surrounding PYCO’s financial viability so as to make it unlikely that PYCO has \$15 million in available funds for acquiring and operating the railroad.

As noted, PYCO needs between \$6,346,000 and \$8,879,000 to acquire and operate All-SAW. Co-Bank’s letter does nothing to show or establish that such funds are available. Furthermore, a careful examination of PYCO’s 2005 Annual Report shows that PYCO actually owns a \$5,160,221 investment in Co-Bank. The Annual Report does not reflect what percentage ownership this is. Is this 100% ownership? Is this a passive investment? Does PYCO control Co-Bank? While these questions remain unanswered, one fact is for sure: Co-Bank is not an independent entity unaffiliated with PYCO providing unbiased testimony or support. Without further information, it cannot be said that Co-Bank’s second letter establishes that PYCO is a financially responsible person.

Although it would be relevant to any independent lender, Co-Bank is quite likely unaware that PYCO’s proposed investment in All-SAW would not pay for itself from the proceeds of future operations of SAW’s lines. As is discussed in Part II, below, contrary to PYCO’s assertions, a PYCO-operated All-SAW would lose significant amounts of money in each of the three years in which it would have to operate, particularly in light of the costly rehabilitation that PYCO plans to undertake. Because it is unclear whether Co-Bank is aware of the circumstances under which it ostensibly would lend money to PYCO (or whether it has

assumed incorrectly, as has PYCO that PYCO's ownership/operation of All-SAW would be viable and self-sustaining), its vague commitments to fund the transaction are highly questionable.

In the end, taking PYCO's FLA at face value, PYCO has not shown that it can pay both the CMV and the required rehabilitation expenses. PYCO's "evidence" of sufficient financial resources is far too vague and unsubstantiated to be reliable, nor is it independent. This stands in marked contrast to KJRY's FLA where KJRY has submitted both a letter and a signed loan commitment from Pioneer's primary bank providing funds for the specific purpose of acquiring and operating the All-SAW lines. In addition to this loan, the Board also has a verified statement from Pioneer's President and CEO committing KJRY's available cash, approximately \$1 million, for KJRY's acquisition and operation of the Lines. Furthermore, at PYCO's insistence, Pioneer has filed its consolidated financial reports for 2005 and produced substantial amount of discovery materials regarding Pioneer's financial ability. PYCO has presented no such similar evidence to the Board or to Pioneer. Without such evidence, PYCO has failed to satisfy the first prong of the test for a "financially responsible person" at 49 U.S.C. 10907(a).

II. PYCO HAS NOT ESTABLISHED THAT IT CAN ASSURE ADEQUATE TRANSPORTATION FOR NOT LESS THAN 3 YEARS

Not only has PYCO failed to show that it has the financial resources to acquire and rehabilitate the Lines, it has also failed to meet the second prong of section 10907(a). That prong requires PYCO to show that it can assure adequate transportation over the Lines for three years. PYCO claims that it does not plan to operate the Lines itself, but will retain an experienced operator, such as West Texas & Lubbock Railway Company ("WT&L") as PYCO's operator. The problem with PYCO's plan and its FLA is that PYCO has never provided a business plan showing how it or WT&L would ensure continued, viable service on All-SAW for at least three

years. In fact, other than having comments from WT&L regarding its willingness to work with PYCO to become its preferred operator, the Board has no other information regarding WT&L's ability to operate the Lines. Yet, the statute and regulations require such a showing by PYCO and its designated operator. In addition, one cannot assume that WT&L, or any other experienced operator, would desire to operate the line without a subsidy. PYCO's operator will have to earn a profit, further increasing the Line's revenue needs, or PYCO will not be able to retain an operator.

As is shown above, PYCO's own record evidence does not demonstrate that it has sufficient funds to both acquire the Lines and rehabilitate them; rehabilitation that PYCO itself claims is necessary in order to operate the Lines. However, even if one assumes that the only required funds are those necessary to pay NLV (or for that matter, KJRY's going concern value), PYCO has still not shown that adequate transportation will be provided over All-SAW for a period of not less than three years. PYCO has simply failed to provide a 3-year *pro forma* balance sheet to establish how All-SAW operations, under PYCO ownership, would be financially viable. Such a shortcoming is critical in light of the requirements of section 10907(a)(2), agency practice, and precedent.

The agency's original FLA rules were explicit that an applicant was required to provide 3-year *pro forma* balance sheets to be found financially responsible. See Feeder Railroad Development, 365 I.C.C. 93, 110 (1981) ("[e]vidence of financial responsibility shall include, but not be limited to, balance sheets and *pro forma* income statements for at least 3 years"). Since then, both feeder line applicants and the agency itself have understood a *pro forma* to be an

essential part of the application consistent with 49 CFR 1151.3(a)(7).⁵ KJRY has filed such a pro forma balance sheet in connection with its proposed operations of All-SAW, which was included in the Verified Statement of J. Michael Carr accompanying KJRY's expanded feeder line application for All-SAW filed on September 27, 2006. A thorough examination of PYCO's numerous submissions reveals that it has never done so. Without such a showing, PYCO cannot claim that it has met the second prong of the statutory requirement.

In the absence of such critical evidence from PYCO, KJRY has asked William J. Brennan of Transportation Economics, Inc., to prepare a 3-year *pro forma* balance sheet for a PYCO-owned All-SAW, relying extensively on PYCO's own record evidence and PYCO's claim that substantial rehabilitation would be required, indeed is "necessary" for the operation of the Lines. Mr. Brennan's statement is attached as Exhibit A.⁶ As Mr. Brennan shows, a PYCO-owned All-

⁵ See, e.g., KJRY-TPW (feeder line applicant supplied 3-year pro forma as evidence of financial ability to operate line for at least 3 years); Caddo Antoine, et al. – Feeder Li. Acq. – Arkansas Midland RR, 4 S.T.B. 326 (1999) ("Caddo Antoine") (proposed operator of line provided 3-year pro forma cash flow statement in response to the requirements of section 1151.3(a)(7)); LI Acquisition Corp. d/b/a Upper Merion & Plymouth Railroad – Abandonment Exemption – In Montgomery County, PA, Docket No. AB-405 (Sub-No. 1X) (ICC Served Aug. 23, 1994) (feeder line application rejected based in part on showings that applicant had failed to provide a 3-year pro forma income statement, balance sheet, or cash flow statement); Kansas Southern Railway Company – Feeder Line Application – Atchison, Topeka and Santa Fe Railway Company, Finance Docket No. 31823, 1991 ICC LEXIS 157 (1991) (FLA not accepted due in part to absence of projected balance sheet); Sandusky County – Seneca County – City of Tiffin Port Authority – Feeder Line Application – Consolidated Rail Corporation Carrothers Secondary in Sandusky and Seneca Counties, OH, Finance Docket No. 31438, 1990 ICC LEXIS 50 (1990) (sale of line to feeder line applicant supported by 3-year pro forma income statement and cash flow projections); Wyoming Colorado Railroad Inc. – Feeder Line Acquisition – Union Pacific Railroad Company Line Between Ontario and Burns, Oregon, Finance Docket No. 31377, 1989 ICC LEXIS 79 (1989).

⁶ In assessing the financial nonviability of PYCO's proposed operation of All-SAW, Mr. Brennan has drawn from the verified statement of Mr. Banks, attached as Exhibit B to PYCO's Modified Valuation. Mr. Banks offers a range of GCV estimates for All-SAW based on certain traffic and revenue assumptions. Noteworthy is Mr. Banks' assumptions alternatively to include

SAW would be very far from self-sustaining, and would require a subsidy to be viable or a substantial increase in rates/revenues. PYCO, however, insists that it “will bear the full cost of acquisition. No other form of subsidization is expected.” PYCO Original FLA at 23.

Yet, Mr. Brennan’s evidence shows that PYCO would never, on a going concern basis and under existing revenue levels, recover its expenses in buying and rehabilitating the lines. Accordingly, either a subsidy would be required (although PYCO has nowhere offered to subsidize operations or shown that it could do so),⁷ or PYCO would have to raise revenues through imposing surcharges. Perhaps PYCO has some undisclosed plan to impose surcharges on the other shippers on the Lines in order to make up the revenue shortfall.⁸ Of course, imposing surcharges on the other shippers would be contrary to purposes of the feeder line statute itself, especially §10907(c)(1)(E), and PYCO would be in violation of § 10907(i).

Not only would the imposition of substantial surcharges be contrary to the intent and purpose of the feeder line statute itself, but it is questionable that PYCO would even have the legal ability to impose such a charge. Indeed, one would assume that if SAW or WT&L/PYCO had the ability to impose a surcharge, they would be doing so now, but they are not (or are they waiting to do so after acquisition to avoid shipper objections to their FLA?). While KJRY

and exclude a \$20/car surcharge against all PYCO traffic. Accordingly, Mr. Brennan has created a range of *pro formae* based on Mr. Banks’ varying assumptions on this and other issues.

⁷ By showing that All-SAW has a negative GCV after factoring rehabilitation, which PYCO does when it postulates its NLV theory, then PYCO itself is confirming that someone would have to subsidize operations in order to operate the Lines in such a post-NLV acquisition scenario. As Mr. Brennan shows, without a subsidy, no rational operator would, on the basis of available revenues, agree to acquire the Lines and undertake the rehabilitation costs that PYCO says are necessary.

⁸ This may be the reason that at least three shippers have privately told KJRY of their concerns about PYCO’s plans but are afraid to go in the record due to concerns that PYCO would retaliate against them if PYCO was successful at acquiring SAW.

addressed the surcharge issue in its expanded feeder line filed on September 27, recent evidence confirms KJRY's conclusions that the Board should not account for surcharges in its CMV analysis. In response to discovery served upon PYCO by KJRY, PYCO has admitted that it has not been, or is not now, paying any surcharge to SAW or West Texas & Lubbock Railway Company. See Exhibit B, attached hereto. Moreover, PYCO itself has objected to the imposition of a surcharge throughout these proceedings, including in its Modified Valuation, and in other proceedings before the Board. For these reasons, it would be inappropriate for the Board to assume that PYCO would make up its revenue shortfall through the imposition of a surcharge; as opposed to providing a subsidy.⁹

PYCO has simply not shown that it can operate the lines via a subsidy or through increasing revenues. This failure to provide adequate evidence of its ability to assure adequate transportation over All-SAW for at least 3 years cannot be cured at this stage of the proceeding regardless of the Board's findings. Assuming the Board finds that NLV is the appropriate GCV and that PYCO is merely required to show its financial ability to acquire the Lines at NLV (and assuming the Board accepts the vague letters from PYCO's affiliated bank as meeting the first prong of the "financially responsible person" test), PYCO has still not shown that it or WT&L could operate the Lines for the required three year period under that scenario— regardless of whether the Board counts or doesn't count rehabilitation costs. PYCO has simply presented no evidence on this point. Likewise, if the Board agrees with KJRY and finds that substantial rehabilitation is not necessary and that the appropriate CMV is GCV, PYCO has also failed to present any evidence that it or WT&L could pay the GCV amount and operate the Lines for the

⁹ For the same reasons, PYCO's GCV estimates assuming the \$20 surcharge are not valid and are unsupported by facts. Likewise, Mr. Brennan's 3-year *pro forma* balance sheets attached as Exhibits 2 and 3 to his verified statement (both of which borrow from Mr. Banks' GCV assumption including the \$20 surcharge) substantially understate PYCO's per-year losses.

required three year period under WT&L's cost structure. PYCO's application fails in either scenario and must be denied.

The statute requires a feeder line applicant to prove that it can operate the lines for at least three years, with or without subsidy, and such financial ability to do so simply cannot be presumed even if the Board's agrees with KJRY and SAW that the scope of rehabilitation is much more modest than PYCO insists so that the appropriate CMV is GCV and not NLV. Moreover, while it is imperative that PYCO meet its burden of financial responsibility under section 10907, which it has failed to do, the operator with whom PYCO purportedly would contract to operate the line, WT&L, has also failed to supply the Board with a 3-year *pro forma* to show that its operation of the line would be viable. In the absence of a 3-year *pro forma* anywhere in its FLA, PYCO cannot satisfy the second prong of the "financial responsible person" test of section 10907(a) or the requirements at 49 CFR 1151.3(a)(7). Accordingly, PYCO is not a financially responsible person and its application must be denied as fundamentally deficient.

III. PYCO'S USE OF REHABILITATION OF ALL-SAW IS UNSUPPORTED AND IS CONTRARY TO PRECEDENT

Perhaps the most noteworthy element of PYCO's valuation evidence is its reliance on whopping, unsupported assertions that extensive rehabilitation and maintenance of All-SAW is essential. In fact PYCO claims that such rehabilitation is "necessary" and apparently would spend anywhere from two to three times All-SAW's purported NLV to rehabilitate the Lines. KJRY, on the other hand, has shown that very little rehabilitation is required. This conclusion is consistent with the evidence presented by SAW. In fact, PYCO's own witness acknowledges that the Lines have been reclassified to and are now being operated as FRA Class I trackage. See Modified Valuation, Exhibit C, V.S. Davis at 3. As operating Class I trackage, no rehabilitation

is necessary. Despite this fact and the evidence presented by both SAW and KJRY, PYCO nevertheless insists that All-SAW *must* be substantially rehabilitated. PYCO's argument is based on the following flimsy assertions: that SAW has deferred maintenance, that SAW's recent maintenance efforts are "short sighted" (*id.*), and that, in the "professional opinion" of PYCO's witness (*id.* at 4), such extensive rehabilitation would be appropriate. This is the closest PYCO comes to establishing a need for rehabilitation, and it is entirely unconvincing.

Certainly if PYCO were to acquire All-SAW, it could do as it pleased in committing whatever millions of dollars were at its disposal to improve the lines, but PYCO has failed to show that such substantial rehabilitation is so necessary that it should be factored into the CMV of All-SAW so as to reduce the Lines' value from GCV to NLV. In fact, precedent, as this record already has made clear, is to the contrary – rehabilitation costs not proven to be necessary, especially where the trackage in question is currently in operating condition, cannot be deducted against either the line's going concern or net liquidation value. See Caddo Antoine, 4 STB at 341-342 (where trains are actively using lines that a feeder line applicant claims need extensive rehabilitation, the Board has assumed that rehabilitation will be minimal). In SAW's Statement in Response to PYCO's Feeder Line Application to Acquire All-SAW ("SAW Statement"), there are over six pages, not counting witness testimony, demonstrating that SAW lines do not require extensive rehabilitation. PYCO's Modified Valuation, filed after, and in response to, the SAW Statement, does nothing either to rebut SAW's evidence or to distinguish the facts here from controlling precedent. Under the circumstances, PYCO's rehabilitation figures should be a nonfactor. They do nothing but artificially understate All-SAW's CMV.

CONCLUSION

For a variety of reasons, PYCO's FLA for All-SAW is fundamentally flawed. Most notably, PYCO has failed to prove itself to be a financially responsible person under 49 U.S.C. 10907(a). PYCO lacks the funds to support its proposed acquisition and rehabilitation of All-SAW. Moreover, neither PYCO nor its proposed operator of All-SAW have prepared and filed a 3-year *pro forma* balance sheet showing how operation of PYCO-owned All-SAW would be financially viable for at least three years. For these reasons, PYCO has failed utterly to satisfy either prong of the two-part test for financial responsibility at section 10907(a)(1)-(2) despite having had numerous opportunities to amend or revise its evidence. Also, the rehabilitation that PYCO insists it would do if PYCO were to acquire All-SAW is not necessary and is used merely to understate All-SAW's CMV. For these reasons, PYCO's FLA is deficient and should not be granted.

Finally, as discussed above, the fatal flaws in PYCO's FLA do not result from haste or a limited procedural schedule. For PYCO, the record is now closed on the merits of its FLA, except for appropriate rebuttal to comments such as this one. Given the procedural status of the case, PYCO may not now attempt to introduce new evidence into this proceeding on rebuttal. Either PYCO has, on the basis of its own case, proven that it is a financially responsible person capable of acquiring All-SAW and operating it for at least three years or it has not satisfied this

critical threshold requirement. PYCO's application must stand or fall on the information it has already supplied.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'William A. Mullins', is written over the printed name.

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Attorneys for Keokuk Junction Railway Co.

October 12, 2006

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34890

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**REPLY OF KEOKUK JUNCTION RAILWAY CO.
TO AMENDED VALUATION EVIDENCE
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EXHIBIT A

**VERIFIED STATEMENT OF
WILLIAM J. BRENNAN**

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. Last month, I submitted testimony in this proceeding on behalf of The Keokuk Junction Railway Co. (“KJRY”). KJRY has now asked me to review the testimony that Mr. Charles Banks submitted on September 28, 2006 on behalf of PYCO Industries (“PYCO”). In particular, I have been asked to assess whether Mr. Banks’ testimony demonstrates that PYCO has proven its financial ability to operate the lines of South Plains Switching, Ltd. (“SAW”) for at least three years as PYCO is required to show pursuant to 49 U.S.C 10907(a)(2).

II. Areas of Agreement

Although the bulk of my testimony will highlight those areas when I disagree with Mr. Banks, I would like to point out that there is much that Mr. Banks and I do agree on. As his latest statement makes clear, we both agree that 2005 was an extraordinary year for SAW. The

2005 harvest of Texas Upland Cotton was without precedent and cannot serve as the base from which future growth is projected.

In my earlier verified statement, I used USDA data to show that SAW might reasonably expect that its “normal” cotton traffic would be one-third less than the 2005 bumper harvest. That is, rather than transporting 8,033 carloads of cotton traffic, SAW might normally expect to carry 5,444 carloads. Mr. Banks obtained data from the High Plains Cotton Growers, which record cotton production statistics for that area of Texas. The data show, as we would expect, that production in the High Plains region is more volatile than the production for both the state of Texas and the United States. The data confirms that SAW’s projected traffic volumes are grossly exaggerated. Although I continue to rely on my initial estimate of 5,444 cotton carloads, Mr. Banks data confirm that my estimate is favorable to SAW.

Not only do Mr. Banks and I agree that the 2005 cotton production in the Lubbock area was atypical, but we also agree that it is highly inappropriate to assume that SAW’s traffic levels are completely inelastic to changes in price. Indeed, Mr. Banks presents evidence suggesting that at least one of SAW’s shippers, Hanson Aggregates, is not captive to SAW. Thus, to assume that all of SAW’s shippers would be willing to tender the same amount of traffic in the face of a \$60 per car surcharge is unreasonable.

III. Areas of Disagreement

Despite substantial agreement in these areas, Mr. Banks continues to accept PYCO’s claim that SAW needs extensive rehabilitation to remain operational, and such costs are a big factor in his testimony concerning SAW constitutional minimum value (“CMV”). I, on the other hand, continue to embrace KJRY’s (and SAW’s) assertions that little or no rehabilitation is needed,

and my estimation of SAW's CMV is calculated accordingly. Certainly, both Mr. Banks and I agree that traffic volumes in 2005 were far higher than what SAW can expect on an on-going basis. Given SAW's *proven* ability to handle its 2005 traffic volumes, I consider it bizarre that PYCO insists that SAW would need an infusion of more than \$4 million to handle *lower* traffic volumes in the future. It also seems highly inequitable to reduce SAW's CMV when one applicant, KJRY, disputes the need to make these investments.

To be clear, I do not doubt that rail shippers in the Lubbock area would benefit if SAW spent \$4-\$6 million in upgrading its physical plant. Rather, I question whether the SAW's owners would benefit from such an investment. I suspect SAW could use a new telecommunications systems, new computer systems, and new locomotives. SAW might also want to hire more workers and train them more intensively. In short, SAW (and every other firm for that matter) has innumerable needs and wants. Unfortunately, in a world characterized by scarcity, it is simply not possible to fulfill all of these desires. The task of a profit-maximizing manager is to strike the right balance among these competing priorities. Formally, an entrepreneur must match his marginal rate of technical substitution with his input prices. Loosely, a profit-maximizing entrepreneur must receive the same "bang for the buck" for each of his purchased inputs; if the pay-off to installing a new computer system exceeds the payoff from rehabilitating a track segment, an entrepreneur will install the computer system. Here, PYCO's argument implies that SAW would reap large benefits by rehabilitating its physical plant, but the revealed behavior of SAW, a profit-maximizing firm, suggests otherwise. For all of PYCO's talk of "deferred" maintenance, it remains true that for each railroad, there is an optimal level of maintenance.

Certainly, there is no evidence on the record to suggest that, after an extensive program of rehabilitation, SAW would increase its profits by \$400,000 annually. Yet, as my attached *pro*

forma calculation show, PYCO would need to generate additional cash flows in this neighborhood to service its higher levels of debt. PYCO might complain that I have assumed it incurs the entire debt in Year 1, when it plans to spread the expenses over 7 years, but PYCO itself asserts that “the present value of the costs, however, is fairly represented by the range” \$4.1 to \$6.6 million.¹ As a result, it is entirely appropriate to assume the low end of that range from the first.

I think it is highly unlikely that PYCO’s strategy would prove viable. There is, after all, a proven path to success in the short-line railroad industry: KJRY and other experienced short-line operators have found that Class III carriers must be very careful with capital expenditures. On a property with deferred maintenance, rather than rehabilitate the property over a short period of time, the profit-maximizing approach is to maintain the property on an on-going basis while making focused and targeted capital improvements that *can* generate positive cash flows.

A key assumption here is that PYCO could borrow an additional \$4,072,000 (in net present value terms) to rehabilitate the SAW in the first place. This assumption is highly suspect; I question why a commercial lender would advance so large a sum of money to rehabilitate the SAW absent a credible showing that it would generate higher cash flows. Thus, *PYCO’s own evidence shows that its operation of All-SAW would be a money losing proposition.*

Of course, if PYCO believes that such rehabilitation investments are necessary, it must also show (absent a subsidy) that it can rehabilitate the lines and maintain a viable railroad operation for at least three years. PYCO has not done so. Tellingly, PYCO has not submitted the customary three-year *pro forma* profit and loss statements. KJRY did produce such a *pro forma*

¹ See *PYCO Industries Modification to Valuation* at 3.

statement and, as discussed further below, I have applied PYCO's evidence to that statement to see if PYCO posits a viable SAW operation for three years or not.

In particular, I created four *pro forma* statements that are consistent with the revenue and expense assumptions contained in Tables 2, 3, 4, and 5 that accompany Mr. Bank's verified statement. Exhibit 1 matches the revenues and expenses reported by Mr. Banks in his Table 2, Exhibit 2 matches Table 3, and so on. Because PYCO did not identify, with specificity, how its operating expenses are likely to be allocated among the various expense categories, I relied upon the allocations generated by KJRY in its original *pro forma*. That is, because track materials accounted for 4.89 percent of operating expenses in KJRY's original *pro forma* in Year 1 (\$48,000/\$981,598), I have assumed that track materials will account for 4.89 percent of operating expenses in the PYCO *pro forma* in Year 1. Expenses in all the other categories were distributed in the same manner – in proportion to the expenses in KJRY's *pro forma*. I suspect that a profit maximizing carrier would allocate its expenses in a different manner, but I had no reasonable basis for assuming any other allocation. My PYCO-specific *pro formae* clearly demonstrate that under each of the scenarios PYCO envisions, it could not assure self-sustaining operations for any period of time once acquisition (at NLV) and rehabilitation costs PYCO insists are required to sustain on-going operations are accounted for.

In creating model *pro formae* to assess PYCO's financial responsibility, I have made two assumptions here that are highly favorable to PYCO. First, I assume that PYCO could obtain financing on the same terms as KJRY, an experienced and capable short line operator. Second, I assume that PYCO could finance the extensive rehabilitation expenses at the same rate that KJRY could finance its acquisition of SAW. I question, however, whether a bank would sink resources into a major rehabilitation effort without significant assurances that this effort would

yield higher cash flows. Both of these assumptions are quite unlikely, but favorable to PYCO. I note, however, that I was forced to rely on these assumptions because PYCO did not offer a three-year *pro forma* balance sheet with its feeder line application as I understand is generally required or expected in such proceedings.

Thus, even after giving PYCO the benefit of every doubt, the *pro formae* statements I have created demonstrate that PYCO could not invest \$4.1 million (in net present value terms) or more to rehabilitate SAW's lines without losing substantial sums into the future. Thus, the modified *pro formae* indicate that PYCO cannot meet its statutory obligation and assure the Board that it is capable of providing adequate transportation for not less than three years. In short, under the statutory requirements laid out at 49 U.S.C. 10907(a) and the requirements of 49 CFR 1151.3(a)(7), PYCO's own evidence proves that it cannot be considered a "financially responsible person."

Exhibit 1: PYCO Pro Forma Table (Consistent with Banks VS, Table 2)

ITEM	Year 1	Year 2	Year 3
OPERATING REVENUES	1,715,818	1,698,201	1,698,976
OPERATING EXPENSES	1,461,827	1,461,827	1,461,827
MAINTENANCE OF WAY			
WAGES, MOW - Employees 2	148,685	149,446	150,175
INS., BENEFITS & TAXES, MOW	52,040	52,306	52,561
TRACK MATERIALS	71,483	72,540	73,595
WEED CONTROL, MOW	29,040	29,469	29,898
BRUSH CUTTING	29,040	29,469	29,898
SIGNAL MAINTENANCE, MOW	14,868	15,088	15,308
TOTAL MAINTENANCE OF WAY:	345,156	348,319	351,434
MAINTENANCE OF EQUIPMENT			
WAGES, MOE	59,569	59,874	60,166
INS., BENEFITS & TAXES, MOE	20,849	20,956	21,058
TOTAL MAINT. OF EQUIPMENT:	80,419	80,830	81,224
TRANSPORTATION EXPENSES			
WAGES, TRANS.	263,296	264,644	265,935
INS., BENEFITS & TAXES, TRANS	92,154	92,625	93,077
FUEL, TRANSPORTATION 1 LOCO 24 HOURS A DAY	278,486	279,912	281,277
OIL TRANSPORTATION 1 LOCO 24 HOURS A DAY - 4 BARRELS MO	21,445	21,555	21,660
LOCOMOTIVE SUPPLIES	14,520	14,594	14,666
LOCOMOTIVE LEASE	126,883	122,627	118,486
CAR HIRE EXPENSES	35,742	34,543	33,376
TOTAL TRANSPORTATION EXP.:	832,525	830,499	828,476
ADMINISTRATIVE EXPENSES			
SALARIES, MANAGEMENT	89,354	89,811	90,249
INS., BENEFITS & TAXES, ADMIN.	31,274	31,434	31,587
DIRECT EDI EXPENSES \$3 PER CAR	31,274	30,225	29,204
INSURANCE, LIABILITY	44,677	43,178	41,720
UTILITIES	7,148	7,530	7,931
TOTAL ADMINISTRATIVE EXP.:	203,727	202,179	200,692
TOTAL OPERATING EXPENSES	1,461,827	1,461,827	1,461,827
Cash Flow	253,991	236,374	237,149
Less Interest Payments on Debt 1/	488,642	488,642	488,642
Profit	-234,651	-252,268	-251,493

1/ \$488,642 in annual interest is required to finance a \$6,346,000 loan at 7.7 percent.

Exhibit 2: PYCO Pro Forma Table (Consistent with Banks VS, Table 3)

ITEM	Year 1	Year 2	Year 3
OPERATING REVENUES	1,828,146	1,834,015	1,859,051
OPERATING EXPENSES	1,463,423	1,463,423	1,463,423
MAINTENANCE OF WAY			
WAGES, MOW - Employees 2	148,847	149,609	150,339
INS., BENEFITS & TAXES, MOW	52,097	52,363	52,619
TRACK MATERIALS	71,561	72,619	73,675
WEED CONTROL, MOW	29,072	29,501	29,930
BRUSH CUTTING	29,072	29,501	29,930
SIGNAL MAINTENANCE, MOW	14,885	15,105	15,324
TOTAL MAINTENANCE OF WAY:	345,533	348,699	351,818
MAINTENANCE OF EQUIPMENT			
WAGES, MOE	59,634	59,940	60,232
INS., BENEFITS & TAXES, MOE	20,872	20,979	21,081
TOTAL MAINT. OF EQUIPMENT:	80,506	80,918	81,313
TRANSPORTATION EXPENSES			
WAGES, TRANS.	263,584	264,933	266,225
INS., BENEFITS & TAXES, TRANS	92,254	92,726	93,179
FUEL, TRANSPORTATION 1 LOCO 24 HOURS A DAY	278,790	280,217	281,584
OIL TRANSPORTATION 1 LOCO 24 HOURS A DAY - 4 BARRELS MO	21,468	21,578	21,683
LOCOMOTIVE SUPPLIES	14,536	14,610	14,682
LOCOMOTIVE LEASE	127,021	122,761	118,615
CAR HIRE EXPENSES	35,781	34,580	33,413
TOTAL TRANSPORTATION EXP.:	833,434	831,406	829,381
ADMINISTRATIVE EXPENSES			
SALARIES, MANAGEMENT	89,451	89,909	90,348
INS., BENEFITS & TAXES, ADMIN.	31,308	31,468	31,622
DIRECT EDI EXPENSES \$3 PER CAR	31,308	30,258	29,236
INSURANCE, LIABILITY	44,726	43,226	41,766
UTILITIES	7,156	7,539	7,940
TOTAL ADMINISTRATIVE EXP.:	203,949	202,400	200,911
TOTAL OPERATING EXPENSES	1,463,423	1,463,423	1,463,423
Cash Flow	364,723	370,592	395,628
Less Interest Payments on Debt 1/	488,642	488,642	488,642
Profit	-123,919	-118,050	-93,014

1/ \$488,642 in annual interest is required to finance a \$6,346,000 loan at 7.7 percent.

Exhibit 3: PYCO Pro Forma Table (Consistent with Banks VS, Table 4)

ITEM	Year 1	Year 2	Year 3
OPERATING REVENUES	1,828,146	1,875,118	1,900,154
OPERATING EXPENSES	1,463,423	1,463,423	1,463,423
MAINTENANCE OF WAY			
WAGES, MOW - Employees 2	148,847	149,609	150,339
INS., BENEFITS & TAXES, MOW	52,097	52,363	52,619
TRACK MATERIALS	71,561	72,619	73,675
WEED CONTROL, MOW	29,072	29,501	29,930
BRUSH CUTTING	29,072	29,501	29,930
SIGNAL MAINTENANCE, MOW	14,885	15,105	15,324
TOTAL MAINTENANCE OF WAY:	345,533	348,699	351,818
MAINTENANCE OF EQUIPMENT			
WAGES, MOE	59,634	59,940	60,232
INS., BENEFITS & TAXES, MOE	20,872	20,979	21,081
TOTAL MAINT. OF EQUIPMENT:	80,506	80,918	81,313
TRANSPORTATION EXPENSES			
WAGES, TRANS.	263,584	264,933	266,225
INS., BENEFITS & TAXES, TRANS	92,254	92,726	93,179
FUEL, TRANSPORTATION 1 LOCO 24 HOURS A DAY	278,790	280,217	281,584
OIL TRANSPORTATION 1 LOCO 24 HOURS A DAY - 4 BARRELS MO	21,468	21,578	21,683
LOCOMOTIVE SUPPLIES	14,536	14,610	14,682
LOCOMOTIVE LEASE	127,021	122,761	118,615
CAR HIRE EXPENSES	35,781	34,580	33,413
TOTAL TRANSPORTATION EXP.:	833,434	831,406	829,381
ADMINISTRATIVE EXPENSES			
SALARIES, MANAGEMENT	89,451	89,909	90,348
INS., BENEFITS & TAXES, ADMIN.	31,308	31,468	31,622
DIRECT EDI EXPENSES \$3 PER CAR	31,308	30,258	29,236
INSURANCE, LIABILITY	44,726	43,226	41,766
UTILITIES	7,156	7,539	7,940
TOTAL ADMINISTRATIVE EXP.:	203,949	202,400	200,911
TOTAL OPERATING EXPENSES	1,463,423	1,463,423	1,463,423
Cash Flow	364,723	411,695	436,731
Less Interest Payments on Debt 1/	488,642	488,642	488,642
Profit	-123,919	-76,947	-51,911

1/ \$488,642 in annual interest is required to finance a \$6,346,000 loan at 7.7 percent.

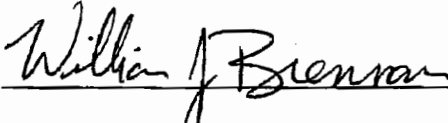
Exhibit 4: PYCO Pro Forma Table (Consistent with Banks VS, Table 5)

ITEM	Year 1	Year 2	Year 3
OPERATING REVENUES	1,715,518	1,762,490	1,787,526
OPERATING EXPENSES	1,463,423	1,463,423	1,463,423
MAINTENANCE OF WAY			
WAGES, MOW - Employees 2	148,847	149,609	150,339
INS., BENEFITS & TAXES, MOW	52,097	52,363	52,619
TRACK MATERIALS	71,561	72,619	73,675
WEED CONTROL, MOW	29,072	29,501	29,930
BRUSH CUTTING	29,072	29,501	29,930
SIGNAL MAINTENANCE, MOW	14,885	15,105	15,324
TOTAL MAINTENANCE OF WAY:	345,533	348,699	351,818
MAINTENANCE OF EQUIPMENT			
WAGES, MOE	59,634	59,940	60,232
INS., BENEFITS & TAXES, MOE	20,872	20,979	21,081
TOTAL MAINT. OF EQUIPMENT:	80,506	80,918	81,313
TRANSPORTATION EXPENSES			
WAGES, TRANS.	263,584	264,933	266,225
INS., BENEFITS & TAXES, TRANS	92,254	92,726	93,179
FUEL, TRANSPORTATION 1 LOCO 24 HOURS A DAY	278,790	280,217	281,584
OIL TRANSPORTATION 1 LOCO 24 HOURS A DAY - 4 BARRELS MO	21,468	21,578	21,683
LOCOMOTIVE SUPPLIES	14,536	14,610	14,682
LOCOMOTIVE LEASE	127,021	122,761	118,615
CAR HIRE EXPENSES	35,781	34,580	33,413
TOTAL TRANSPORTATION EXP.:	833,434	831,406	829,381
ADMINISTRATIVE EXPENSES			
SALARIES, MANAGEMENT	89,451	89,909	90,348
INS., BENEFITS & TAXES, ADMIN.	31,308	31,468	31,622
DIRECT EDI EXPENSES \$3 PER CAR	31,308	30,258	29,236
INSURANCE, LIABILITY	44,726	43,226	41,766
UTILITIES	7,156	7,539	7,940
TOTAL ADMINISTRATIVE EXP.:	203,949	202,400	200,911
TOTAL OPERATING EXPENSES	1,463,423	1,463,423	1,463,423
Cash Flow	252,095	299,067	324,103
Less Interest Payments on Debt 1/	488,642	488,642	488,642
Profit	-236,547	-189,575	-164,539

1/ \$488,642 in annual interest is required to finance a \$6,346,000 loan at 7.7 percent.

VERIFICATION

I, William J. Brennan, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 12th day of October, 2006.



William J. Brennan

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34890

**PYCO INDUSTRIES, INC. — FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

**REPLY OF KEOKUK JUNCTION RAILWAY CO.
TO AMENDED VALUATION EVIDENCE
OF PYCO INDUSTRIES, INC.**

EXHIBIT B

BEFORE THE
SURFACE TRANSPORTATION BOARD

PYCO INDUSTRIES, INC. ---)
FEEDER LINE DEVELOPMENT --) F.D. 34890
SOUTH PLAINS SWITCHING LTD.) (revision of F.D. 34844)

PYCO INDUSTRIES, INC.
RESPONSE TO FIRST INTERROGATORIES
PROPOUNDED BY PIONEER/KJRY

General objection: PYCO objects to the interrogatories as unduly burdensome and unnecessary to the extent they seek information already of public record or which Pioneer/KJRY could obtain directly from SAW or attorney work product. Reserving this objection, PYCO otherwise responds as follows.

1. Please describe in detail the charges, including any surcharges, that PYCO, its customers, or its consignees pay to WTL, SAW, or BNSF for the transportation of traffic to and/or from PYCO-owned and/or operated facilities located on SAW's rail lines.

ANSWER: The only payments known to PYCO are as follows:

(a) PYCO pays a tariff to BNSF. PYCO understands that BNSF currently pays WTL a division in accordance with the SAW/BNSF purchase and sale agreement out of that tariff with WTL standing in the shoes of SAW. The amount of the division for all customers on SAW lines is already in the public record insofar as PYCO is aware of the amount.

(b) PYCO pays no charge or surcharge to WTL, except for a \$150/car charge for traffic moved between PYCO plant no. 1 and PYCO plant no. 2. Prior to alternative service, PYCO paid the same charge to SAW. However, in most years there is little or no inter-plant movement.

(c) PYCO pays no charge or surcharge to SAW at this time. Prior to PYCO's seeking alternative rail service in F.D. 34802, SAW purported to impose a \$20/carload surcharge on PYCO, and a "constructive placement" charge of \$150/carload. According to information received from SAW, SAW has not sought to impose any such charges on any other customer. PYCO is contesting the lawfulness of such charges as imposed on PYCO in a Complaint proceeding filed in F.D. 34870. PYCO is currently paying no charges of any sort to SAW. PYCO has constructed additional track, and is prepared to construct yet more track, to avoid the "constructive placement" charge entirely, even were it lawful, which it is not.

(d) PYCO from time to time has paid to SAW or pays to WTL

demurrage on certain categories of cars (boxes and hoppers), but understands these payments are passed through to BNSF.

2. In connection with Interrogatory No. 1, above, what per-car charges, or per car surcharges if any, has PYCO or any of its customers or consignees paid to WTL, SAW, or BNSF for WTL's transportation of traffic to and/or from PYCO-owned and/or operated facilities located on SAW's rail lines?

ANSWER: None except as set forth in answer 1(b) above.

Pursuant to 28 U.S.C. § 1746, I declare and verify under penalty of perjury under the laws of the United States of America that I have read the foregoing answers and that they are true and correct.

Executed on September 27, 2006

Laith Hay
for PYCO Industries, Inc.

The objection is respectfully submitted by:

[Signature]

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34890

**PYCO INDUSTRIES, INC. — FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

**REPLY OF KEOKUK JUNCTION RAILWAY CO.
TO AMENDED VALUATION EVIDENCE
OF PYCO INDUSTRIES, INC.**

EXHIBIT C

**VERIFIED STATEMENT OF
J. MICHAEL CARR**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. 34890

**PYCO INDUSTRIES, INC. — FEEDER LINE APPLICATION —
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.**

**REPLY OF KEOKUK JUNCTION RAILWAY CO.
TO AMENDED VALUATION EVIDENCE
OF PYCO INDUSTRIES, INC.**

**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; of CFO of KJRY since 1996; and President of Pioneer's subsidiaries, including KJRY, since early 2005. I am a Certified Public Accountant, and had seven years experience in the banking business, prior to coming to Pioneer.

I reviewed the Financial Statements provided by PYCO and have substantial concerns regarding the financial ability of PYCO to acquire and operate the lines of South Plains Switching, Ltd. Co. ("SAW"). Under PYCO's proposal, PYCO would require anywhere from \$6,346,000 (the net liquidation value ("NLV") of \$2,274,000 plus present value for rehabilitation of \$4,072,000) to \$8,879,000 (NLV of \$2,274,000 plus present value for rehabilitation of \$6,605,000) to acquire, operate, and rehabilitate the lines. My review of PYCO's 2005 Annual Report indicates that PYCO does not have sufficient funds to carry out its proposal. In particular, I note that PYCO has negative retained earnings, as well as significant accumulated losses, totaling in excess of \$7 million.

While PYCO apparently had exceptionally good years in 2004 and 2005, that has not always been the case. For example, as recently as September 30, 2004, PYCO's financial statement shows that it had zero cash on hand. It is difficult for me to understand how a company that had zero cash on hand in 2004 and accumulated losses of up to \$7 million could afford to acquire and operate SAW's lines. I note also that for a company that had sales in excess of \$200 million, it is remarkable, and indeed raises substantial issues of concern, that PYCO's cash position on September 30, 2005 (the most recent date provided) ¹was less than \$250,000. I also note that sales revenue increased by approximately 33% in 2005 (\$202.4 million, vs. \$151.8 million), over 2004, yet total net "margin" (profit) declined by almost 50% (\$7.4 million in 2005, vs. \$15.3 million in 2004). This does not indicate a healthy viable company. I would certainly like to see the 2003 financials, as well as more recent financial statements. Without such a three year review of PYCO's financial statements, I cannot, nor can the Board, determine whether PYCO has the financial stability necessary to acquire and operate the line.²

While I understand that PYCO says it can acquire and operate SAW because of a loan commitment letter from its affiliated entity, CoBank, that letter does not commit those funds to the acquisition and operation of SAW. Instead, the CoBank letter is extremely vague and merely purports to provide a current loan commitment of "up to \$15 million" for "capital expenditures" and an unspecified amount for "ongoing working capital." This \$15 million cannot all be available for SAW. Indeed, a review of the Financial Statements shows long-term debt as of September 30, 2005 (the most recent date provided)³ at over \$26 million, another \$3 million in long-term debt currently due, and short-term borrowings for the year of \$61.5 million, of which \$11.5 million remained outstanding as of September 30, 2005. Does this leave only about \$3.5 million to acquire and operate SAW?

¹ I note that PYCO criticized KJRY's financial information as not being current. Yet, KJRY's information was as of December 31, 2005 not September 30, 2005. Furthermore, KJRY and Pioneer have both provided updated financial information, PYCO has not.

² KJRY has provided three years of historical financial statements, as well as 2006 financials up to June 30.

³ Again, I note that PYCO has failed to provide updated financial information, while KJRY has done so.

It would appear that PYCO's existing loan commitments and capital needs may well be substantially in excess of that being provided by CoBank. What, if any, additional funds CoBank would be willing to lend to PYCO for this feeder line acquisition is not stated. Given PYCO's history of losses, another less than stellar year could eliminate PYCO's cash position of less than a quarter of a million dollars (\$233,146, to be exact) and force it to borrow again to meet operating expenses.

Based upon the Financial Statements PYCO has provided, it is my professional opinion that this PYCO lacks the requisite financial responsibility to make an FLA for SAW Lines and to operate the lines for the required three year period..

VERIFICATION

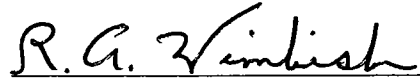
I, J. Michael Carr, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 12th day of October, 2006.

A handwritten signature in black ink that reads "J. Michael Carr". The signature is written in a cursive style with a large, stylized initial "J".

J. Michael Carr

CERTIFICATE OF SERVICE

I, Robert A. Wimbish, hereby certify that on October 12, 2006, I caused a copy of the foregoing Reply of Keokuk Junction Railway Co. To The Amended Valuation Evidence Of Pyco Industries, Inc. to be served by first class mail, postage prepaid, or by more expeditious service upon all parties of record in STB Finance Docket No. 34890.


Robert A. Wimbish