

CHARLES H. MONTANGE
ATTORNEY AT LAW
426 NW 162ND STREET
SEATTLE, WASHINGTON 98177
(206) 546-1936
FAX: (206) 546-3739



18 October 2006
by express

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

Re: PYCO Industries -- Feeder Line Application --
South Plains Switching, Ltd., F.D. 34890 - 217833
and related F.D. 34992 - 217854
PYCO's Rebuttal: due 19 October

Dear Mr. Williams:

On behalf of PYCO Industries, enclosed please find an original and ten copies of a Rebuttal and supporting exhibits for the above proceedings. Please note that Lacy Declaration Appendix I and Exhibit F are marked highly confidential and are submitted separately under seal pursuant to the protective order.

Copies of the protected material will be furnished to requesting counsel upon receipt of signed undertakings pursuant to the protective order.

Thank you for your assistance.

Very truly,

Charles H. Montange
for PYCO Industries, Inc.

Encls.

cc. counsel per certificate of service (w/encl.)
Mr. McLaren

ENTERED
Office of Proceedings

OCT 19 2006

Part of
Public Record

OCT 19 2006

BEFORE THE
SURFACE TRANSPORTATION BOARD

Part of
Public Record

PYCO INDUSTRIES, INC. --)
FEEDER LINE DEVELOPMENT --) F.D. 34890
SOUTH PLAINS SWITCHING LTD.) and F.D. 34992

-217853
-217854

PYCO INDUSTRIES, INC.'S
REBUTTAL

Pursuant to this Board's scheduling orders, PYCO Industries, Inc. (PYCO) makes this Rebuttal to replies/comments filed by South Plains Switching, Ltd. (SAW) and Pioneer Railcorp d/b/a Keokuk Junction Railway (KJRY) to PYCO's feeder line application (FLA). For ease of reference, PYCO's Rebuttal is organized as follows:

Part I -- Valuation

- A. Net Liquidation Value
- B. Going Concern Value

Part II -- Sufficiency of PYCO's
Feeder Line Application

- A. Inadequacy of SAW service
- B. PYCO's financial responsibility
- C. likelihood of service improvements should PYCO be authorized to acquire

Part III -- Other matters germane to PYCO's FLA

- A. All-SAW versus Alternative Two
- B. Other issues

I. Valuation

A. Net Liquidation Value

In PYCO's revised valuation of SAW, PYCO derived an NLV based on assumptions that SAW owned all its property in fee, and employed an across the fence valuation methodology, ultimately discounted by a cost of sale factor indorsed by SAW's own

witness (Mr. Landreth). To this, PYCO added the salvage value of rail and ties, also in a fashion indorsed by SAW's own witness Landreth. PYCO incorporated all trackage claimed by SAW, even though that was markedly in excess of what SAW and BNSF had represented to STB and to the public that SAW had acquired from BNSF. PYCO showed the NLV, under assumptions favorable to SAW (and consistent with SAW's own witnesses testimony) for all of SAW to be \$2,274,000.

SAW does not dispute these figures, and instead relies on alleged offers it claims to have received from KJRY or U.S. Rail Partners. The "offers" were based on due diligence to confirm traffic levels and costs that would support a going concern valuation of that level. USRP evidently never completed due diligence; and KJRY has persuasively disavowed any intention that its communications with SAW were to be construed as an unconditional offer to buy SAW for \$6 million. To the contrary, KJRY is now seeking to compel the sale of SAW for substantially less. In the circumstances, neither offer can be relied upon as setting the NLV for SAW, nor is there any case law that would support such reliance.¹ The cases on which SAW relies in effect involved contracts, or at the very least documents which required only an acceptance to fix the value. That is not the case here. It is relatively easy to contrive "offers"

¹ In general, this Board has looked at offers only as confirming disputed NLV evidence derived from appraisal and land title information. Here there is no dispute over appraisal and land title information.

contingent upon due diligence; these amount only to expressions of interest, and as such are unreliable because they do not bind either party to any particular valuation or transaction.² They should not be admissible evidence under 49 C.F.R. § 1114.1. PYCO's essentially uncontested computation of NLV is far more persuasive of the NLV for SAW, and itself is derived in a fashion highly favorable to SAW.

Since PYCO made this computation, PYCO has learned from discovery information supplied by SAW that SAW has purported to sell various portions of its trackage to Choo-Choo Properties, Inc. this calendar year. PYCO now knows there have been other sales as well. As a result, PYCO's NLV computation is even more favorable to SAW than heretofore thought. PYCO reiterates its request that the various sales and transfers to Choo-Choo be voided.

Conclusion: NLV should be set no higher than \$2,274,000.

B. Going Concern Value

Based on discovery information from SAW and employing a present value analysis with appropriate adjustments for the base year, PYCO's experts prepared four basic GCV scenarios, but testified in favor of the scenario resulting in a GCV of \$2,300,745 (Banks, Sept. 28, Table V), not taking into account rehabilitation costs. This scenario did not include any revenue from surcharges, assumed that a successor to SAW would "win

² Reliance on purported offers alone would make valuation proceedings subject to manipulation of evidence and fraud.

back" traffic equivalent to that SAW had experienced in 2005 from Hanson (roughly 3000 carloads), also continued to enjoy the Burris revenue that SAW claims to have "won" in litigation against BNSF.

PYCO now believes that the GCV is excessive in including the Burris revenue for the reasons stated by BNSF in its comments filed October 12, and as attested in the Declaration filed by Mr. Hale for BNSF. While Mr. Banks has not had time to calculate a set of tables without the Burris revenue, he has calculated the relevant deduction from GCV to be \$314,500. See C. Banks Rebuttal V.S., at 2.

Since the valuation advocated by KJRY was close to the revised GCV calculated by PYCO (nonetheless, we note that KJRY made several errors or assumptions rendering its GCV excessive), we will focus on comments made by SAW concerning our GCV.

1. Plaistow valuation opinion is unreliable junk science. SAW's witness on GCV valuation was Mr. Plaistow. Mr. Plaistow's critique of PYCO's revised valuation takes two basic forms: Mr. Plaistow's alternative valuation and embodied criticism filed on September 10, and his Reply filed on October 12. Mr. Plaistow is not an employee of SAW, and is evidently tendered by SAW as an expert witness. Under 49 C.F.R. § 1114.1, this Board should either exclude his testimony or give it no weight if it is unreliable. STB has no developed case law on how to evaluate the reliability of proffered expert testimony. The United States Supreme Court does. In cases construing

Federal Rule of Evidence 702,³ the Court has made it clear that federal judges have an important "gate-keeping" function when confronted with proffers of expert testimony. In particular, in Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 113 S.Ct. 2786, 2795 (1993), the Court ruled that Rule 702, in conjunction with F.R.Ev. 104(a), requires the a trial judge to ensure that the allegedly scientific expert testimony is reliable and relevant. The Court noted that the term "scientific knowledge" established a standard of evidentiary reliability. 113 S.Ct. at 2795. The Court read "scientific" to mean grounded in the methods and procedures of science, and "knowledge" to mean more than a subjective belief in unsupported speculation. Id. at 2794. In order to qualify as scientific knowledge, the proposed expert testimony must be supported by appropriate validation. Although the Daubert ruling was limited to expert testimony based on scientific knowledge, the Supreme Court in Kumho Tire Co. v. Carmichael, 526 U.S. 136, 119 S.Ct. 1167, 1174, 1177-79 (1999), applied the Daubert ruling to "non-scientific" expert testimony, in affirming the district court's

³ F.R. Ev. 702 provides that
"If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify therein in the form of an opinion or otherwise."

Expert testimony is admissible under this Rule if it "concerns (1) scientific, technical, or other specialized knowledge that (2) will aid the jury or other trier of fact to understand or resolve a fact at issue." Westbury v. Gummi, 178 F.3d 257, 260 (4th Cir. 1999).

exclusion of plaintiff's expert testimony and resulting grant of summary judgment for defendants because there was no proof that other experts in the field used the alleged expert's methodology and it was not sufficiently reliable. Certainly Daubert applies to proffers of economics testimony (Virginia Vermiculite, Ltd. v. W.R. Grace, 98 F.Supp.2d 729 (W.D. Va. 2000)), which is what Plaistow purports to offer.

Under Daubert, there are at least four factors which the Court may consider in determining whether expert testimony is admissible under F.R.Ev. 702: (a) whether the scientific theory or technique can be (and has been) tested; (b) whether the technique has been subjected to peer review; (c) what the known and potential rates of error are; and (d) general acceptance in the scientific community.

STB, of course, has no elaborate set of evidentiary rules. Rather, 49 C.F.R. § 1114.1 calls for the agency to employ reliable evidence. But section 1114.1 does specifically point to the standards used in the federal judiciary for elaboration of evidentiary standards. In any event, the courts of appeal in general are indorsing the Daubert case as guidance for administrative agencies, for "'[j]unk science' has no more place in administrative proceedings than in judicial ones." Niam v. Ashcroft, 354 F.3d 652, 660 (7th Cir. 2004). In essence, an administrative agency should no more consider or rely upon "junk science" than a trier of fact in court. Accord, Peabody Coal Co. v. McCandless, 255 F.3d 464, 469 (7th Cir.

2001); Lobster Inc. v. Evans, 346 F.Supp.2d 340, 344, 345 (D. Mass. 2004).

PYCO retained an economics expert (Mr. Mahle), specializing in law and economics, to evaluate the proffered expert valuation testimony by Mr. Plaistow and others in this proceeding. Mr. Mahle, who in contrast to Mr. Plaistow holds a PHD in economics, in his attached Declaration (Ex. A) notes that Mr. Plaistow makes two fundamental errors in methodology. The first error is that he assumes that demand for rail transportation in Lubbock is perfectly inelastic (will not decrease if price goes up). As Mr. Mahle states, this is fundamentally at odds with economic science. Mr. Mahle notes that Plaistow dismisses economic arguments to the contrary on the ground they are "esoteric." But as Mr. Mahle indicates, far from being "esoteric," they are elementary. An "expert" who blithely dismisses the elementary and the fundamental of a science hardly can purport to qualify his opinion as an expert opinion under that science. Mr. Mahle notes another major debacle in Plaistow's insistence on 2005 as a valid base year on which to make projections, in the face of persuasive evidence that rail demand fluctuates with annual weather conditions in Lubbock. Indeed, as we note elsewhere, Plaistow's own exhibit at page 12 shows that 2005 is abnormally high in shipments; what he so glibly misses is that it reflects the good growing season of 2004. Similarly, shipments in 2006 will turn out to be high, due to even better weather in 2005. But weather conditions in 2006 returned to the patterns of 2000-

2003, and shipments will thus be dropping to those levels.

For both reasons, Mr. Mahle states that in his expert opinion, Plaistow's proffered valuation is unreliable junk science and should be excluded or given no weight. Mahle at p. 16. Mr. Banks corroborates and discusses yet further the fundamental errors underlying Plaistow's conclusions (see Exhibit C). STB must either throw it out, or give it no weight in accordance with the applicable case law. This result certainly comports with national rail policy. Congress intends STB to foster sound economic conditions (49 U.S.C. § 10101(5)) and overvaluing SAW by reliance on Plaistow's junk science would certainly be contrary to that.⁴

2. SAW's critique of PYCO's revised valuation evidence.

PYCO's GCV valuation in essence was presented on September 28, 2006, when PYCO presented its discovery-based valuation for all-SAW. Criticism of PYCO's valuation evidence before that date is

⁴ Neither PYCO's valuation expert (Banks) nor KJRY's valuation expert (Brennan) made the fundamental errors that render Plaistow's conclusions unreliable.

There are additional grounds to reject the opinion of Plaistow as unreliable. In addition to his evaluative shortcomings in the scientific expertise of economics at the conceptual or theoretical level, he fails to exercise evaluative skill in assessing the facts out of which his opinion arises. For instance, he is willing to rely uncritically on parties to the litigation (e.g. Ms. Wisener's claims) to which true experts would accord little weight without substantiation. Unless reasonable evaluation of factual premises and data is not an intrinsic part of reliable methodology, then Plaistow's qualification as an opinion expert are undercut by his uncritical selection of factual predicates for his opinions.

In sharp contrast to Plaistow, PYCO's experts (including Sneed on rail NLV and Banks on GCV) have critically considered evidence supplied by SAW, and have adopted it where it could be reasonably substantiated.

premature or irrelevant, because, although PYCO did its best with the limited material available to it, PYCO represented from the initiation of this proceeding last May that PYCO wished to refine its presentation based on discovery. We therefore will focus here on statements made in SAW's critique of Mr. Banks' valuation as filed on October 12, 2006. SAW offers that critique on the basis of two witnesses: Delilah Wisener and Mr. Plaistow.

a. In PYCO's revised valuation, Mr. Banks did not employ 2005 as a base year. SAW argues in its reply comments in essence that 2005 should be the base year. Ms. Wisener asserts or implies that PYCO has long term contractual commitments which require it to use rail transport at levels approximating 2005. Plaistow relies on Ms. Wisener's claims. We furnish herewith a Rebuttal Declaration by Robert Lacy in which Mr. Lacy explains there are no such long-term contractual commitments. Lacy ¶5, pp. 4-5. PYCO is obligated to accept a percentage of the cottonseed generated by its member gins, but has no long-term (i.e., more than one year) contractual commitment to receive a specific volume, nor does PYCO have a long term commitment to ship out any specific volume of cottonseed or oil. Weather conditions render the real world too volatile for such contracts. In any event, PYCO cannot ship oil or cottonseed if nature prevents farmers from growing the cotton, whatever a contract says, and PYCO certainly has no take or pay transportation contract with either BNSF or SAW.

Amusingly, in the alternative use proceeding (Finance Docket 34802), SAW presented a newspaper article asserting that weather conditions had rendered 2005 an exceptional year in the Texas cottonbelt, and stated that the Board should take this into account as a reason for local transportation conditions.⁵ Yet in its Rebuttal filing, SAW has its witnesses Ms. Wisener and Mr. Plaistow representing that 2005 should be considered the norm. SAW's acknowledgement of the weather in F.D. 34802 should carry over to F.D. 34890.

Plaistow's own table on page 12 of his testimony shows that shipments in 2005 were roughly three times the levels in preceding years. Shipments in 2006 will likely be in the same range. But the reason is that 2004 was an excellent crop year, and 2005 was at least as favorable. Unfortunately, as detailed by Mr. Lacy in his Rebuttal Declaration (Ex. B), the 2006 crop year was more like the 2000-2003 period. Instead of 6000 or so carloadings, PYCO is projecting less than 2000.⁶

Plaistow claims that national statistics show that the cotton industry is not so volatile. The national average of course will not be as volatile as the data for a region, and a region (say, the southwestern U.S.) will not be as volatile as for a portion of a state (e.g., the Texas cottonbelt served by

⁵ E.g., Letter, T. McFarland (for SAW) to Secretary Williams (STB), Jan. 19, 2006, filed in F.D. 34802.

⁶ PYCO's specific projection and the reason for the projection is set forth in Lacy Rebuttal Dec, Appendix I, marked highly confidential under the protective order and filed under seal.

PYCO's Lubbock oil mills). Plaistow's reliance on national data itself makes his prediction of conditions in Lubbock unreliable, and this is especially the case when PYCO's experts have identified local data that shows exactly the volatility that makes Plaistow's predictions unreliable. At the very least, Plaistow commits a huge error in choosing a high point at Lubbock to which to apply his national average argument.

b. Plaistow says that cottonseed crush is stable.⁷ That is basically correct, but irrelevant. As Mr. Lacy explains in his Rebuttal Declaration at p. 5 et seq, PYCO devotes sufficient cottonseed to crush to meet demand for its oil; this amounts to around 700 to 1000 tankcars of oil per year. Excess seed is sold as cattlefeed, and is transferred by rail (it is rail dependent) to the California dairy industry. In each year after a good growing season, cottonseed shipments to California are high. In each year after an average growing season, there are no outbound cottonseed shipments.

c. Ms. Wisener claims that PYCO ships in cottonseed in bad years, claiming that PYCO received 2500 carloads inbound in 2002 and 2003. This is belied by Plaistow on p. 12 (his table shows no such shipments). As Mr. Lacy states (Ex. B at pp. 6-7), PYCO did mothball its Mississippi oil plant in 2001 (a bad year) and shipped (by rail) all cottonseed into Lubbock, but that was uneconomic and PYCO lost money doing so. PYCO has taken

⁷ Plaistow's data in fact seem to show that cottonseed crush is relatively stable, but has markedly declined over the last couple decades.

measures so this is not repeated. As Mr. Lacy states, if anything, the episode shows that PYCO inbound movements of cottonseed are indeed price sensitive, but that contradicts SAW's witness Plaistow at the very heart of his "junk science" (Mr. Mahle's term) assumption that demand for rail in Lubbock is perfectly inelastic.

d. To the extent that Plaistow otherwise quibbles with Mr. Banks' calculations, Mr. Banks addresses his claims in his statement attached as Ex. C. Mr. Lacy's Rebuttal Declaration (Ex. B) also contains information describing errors by Mr. Plaistow. Mr. Banks indicates that none of Plaistow's criticisms warrant adjustment to his GCV. Moreover, Mr. Banks did not make the methodological errors that Mr. Mahle indicate render the Plaistow alternative valuation unreliable.

In short, Mr. Banks evidence that the GCV for SAW is no greater than \$2,300,745 is reliable and persuasive evidence of GCV, if rehabilitation and maintenance needs are not taken into account. However, as indicated in Table V of Mr. Banks' statement filed September 28, that valuation includes revenue SAW claimed from Burris (as a result of litigation with BNSF). BNSF has persuasively argued that the Burris revenue should not be treated as permanent. If the portion of GCV attributable to Burris (\$314,500) is deducted from Mr. Banks' Table V calculation, then the value of SAW falls below the NLV calculated by PYCO (\$2,274,000).

3. SAW and KJRY critique of consideration of

rehabilitation costs. PYCO has argued that rehabilitation costs must be taken into account in valuing a railroad, just as the cost to rebuild an engine must be taken into account in valuing a used car with a burned out engine. PYCO's experts have indicated that the track is worn out and the ties essentially all discards. KJRY's expert in his valuation agreed.⁸ Nonetheless, SAW and KJRY argue that it is irrational for PYCO to seek to purchase a railroad that has a negative GCV. It is not irrational. PYCO is rail dependent. Unless it is assured reliable rail service, it must either move or go out of business. It is cheaper for PYCO to acquire SAW's lines and fix them up than to move. If one looks at the legislative history of what is now 49 U.S.C. § 10907 (the feeder line statute), one would see that its sponsor envisioned its use by shippers (and indeed by agricultural cooperatives like PYCO) exactly for feeder lines like this that the existing railroad was allowing to deteriorate (deferring maintenance) until service got so bad no customers were left even to cover crew and fuel costs. More specifically, the feeder line statute was offered as a floor amendment by Congressman Madigan on the day the House adopted its version of the Staggers Act.⁹ Congressman Madigan

⁸ KJRY FLA at p. 13.

⁹ The Senate's bill did not contain a feeder line provision (although it did contain language that was the precursor to the OFA statute). The House version as reported by committee did not contain an OFA provision, but did include, as section 502, a feeder railroad development provision applicable upon abandonment. It would have required sale of lines approved for abandonment at net liquidation value, and that a carrier

explained that the feeder line statute was designed as a remedy for "slow motion abandonments" in which a railroad allows its service to deteriorate or fails to provide proper maintenance or service to the point where enough customers drop off the line or go out of business so that the railroad can obtain outright abandonment authorization.¹⁰ Under the SAW/KJRY theory, no one would buy such lines and the feeder line statute would be a dead letter for the very lines for which its sponsor intended it to be applicable. No one disputes that SAW is engaging in deferred maintenance, and PYCO has already supplied evidence of how SAW is selling off portions of the lines it acquired from BNSF, almost from SAW's inception.¹¹

Although KJRY admits the lines are worn out, it claims that they can be operated upon safely, and with some minor exceptions, do not require rehabilitation. SAW certainly claims that its lines are operable. Yet Larry Wisener for SAW claimed that the heart of its system (its rail yard which PYCO's plant no. 1 surrounds) was too unsafe for PYCO's trackmobile in the alternative use proceeding (Finance Docket 34802).¹² If the

intending to abandon a line to attempt to find a potential purchaser. See H. Report 96-1035, 96th Cong., 2d Sess. pp. 2-23 (language of bill) & p. 71 (explanation) (May 16, 1980). This language was entirely supplanted by Congressman Madigan's amendment, discussed in the text.

¹⁰ 126 Cong. Rec. 21840 (Sept. 9, 1980).

¹¹ Exhibit A to Motion filed October 16, 2006 in F.D. 34890 (deeds showing a sell-off in 2000).

¹² Wisener Verified Statement at p. 3, filed by SAW in F.D. 34802 under Reply dated Dec. 28, 2005.

only safety issue were training, that could have been provided, so Mr. Wisener's conclusions must have referred to SAW's trackage, and it visibly is in poor shape. WTL, which has been operating on the SAW trackage under the alternative service order, has sustained a costly derail, encountered a broken rail in the past week, and has warned PYCO that portions of the track must be rehabilitated or they should be embargoed by the owner until repaired. See Lacy Rebuttal Dec. at pp. 14-15. WTL concurs in the assessment by the RL Banks firm that rehabilitation is required. See Stephen Gregory Declaration, Ex. D, at pp. 8-10. Ms. Wisener's purported recent reclassification of SAW's long-excepted status track to Class II is a contrived exercise, and does not alter the fact that the track needs work. See Gene Davis Rebuttal, Ex. E. Mr. Davis in his Exhibit E offers a detailed rebuttal to SAW witness Landreth's critique of Mr. Davis' earlier statement (and Landreth's assertion that no rehabilitation was necessary), and further demonstrates that the lines require rehabilitation. Mr. Davis also shows that the Pioneer and KJRY witnesses are incorrect in their claims concerning rehabilitation. In short, these lines are in poor shape; they have been under deferred maintenance since before the advent of SAW; and they need rehabilitation simply to get to the point that a normal maintenance program can be undertaken to keep them in reasonable condition. Whether one calls this a rehabilitation, or extraordinary maintenance in the end makes little difference.

But the cost of fixing up SAW's lines must be taken into account as a deduction from preliminary GCV.

4. Summary on GCV. Whether one takes into account rehabilitation or not, if the Burris revenue is deleted from SAW's reasonably expected future revenue, the GCV for SAW drops below its NLV. Thus the effective value for SAW under 49 U.S.C. § 10907 is the NLV (\$2,274,000). If this Board elects some other preliminary GCV than the GCV shown by PYCO, then the Board should deduct the rehabilitation costs associated with this line as found by Mr. Davis and Mr. Banks from that GCV.¹³ Under any realistic formulation of the GCV of SAW, the result of taking into account the result of the year's of deferred maintenance on these lines will be to reduce GCV to a level below NLV.

II. Sufficiency of PYCO's Feeder Line Application

A. Inadequacy of SAW Service

In its filing on September 18, 2006, in this docket, SAW stated at page 2 that "SAW does not oppose a finding that PC&N permits sale of All-SAW." SAW reiterates that position at page 3 of its Reply filed October 12, 2006. On the other hand, Delilah Wisener in her Verified Statement at p. 10 filed on October 12, 2006, claims that the feeder line statute is "NOT appropriate for application to SAW" and also claims that a forced sale of SAW will have an adverse impact on SAW, and on

¹³ The revised rehabilitation costs, taking into account discovery information received from SAW, is set forth in Verified Statement (Based on Discovery) of Gene A. Davis, P.E., page 8, table two, filed 28 September 2006 on behalf of PYCO.

customers in Slaton, Texas.

It is confusing for SAW repeatedly to state it does not oppose a finding of PC&N for All-SAW, but then to introduce at the last minute a Verified Statement by SAW's purported owner which basically opposes a finding of PC&N.

While PYCO regards SAW as bound by its representations on September 18 and October 12 that it would not oppose a finding of PC&N, PYCO as a precaution is responding to Ms. Wisener's apparent contradiction in at least summary form.

Mr. Lacy in Exhibit B at pp. 2-3 attached hereto summarizes evidence from F.D. 34802 attesting to inadequate service by SAW to PYCO. Shipper letters introduced under cover letter of August 2 further indicate that a majority of shippers concur that service from SAW was inadequate. Many shippers supplied verified statements of declarations indicating that they had been subject to retaliation or threats of same by SAW.

As to Ms. Wisener's claim that SAW would suffer financial harm within the meaning of 49 U.S.C. § 10907 in the event of sale, that is impossible as a matter of law. SAW will receive the constitutional minimum value for the properties in question, and that fully compensates SAW. SAW is not entitled to a premium for providing inadequate service, and overcompensation of SAW is contrary to the policies embodied in 49 U.S.C. § 10101(5). Ms. Wisener claims that receiving constitutional compensation for the property SAW obtained for free from BNSF in Lubbock will "hurt our ability to provide good service to

customers remaining (that is, those at Slaton, TX) after the conclusion of a forced sale of SAW." Evidently this is a reference to customers of South Plains La Mesa Railroad, which operates in Slaton. Ms. Wisener supplies no evidence of such harm, and SAW has never claimed it before. South Plains La Mesa is a separate entity from SAW, and is too distant on the BNSF mainline from SAW to be operated in conjunction therewith in any significant way. Receipt of constitutional compensation for property by definition cannot cause harm to another entity somewhere else. Since SAW received its property for zero, its receipts from the feeder line sale essentially will be entirely profit. If PYCO's valuation is accepted, SAW will provide its owners with a profit of \$2,274,000, in addition to profit from all the sales they have evidently made of parts of SAW to date (other than those sales this Board voids or has already voided). If the Wisener family elects to invest some of its profits into operations in Slaton, then service in Slaton can only be improved, not hurt, by the feeder line sale.

B. PYCO's Financial Responsibility

SAW does not contest PYCO's financial responsibility. Pioneer purports to do so. We question KJRY's standing to even raise this issue. Neither KJRY, nor its parent Pioneer, nor any of Pioneer's subsidiaries are owners of these lines, so they need not fear they will be enduring a proceeding at the conclusion of which PYCO will not have the purchase money to follow through. And neither KJRY, its sisters or its parent, is

a shipper on the lines, so none need not fear that PYCO will have insufficient funds to rehabilitate (which they say is not required anyway) or to operate. In the end, the KJRY objection on financial responsibility grounds seems to be that the projected revenue from the lines would not be sufficient to cover purchase, operation and rehabilitation without a subsidy. PYCO agrees; we do not hide the fact that we intend to subsidize the acquisition and rehabilitation. Nothing in 49 U.S.C. § 10907 bars PYCO from subsidizing the acquisition and rehabilitation. The fact that PYCO is prepared to do so is not an indication of financial irresponsibility. It is just an indication that PYCO's application is superior to KJRY's application.

Contrary to KJRY's claims, PYCO submitted ample evidence of financial responsibility. In PYCO's Appeal in F.D. 34844 and in PYCO's Revised Application in F.D. 34890, PYCO supplied a Declaration by our chief financial officer (CFO) that PYCO had a \$50 million operating line of credit, and a term loan revolver of \$20 million with CoBank, in which as of June 7, 2006, it had \$54 million in available credit. In addition, PYCO had a specially negotiated \$15 million line of credit for new capital spending, including specifically spending related to the SAW lines.¹⁴ While the \$15 million line of credit is sufficient to

¹⁴ See PYCO's Appeal from Dismissal of Feeder Line Application in F.D. 34844, filed June 12, 2006, hereby incorporated herein, Exhibit A (verified letter by PYCO CFO Morton noting that PYCO maintains an operating line of credit with CoBank in the amount of fifty million dollars and a term

(a) purchase SAW, (b) pay for rehabilitation, and (c) operate SAW for three years, PYCO never said it would rely upon it for any of those purposes. PYCO need not rely on it at all. PYCO's general credit lines are more than sufficient for any or all of these purposes. And the existence of the lines of credit is attested pursuant to 28 U.S.C. § 1746.

KJRY argues that the CoBank letter does not state that it is for rehabilitation. That is true, but PYCO showed \$70 million other credit lines, and attested that \$54 million was available. In any event, KJRY argues that no rehabilitation is necessary. This means that KJRY asks that the Board toss PYCO's application because PYCO has not shown a specific loan commitment to do something that KJRY says is unnecessary, and which it itself makes no showing it would, could or should do. With respect, KJRY's position on this score is not just internally inconsistent, but amusingly illogical. What would be much more consistent is for PYCO to argue that KJRY's application should be thrown out because neither it nor Pioneer have the funds to rehabilitate the lines, nor any intent to do

loan revolver in the amount of twenty million dollars. PYCO's CFO explained that PYCO had \$54 million in available credit. In addition, PYCO had arranged a special line of credit of up to \$15 million with CoBank for new capital expenditures, including specifically acquisition of SAW. All this information is also supplied in Exhibit A to PYCO's Revised Feeder Line Application in F.D. 34890. The existence of the \$15 million line of credit for capital expenditures including "the acquisition of the aforementioned Feeder Line" was specifically confirmed by a letter addressed to this Board by Jim Stutzman, a Vice President of CoBank. That also has long been of record in the referenced exhibits.

so.

KJRY also seeks to create some kind of "pro forma" requirement for three years of operation. There is no such requirement, although it is a good idea for a highly leveraged operation like the one Pioneer intends for KJRY here to show how it might work through three years of pro formas. PYCO, however, intends to subsidize the acquisition, and to contract with WTL to operate the lines based on the revenues streams derived from BNSF under the BNSF/SAW agreement. The situation for this kind of approach is quite different from what Pioneer contemplates for KJRY. Our showing was the following: PYCO has \$70 million in credit lines for all purposes, over and above a separate \$15 million credit line available for acquisition. As of June 7, 2006, PYCO had \$54 million in available credit in its all-purpose lines, and all of the \$15 million in the separate capital acquisition line. This is an overwhelming amount of liquidity -- roughly ten times expected costs of acquisition, rehabilitation, and operating capital. This showing was further supported by the Banks firm earlier determination that PYCO (or its operator) could operate SAW's lines out of expected revenues. Although those revenues will not be sufficient to pay for necessary rehabilitation, especially in a single year, Mr. Davis (one of the Banks experts) has pointed out that rehabilitation would logically be spread over a period of

years.¹⁵

PYCO has also supplied "working capital estimates" for the capital needed to operate SAW's lines for three years (in addition to purchase price and rehabilitation expenditures). See Exhibit D to PYCO Revised Feeder Line Application served 13 June 2006. PYCO's financial and general lines of credit show that the working capital requirement is slight for PYCO. But there is more. PYCO intends to contract with WTL for operations. Mr. Gregory indicates that WTL has provided service to PYCO without surcharge, has covered all costs, and does not expect to be reliant on any surcharges should PYCO acquire the lines. Exhibit D, pp. 6-7 and passim.

In short, PYCO's showing of financial responsibility is more than adequate to cover the working capital needs, along with purchase and rehabilitation. PYCO plans to subsidize purchase, and has the wherewithal and motivation to do so. This greatly simplifies the question of financial responsibility as to PYCO, because PYCO will not be relying on the revenue stream and attempted surcharges or other revenue augmentations that KJRY must rely upon to pay off purchase loans. There is thus no real possibility the lines if owned by PYCO will go under due to cash flow problems or indebtedness.

¹⁵ Verified Statement (Based on Discovery) of Gene A. Davis, P.E., filed 28 September 2006 on behalf of PYCO.

In any event, PYCO has other funds to expend for rehabilitation, and as a shipper, has a compelling case to obtain federal and state assistance to rehabilitate the property for the Lubbock rail community.

KJRY's claims as to PYCO's financial responsibility also seem more directed at KJRY itself. KJRY in its feeder line application relies on a loan to Pioneer from Pioneer's bank. The loan is a \$3 million line of credit secured on SAW's ties and tracks, and other assets of Pioneer. If PYCO with \$54 million in general credit plus \$15 million in a special line of credit is not financially responsible, then KJRY and its parent are definitely not financially responsible, for on the record to date they have 3/69 (1/23) the money to bring to the table on this project that PYCO has demonstrated. Pioneer is extremely unlikely to persuade its banker to give it a loan sufficient for rehabilitation required for these lines, which presumably is why KJRY so heatedly contests the need for rehabilitation. But this is just another way of saying that Pioneer as a whole and KJRY as a part are not financially responsible for this project.

PYCO's CFO has prepared an update to his letter of June 7, 2006, which provides PYCO's most recent balance sheet and Statements of Operations. The update, attached as Exhibit F, confirms that PYCO has "the ability to operate the railroad even at significant losses without impairing the financial position of PYCO." It demonstrates that PYCO in fact at the current time has cash reserves to buy the SAW lines, and that PYCO "has the ability to write a check for the purchase price of the railroad at the very moment that [feeder line application] is approved." If anything, PYCO's economic condition for purposes here has improved since June 7. Because the specific data is not public

and is business confidential, we are submitting it pursuant to the protective order as "highly confidential" and under seal.

C. Likelihood of Service Improvements Should
PYCO Be Authorized to Acquire

SAW does not contend that service is unlikely to improve should PYCO acquire the rail lines. However, KJRY seems to question whether PYCO will provide adequate rail service to shippers. PYCO has entered into a letter of intent with WTL under which WTL would operate the lines in Lubbock should PYCO acquire them. Since WTL already operates in Lubbock, this arrangement offers a host of efficiencies that can be achieved by no other available rail provider. Mr. Gregory demonstrates that WTL as operator is uniquely positioned to ensure not just adequate but vastly improved service and efficiencies in Lubbock, especially in combination with PYCO's acquisition of the lines at PYCO's expense. See Exhibit D. Additionally, Mr. Gregory confirms that WTL as operator (and in contrast to KJRY) does not intend to surcharge the line, for the revenue stream from BNSF is sufficient to cover its costs.

Operating in a hostile environment (due to SAW), WTL markedly improved service to PYCO, working off PYCO's backlog, and between the end of January and middle of September, moving over 9200 fulls and empties for PYCO, and an additional 1800 cars for SAW. BNSF has indicated a marked improvement in velocity, and this means relief from yard congestion. As Mr. Lacy explains in his Rebuttal, PYCO expects its own demand for rail to be only a fraction of 2006 or 2005 levels due to weather

conditions. However, WTL's performance to date confirms it will easily be able to provide adequate rail service to all SAW customers, even were PYCO's levels of use at the levels conjured by Plaistow.

PYCO intends to subsidize purchase, and to plow any revenues in excess of operating costs back into rehabilitation of the lines to address the deferred maintenance backlog. That alone will markedly improve service to shippers. In addition, PYCO's consultants have identified some track reconfigurations that should assist in relieving congestion (in the form of competition by the switch provider with BNSF for track time) on the BNSF mainline. With the cooperation of BNSF, PYCO will seek to implement these changes, thus upgrading service to local shippers yet more.

Finally, PYCO's operator, WTL, has assured PYCO that WTL will continue to implement its traditional policies aimed at cooperation with the Class I line-haul operator, and designed to stimulate and to grow the local switching business.

Delilah Wisener in her Verified Statement filed October 12 seems to suggest that Hanson (the major rock customer on SAW in 2005) has left the Lubbock market because it is no longer competitive, but that Vulcan will expand use. To the contrary, Hanson has informed PYCO that it regards itself as competitive, and that it is renewing its lease for rail unloading in Lubbock. E-mail, Stan Dacus to C. Montange, October 17, 2006. We understand that this is in the hope that PYCO is allowed to

acquire the associated rail lines, such that Hanson can receive adequate rail service. That is why PYCO's expert all along has included Hanson traffic in our GCV calculations. And that is also testament to the general expectation in the shipper community that service will definitely improve if PYCO is allowed to acquire the SAW lines.

III. Other Matters Germane to PYCO's FLA

A. All-SAW versus Alternative Two

SAW in its cover memo says PYCO stands alone in advocating Alternative Two. Actually PYCO, as this Board knows, all along has preferred to acquire all of SAW. Any remaining presence by SAW in Lubbock under its current ownership would result in a continuation of the hostile environment that PYCO has been experiencing off and on since the inception of SAW in Lubbock. We note in particular SAW's effort to transfer PYCO's rail leases, for which PYCO paid Mr. Wisener \$100,000 for a twenty year extension, to Choo-Choo (Mr. Wisener) which then has purported to terminate the leases, not for rail purposes, but to pressure and retaliate against PYCO for seeking relief before this Board.¹⁶ SAW has exhibited that it is ever ready to exploit a retaliatory opportunity. PYCO seeks to acquire all of SAW is because the majority of shippers in Lubbock, including the vast majority who have expressed any opinion on the issue,

¹⁶ PYCO filed a motion on October 16, 2006 to invalidate the lease transfer agreement and certain other transfers to Choo-Choo that have not already been invalidated or voided by this Board.

support this action.

However, if for any reason this Board finds that PYCO is not authorized to acquire all of SAW, then PYCO does reiterate its desire to acquire the portions essential for service to PYCO, Attebury and Compress (Alternative Two, as modified to include the entire SAW yard).

B. Other issues

In SAW's reply filed October 12, Ms. Wisener in particular launches into hearsay statements about PYCO contracts, statements by PYCO, reasons why Hanson is doing particular things, and claims that Vulcan will make up for the loss of business by Hanson. PYCO supplies specific evidence, or references evidence refuting most of Ms. Wisener's assertions/conclusions. She supplies no evidence to back them up, and they are unsupported conjectures that her witness Plaistow for the most part uncritically relies upon for his unsupported valuation. Her claims should be totally discounted as unreliable and belied by the record as a whole. We believe the Vulcan business is primarily to service a road contract and will be of limited duration. However, as we have indicated, this is largely moot for our own GCV calculation assumes that rock business experienced by SAW in 2005 will continue.

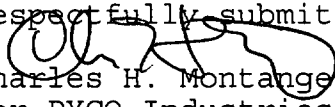
PYCO believes it has rebutted all significant claims made by SAW in SAW's reply filed October 12, and all criticisms made by SAW in its September 18 filing that are not moot based on PYCO's discovery-based valuation modifications as well. To the

extent we have overlooked anything, it should not be construed as an admission, but instead as an implied conclusion that the point was irrelevant, immaterial, or subsumed elsewhere. As to KJRY's various claims, we have addressed these in part on comments filed October 12, and in this rebuttal, and we intend to make additional comment in a filing due now on October 24.

Conclusion

PYCO meets the requirements for transfer of SAW's lines as set forth in 49 U.S.C. § 10907. This Board should authorize transfer of the SAW lines to PYCO at NLV as set forth in our revised valuation. Only in this fashion may shippers in Lubbock be ensured that service not only will be better than under SAW, but also vastly improved.

Respectfully submitted,


Charles H. Montange
for PYCO Industries, Inc.
426 NW 162d St.
Seattle, WA 98177
(206) 546-1936
fax: -3739

Of counsel:

Gary McLaren, Esq.
Phillips & McLaren
3305 66th St., Suite 1A
Lubbock, TX 79413
(806) 788-0609
for PYCO Industries, Inc.

Exhibit A -- Declaration of Steven Mahle, PHD, JD
Exhibit B -- Rebuttal Declaration of Robert Lacy (PYCO)
[submitted with two appendices, one UNDER SEAL]
Exhibit C -- Declaration of Charles Banks (RL Banks & Associates)
Exhibit D -- Declaration of Stephen Gregory (WTL)
Exhibit E -- Rebuttal Dec. of Gene Davis (RL Banks & Associates)
Exhibit F -- Letter, PYCO CFO Morton, Oct. 18, 2006
[HIGHLY CONFIDENTIAL/UNDER SEAL]

Certificate of Service

I hereby certify service of the foregoing Appeal and Petition upon the following counsel of record by express service, next business day delivery, this 18th day of October 2006:

Thomas McFarland
208 South LaSalle Street, Suite 1890
Chicago, IL 60606-1112 (for SAW)

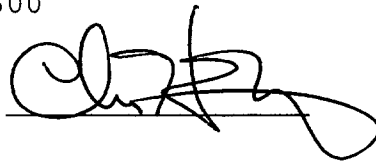
William Sippel, Esq.
Fletcher & Sippel
29 North Wacker Drive, Suite 920
Chicago, IL 60606-2832 (for US Rail Partners)

John Heffner, Esq.
1920 N Street, N.W., Suite 800
Washington, D.C. 20036 (for WTL)

William A. Mullins, Esq.
Baker & Miller
2401 Pennsylvania Ave. NW, Suite 300
Washington, D.C. 20037 (for Pioneer/KJRY)

Adrian Steel, Esq.
Mayer, Brown, Rowe & Maw
1909 K Street, N.W.
Washington, D.C. 20006-1101

Andrew Goldstein, Esq.
McCarthy, Sweeney & Harkaway
2175 K Street, N.W., Suite 600
Washington, D.C. 20027

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

BEFORE THE
SURFACE TRANSPORTATION BOARD

PYCO INDUSTRIES, INC. --)
FEEDER LINE DEVELOPMENT --) F.D. 34890
SOUTH PLAINS SWITCHING LTD.) and F.D. 34992

PYCO INDUSTRIES, INC.'S
REBUTTAL

ENTERED
Office of Proceedings

Exhibits

OCT 19 2006

Part of
Public Record

Exhibit A -- Declaration of Steven Mahle, PHD, JD
Exhibit B -- Rebuttal Declaration of Robert Lacy (PYCO)
[submitted with two appendices, one UNDER SEAL]
Exhibit C -- Declaration of Charles Banks (RL Banks &
Associates)
Exhibit D -- Declaration of Stephen Gregory (WTL)
Exhibit E -- Rebuttal Dec. of Gene Davis (RL Banks & Associates)
Exhibit F -- Letter, PYCO CFO Morton, Oct. 18, 2006
[HIGHLY CONFIDENTIAL/UNDER SEAL]



Exhibit A

**PYCO Industries, Inc.—Feeder Line Application –South Plains
Switching, Ltd.**

F.D. 34890

And

**KJRY – Feeder Line Application – SAW
F.D. 34992 (related proceeding)**

**Declaration of
Stephen E. Mahle, JD. Ph.D.**

I. Introduction

My name is Stephen E. Mahle. I am an economist and attorney in Boca Raton, Florida. My practice centers on evaluating economic, accounting and scientific testimony offered in civil matters. My qualifications are detailed in Exhibit 1. PYCO Industries, Inc. ("PYCO") engaged me to evaluate the testimony of purported expert witnesses related to the valuation of the rail lines of South Plains Switching Ltd., Co. ("SAW") in this feeder line application proceeding. Due to time limitations I have focused on the testimony of SAW's proffered witness Joseph Plaistow, as articulated in his statement of September 15, 2006. I have also considered Mr. Plaistow's revision, dated September 30, 2006. I have examined Mr. Plaistow's methodology to determine if his approach comported with economic science and employed acceptable methodology so as to render his conclusions reliable. As indicated below, I find his assumption that SAW can raise its price for shipping services without experiencing any resulting decrease in the sales of those services unsupported by economic science and without any foundational evidence to support it. Indeed, his assumption that SAW can raise its price for shipping services without experiencing any resulting decrease in the sales of those services is not only unsupported by economic science, it is affirmatively rejected by economic science. In

addition, Mr. Plaistow's use of 2005 as a base year for forecasting SAW's expected future earnings does not reflect appropriate methodology. Either one of these two flaws render his conclusions scientifically unreliable.

II. Joseph Plaistow's Determination of the "Going Concern Value" ("GCV") of SAW's Rail Lines

Mr. Plaistow's claimed method is quite simple, its affected complexity notwithstanding. He takes 2005 as a base year and assumes that SAW's 2005 revenues can be increased, by a simple price increase, sufficiently to more than double, (indeed, almost triple) SAW's annual earnings by 2006 relative to their 2005 level. He posits even higher earnings into the future and enters those more-than-doubled proposed earnings into a present value model and posits the resulting numbers as the value of SAW. In doing this, he errs in two fundamental ways, as detailed below. But analyzing this testimony requires reference to the model that Plaistow uses; so first I briefly summarize the requirements of the present value model.

A. The Present Value Model

1. Background

The basic method of discounting expected future cash flows to find the present value of an asset, the method that Mr. Plaistow claims to use to estimate GCV, is the accepted method, both academically and forensically, of determining the value of assets that provide cash flows. This method is known in the academic literature as capital budgeting analysis or Present Value (hereinafter PV) analysis. *See* Eugene F. Brigham, *Fundamentals of Financial Management* Ch. 9 at 337 (7th ed. 1992) (Chapter 9 explains the basics of the present value model and capital budgeting. Brigham's equation 9-1 is my equation 1 below); Stephen A. Ross & Randolph W. Westerfield, *Corporate Finance*

Chapter 9 at 212-13 (1988) (Chapter 9 summarizes Capital Budgeting and Risk). PV analysis is the proper method of analysis for an asset such as SAW. This seems not to be a point of contention between the parties, aside from Mr. Plaistow's misplaced critique of Mr. Banks' use of pre-tax magnitudes. As asserted by Dr. William J. Brennan, Brennan Verified Statement at 3, Mr. Plaistow's critique of Banks' analysis simply misses the equivalence of the two approaches.

In the general model:

$$GCV = PV = \sum CF_t \times 1/(1+r_t)^t \quad (\text{equation 1}),$$

CF_t is the expected cash flow provided by the asset in some future time t ,

and

r_t is the annualized risk adjusted t -period interest rate appropriate for discounting such cash flows back to present value,

and

the sum is taken across all relevant periods in the future.

It is critical to emphasize that the CF_t are *expected* future cash flows. In fact, they are often denoted $E[CF_t]$, and read "the expected value of the cash flow at time t ," to indicate carefully that the values are expectations, not known magnitudes. My use of the simpler notation CF_t is merely used to simplify the notation and should not divert attention from the critical fact that only *expected* cash flows enter into the model.

This model is widely studied, analyzed and accepted¹, and standards exist for the reliable use of the model. Brigham, *supra* at 337; Ross & Westerfield, *supra* at 212-13; Paul A. Samuelson, *Economics* at 614 (9th ed. 1973); Richard A. Posner, *Economic*

¹ This model simplifies to the model of Dr. Brennan, Verified Statement at 3, if all cash flows are identical for all periods and the yield curve is flat.

Analysis of Law at 194 (4th ed. 1992). Many of the standards for the proper use of this model concern how the analyst projects terms CF_t , the expected future cash flows.

One of the keys to applying the model properly is to think carefully about the plain English description of the model. The model discounts *expected* future cash flows back to a present value, so it is critical that the cash flows entered into the model must actually be *expected* in the future. See Shannon P. Pratt, Robert F. Reilly & Robert P. Schweihs, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* at 53 (4th ed. 2000). The model and the results of the model are very sensitive to violations of this requirement. Indeed, reflecting this importance, more generalized versions of my equation 1 allow for each CF_t to be replaced by a distribution of possible period- t outcomes. See Ross & Westerfield, *supra* at 212-213 on $E[CF_t]$. See Ronald J. Gilson, *The Law and Finance of Corporate Acquisitions* at 86-97 (1986). In these more sophisticated versions of the model, the word “expected” takes on a more formal definition as the expected value of the distribution of outcomes posited as possible for time t , and that mathematical expectation (the mean) is also written $E[CF_t]$. See Ross & Westerfield, *supra* at 130 on calculation of expected values. This highlights the fact that the cash flows entered into the model must be actually “expected.” In all cases, use of cash flows that are just “possible” misses this critical **requirement** of the PV model and do not suffice as inputs to the model.² To comport with the standards for the use of the present value model, the inputs must be expected, not just possible or hoped-for. See

² The nature of a distribution goes to the idea that there are many possible outcomes in the future, and that they can roughly be assigned probabilities of occurring. It is possible that a company will double its earnings into the future, but it is also possible that they will halve them. Introductory textbooks call this “state dependent outcomes” and pedagogically posit 5 possible outcomes, worst, bad, average, good and best and assign them probabilities like 10%, 20% 40%, 20% and 10%. My analysis of Plaistow’s analysis does not posit that the outcome he assumes cannot occur: it merely posits that they are not expected, and it is expected values that drive the accepted valuation model.

Ross & Westerfield, *supra* at 130. Mr. Plaistow does not enter cash flows into his model that are expected values.

Two issues concerning the expected value of these future cash flows are conspicuous in the instant matter. One issue concerns the value of SAW under its current pricing structure; the second concerns whether SAW would be worth more if it raised its prices by imposing a menu of tariffs. I address the latter issue first.

2. The Ability of SAW to Increase Price: The Price Elasticity of Demand

Every scenario that Mr. Plaistow estimates assumes that SAW can increase its price without decreasing the amount of its service that is demanded. Comparing Plaistow's Exhibit 51 (Full surcharge) and Exhibit 63 (\$20 surcharge), demonstrates: Total SAW shipments are identical under these two scenarios, even though SAW's price under the former is substantially higher than under the latter.

A seller's ability to increase price without suffering a decrease in the quantity demanded of its product requires that demand for its product be perfectly inelastic. The balance of this section shows that what economics knows about elasticity of demand indicates that demand for SAW's services is not perfectly inelastic and that Mr. Plaistow's assumption that SAW can raise price without decreasing quantity demanded is wrong. In doing so it shows that all of Plaistow's valuation scenarios are wrong in the same fundamental way.

Elasticity of demand, ξ , is a summary measure of how demand for a product changes in response to changes in the price of the product. In words, the price elasticity of demand is the percent change in the quantity demanded of a seller's product that accompanies a one percent change in the price of the product. Jack Hirshleifer, *Price*

Theory and Applications at 131-2 (3rd ed. 1984). There are three major elasticity points that form a frame of reference. (1) Demand is “infinitely elastic” ($\xi=\infty$) if any increase in price causes consumers to stop buying the seller’s product completely. (2) Demand is “unit elastic,” ($\xi=1$) if a one percent increase in price elicits a one percent reduction in quantity demanded.³ In such a case any percentage increase in price is met by an identical percentage decrease in sales. Since revenue equals price multiplied by quantity, if demand elasticity is 1.0, increasing price leaves revenue unchanged. (3) If demand is “perfectly inelastic,” sellers can increase price without any change in quantity demanded. Introductory microeconomic textbooks teach that demand is perfectly inelastic for goods that are absolutely essential. The classic example of perfectly inelastic demand is medication without which the consumer dies. Patterson, G, *Does the Commerce Clause Value Public Goods*, 44 Cath. U. L. Rev. 977 at n. 243. If the price doubles, the consumer still buys what they need.⁴ Perfectly inelastic demand is a very rare condition that exists more as a theoretical construct than as an actual example of how a market would work. Nevertheless, Mr. Plaistow assumes perfect inelasticity of demand for SAW’s services in each of his four scenarios.

Mr. Plaistow’s first scenario demonstrates his assumption that SAW faces a perfectly inelastic demand for its transportation services. He assumes that quantity shipped does not fall at all as SAW increases price: He assumes that the price-change-

³ Or more generally, for any number x, an x% price increase causes an x% reduction in quantity demanded

⁴ At least, those with the resources to buy it continue to buy it, although those without the resources to buy it just die. The analogue to a business, is that even if a business were to have a perfectly inelastic demand for some input, it will cease to purchase the input at the point that the price increase makes the business unprofitable.

Demand is said to be inelastic if the elasticity is between zero and 1, while demand is said to be elastic if the elasticity is between 1 and infinity. References to the elastic or inelastic portions of the demand curve refer to these ranges. They are behaviorally important because the elasticity determines whether revenues go up or down with price increases, the dividing point being where $\xi=1$.

induced percent change in quantity demanded equals zero, the definition of perfectly inelastic demand. Mr. Plaistow's assumption that demand for SAW's product is perfectly inelastic does not comport with reliable economic analysis. In fact it violates one of the most fundamental results in economics, known as the "Law of Demand," which posits that demand curves slope downward, meaning that quantity demanded decreases as price increases.

B. Mr. Plaistow's report is wrong because it assumes that demand for SAW's product is perfectly inelastic and informed economic analysis demonstrates this assumption to be false.

In particular, informed economic analysis knows that SAW faces an elastic demand curve.⁵ Indeed, one of the most famous results in the economics of monopoly pricing is that the monopolist operates in the elastic portion of its demand curve.

Hirshleifer, *supra* at 244. This is a widely known result in economics whose publication history dates from the 1930's to the present. The point is so well established that Judge Richard Posner's *Economic Analysis of Law* makes proving this proposition a homework problem for readers of the treatise. Posner, *supra* at 284, Problem #1. Hirshleifer, *supra* at 244 provides such a proof.

After I completed my initial analysis for this declaration, I received Mr. Plaistow's third statement on this issue, in which he attempts to justify his assumption that SAW faces a perfectly inelastic demand for its product. Reply Verified Statement of Joseph J. Plaistow dated October 12, 2006. In pertinent part, Plaistow's reply is directed

⁵ Shortly after I completed the core of my analysis of this issue and wrote this paragraph, I received the affidavit of Dr. Brennan, who, without citation, makes essentially the same statement. See Brennan Verified Statement at 16. For citations, see Harry Townsend, Scale, Innovation, Merger and Monopoly: An Introduction to Industrial Economics at 72 (1968) (all forms of business entities, monopoly, oligopoly and perfect competition have elasticity greater than 1, the unit elasticity discussed above.)

to the statement of Dr. William Brennan that I reference in footnote 5, and Dr. Brennan's comments on elasticity of demand, which are consistent with my comments on elasticity of demand. Mr. Plaistow's reply does not alter my conclusions. One issue that he raises in his reply is so conspicuous that it demands consideration. In making his case that elasticity of demand is not important in the calculation of the value of SAW, Mr. Plaistow characterizes Dr. Brennan's discussion of elasticity as "an esoteric discussion regarding economic theory." Plaistow Reply Statement at 8, referencing Brennan Statement at 16-17.

Dr. Brennan's analysis of elasticity, although less detailed than mine, mirrors my own analysis of elasticity. While esoteric discussions of demand elasticity surely exist, neither Dr. Brennan nor I rely on any of them. Indeed, my discussion of elasticity relies upon nothing beyond undergraduate textbook treatments of elasticity. While these undergraduate textbooks treatment of elasticity are consistent with the treatments of elasticity in advanced graduate texts and with the peer reviewed literature that some might consider esoteric, they are the economics version of Black Letter Law: positions that are so well accepted that no one even debates them any more. Perhaps the fact that Mr. Plaistow's considers mainstream **undergraduate** economics principles to be "esoteric" explains some of the fundamental errors in his analysis. Whether this is due to Mr. Plaistow's limited educational background or some other cause, it is bizarre for a witness to proffer himself as an expert in the field of economics while still viewing core undergraduate results in economics as "esoteric".

Mr. Plaistow's stunning admission notwithstanding, the fact that businesses face elastic demand curves is generally accepted in economic analysis at all levels.

Empirical economics confirms this elasticity of demand and rejects Mr. Plaistow's assumption on the perfect inelasticity faced by SAW. Appropriate empirical studies estimate that demand elasticity in such cases are in the elastic range of the demand curve⁶, or more specifically in the range to the elastic side ($\xi > 1$) of the unit elastic point. See Dr. Brennan Verified Statement at 17, citing empirical evidence from the transportation industry that elasticity of demand is 1.9. See also Walter Nicholson, *Microeconomic Theory: Basic Principles and Extensions* at 140 (1978) (summarizing empirical studies of demand elasticities). Thus the empirical evidence confirms what the principles of microeconomics say: SAW's revenues would be expected to fall with if they raise their price. Since SAW's revenues would be expected to fall as a result of a price increase, Plaistow's assumption that revenue will increase lock-step with price increases is refuted by economic analysis, his projected earnings cannot be expected to occur as a result of the price increase and cannot be used as inputs of expected cash flows into the PV model that Mr. Plaistow uses. In addition, the preceding analysis establishes a much stronger result than is needed to establish the unreliability of Mr. Plaistow's analysis: The economic evidence indicates that demand for SAW's product is in the elastic range. This not only rules out the perfect inelasticity that Plaistow assumes as an expected outcome, it rules out the entire inelastic portion of the demand curve. In short, Mr. Plaistow's assumption is not only wrong; it is not even in the right neighborhood. Both theoretical and empirical economics rule out the inelasticity of demand that Mr. Plaistow assumes in all of his scenarios.

⁶ Demand is said to be elastic if the elasticity is above 1.0 and demand is said to be inelastic if the elasticity is less than one. References to the elastic or inelastic portions of the demand curve refer to these ranges. They are behaviorally important because the elasticity determines whether revenues go up or down with price increases, the dividing point being where $\xi = 1$.

Finally, there is already early evidence that in the case of this particular asset even threatened price increases have reduced the quantity of its product demanded. This evidence is summarized sufficiently by others, so here it will suffice to recall that Hanson Building Materials (SAW's second largest customer in 2005) states it will not use SAW services again (Michael Hyer Letter dated Aug. 1, 2006); Floyd Trucking states that it wishes to develop a transload facility to take business from SAW if it raises rates (O.E. Floyd Letter dated October 5, 2006); and BNSF raises a variety of reasons to doubt SAW's ability to surcharge (Hale Verified Statement executed Oct. 11, 2006 at pp. 4-5).

Putting these three points together, microeconomic analysis summarizes that most businesses operate in the elastic portion of their demand curve, meaning that price increases mean reductions in sales;⁷ Empirical evidence published in peer reviewed scholarly journals confirms this analysis; There is mounting evidence of some of the elasticities that SAW is actually facing even as it threatens to raise prices. Yet despite this mountain of evidence that demonstrates that demand for SAW's product is elastic, Mr. Plaistow's scenarios assume not only that demand is in the inelastic range, they assume that demand for SAW's product is perfectly inelastic. This is a critical error and invalidates Plaistow's analysis.

Since each of Mr. Plaistow's scenarios presupposes the ability of SAW to raise prices into a perfectly inelastic demand curve, they are all estimates of revenues for a world that does not exist. Such revenue estimates cannot be the basis of expectations of new revenue for SAW. As such, Mr. Plaistow's proposed expected future cash flows do not meet the requirements of the Present Value model that he uses.

⁷ Townsend, *supra* at 72; Posner, *supra* at 284.

No matter how correct is a basic model, and the PV model is the correct model for this analysis, when incorrect inputs are used, incorrect outputs are generated.

Reminiscent of Mr. Floyd's language, this principle is summarized as garbage in – garbage out (GIGO). All of Mr. Plaistow's scenarios violate fundamental economic principles, none of the revenue forecasts contained in his Exhibits 50, 56, 62 or 68 suffice as inputs into the valuation model that he uses and none of the numbers that his scenarios produce are evidence of the value of SAW.

C. Summary of Elasticity Analysis

Mr. Plaistow's analysis does not provide evidence of the value of SAW because it assumes that demand for SAW's product is perfectly inelastic, while all the evidence points to the fact that demand for SAW's product is in the elastic range. Sensitivity analysis of Mr. Plaistow's results shows them to be very highly sensitive to the ability of SAW to raise price without experiencing a reduction in quantity demanded. Indeed, more than half of Plaistow's total valuation of SAW stems from his assumed ability of SAW to raise revenues by raising price. Correcting just this one error in Plaistow's analysis (but leaving many other to be corrected) reduces his Exhibit 50 valuation, under other assumptions very favorable to SAW, from \$8,537,903 to \$3,835,648 or less. See Exhibit 2.

But even if Mr. Plaistow corrected this error, his analysis still fails because even if the price increases are factored out of his analysis, he uses inputs into the valuation model that are not the expected future cash flows that the model requires.

D. Projections of expected future cash flows based on the historical record.

Mr. Plaistow makes much of the proposition that it is the future that matters, not the past. Plaistow at 6. This statement is correct at one level but incorrect at another. As indicated throughout this affidavit, only expected *future* cash flows enter into equation 1. But in most cases the best predictor of the expected future cash flows used in equation 1 is an analysis of the cash flows that the asset has generated in its recent history.

Therefore, an estimation of expected future cash flows begins with an analysis of historical cash flows. One naive method is to simply project the asset's most recent year cash flows as the asset's expected future cash flows. Less naive methods would project an average of several past years' cash flows as an expected value for future cash flows, or perhaps search out a trend line in the returns that would suggest a rate of increase in the asset's cash flows.

In this context, Mr. Plaistow's decision to simply select 2005 as a base year is remarkable, since all the evidence concerning 2005 indicates that it was an anomaly expected not to recur with any real likelihood in the next decade. In 2005, cotton-related shipments and production in the Lubbock area involved a confluence of perfect conditions, detailed in other witness statements, that are reminiscent of the Perfect Storm: The only expectation formed about 2005 in this regard is that it was anomalous and unlikely to recur in the near future. As a result, both shipments for 2005 and, for that matter, 2006 are not appropriate starting points from which to predict future cotton-related shipments.

In a sense the most informative way to explore the appropriateness of selecting 2005 as a base year is to recall the discussion of page 3 and answer the question, "are

2005 shipment levels expected to be repeated in following years?” Are the 2005 revenues expected to persist and grow next year and then in the year after that, and regularly into the future, as Mr. Plaistow assumes? The answer is clearly no. While 2006 shipments have remained high, 2006 weather conditions were worse than 2004 or 2005. Thus 2007 shipments are expected to be far lower.

Mr. Plaistow notes that “there is no one right way to determine GCV,” (Verified Statement of Joseph J. Plaistow at 18) but that does not change the fact that there are several wrong ways. Projecting 2005 cash flows blindly into the future is one of the wrong ways. Based on 2006 weather, the expectation is for a substantial retreat from, not repeat of, 2005. Certainly no one expects the string of 2005’s that Mr. Plaistow erroneously uses as expected future cash flows.

And again, this is elementary: It is all textbook analysis, most of it the economic analogue of Black Letter Law. While there are more sophisticated discussions that dismiss Mr. Plaistow’s analysis, he fails so openly on such fundamental issues that there is no need to address his more complicated errors.

III. Standards of admissibility of expert testimony in Surface Transportation Board proceedings

The rules of evidence in Surface Transportation Board (“STB”) hearings admit evidence in any of three disjunctive categories. First, they admit “[a]ny evidence that is sufficiently reliable.” 49 C.F.R. §1114.1. Mr. Plaistow’s testimony does not meet this standard: His projections are possessed of no indicia of reliability from any source, and they are possessed of many indicia of unreliability. While the STB does not have evidentiary rules otherwise addressing the question of reliability, there is a well-known

series of opinions in the courts of the United States that squarely address the reliability of economic expert testimony. These rules elaborate the third of §1114.1's disjunctive categories of testimony admissible in STB hearings, namely, evidence admissible under "the rules of evidence governing proceedings in matters not involving trial by jury in the courts of the United States." These are the *Daubert* line of cases, named after *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993) and they are precisely on point concerning the reliability that §1114.1 invokes but does not define.

Daubert evaluates the reliability of expert testimony by 4 factors: (1) whether the methods upon which the testimony is based have been tested; (2) the known or potential rate of error associated with the testing; (3) whether the method has been subject to peer review; and (4) whether the method is generally accepted in the relevant scientific community.⁸ As I have discussed, Plaistow's method of entering non-expected cash flows into the present value model and then declaring that the results of that misstep place a value on SAW are demonstrably unreliable. The simplest tests of this method show it to well more than double the value of an entity that provides expected cash flows anywhere in the range that SAW rationally expects. His error rates exceed 100%, apparently by a wide margin. The peer-reviewed literature, indeed, undergraduate textbooks, articulates a generally accepted method for valuing income-producing assets. Plaistow flaunts the most fundamental requirements of that method.

⁸ *Daubert* presages the four factors with the requirement, adopted from the learned and scientific literature, that "to qualify as 'scientific knowledge,' an inference or assertion must be derived by the scientific method." 509 U.S. 579 at 590. The phrase "the scientific method" is a term of art within the scientific community and has a specific meaning within that community. The scientific method requires that the investigator test a hypothesis at some rate of error and publish those results for other scientists to confirm or refute. Indeed, much of the language relied upon by the Court in its discussion of the scientific method is strikingly similar to the language used in amicus briefs filed by or on behalf of scientists from industry and academia. *Daubert*'s criteria mirror the criteria of the learned literature enough to be persuasive as indicia of the criteria that the expert's work would face in his home discipline's criteria for reliability.

Plaistow compounds this by assuming perfect inelasticity of demand, even though the tests published in the peer-reviewed literature indicate that demand is elastic. Plaistow's approach thus not only fails to adopt a reliable methodology, it again flaunts reliability. It does not even meet the standards of undergraduate microeconomics or finance. It is just plain wrong. One cannot be permitted to present arbitrary conclusions as "expert" opinion.

While *Daubert* and its progeny were developed in judicial proceedings construing FRE 702, there is a considerable body of case law applying *Daubert* in administrative proceedings. For example, acknowledging that *Daubert* interprets FRE 702, and the federal rules of evidence do not apply to federal administrative agencies, the 7th Circuit said that "the spirit of *Daubert*, as *Donahue v. Barnhart* . . . and other cases indicate, does apply to administrative proceedings." The court also said "'Junk science' has no more place in administrative proceedings than in judicial ones." *Niam v. Ashcroft*, 354 F3d 652, 660 (7th Cir. 2004). While no one would characterize Mr. Plaistow's analysis as science, any informed disinterested observer would characterize it as junk.

In *Peabody Coal Co. v. McCandless*, 255 F.3d 465 (7th Cir. 2001), the 7th Circuit said it does not make sense to provide for non-admission of junk science, but then "permit the dispute on the merits to be resolved by arbitrary considerations" 253 F.3d at 469. The 7th Circuit held in effect that *Daubert* and *Kumho* prevent an agency from relying on arbitrary assertions, at least, as here, when there is expert evidence to the contrary.

In *Elliott v. CFTC*, 202 F.3d 926 (7th Cir. 2000), the 7th Circuit in dicta seemed to indicate that it would have upheld non-admission of alleged expert testimony, but that

the controversy was resolved by the apparent fact that the suspect testimony was given no weight. "Thus a factfinder should employ the reliability benchmark in situations, as here, in which unreliable expert testimony somehow makes it in front of the factfinder, and assign the unreliable testimony little if any weight." 202 F.3d at 934.

In short, the case law seems to contemplate outright exclusion of junk science expert testimony (e.g., dicta in *Lobsters Inc. v. Evans*, 346 F.Supp. 2d 340, 344, 345 (D. Mass. 2004)) in administrative proceedings, or alternatively giving it no weight.

Part of what makes *Daubert* so persuasive is the fidelity with which *Daubert* adopts the standards that are actually used in science and the other learned disciplines into the federal courts. When tribunals apply the *Daubert* criteria, they apply criteria analogous to those applied in the scholarly disciplines that underlie the forensic expertise put before the tribunal, because the *Daubert* factors mirror the standards that scholars apply to their own work and the work of their colleagues. When tribunals apply the *Daubert* criteria, they assess the reliability of proffered testimony with criteria analogous to the criteria that the expert's discipline would apply in its faculty lounges, student seminars and peer-reviewed literature.

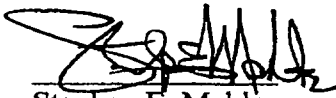
Conclusion

It is my professional and expert opinion as an economist and specialist in law and economics that Mr. Plaistow's proffered testimony is unreliable and does not meet the standards of *Daubert*. When Mr. Plaistow discounts standard economic theory as "esoteric" and dismisses it, as he does in his reply, red flags should go up. In all events, his approach shows fundamental methodological flaws rendering his analysis unreliable and arbitrary. It either should be excluded or given no weight.

VERIFICATION

Pursuant to 28 USC §1746, I declare and verify under penalty of perjury under the laws of the United States of America that to the best of my knowledge the foregoing is true and correct.

Executed on October 17, 2006



Stephen E. Mahle

Exhibit 1

STEPHEN E. MAHLE
ATTORNEY AT LAW
ECONOMIST

PENINSULA PLAZA, SUITE 314
2424 NORTH FEDERAL HIGHWAY
BOCA RATON, FLORIDA 33431
(561) 392-4300
sm@daubertexpert.com

EDUCATION

- J.D. The University of Virginia School of Law, May 1995**
Olin Scholar in Law and Economics
- Ph.D. The Ohio State University, June 1987, Economics**
Concentrations in Finance, Labor Economics and Econometrics/Statistics.
Ohio State University Fellow
- B.A. Case Western Reserve University, May 1977, Economics**
magna cum laude

EXPERIENCE

Attorney at Law & Financial Economist, Keeley, Hayes, Garrett, Lee & Mahle, PL, April 1997-present. Economics expert analysis and Daubert motion practice to exclude economics and finance expert testimony in business litigation. Practice concentrated in applications of law & economics strategies in complex commercial litigation, including litigating economics, finance and expert testimony issues. Experience in securities and commodities litigation and expert testimony, including 10b-5, arbitration, and SRO proceedings; in trade secret and non-competition litigation; and in general commercial litigation, including contract and corporate acquisition matters. Econometric analysis of damages.

Adjunct Professor of Economics, Florida Atlantic University, 2006

Adjunct Professor of Law and Adjunct Professor of Finance, Sheppard Broad Law Center and Graduate School of Business, Nova Southeastern University, 1998-2000. Teach advanced courses in the university's law school and executive MBA program.

Assistant Professor, Department of Finance, Florida Atlantic University, August 1996-May 1998. Scholarly research in law and finance, concentrating on *Daubert* standards for admissibility of expert testimony in securities and commercial litigation. Teach Advanced Managerial Finance and Financial Institutions. Virginia Tech, August 1991-August 1992, and The University of Iowa, August 1986-August 1991. Original scholarly research in finance, economics and law, employing regression and related statistical techniques, simplifications of which are used by forensic scientists in commercial litigation. Authored agency-cost law review article chosen as among the ten best securities law articles published in 1990. Taught most core Economics classes, and Corporate Finance, Advanced Managerial Finance, Banking and Futures and Options, graduate and undergraduate.

EXPERIENCE (continued)

Senior Corporate Planning Analyst, AmeriTrust Corporation (a multi-bank holding company), 1979 - 1981. Acquisition team member for M&A program to aggressively expand major commercial bank. Financial due diligence. Accounting systems development to construct asset-liability management model that electronically accesses the bank's accounting systems to determine instantaneous interest rate risk.

PUBLICATIONS AND PRESENTATIONS

Challenging the Financial Expert in the *Daubert* Era, The National Judicial College. Moderator for continuing judicial education (CJE) seminar, November, 2003.

Successful Strategies for Winning Commercial Cases in Federal Court, Westlaw/Florida Bar CLE presentation, September, 2002.

Expert Testimony in Florida Business Litigation, in "Business Litigation in Florida," (Fla. Bar, 4th ed., 2001).

Identifying and Excluding Evidentiarily Unreliable Economics Expert Testimony in Commercial Litigation. CLE Presentation, December 2001.

Daubert v. Merrell Dow Pharmaceuticals: The Law and Science of Expert Testimony, CLE Program delivered June 2001, available online at www.celesq.com.

The Impact of *Daubert v. Merrell Dow Pharmaceuticals* on Expert Testimony: With an Application to Securities Litigation, The Valuation Compilation: Special Issue on Daubert. National Association of Certified Valuation Analysts, 2001.

The Law, Science and Economics of Expert Testimony in Business Litigation, CLE Program sponsored by the Business Law Section of the Florida Bar, November 1999.

The Impact of *Daubert v. Merrell Dow Pharmaceuticals* on Expert Testimony: With an Application to Securities Litigation, The Florida Bar Journal, March 1999.

Calculation of Damages in Securities Class Actions, Presented to the Annual Meeting of the American Bar Association, August 1995. With Joseph F. Johnston, Jr.

Proxy Contests, Agency Costs and Third Generation State Antitakeover Statutes, Securities Law Review, 1992

Dividend Policy, Agency Costs and Executive Separation, Presented to the Annual Meeting of the Financial Management Association, October, 1991.

Proxy Contests, Agency Costs and Third Generation State Antitakeover Statutes, Journal of Corporation Law, Summer 1990.

Exhibit 2

Projecting SAW's 2005 earnings of \$272,331 forward perpetually into the future and assuming a 3% growth rate yields a hypothetical present value of $272,331/ (.101-.03) = \$3,835,648.00$.

The same analysis assuming a 1% growth rate yields a hypothetical value of $\$272,331/ (.101-.03) = \$2,992,648.35$.

I do not pose these as refined valuations of SAW, merely as indications of how sensitive the valuation of SAW is to Mr. Plaistow's untenable assumption of perfect inelasticity of demand.

The assumption that SAW can increase price without suffering a corresponding loss of shipments more than doubles the calculated hypothetical valuation of SAW.

This of course begs the question raised in other analyses: If imposing these surcharges is going to be so easy, and imposing these surcharges is going to more than double the value of SAW, why has SAW not imposed them?

Exhibit 2

Projecting SAW's 2005 earnings of \$272,331 forward perpetually into the future and assuming a 3% growth rate yields a hypothetical present value of $272,331/(\cdot 101 - \cdot 03) = \$3,835,648.00$.

The same analysis assuming a 1% growth rate yields a hypothetical value of $\$272,331/(\cdot 101 - \cdot 03) = \$2,992,648.35$.

I do not pose these as refined valuations of SAW, merely as indications of how sensitive the valuation of SAW is to Mr. Plaistow's untenable assumption of perfect inelasticity of demand.

The assumption that SAW can increase price without suffering a corresponding loss of shipments more than doubles the calculated hypothetical valuation of SAW.

This of course begs the question raised in other analyses: If imposing these surcharges is going to be so easy, and imposing these surcharges is going to more than double the value of SAW, why has SAW not imposed them?

Exhibit B

BEFORE THE
SURFACE TRANSPORTATION BOARD

PYCO INDUSTRIES, INC. --	)	
FEEDER LINE APPLICATION --	)	F.D. 34890
SOUTH PLAINS SWITCHING LTD.	)	

Rebuttal Declaration of
Robert Lacy

I, Robert Lacy, make this Rebuttal Declaration in support of PYCO Industries, Inc.'s, Feeder Line Application. I will specifically address some claims and assertions by Delilah Wisener on behalf of South Plains Switching (SAW); some key issues relating to statements of South Plains Switching (SAW) witness Plaistow in his critique of the revised valuation of Mr. Banks, and some claims made by Pioneer Railcorp (d/b/a Keokuk Junction Railway) in its feeder line application and comments concerning PYCO.

1. I am the Senior Vice President-Marketing for PYCO Industries, Inc., and am responsible for overseeing shipment of product to customers. As such, I am familiar with PYCO's rail-dependent operations. This Declaration is made on behalf of PYCO.

2. There was no alleged offer of \$5.5 million by PYCO. In her Reply Verified Statement filed October 12, 2006, Ms. Wisener makes a number of claims concerning events she did not witness and either has no knowledge concerning, or only hearsay views from her husband, Larry Wisener. Contrary to the statement of Ms. Wisener (SAW Oct. 12 filing, Exhibit 1, at p. 2), I did not "verbally offer[] to pay \$5.5 million for a portion of SAW." At no point did

PYCO offer Mr. Wisener or anyone else associated with SAW any amount other than the amounts we are setting forth in our feeder line application. Ms. Wisener was never involved in any conversation PYCO had with SAW, ever. As indicated below, Ms. Wisener's husband (Larry Wisener) demanded that PYCO agree to pay \$5.5 million for some unspecified part of SAW but we did not agree.

3. Ms. Wisener's claims about the feeder line proceeding are wrong. Ms. Wisener also claims that the feeder line proceeding was initiated because of SAW's \$20 surcharge on PYCO. Wisener Reply at 9. Ms. Wisener also seems to claim that SAW service to PYCO was adequate such that the "Feeder Line Remedy" should not be applicable to SAW. Wisener Reply at 10. From 1999 until the time of PYCO's alternative service petition, SAW was run by Mr. Larry Wisener. Mr. Wisener had a consistent reputation for blowing up at people, threatening them with physical and economic retaliation if they did not do what he wanted. Mr. Wisener got into a prolonged dispute with BNSF and, in retrospect, manipulated service to PYCO in an effort to force PYCO into "taking sides" and to punish PYCO if PYCO did not choose SAW's position. PYCO suffered from months of service problems with SAW in the winter of 2004-2005. PYCO complained concerning lack of service to STB's Office of Compliance and Enforcement, which successfully intervened at the time, such that PYCO did not file a feeder line application which it had prepared. Things appeared to be getting better. Then, in May of

2005, Mr. Wisener circulated a request for proposals to sell SAW either in its entirety or in parts. Mr. Wisener subsequently demanded that PYCO sign a letter of intent to buy an undisclosed portion of SAW for \$5.5 million (his price). PYCO asked that the contract include a due diligence clause so we could determine the extent and condition of the property and whether it was worth it. Mr. Wisener essentially blew up at that point and told me in effect that PYCO would have to "take care of itself." Mr. Wisener proceeded to retaliate against PYCO by limiting service to one switch per day, placing derails so we could not reposition cars, causing congestion and then charging us for it, and taking all manner of other actions such that we were running out of storage capacity for our cottonseed oil due to a lack of rail service. I detailed all this previously in my statements filed in the alternative rail use proceeding, Finance Docket 34802. SAW's service to PYCO was inadequate. SAW has similarly threatened economic and physical intimidation against other shippers as the record will demonstrate. The simple fact is that SAW service is inadequate.

4. PYCO did not make any \$5.5 million offer. SAW, through Delilah Wisener, for the first time now claims that PYCO made a verbal \$5.5 million offer for some unknown part of the SAW system. At page 2 of Ms. Wisener's statement, she claims PYCO insisted that its offer be contingent on some kind of waiver of BNSF's right of

first refusal. Again, Ms. Wisener was not present at any discussions and has no notion of what she speaks. As I indicated in part 3 above, Mr. Wisener demanded that PYCO offer \$5.5 million. PYCO refused without due diligence. In retrospect, we now believe that Mr. Wisener's demand for \$5.5 million was a contrived exercise so he could claim in future feeder line proceedings (or in the event BNSF wished to use its right of first refusal) that PYCO had in fact offered \$5.5 million. For Delilah Wisener to assert that we orally did what we refused to do renders suspect everything that she claims. SAW is simply inventing "offers" in a wrongful attempt to inflate its value.

5. The question of 2005 as a base year. Ms. Wisener (Reply Ver. Statement at p. 4) and SAW's expert witness Plaistow (e.g., Reply Verified Statement at 17) profoundly misrepresent PYCO's business when they appear to contend that if the Texas cotton crop fails or is low, PYCO ships in product in order to fulfill contracts and from this position argue (in Plaistow's case) that 2005 is thus a good "base year" for projecting SAW revenue.

PYCO has no long term contracts for input or output that fix volumes. PYCO contracts particular volumes on a year to year basis once we see how the cotton crop is progressing. PYCO is contractually committed to accept a certain percentage of the cottonseed produced by member cotton gins in the Texas cottonbelt. That cottonseed arrives at PYCO by truck. In recent years, PYCO

has also brought in some raw cottonseed oil by tankcar from other mills for further refinement at PYCO facilities. PYCO's "high value" product is refined cottonseed oil.

PYCO devotes sufficient cottonseed to oil production to fulfill its annual contracts with its oil customers. Those contracts themselves are not long term. They are negotiated each year based on the prospective cotton harvest. PYCO cottonseed oil moves out almost exclusively by tankcar and is heavily rail dependent for all such movement.

PYCO's annual minimum volume is approximately 700 to 900 carloads of outbound cottonseed oil. In producing that much oil, PYCO also typically produces 5 to 10 carloads per week of linters (300 to 600 carloads per year). PYCO may also bring in some raw cottonseed oil for further refining: this movement may total 200 or 300 cars. All this movement is rail dependent.

In good weather years, PYCO is supplied a surplus in cottonseed by its member gins, beyond what PYCO needs for oil. In that event, PYCO markets the surplus locally to cattle feeding operations (shipment generally by truck) but a more attractive market is the California dairy industry through PYCO's relationship with Penny-Newman, which movement by rail is imperative. In 2004 and 2005, weather in the Texas cottonbelt was excellent. The large 2004 crop was reflected in large 2005 shipments of cottonseed. The even better 2005 weather was reflected in even larger shipments

in 2006(roughly 4,000 or more carloads of seed). But the weather in 2006 was more typical of 2000-2003. PYCO will have sufficient cottonseed to meet the needs of its oil customers but insufficient cottonseed to supply the California dairy market. This means that PYCO's rail demand in the next season (roughly now through October 2007) will be down roughly 4,000 carloads or more from year 2005 levels. Indeed, PYCO's current projection is that its use of rail for the coming season will drop to year 2000 levels. I attach our current projection as Appendix I (this is marked "highly confidential" because it contains proprietary information of potential value to competitors).

Contrary to the claims of Ms. Wisener (on which Plaistow relies), I can state categorically that PYCO has no long term contracts to ship fixed volumes or quantities of cottonseed or cottonseed oil in or out of Lubbock. PYCO contracts on a year-by-year basis. Our industry is too weather dependent to permit otherwise. Ms. Wisener's claims to the contrary reflect the fact that she does not know what she is talking about.

Ms. Wisener suggests that in poor production years in the Texas cottonbelt, PYCO moves in cottonseed by rail from other areas. She states that in 2002 and 2003, PYCO moved in over 2,500 carloads of cottonseed. D. Wisener at page 4. Unfortunately for Ms. Wisener, SAW's data do not substantiate her claim and data advanced in her own witnesses Reply Verified Statement contradict

her argument.

In his Reply statement, Mr. Plaistow presents a chart (Plaistow Reply at page 12) purportedly based on SAW's data. It does not support Ms. Wisener's claims. Since he relies on those claims for his position that 2005 is an acceptable base year, they have a kind of shell game going. Plaistow shows the following for PYCO, based on SAW data:

PYCO Carloads

Year	Inbound	Outbound
2000	192	1,415
2001	1,653	1,164
2002	594	1,347
2003	483	1,512
2004	393	1,527
2005	309	5,641

Contrary to Ms. Wisener's claims, there is no importation of 2500 carloads of cottonseed (or the sum of all commodities) by PYCO in 2002 or 2003.

Plaistow, incidentally, makes a rather incredible mistake in his testimony. He asserts that crop yield is not linked to rail shipments in Lubbock. His error is that the crop yield in year one is tied to the rail use in year two. Thus, his table at page 12 shows that the high crop yield in 2004 in fact resulted in a huge bump in rail use by PYCO in 2005. The cotton rush begins in October. This means that crops are harvested and begin to reach PYCO in October. PYCO's outbound rail shipments (of oil, linters or seed) start afterward. If crops are poor in 2006, that will be

reflected in 2007, not 2006 SAW carloads. Mr. Plaistow's failure to recognize this fact shows he does not understand agriculture.

Mr. Plaistow at page 12 also remarks on 2001 rail shipments into Lubbock. 2001 was a poor cotton harvest year and PYCO, in order to save money, mothballed its Greenwood, Mississippi cottonseed mill with the idea of concentrating oil production in Lubbock. In that year, PYCO did bring in over 1,000 carloads of cottonseed for processing from member gins in Mississippi and other locations where PYCO then operated receiving facilities. However, PYCO found that rail freight rates were prohibitive and lost money. In response, PYCO sold all its receiving facilities other than Helena (Arkansas); PYCO otherwise now continues to receive only at its oil mills at Greenwood and Lubbock; and PYCO has fewer member gins in Mississippi as well. In sum, 2001 is the only year in the 2000-2005 sequence in which PYCO lost money for its members and PYCO has taken measures such that it will not be repeated. If anything, the episode shows that movement of cottonseed feedstock by rail is price sensitive to PYCO's oil mills in Lubbock. BNSF line haul rates already make such shipments uneconomic; any surcharge by SAW on cottonseed coming into PYCO makes importation of cottonseed to produce oil all the more uneconomic.

Since cottonseed as cattlefeed must compete with many other sources of cattlefeed, any surcharges by SAW make cottonseed shipments to California less competitive as well.

The data set forth by Mr. Plaistow at page 12 of his Reply statement demonstrate how wrong Plaistow is to rely on 2005 as his base year. What the data does show is average PYCO carloads of less than 2,000 carloads per year (when adjusted for the ill fated and not to be repeated one year cottonseed importation into Lubbock by rail) from 2000 through 2004. Plaistow's data shows that 2005 is nearly three times that level. Based on that data, no reasonable analyst could contend that due to contracts or some other kind of magic, the anomalous year 2005 now reflects PYCO's future rail demand. In any event, I do not understand how a PYCO contract to buy or to sell product would translate into rail use on SAW anyway. If the crop is not grown, there is nothing to ship. PYCO certainly has no take or pay contract with either SAW or BNSF. Wisener and her analyst appear to be conjuring something out of nothing or are spouting conclusions based on a total lack of understanding of our operations.

2005 SAW carloadings reflects the surplus in cottonseed moving out of Lubbock due to the exceptionally good weather in 2004 in the Texas cottonbelt. 2006 shipments also have been very high, because 2005 exhibited favorable weather. While the Texas cotton industry relishes good weather, one cannot assume it every year, for it is only reflected once in shipments during the period 2000-2005. As I have said earlier, 2006 will also result in high shipments but 2007 will be back to 2000 levels.

I note that Mr. McFarland for SAW has just filed an incorrect newspaper article claiming that the 2006 cotton crop will be the third largest crop on record. The reporter on that article got it wrong, and the article is unreliable. I attach as Appendix II an article (actually a news station report) indicating that industry experts are disputing the article. The stated projection in Appendix II is 3.3 million bales, which is roughly equivalent to 2002 production levels. I attach in Appendix II the data on production from Plains Cotton Growers from 1928 to 2004. I have handwritten in the PCG figures for 2005.

Non-cotton agricultural shipments in Lubbock per SAW's figures do not show any increase at all over time. The closest approximation for non-cotton agricultural commodities is SAW's customer, Attebury Grain. I reproduce below the Attebury Grain figures from SAW¹:

Attebury Grain Carloads

Year	Inbound	Outbound
2000	140	524
2001	765	108
2002	268	1,263
2003	108	251
2004	0	706
2005	51 ²	590 ³

¹ The chart for 2000 to 2004 is based on information SAW supplied prospective buyers in or around May 2005.

² SAW supplied discovery data for 2005 to PYCO on September 21, 2006, indicating that inbound shipments in Attebury for 2005 totalled 51.

Inbound grain clearly spiked in the same year (2001) PYCO's inbound shipments spiked but outbound volumes appear highly variable and are only 12.5 percent greater in 2005 (590) than in 2000 (524). This does not so much suggest growth as stagnation in shipments. The average outbound shipment over the six-year period is 574, per SAW's own data. Inbound shipments for Attebury average 299 carloads per year over the period. If one adds inbound and outbound shipments, Attebury's overall use of SAW was below average in both 2004 and 2005 (Attebury's average total use is 873 carloads/year but the 2004 total use was only 706 while the 2005 use was only 641). This suggests that Attebury's use of SAW is not measurably increasing and may be decreasing. In fact, grain production and cotton production are related in two ways: (a) Good weather increases per acre yields; bad weather decreases yields. (b) But increases in acreage planted to grain is directly related to cotton crop failures. Cotton is planted in May to early June. If the cotton is ruined by hail storms or lack of moisture (such that it does not germinate), then farmers will plant grains in June and July to replace the cotton. Thus when cotton acreage is down, grain acreage tends to be up.

The long and short of this data is that if there is any expected growth in the use of SAW to ship agricultural products, it is linked to good weather (and its impact on Texas cotton

³ The 2005 data is also based on SAW's September 21 discovery response.

production). Mr. Plaistow errs in assuming that from 2006 onward, Texas will experience nothing but good weather. That assumption is not validated by the past and since 2006 was a bad weather year, he already has essentially been proved wrong in terms of his future prediction.

Even though PYCO's rail use will be way down in the coming year, PYCO remains heavily rail dependent and still seeks to acquire the SAW system. However, PYCO should not be required to pay for the system on the assumption that its use each year will be equivalent to what it was in 2005 and expanding from there. That simply penalizes PYCO's farmer-owners and unfairly enriches the owners of SAW for providing inadequate rail service.

6. Plaistow's misrepresentation of the rail needs of the Texas cotton industry. Plaistow makes a number of mistakes which I already have discussed; I will focus on two more here. First, he seems to rely on national average data for cotton production to support his argument that it fluctuates little from year to year. That may be true but it is irrelevant to what happens in a specific growing region. The United States is a large country. Bad weather in one growing area for a crop is likely to be balanced by good weather in another growing area in a large country, such that the national average shows relative stability. But within a particular area, there can be great variability in weather from year to year, such that crop yields vary much more greatly than on a national

average. Since data exist for the Lubbock area, this data should be used, not the national average. Put another way, the logic of Plaistow's argument would suggest he use a Lubbock average for cotton production, and not Lubbock's best recorded year.

Plaistow (Reply at 13) also remarks on the stability of cottonseed crushings. Certainly PYCO devotes its cottonseed first to oil production and only any surplus to seed. But PYCO also generally produces only 700 to 1000 tankcars of cottonseed oil in Lubbock per year. PYCO sells any left-over cottonseed as cattlefeed. Thus PYCO production of cottonseed oil tends to be stable and its demand for rail oil tankcars relatively stable. What is unstable is PYCO's demand for rail transport of cottonseed. In good years, PYCO ships seed to California to the dairy industry and PYCO's overall reliance on rail transport is thus closely associated with crop yield (in the cottonbelt in Texas) in the prior year.

Plaistow (e.g., page 13) seems to intimate that the Texas cottonbelt is responsible some huge percentage of U.S. production. This is not correct. The Texas cottonbelt served by PYCO's Lubbock facilities encompasses less than 30 percent of overall U.S. production.

7. Contrary to SAW/Pioneer, PYCO's position on rehabilitation and going concern value is logical. One of the confusing aspects of both the SAW and Pioneer positions is that they both critique

PYCO for claiming that SAW has a negative going concern value because of the costs to fix it up. They imply it is irrational for PYCO to buy an asset with negative going concern value. But the feeder line statute as PYCO understands it is supposed to be for lines whose owners are allowing them to deteriorate in favor of short term profits. What SAW and Pioneer see as irrational is evidence instead that they intend to let the lines further deteriorate until shippers cannot be served at all. This in turn is evidence that neither one can or will adequately serve shippers on the line because they both intend to let the physical plant continue to decay indefinitely.

PYCO is a captive shipper. PYCO's alternative to use of rail is to move or to shut down. For PYCO, acquisition of the rail system becomes a cost of doing business. PYCO is not looking at the SAW lines as a profit center. Nor does PYCO need to draw money from rail operations in order to pay interest on a bank loan for acquisition or to pay off the principal of the loan. To the contrary, PYCO intends to plow all rail revenue from the lines in excess of operating costs (and a reasonable return to PYCO's contract rail operator) into rail line rehabilitation and repair until the lines are restored. No one has disputed the fact that the SAW lines were on a deferred maintenance basis prior to SAW's acquisition and that SAW has continued to defer maintenance since. WTL at one point told PYCO that portions of the SAW line are in

such poor condition that the owner should consider an embargo. In response, PYCO requested an FRA inspection but FRA said the track was in excepted status such that essentially no minimum requirements applied and nothing could be done. WTL has incurred over \$20,000 in repair costs due to derailments, and informs us that it must operate in an inefficient manner due to poor track conditions. Staff at R.L. Banks & Associates, Inc. (RLBA) also inspected the track and consistent with WTL's reports, recommend rehabilitation of the portions of the system sustaining the most use. RLBA also has suggested a number of switch and lead modifications which will likely improve service and reduce congestion on (or competition for use of) the BNSF mainline to switch traffic to ease BNSF concerns about congested operations. PYCO intends to undertake at least some of those improvements if BNSF is agreeable. In contrast, SAW's primary relationship with BNSF appears to be to litigate against BNSF. Pioneer is at least as bad. Pioneer would rely on a bank loan to acquire the lines, and any revenue over operating costs achieved by KJRY would go to Pioneer to pay loan interest and balance, or to cover Pioneer overheads. Pioneer denies any need to undertake major track structure maintenance because it has neither the money nor the intent to undertake such a program, not because such a program is unneeded.

8. PYCO is likely to improve service to shippers; Pioneer is

not. PYCO has signed a letter of intent with WTL for WTL to operate the SAW lines in the event PYCO is authorized to acquire them. WTL already operates in Lubbock and has provided excellent service to PYCO under the alternative service order. BNSF has repeatedly informed PYCO that WTL's involvement has relieved congestion at the BNSF Lubbock yard and mainline. Many SAW customers are also WTL customers. WTL has demonstrated it can improve service to SAW's customers and it certainly has done so for PYCO.

KJRY is unlikely to improve service over what shippers are receiving from SAW. KJRY's acquisition will be based on a highly leveraged bank loan. Any "profit" will be paid to the bank or apparently to Pioneer for overhead. Nothing will be left to address the sorry state of the lines, which Pioneer/KJRY acknowledge when they discuss net liquidation value in their feeder line filing, but then otherwise ignore. Pioneer has a reputation for being litigious, similar to the reputation of Mr. Wisener and SAW, but on a broader scale. Litigation will increase Pioneer's overhead costs (as it has SAW's). Certainly all this bodes ill for shippers because it means that Pioneer's relationship (like SAW's) with both BNSF and SAW shippers is likely to be hostile. Because Pioneer/KJRY's purchase is so highly leveraged and because rail traffic is heading downward in the coming year, Pioneer/KJRY is likely to seek surcharges at the same time it allows service to

deteriorate.

Although they deny it to the STB, Pioneer's management told PYCO that they were invited into this proceeding by SAW. (This is consistent with Mr. Wisener's approach of trying to solicit something he thinks he can represent as an "offer" in his effort to run up the value of SAW in connection with either feeder line application proceedings or BNSF's right of first refusal.) Pioneer/KJRY to date have spent most of their energy in this feeder line proceeding attacking PYCO, and in private communications, attacking directly or indirectly PYCO's management and legal counsel. This is not a very sensible way for a responsible carrier to introduce itself to a prospective customer, unless it intends to abuse the customer and thinks the customer so captive that it can do nothing about it.

PYCO has supported an expeditious feeder line proceeding so that it is not dependent on SAW when the alternative service authorization expires (according to the Board, the alternative service order expires on or about November 22, 2006). Although Pioneer/KJRY now acknowledges that SAW service is inadequate, Pioneer/KJRY repeatedly has taken actions to delay this proceeding, even in the face of PYCO's need for a prompt result to avoid retaliation from SAW. If their conduct in this proceeding is a guide to their regard for shippers, then Pioneer/KJRY will be no better than SAW, and quite likely worse, because SAW had no debt to

pay off, whereas Pioneer will.

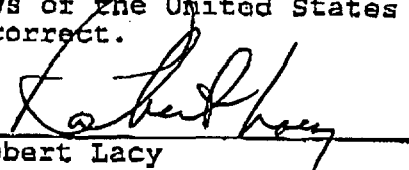
12/24/2000 17:03 FAX 208 546 3739

CHARLES MONTANBE

002/002

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 the foregoing is true and correct.

Executed on October 18, 2006


Robert Lacy

Appendix I
to
Lacy Rebuttal Declaration

due: 19 Oct. 06
F.D. 34890

HIGHLY CONFIDENTIAL

PROTECTIVE ORDER APPLICABLE

Appendix II
to
Lacy Rebuttal Declaration

c.montange

From: "Robert Lacy" <rlacy@pycoindustries.com>
To: "c.montange" <c.montange@verizon.net>
Sent: Wednesday, October 18, 2006 5:42 AM
Attach: SCAN2351_000.pdf
Subject: Article & production #'s

This article is from a Plains Cotton Growers VP and disputes the article that was sent to the STB by McFarland. These guys are the experts in the West Texas cotton industry and are the ones that produce the production numbers that are also included in this email.

Robert

10/18/2006

[<<Back](#)



10/16/06

Local Cotton Experts Dispute USDA Report

Some local farmers are disputing a USDA report that estimated the hi-plains was on track to produce the third largest cotton crop on record, 3.8 million bales.



Roger Haldenby, Vice President of Plains Cotton Growers, says "I do believe it's misleading to look at this crop production estimate, and forecast that we're going to have the third largest crop in history, and make the interpretation that that's a good thing. The cost of production of the 2006 crop, even for those producers making a good crop, their cost of production probably exceeds the revenue that they're going to get from it so it could have a very negative effect on all of our economies."

Plains Cotton Growers Vice President Roger Haldenby says they instead expect to produce up to 3.3 million bales which would not be horrible considering most dry land cotton was lost because of drought. He says what farmers need right now is a dry October and November to get the cotton out of the ground.

Look Up the Latest Rain Totals for the South Plains



Look up daily National Weather Service recorded rain totals for each county on the South Plains.



All content © Copyright 2000 - 2006 WorldNow and KCBD, a Raycom Media Station.
All Rights Reserved. For more information on this site, please read our [Privacy Policy](#) and [Terms of Service](#).



Plains Cotton Growers, Inc.

PCG Email What's News? Cotton News
 Technical Issues Boll Weevil Cotton Improvement
 Home About PCG Who's Who? Facts & Stats

High Plains Cotton Production 1928-Present

1928-30 - 1940's - 1950's - 1960's - 1970's - 1980's - 1990's - 2000's

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1928	18	1,666,500	1,599,840	100.8	335,820				
1929	18	1,719,500	1,650,720	108.0	371,390				
1930	18	1,886,200	1,618,752	85.7	289,000				
1931	20	1,616,600	1,551,936	185.5	599,730				
1932	22	1,744,850	1,675,056	183.0	638,500	132.5	446,888		
1933	10	1,830,700	1,757,472	142.5	521,920	140.8	484,108		
1934	21	1,090,080	1,046,486	45.2	98,560	134.8	429,542		
1935	22	1,295,500	1,243,680	144.7	374,910	147.4	446,724		
1936	22	1,708,200	1,637,952	122.7	418,770	133.9	410,532		
1937	22	2,141,800	2,056,128	266.5	1,141,570	158.5	511,146	145.2	479,017
1938	22	1,492,200	1,432,612	158.3	472,450	162.2	501,252	150.9	492,660
1939	22	1,343,000	1,289,280	159.3	427,840	177.7	567,108	156.2	496,325

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1940	22	1,486,800	1,427,328	161.4	479,820	180.0	588,090	164.3	517,407
1941	25	1,424,100	1,359,050	232.2	657,608	201.7	635,838	168.3	523,185
1942	25	1,547,100	1,441,700	232.9	699,393	189.0	547,402	172.9	529,274
1943	24	1,467,800	1,443,100	193.7	582,405	188.3	569,393	178.7	535,323
1944	25	1,323,210	1,291,180	234.6	631,041	210.3	610,033	193.2	588,571
1945	24	543,000	520,225	128.9	139,883	214.0	542,006	195.1	565,048
1946	25	835,800	767,080	154.9	247,547	202.1	460,014	201.9	547,926
1947	25	2,369,650	2,344,230	227.2	1,109,430	204.3	542,021	186.4	544,712
1948	25	2,357,450	2,287,870	149.1	710,480	188.9	567,636	182.6	568,515
1949	24	3,205,500	3,174,600	284.1	1,945,200	219.2	830,468	215.3	720,251

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1950	24	1,908,830	1,787,880	230.5	858,480	225.7	974,227	221.7	758,117
1951	25	3,565,300	3,344,600	193.9	1,351,220	221.6	1,194,962	215.8	827,488
1952	25	3,902,500	3,633,700	200.1	1,515,160	215.2	1,276,108	211.9	909,065
1953	25	2,543,200	2,208,500	302.7	1,392,850	239.8	1,412,502	222.5	990,109
1954	25	2,529,600	2,420,300	329.0	1,659,100	242.8	1,355,362	233.3	1,092,915
1955	25	2,343,400	2,214,100	315.1	1,453,650	258.0	1,474,396	243.0	1,224,312
1956	25	2,292,000	2,090,700	394.2	1,716,950	296.5	1,547,542	258.1	1,371,252
1957	25	2,276,500	2,174,100	357.7	1,620,200	338.9	1,588,550	269.5	1,422,329
1958	25	2,309,400	2,186,000	458.7	2,088,950	389.7	1,707,770	298.8	1,580,176
1959	25	2,439,500	2,243,900	418.0	1,844,650	388.3	1,764,880	308.1	1,560,121

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1960	25	2,430,200	2,249,700	430.7	2,018,800	411.8	1,877,910	324.9	1,676,153

1961	25	2,593,440	2,416,000	485.5	2,443,900	430.9	2,023,300	359.5	1,785,421
1962	25	2,525,900	2,374,900	479.0	2,389,850	454.7	2,173,230	397.7	1,870,890
1963	25	2,343,100	2,178,300	474.7	2,154,350	457.8	2,186,310	414.5	1,947,040
1964	25	2,408,000	2,094,500	447.5	1,952,660	464.1	2,187,912	426.9	1,976,386
1965	25	2,273,300	2,149,200	513.9	2,301,100	480.4	2,244,372	446.5	2,081,141
1966	25	1,544,400	1,456,300	450.8	1,387,600	475.0	2,029,112	451.9	2,026,206
1967	25	1,450,600	1,249,100	475.0	1,236,020	473.9	1,802,346	463.2	1,987,788
1968	25	1,749,450	1,608,400	496.1	1,662,300	477.9	1,703,936	466.4	1,945,123
1969	25	2,173,950	1,947,700	349.6	1,418,600	455.7	1,597,124	460.6	1,882,518

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1970	25	2,277,200	2,174,700	380.0	1,721,750	421.4	1,481,254	455.1	1,862,813
1971	25	2,499,700	2,322,400	284.4	1,279,150	377.8	1,463,564	428.6	1,746,338
1972	25	2,657,800	2,356,400	456.9	2,242,850	383.9	1,664,930	425.9	1,733,638
1973	25	2,825,050	2,784,000	498.1	2,888,700	395.7	1,910,210	430.6	1,807,073
1974	25	2,626,100	2,173,000	263.5	1,193,100	379.0	1,866,110	410.9	1,731,117
1975	25	2,712,600	2,444,750	278.8	1,420,200	358.6	1,804,800	384.4	1,643,027
1976	25	2,786,300	2,609,100	365.5	1,986,500	377.7	1,946,270	377.7	1,704,917
1977	25	3,749,600	3,638,000	424.1	3,215,400	376.4	2,140,780	378.6	1,902,855
1978	25	4,043,000	3,584,300	274.4	2,049,100	327.7	1,972,660	358.0	1,941,536
1979	25	4,565,800	3,789,250	348.5	2,750,800	341.2	2,284,400	357.2	2,074,756

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1980	25	4,627,000	4,002,000	246.2	2,053,000	328.3	2,410,960	340.8	2,107,880
1981	25	4,644,900	4,473,500	377.9	3,522,000	334.7	2,718,060	351.4	2,332,165
1982	25	3,685,700	2,380,900	269.2	1,285,600	307.0	2,332,100	336.7	2,236,440
1983	25	2,486,800	2,115,500	305.5	1,346,450	313.8	2,191,570	320.2	2,082,215
1984	25	3,349,400	3,102,600	359.6	2,324,250	314.5	2,106,260	327.9	2,195,330
1985	25	3,051,800	2,781,900	326.8	1,893,650	335.2	2,074,430	331.5	2,242,695
1986	25	2,982,700	1,878,800	302.5	1,184,200	314.8	1,606,870	328.9	2,162,465
1987	25	2,819,800	2,599,000	482.8	2,668,550	362.3	1,883,460	329.5	2,107,780
1988	25	3,227,000	3,119,200	497.8	3,234,700	402.5	2,261,110	353.4	2,226,340
1989	25	2,812,700	2,120,100	364.1	1,608,200	406.7	2,117,900	354.8	2,112,080

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
1990	25	3,183,700	2,775,100	510.4	2,950,900	447.5	2,329,310	386.5	2,201,870
1991	25	3,481,900	2,922,800	382.3	2,327,700	453.5	2,550,010	387.5	2,082,440
1992	25	3,201,800	1,496,400	455.0	1,418,600	445.5	2,308,020	403.8	2,095,740
1993	25	3,243,100	2,992,200	554.9	3,468,800	458.8	2,352,840	429.4	2,308,975
1994	25	3,219,800	3,035,000	485.1	3,087,200	480.1	2,644,640	444.4	2,381,270
1995	25	3,621,800	3,274,800	385.4	2,629,300	451.3	2,580,320	449.5	2,454,815
1996	25	3,457,400	2,497,200	591.4	3,076,900	492.8	2,730,160	473.0	2,644,085
1997	25	3,543,500	3,302,600	498.4	3,415,600	497.3	3,129,540	473.9	2,718,780
1998	25	3,607,200	2,095,700	582.6	2,587,400	499.3	2,955,260	480.5	2,654,050
1999	25	3,828,300	3,072,800	469.9	3,008,400	496.0	2,943,500	488.3	2,794,070

Crop Year	No. Counties	Acreage Planted	Acreage Harvested	Production Yield/H.A.	Production Bales**	5-yr Average Yield/H.A.*	5-yr Average Bales	10-yr Average Yield/H.A.	10-yr Average Bales
2000	25	3,875,800	2,837,100	389.8	2,302,800	500.4	2,678,200	475.9	2,729,260
2001	25	3,681,800	2,421,100	494.2	2,492,700	482.7	2,761,360	487.7	2,745,760
2002	25	3,582,200	2,825,900	551.3	3,245,600	493.9	2,727,380	495.7	2,928,460
2003	25	3,625,000	2,395,900	436.8	2,180,300	488.6	2,645,960	484.3	2,800,610
2004	41	3,677,000	3,273,400	715.0	4,877,800	527.0	3,019,800	511.2	2,918,650
2005	41	3,703,000	3,425,000	795.0	5,677,000				

Exhibit C

**Before The Surface Transportation Board
STB Finance Docket No. 34890
PYCO Industries, Inc., et al. – Feeder Line Application --
Lines of South Plains Switching, Ltd. Co.**

**Rebuttal Verified Statement
of
Charles H. Banks**

October 18, 2006

Before The Surface Transportation Board
STB Finance Docket No. 34890
PYCO Industries, Inc., et al. – Feeder Line Application --
Lines of South Plains Switching

Rebuttal Verified Statement
of
Charles H. Banks

Qualifications

I am the same Charles H. Banks, a consultant and President of the firm, R.L. Banks & Associates, Inc. (RLBA) who filed a previous Verified Statement on May 3, 2006 in connection with Docket 34844, a Revised Verified Statement on August 11, 2006, a Verified Statement (Based on Discovery) on September 28, 2006 and a Verified Statement Based on an Expanded Competing Feeder Line Application on October 11, 2006 in this proceeding. My qualifications were detailed in Exhibit A of the original statement. I appear in this proceeding on behalf of PYCO Industries, Inc. (PYCO).

Scope of Testimony

I continue to disagree with the evidence submitted by Witness Plaistow on behalf of SAW in many respects and, in fact, continue to stand by the going concern valuations which I advanced in my September 28, 2006 Verified Statement.

Contrary to the claim of Witness Plaistow at page three of his Reply Verified Statement, I never "admitted" that URCS "should not be used in this context." In fact, I believe it provides a better indication of the "value to the seller" than the full cost approach that Witness Plaistow has employed throughout the subject proceedings insofar as it

captures only the variable costs incurred by the incumbent carrier and, incidentally, maximizes going concern valuation as compared with the full costs approach Witness Plaistow adopted. I adopted Mr. Plaistow's full cost and, incidentally, revenue numbers primarily because I was so confident of my client's position that I set out to prove PYCO's case using to the fullest extent possible the numbers advanced by the opposition. I knew I could hang Witness Plaistow by his own petard and I sought to minimize the number of differences between the parties so as to minimize the burden on the STB to get to the bottom of the facts.

As to the issue of surcharges, addressed by Witness Plaistow beginning at page six of his Verified Statement, I do not find his arguments persuasive in the least. To the contrary, I concur entirely with the argument advanced by BNSF's Witness Hale.

Similarly, as to the issue of Burris, Texas revenues associated with traffic generated by Jarvis Metals, addressed by Witness Plaistow on page nine of his Verified Statement, I do not find his arguments persuasive in the least again. To the contrary, I am persuaded by Mr. Hale's argument that revenues generated in connection with the Burris traffic cannot be relied upon as an indicator of SAW's cash generating capability, as manifest in a going concern value. According to Witness Plaistow's Exhibits 51 and 63, revenues associated with Burris traffic amounted to \$46,875 in 2005, which equate to a net present value of approximately \$315,000.

With respect to Witness Plaistow's argument that PYCO is inextricably contractually linked to cotton production, I have reviewed and concur in the statements advanced by Robert Lacy and wish to note that PYCO is owned by the farmers which supply it. Surely there would be no rationale for them to act other than in concert with partner, PYCO.

I also dispute the argument advanced by Witness Plaistow on page 12 that I advanced a "hypothesis that the crop yield in the Lubbock area is the sole determining factor in the

shipment of agricultural commodities or even of cotton products on SAW." I said no such thing.

With respect to Witness Plaistow's critique on page 16 that I applied a downward adjustment to two-thirds of the traffic, as a surrogate for agricultural business, perhaps he has forgotten that he applied his cotton index to two-thirds of SAW's traffic, a fraction I merely adopted. So, if he has a problem with that fraction, he should resolve it with himself and then the rest of us know the outcome of the struggle.

Now to the most egregious of Witness Plaistow's errors. Witness Plaistow's approach to arguing in favor of unsupportable and outrageous assumptions can best be characterized as "[I]f at first he doesn't succeed, try, try again." One has to wonder why such an experienced railroad consultant would try so hard to resurrect his client's case by arguing again and again for the substitution of national data for local data obviously more germane to the going concern value of the SAW enterprise. I can only conclude that he continues to claw away against insurmountable evidentiary odds because he recognizes (because he constructed) going concern valuations are driven more than any other factors by two elements: 1) a terminal value construct which places a huge amount of the value of the SAW franchise on cash flows supposedly generated in the out-years of the model and 2) the traffic base year.

With respect to the terminal value, it is obviously ridiculous to place such a high percentage of the value on estimated cash flows supposedly generated in the out-years. No reasonable and knowledgeable analyst would argue that the franchise which SAW operates is anything other than a mature business. One would, therefore, not expect that so much of the supposed value of the enterprise would be realized so far into the future. I recognize that part of the SAW's litigation strategy has been to argue that my valuations are not forward looking but SAW could not look forward with any certainty to earning the kind of contributions to its supposed net present value that are reflected in Witness Plaistow's perpetual income stream generator machine.

One of the many building blocks of Witness Plaistow's magic valuation machine is his use of the railroad industry's cost of capital. The cost reflects the weighted average cost of capital derived in connection with Class 1 railroads, including a reflection of the risk that the capital markets place on the enterprises that comprise the Class 1 railroad industry. No reasonable and knowledgeable analyst would assume that the SAW property provides the same risk profile to investors as do the Class 1's. The appropriate, higher risk premium to attach to the SAW property, whatever it is, would have the effect of increasing the discount rate and decreasing the going concern values that all parties have calculated. In work that my firm has hired to do in conjunction with private sector providers of acquisition and rehabilitation capital, we have either suggested or been directed to employ risk premiums between three and six percent above and beyond the railroad industry cost of capital when evaluating the going concern values of short line and regional railroads. It seems to me that a risk premium at least in that range would be appropriate to the SAW franchise. After all, unlike Class 1 railroads, the cash flow generation capabilities of the SAW franchise could be devastated and the company could fail in the event that there were a significant decline in rail use by either of SAW's predominant traffic generators, namely PYCO and/or rock distributors. Perhaps this helps to explain why SAW does not have access to the public financial markets.

Equally unsupportable is Witness Plaistow's adherence to employing a high traffic base year, in conjunction with a traffic forecast that is unrealistically high and, therefore, in combination, yield unrealistically high going concern valuation "conclusions." Essentially, Witness Plaistow employs 2005 SAW carloadings, which reflect the movement of two bumper crop years, as his baseline and attempts to show how reasonable he has been by reducing his agricultural product revenues in all forecast years by using a forecast of national cotton production which shows approximately a ten percent reduction from his base year in each forecast year.

I take two exceptions to his approach. First of all, any experienced analyst would be leery of the fact that the crop year which is driving Witness Plaistow's SAW traffic "base"

stands in such contrast to the otherwise extremely consistent forecast year production totals. More important, though, is the implication of his continued dependence on and allegiance to a national forecast. He argues that the STB would rather rely on an independent forecast than on case-driven forecasts or historical facts, all else equal. But all else is not equal and I am confident that faced with a choice, STB staff will exercise its discretionary thinking in this respect and choose the approach I advocate below, consistent with but at slight variance from that which I have advocated in my two previous Verified Statements in this matter.

I want to focus on two elements which affect the agricultural carloadings underlying the forecasted SAW revenues which drive up Witness Plaistow's going concern magic values. The first is the need to make an appropriate adjustment from historical SAW 2005 carloadings to account for the drop off that Witness Plaistow and I expect to occur in future years. We agree on the drop, just not the amount (percentage) of the adjustment necessary to reflect the drop. Mr. Plaistow continues to insist that the use of a national index to adjust SAW carloadings in future years is based on his insulting assumption that the STB will be so fixated on his use of a forecast that it will blindly follow him down the primrose path to magical valuations. He is sadly mistaken. I would gladly agree with his use of the national cotton forecast were the issue at hand to adjust national carloads of cotton-related products into the future based on historical national carloads of cotton-related products. But the subject case has nothing to do with national cotton product carloads.

In Exhibit 78 to his Reply Verified Statement of October 12, Mr. Plaistow provides a forecast of upland cotton production covering the crop years 2004/05 through 2015/16. Reading across the line labeled "Production," the number of bales, in thousands, drops from a high of 22,505 in crop year 2004/05 and 22,517 in crop years 2005/06 to an incredibly consistent and tight range of between 20,400 and 20,800 in every remaining year of the forecast. Now the less than ten percent drop between the highest crop years in the forecast, 2005/06 and the following crop years, 2006/07 may seem like a reasonable assumption as to the nation as a whole but that is not at issue in this case.

One would expect national cotton crop production to fall off its bumper crop year production totals in 2006/07 and it has. One would also expect that the inclusion of all the upland cotton crop across the country would result in a smoothing out of great variations across the country and within regions and, again, one would not be disappointed.

A perusal of my Table -1 (Rebuttal) should throw Witness Plaistow's dreams into the waste paper basket permanently. It is a scanned reproduction of a web page available to members of the National Cottonseed Products Association (NCPA), to which PYCO belongs although a truncated version of it, excluding the forecast year is available at the website indicated. The member's version shows that total cotton production across the entire country, seen at the bottom of the table, is forecast to drop 13.5 percent in the crop year coming to an end this autumn from the volume produced in the previous crop year, a percent which roughly parallels the approximately 9.5 percent decline advanced in Witness Plaistow's Exhibit 78. However, the same forecast shows that the decline in this crop year's production in Texas is expected to be 35.6 percent, almost three times as much. The huge variance between the national and Texas forecast numbers and, for that matter, historical production values, proves the fallacy underlying Witness Plaistow's so-called forecast. Cotton production and, in fact, the production of most crops, purposely has been spread around the country, conditions permitting, so that adverse weather and other factors do not have a devastating impact on the national production. That is precisely why the application of a national index, such as the one Witness Plaistow advocates is so inappropriate in the instant case. I submit that that forecast I advance in Table 1 (Rebuttal) is far more germane to the development of a base traffic forecast year on which to build going concern valuations of the SAW franchise than the national forecast Witness Plaistow advocates.

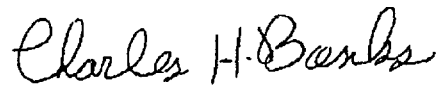
So to summarize, I believe my cotton crop forecast and the going concern values derived therefrom are superior to the similar evidence offered by Witness Plaistow for two primary reasons. First, I adjust the bumper crop in my adopted base year to reflect the anomaly in production in the Lubbock area, as opposed to the anomalies of the

recent cotton crop production in Texas or the nation as whole. Second, I increased the amount of cotton I assumed would be handled by SAW in the out-years by 3.3 percent each year, based on the historical growth rate in the Lubbock area. That growth rate is superior to the stagnant production of cotton nationwide. I believe it is more appropriate to use local circumstances than national forecasts as I believe I have proven beyond the shadow of a doubt that there is little or no correlation between national and Lubbock area cotton production.

Under 28 USC 1746, the following language converts any statement into a verified statement, equivalent to a statement made under oath, and evidentiary in all federal agency proceedings otherwise requiring affidavits or other verification:

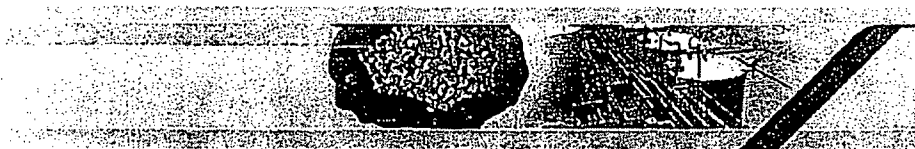
"Pursuant to 28 U.S.C. 1746, I declare and verify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on: October 18, 2006



[signature]

Table 1 (Rebuttal)



► Members Only

MEMBERS ONLY
 ABOUT NCPA
 CONTACT US
 WHAT'S NEW
 SUPPLIERS
 MEMBER SITES
 PUBLICATIONS
 TECH RESOURCES
 CONVENTION
 CALENDAR
 LINKS
 EN ESPAÑOL
 HOME

[Cottonseed Statistics](#) | [Current Newsletter](#) | [Mexico Consultants Reports](#) |

[Regulatory Affairs](#) | [Convention Reports](#) | [Press Releases](#) |

[Member News & Updates](#) | [Newsletter Archives](#)

October 2006 Forecast U.S. Cotton Production
 (All Cotton - 1,000 bales)

	Actual 2004-05	Actual 2005-06	Est. 2006-07	% Change vs 05/06	% Change vs 04/05
AL	814	848	525	-38.1%	-35.5%
FL	109	135	125	-7.4%	14.7%
GA	1,797	2,140	1,700	-20.6%	-5.4%
NC	1,380	1,437	1,500	4.4%	10.3%
SC	390	410	435	6.1%	11.5%
VA	181	183	178	-2.7%	10.6%
Southeast	4,631	5,153	4,463	-13.4%	-3.6%
AR	2,089	2,202	2,600	18.1%	24.5%
LA	885	1,098	1,250	13.8%	41.2%
MS	2,346	2,147	2,100	-2.2%	-10.5%
MO	830	864	1,030	19.2%	24.1%
TN	984	1,122	1,250	11.4%	27.0%
Mid-South	7,134	7,433	8,230	10.7%	15.4%
KS	70.7	88	120	36.8%	69.7%
OK	303	358	210	-41.3%	-30.7%
TX	7,778	8,484	5,460	-35.6%	-29.8%
Southwest	8,152	8,930	5,790	-35.2%	-29.0%
AZ	729	622	593	-4.7%	-18.7%
CA	2,473	1,623	1,460	-10.0%	-41.0%
NM	132	130	123	-5.4%	-8.8%
West	3,334	2,375	2,176	-8.4%	-34.7%
U.S.	23,251	23,891	20,659	-13.5%	-11.1%

*

*

Exhibit D

BEFORE THE
SURFACE TRANSPORTATION BOARD

PYCO INDUSTRIES, INC. --	)	
FEEDER LINE DEVELOPMENT --	)	F.D. 34890
SOUTH PLAINS SWITCHING LTD.	)	and related case
	)	F.D. 34992

Declaration of Stephen Gregory

I, Stephen Gregory, make the following Declaration in support of PYCO's rebuttal of comments made by Keokuk Junction Railway (KJRY) and in support of the feeder line application filed by PYCO Industries, Inc.

1. I am the Vice President - Marketing for West Texas & Lubbock Railway (WTL). Pursuant to orders of the Surface Transportation Board in Finance Docket 34802, WTL provides rail service to PYCO over the lines of SAW in Lubbock, Texas. WTL has signed a letter of intent with PYCO to operate the SAW lines should PYCO be authorized to acquire the lines pursuant to Finance Docket 34890. PYCO and WTL anticipate that PYCO would acquire the lines at PYCO's own cost, and that WTL would operate the lines on behalf of PYCO in accordance with the existing SAW/BNSF contract, but using WTL's customer-oriented policies and operational efficiencies to ensure improved service to all shippers and BNSF. WTL would not impose surcharges but draw revenue from a revenue-sharing formula as set forth in the existing SAW/BNSF contract unless that formula were modified by mutual consent. WTL's own demurrage policies are

shortline industry standards and WTL would not impose excessive and discriminatory charges upon its shippers. Pursuant to PYCO's and WTL's understanding, WTL would devote the revenues which it receives under the BNSF/SAW contract to covering its costs and a reasonable return on its investment, with the excess being devoted to long overdue track maintenance and rehabilitation. This would be supplemented by grant and loan applications for rehabilitation assistance as further discussed below.

2. WTL is part of Permian Basin Railways, which is the rail operating unit of Iowa Pacific Holdings, which operates over 500 miles of track with four railroads in four states. The safety record of WTL and Permian Basin Railways as a whole is at least as good as the safety record claimed on behalf of KJRY in Finance Docket 34992. (WTL has had one minor lost-time injury since it was acquired in 2002.) The overall experience level of WTL and Permian Basin Railways is at least as good as that claimed on behalf of KJRY and its parent Pioneer in Finance Docket 34992. But in contrast to KJRY, WTL has a series of significant advantages that make it uniquely equipped, motivated, and ready to provide service to SAW's current customers superior to the service provided by SAW.

In addition, Iowa Pacific Holdings, Permian Basin, and WTL places great emphasis on marketing and business development in order to expand and to improve service.

3. Whereas neither KJRY or its affiliated companies has any

rail operations in Texas, WTL has operated in Lubbock for over four years and is familiar with the fundamentals of the local economy. WTL has committed resources to market research and other business development techniques that have contributed to an increase of 23% in carload volume and 6 new customers (excluding any PYCO-related traffic) since 2002 on our Lubbock lines. WTL maintains an active business development program which has contributed to the development of an ethanol facility (now under construction) and the initial planning for a new container facility at Reese Technology Center. As exhibited by our sister company, Arizona Eastern Railway, which is engaging (with STB authorization) in construction of a new ten-mile branch to serve a copper mine and related facilities to better serve Phelps Dodge Corporation, Permian Basin Railways does not buy feeder lines to maintain the status quo but instead to grow them, to rehabilitate them, and to improve them.

4. When this Board authorized alternative rail service to PYCO last January, WTL was uniquely positioned to provide efficient and cost-effective rail service, because we had equipment and crew in place already. This kind of "synergy" -- an overused term but one that applies here -- would be available to all current customers on SAW's lines. The synergy goes beyond our merely being located nearby and familiar with the local economy. We actually have facilities in place which offer service improvements. For

example, as part of a major line relocation completed in early 2002, WTL customers benefit from a modern 150-car classification yard and transload facility. WTL has used this yard to temporarily store surplus cars for PYCO and if we become operator on the SAW lines, we would make this facility available to all SAW customers. But in addition to the expanded track facilities which we bring to the table, we can offer other economies of scale. Due to our existing presence in the Lubbock terminal, the additional traffic that we would handle from SAW's other customers would suggest the strong likelihood of increased interchange frequency. This would benefit all current WTL and SAW customers, and improve the fluidity of BNSF Lubbock operations generally. This is a benefit no other feeder line applicant can offer, for none have facilities or operations in Lubbock.

5. WTL has an excellent working relationship with BNSF, and indeed with all our Class I connections. In contrast to both SAW and Pioneer, neither WTL nor any Iowa Pacific Holdings/Permian Basin railroad has been involved in litigation or formal disputes with its Class I connections. We concentrate on service, not litigation. Our successful relationship with BNSF is exhibited in the record of Finance Docket 34802. In order to obviate congestion and to improve service under the alternative service order, WTL has taken a number of steps which illustrate in concrete terms how we in fact have improved service over that experienced under SAW.

(a) WTL initiated a toll-free daily conference call at WTL expense, consistent with this Board's orders, open to SAW, PYCO, and BNSF. That call has been conducted consistently since February. SAW has never participated, but the communication has markedly assisted in service and the alleviation of congestion in the BNSF yard. In order to relieve congestion and facilitate service, WTL has switched not only PYCO traffic but has also moved all SAW cars from the BNSF yard to the SAW yard. Through October 15, WTL handled almost 9200 loaded and empty car movements for PYCO, and another 1700 carloads in haulage service from BNSF to SAW. There was no interruption of service other than those resulting from track defects. WTL has provided service not only during the normal five-day workweek, but also usually at least one weekend day and sometimes two. This is more frequent service than SAW at no additional cost to shippers, and it has contributed to reduced congestion, improved velocity, and better utilization of freight equipment, as acknowledged by BNSF in filings in Finance Docket 34802.

(b) Our experience with PYCO offers another important illustration of improved service, flowing from our approach to cooperative service design. Since there was little time available at the start-up of alternative service and the SAW operating environment was hostile, the adopted operating protocol basically reflected the operational status quo of how SAW had provided

service. However, after some experience on site, WTL determined with BNSF that a different schedule for service to PYCO would reduce congestion as well as interference with other BNSF traffic.

We worked out a new schedule satisfactory to PYCO which improved service for both BNSF and PYCO. We expect to be able to further improve service and minimize congestion on the BNSF mainline and Lubbock yard if PYCO is successful in its feeder line application.

While it is premature to meet with SAW customers at this time, we would do so immediately upon the granting of PYCO's feeder line application so that we could evaluate their current service, determine the most cost-effective and efficient improvements, and work out the best way to integrate the customer requirements with BNSF.

6. PYCO's feeder line application offers an enormous advantage over the application of KJRY in another important respect. PYCO, as a captive shipper, views acquisition of the SAW system as a cost of doing business. In other words, PYCO plans to subsidize the acquisition of the SAW system. PYCO will not look to other shippers to pay for this acquisition directly or indirectly (through a draw on the existing revenue stream or through surcharges). This means that shippers will not face the potential for rate hikes due to the transfer of SAW property to PYCO. This cannot be said for KJRY. In addition, this also means that the revenues from SAW's customers can be devoted entirely to covering

operating costs and rehabilitation needs. Again, this cannot be said for KJRY.

(a) WTL believes the railroad can be successfully operated without a surcharge. Indeed, we have done so for several months and are satisfied with the financial performance. Our evaluation of the all-SAW scenario indicates that the revenue from BNSF is sufficient to cover all operating and maintenance costs.

(b) WTL is not surprised that KJRY feels it would need a surcharge. A key reason that WTL does not need a surcharge is the sharing of train crew, supervision and other resources with the existing WTL (and Texas-New Mexico) operations in West Texas. This sharing of resources means that the SAW operation is incremental to WTL, a lower-cost addition to an existing operation. KJRY, of course, does not have any other operations in West Texas so it must cover all its costs on a standalone basis. If anything, it has underestimated the surcharge it would require.

7. Based on WTL's experience to date with service on these lines, WTL will need little or no new investment in equipment to operate the lines. We did not require additional investment (other than for emergency track repairs due to defects in SAW's trackage) to provide alternative service to PYCO, as we had adequate locomotives available. We emphasize that 2006 shipments for PYCO were the result of excellent weather conditions in 2005. Due to adverse weather in 2006, shipments for PYCO will be less.

We continue to expect no major investment need in locomotives. WTL does have four GP20-type locomotives stored in Brownfield, Texas, that could be put in service to augment our existing fleet, and we also have a \$2 million line of credit for locomotive acquisition provided by WTL's parent, Iowa Pacific. WTL has a fleet of 60 boxcars for use by its customers, and this fleet would also be available to benefit SAW customers. We also from time to time lease cars for specific markets to augment the BNSF car supply, and are prepared to do that for SAW customers as well.

8. Based on our experience, the major capital investment required in connection with the SAW lines (other than the purchase price which PYCO would handle) is rehabilitation. In the pleadings to date, KJRY admits only that some crossings need rehabilitation, and otherwise KJRY and SAW seem to suggest that the track may be operated upon indefinitely. WTL has not operated over all of the SAW lines, but we have operated on extensive portions of those lines to and through the SAW yard to serve PYCO's Plant no. 1, and also through Compress to reach PYCO's Plant No. 2. Based on that experience, rehabilitation (or considerable increased investment in maintenance) is necessary. WTL sustained a major derailment which we believe was due to worn out switch points which cost us over \$20,000 to repair, and our crew encountered a broken rail as recently as October 12.

(a) WTL has reviewed the submission of Mr. Gene Davis of the RL Banks firm with respect to track rehabilitation, and of course is experienced in dealing not only with track conditions on the SAW but with track in West Texas, which is subject to harsh natural elements including high wind, extreme heat, and torrential rain.

(b) WTL looks at the FRA standards as safety standards, not engineering standards. This means that while a section of track which minimally complies with FRA Class I is safe for 10 mph, the moment a tie goes bad, it is no longer safe at 10 mph. The fact that the SAW track has been moved back and forth between Class I and "Excepted" (which means non-compliance with Class I) is a clear indication that it is only minimally compliant and therefore is clearly subject to track-caused derailments, which have in fact occurred.

(c) Mr. Davis proposes using industry engineering standards for benchmarking rehabilitation needs. While Mr. Davis (and WTL) do not propose upgrading the track to a higher FRA class than Class I, the track would more than minimally meet Class I allowing for normal deterioration while remaining within a margin of safety.

(d) Our experience operating trains in West Texas, where hot sun causes sun kinks, downpours cause washouts, and high winds blow dirt over the top of the rail, indicates that Mr. Davis has the correct approach to developing a reliable infrastructure. Improvement of anchors, ballast, and drainage are essential in West

Texas. Given KJRY's lack of experience there, it is not surprising they would not be aware of this. Of course the existing owners of SAW also operate a track contracting business in the Lubbock area, so it was probably at times cost effective for them to band-aid the railroad back together instead of rehabilitating it to an appropriate level.

(e) WTL further believes that the cost of rehabilitation proposed by Mr. Davis is appropriate for the mileage and tonnage involved. WTL attended a meeting this week in Lubbock sponsored by BNSF at which BNSF personnel made presentations regarding their current and future operations. It was clear from these presentations that a greater percentage of cars moving on the SAW will be of 286,000 gross rail load, and that rock trains will grow to 90-100 car units, which argues for rail replacement. Where WTL has handled rock units of this nature, the primary rail weight is 115 pounds and we have had no problems. On the three miles or so of rock train operations on WTL with 90 pound rail we have incurred more maintenance. So, WTL's strong preference would be for PYCO to rehabilitate the railroad with heavier rail.

(f) In the event that PYCO rehabilitates the track, WTL would expect to assist in applying for FRA RRIF funds, and WTL would be eligible for the "shortline tax credit" both of which would contribute to minimizing the per car cost of the rehab. WTL is familiar with both FRA RRIF funding and the shortline tax credit,

and we have actually applied for RRIF funding to rehabilitate the WTL.

9. In its pleadings, KJRY has raised the question whether PYCO would cause its rail operator to discriminate against other customers currently being served by SAW. Pursuant to our letter of intent, we would be the rail operator. We would not discriminate, nor would PYCO cause us to do so.

(a) Some SAW customers have been WTL customers, and WTL would have no incentive to discriminate, nor would WTL agree to discriminate. WTL is in business to grow business.

(b) In all events, for the record here, WTL crews in switching have been instructed to prefer other SAW customers over PYCO if the necessity arises. WTL currently brings the cars of all SAW customers from the BNSF yard to SAW's yard. Of course WTL can switch cars from BNSF to SAW only when BNSF makes the cars available on the designated interchange track, but in the vast majority of instances, such cars were delivered to SAW within a few hours of their availability. The tiny minority not so handled were the result of congestion or generally related expiration of crew time. There was no discrimination against any SAW customer; in the event of congestion, they were preferred over PYCO.

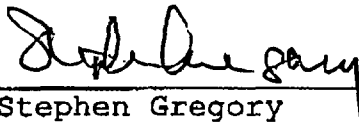
(c) WTL has no incentive to discriminate: as a service-oriented common carrier, we are obligated and do treat all our customers fairly. In the event of congestion, we will make every

effort to fairly allocate service resources. This leads me to the following observation, which in our mind, drives the proverbial nail into the coffin of the idea that PYCO or WTL would discriminate. PYCO owns a trackmobile, and can perform some of its own switching out of the current SAW yard into PYCO's adjacent Plant No. 1. (One of the reasons for the deterioration of service to PYCO last winter was that SAW refused to permit PYCO to operate its trackmobile for that purpose, and did not itself then provide the switching PYCO had done for itself.) WTL would ensure that PYCO's trackmobile personnel were trained in all WTL operating rules and procedures so PYCO could operate its trackmobile in compliance with FRA requirements. Then PYCO could go a long way to serving itself without the need for WTL crews to perform switching at Plant No. 1 once cars were delivered to the current SAW yard. This action alone would be a major improvement of service for PYCO over what it experienced with SAW. The more switching PYCO does for itself (which PYCO informs us it wishes to do for purposes of its own efficiency), the more resources WTL will have for the balance of the operation. Simply working with PYCO so PYCO can operate its trackmobile in compliance with FRA requirements will improve service to PYCO far beyond anything that would result from discrimination in favor of PYCO. The suggestion in the KJRY (Pioneer) pleading that PYCO might discriminate reflects KJRY's (Pioneer's) failure to understand the rail business in Lubbock.

10. In conclusion, WTL is already in a position and has every incentive to provide improved service to all SAW's shippers in Lubbock. WTL has demonstrated that it can and will provide improved service by doing so to SAW's largest customer, PYCO, pursuant to the alternative service order, even under hostile conditions, and this improvement has been acknowledged by both BNSF and PYCO. If PYCO's feeder line application is granted, profits above WTL's costs and return on investment would be reinvested in rehabilitation of the lines. In contrast, KJRY has demonstrated in its pleadings a lack of understanding of PYCO's rail needs, a hostile attitude to the customer which would be its largest shipper, and has also adopted a position antagonistic to BNSF's right of first refusal. Moreover, KJRY denies that the lines need substantial rehabilitation, which we know is false on the basis of our extensive experience with poor track conditions under the alternative service order. We believe it clear that although service to SAW shippers would improve under WTL, there is little or no likelihood of improvement should KJRY obtain control.

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 the statements I make in the foregoing are true and correct.

Executed on October 18, 2006.



Stephen Gregory

Exhibit E

Before The Surface Transportation Board
STB Finance Docket No. 34890
PYCO Industries, Inc., et al. – Feeder Line Application --
Lines of South Plains Switching, Ltd. Co.

Rebuttal Verified Statement
of
Gene A. Davis, P.E.

**Before The Surface Transportation Board
STB Finance Docket No. 34890
PYCO Industries, Inc., et al. – Feeder Line Application --
Lines of South Plains Switching, Ltd. Co.**

**Rebuttal Verified Statement
of
Gene A. Davis, P.E.**

Table of Contents

	<u>Page</u>
Qualifications	1
Scope Of Testimony	1
General	2
Rebuttal Comments.....	3
Conclusions	13

Photo Log

1	Rail Wear on Open Deck Bridge	1
2	Swinging Joint	2
3	Worn Switch Point.....	3
4	Turnout Close-up	4
5	Attebury Switch	5
6	Open Deck Bridge.....	6

**Before The Surface Transportation Board
STB Finance Docket No. 34890**

**PYCO Industries, Inc., et al. – Feeder Line Application --
Lines of South Plains Switching**

**Rebuttal Verified Statement
of
Gene A. Davis, P.E.**

Qualifications

I am the same Gene A. Davis, P.E., a consultant with the firm of R.L. Banks & Associates, Inc. (RLBA) who filed previous Verified Statements on August 7, 2006 and September 27, 2006 in this proceeding. My qualifications were detailed in Exhibit A of the August 7, 2006 statement. I appear in this proceeding on behalf of PYCO Industries, Inc (PYCO).

Scope of Testimony

PYCO requested RLBA to review and provide comments concerning Verified Statements regarding South Plains Switching, Ltd. Co. (SAW) tracks submitted by:

- Mr. Edward W. Landreth "Engineering Inspection Report of Railroad Assets" dated July 27, 2006, on behalf of SAW;
- Mr. Edward W. Landreth "Second Verified Statement" dated September 5, 2006, on behalf of SAW
- Mr. Thomas F. McFarland "Response to PYCO's Feeder Line Application To Acquire All-SAW" dated September 15, 2006, on behalf of SAW and

- Mr. Roger Stice dated August 26, 2006 on behalf of KJRY regarding current track conditions on SAW tracks.

General

Much has been said by all parties in this proceeding regarding the need (or not) to rehabilitate SAW's track structure to overcome years of deferred maintenance¹. SAW recently reclassified its track in the Lubbock area to Federal Railroad Administration (FRA) Class 1 on August 28, 2006 in an apparent attempt to prove that the current track structure easily could be brought to FRA Class 1 status with little or no rehabilitation. My overarching comment on the sudden reclassification is that it is a convenience, achieved at little or no cost, to suit the temporary regulatory argument needs of SAW. It is a whole lot easier and less expensive to claim that its track structure is sufficient to meet FRA Class 1 standards than it is to consistently maintain the track structure at that track class.

By moving the track structure from "Excepted" status to FRA Class 1, additional track parameters now have to be monitored and when defects are noted, the track either has to be repaired immediately or taken "Out of Service." As was pointed out in my August 7 Verified Statement, certain conditions photographed were not FRA defects due to the track being classified as "Excepted." Since the track is now classified as FRA Class 1, were the same conditions present, those conditions would be considered FRA defects.

As I stated in my September 27, 2006 Verified Statement, during my years of **constructing** and **maintaining** track and bridges at Norfolk Southern Corporation (NS) as an Assistant Track Supervisor, Track Supervisor, Bridge Supervisor and Assistant Division Engineer – Bridges, I was exposed to numerous situations involving track and bridge structure exhibiting deferred maintenance conditions similar to that seen on SAW's property during my July 24 and 25, 2006 inspection and am quite familiar with what is necessary to overcome that state of disrepair. Having attempted both approaches to overcome deferred maintenance conditions (minimal or band-aid versus going well beyond the minimal), time and again the most economical approach to

maintenance, over the long run, was to perform rehabilitation and then initiate an on-going maintenance program.

I understand that almost all short line railroads have limited capital funds to rehabilitate track and bridge structures; however, at some point in time it becomes prudent and economical to invest in the railroad infrastructure to overcome years of deferred maintenance. Otherwise, track structure maintenance and operating costs (derailments, crew overtime, etc.) soar while customer relations deteriorate. I believe that the current SAW properties in the Lubbock area have reached that point in time.

Rebuttal Comments

July 27, 2006 Landreth Statement

In part D.2 of Mr. Landreth's Verified Statement, he illustrates his opinion with eight panoramic photos illustrating relatively good surface and alignment in Attachments 2, 3, 4 and 5. While those photos generally illustrate overall alignment and profile, they do not portray the up-close inspection frequently required to determine FRA compliance, as seen in the photos contained within Exhibit B of my August 7, 2006 Verified Statement.

Mr. Landreth goes into detail regarding existing rail conditions and sizes along with their capacities in section D3 of his Verified Statement. While Mr. Landreth is correct that even smaller rail sections (85 and 90 pound per yard) can and do support 263,000 and, to a lesser extent, occasional 286,000 pound rail cars, he also acknowledges that the industry is shifting to heavier rail cars and that the rail infrastructure, in its current state, is capable of handling the current annual traffic volume and maximum train speed.² If the thought process of SAW is that smaller rail is sufficient to handle the current volume of traffic, that thought process is inconsistent with the fact that either SAW (or a predecessor) upgraded the track on the main between the east end of SAW yard and the BNSF main track to 110 pound per yard rail. Further, SAW recently replaced a switch on the east end of SAW Yard and it is constructed of 115 pound per yard rail along with the same sized appliances. The current industry

¹ Landreth September 6, 2006 Verified Statement, page 3, section C.

trend is to replace smaller weight rail with rail sections of at least 112 pounds per yard, allowing the track structure to be able to handle greater volumes of 286,000 pound loads.

Mr. Landreth states that *"The ties were predominately covered by ballast and dirt"* and that *"[T]he ties are serviceable."*³ While one can speculate as to whether or not the ties have sufficient holding power, the truth is that without uncovering the ties, it is not truly known. The supporting tie structure has a great deal of impact on the overall capacity of the track and whether or not it can consistently handle heavier rail cars.

According to Mr. Landreth, *"[T]he switches were all in a good serviceable condition with no requirements for preventative maintenance on switch frogs. Additionally, the switch points were all serviceable however a few were observed that had approximately 8" of wear and they will need to be watched and probably will require repair in the next 6-12 months."*⁴ As is clearly seen in the Exhibit B Photos # 2, 3, 4, 5 and 6 of my August 7, 2006 Verified Statement, conditions existed that were it not then classified as "Excepted" track, most assuredly would have been FRA defects. Photo # 3 of my August 7 Verified Statement clearly shows almost fifteen (15) inches of wear on the turnout side of the West end SAW Yard Track # 2 switch, well above the eight inches mentioned in Mr. Landreth July 27 Verified Statement. Other comments regarding this area of concern will be rebutted later.

Probably most troubling in Mr. Landreth's July 27, 2006 Verified Statement is his assertion in part D7 that *"... no defects that would indicate that the track maintenance level was less than an FRA Maintenance Class 2 standard were observed during the inspection."*⁵ As already has been demonstrated and will be further amplified, conditions on the ground could have been classified as FRA defects were it not classified as "Excepted" track.

Mr. Landreth also furnishes a copy of the July 24, 2006 FRA inspection noting no defects and that it was inspected under "Excepted" track status as an indication that the track structure was sufficient to meet the lowest possible then current track class

² Landreth July 27, 2006 Verified Statement, part D3.

³ Landreth July 27, 2006 Verified Statement, part D4.

⁴ Landreth July 27, 2006 Verified Statement, part D5.

⁵ Landreth July 27, 2006 Verified Statement, part D7.

standard. While this is true, I again call attention to the fact that under "Excepted" status, only track gage over four feet, ten and one quarter inches (4' 10¼") can be classified as an FRA defect. No other track conditions can be listed as a defect in "Excepted" Class track. So, in and of itself, the fact that an inspection of Excepted Track yields no defects, no indication that the one element that can be measured does not meet its generous standards, is not dispositive whatsoever with respect to deferred maintenance of the SAW track structure. There could be millions of dollars of deferred maintenance on a rail line and so long as the gage is no more than four foot, ten and one-quarter inches, FRA would be prohibited from characterizing the track structure as manifesting any defects.

September 15, 2006 McFarland Response

Rebutting assertions made by Mr. Thomas F. McFarland in his Response to PYCO's Feeder Line Application to Acquire "All-SAW" dated September 15, 2006, I have detailed comments to further clarify my stance on rehabilitation and maintenance practices.

Mr. McFarland states that my annual normalized maintenance cost estimate of \$20,085 (per mile) is three times that of a reasonable amount (he cites \$6,500 as a reasonable amount). Mr. McFarland's statement is an attempt to substitute dated information in to a current economic situation. The \$6,500 figure may have been an accepted standard in 1993; however its use today is quite irrelevant. One only has to look at the price differences of steel (rail), ties and labor between 1993 and the current climate to see that the \$20,085 per mile cost estimate is much more accurate. This is reiterated by J. Michael Carr of Pioneer Railcorp in his August 4, 2006 Verified Statement⁶.

Mr. McFarland falsely assumes that I recommend performing all the rehabilitation work at the transfer of the railroad to new ownership, which I clearly show in my September 27, 2006 Verified Statement is not the assumption that I would recommend. I believe that rehabilitation can and should be a phased in over a period of say seven years, such as that described in my September 27 Verified Statement. If individual

economic conditions prevent a seven-year program of rehabilitation, then a ten-year approach would have to suffice. I believe that SAW has owned the property about six years and given its minimal approach to rehabilitating years of deferred maintenance, it clearly has not turned the tide as far as track structure is concerned.

While Mr. McFarland views Mr. Landreth as "considerably more experienced and qualified than PYCO's witness on track conditions," I would simply state that while Mr. Landreth may be older, more experience does not always equate to better judgment. Mr. McFarland calls attention to an October 24, 2005 FRA inspection by Mr. David Roberts that show only eight items to be corrected. It should be noted that SAW property was placed in "Excepted" status on January 2, 2003. That means that the inspection during October 2005 was conducted under "Excepted" conditions. For an FRA inspector to note items under those conditions, the on-ground conditions must have been such that without immediate correction, the inspector would have been forced to shut the railroad down. All items except two were corrected that day and those two were corrected four days later.

The majority of Mr. McFarland's comments regarding my cost estimates and condition assessment mirror that of Mr. Landreth so to prevent redundancy, I will move ahead to rebut comments in Mr. Landreth's September 6 Verified Statement.

September 5, 2006 Landreth Statement

In Mr. Landreth's September 6, 2006 Verified Statement, regarding the photos contained as Exhibits to my August 7, 2006 Verified Statement, he states that "... but are merely isolated locations that Mr. Davis & Mr. Sneed chose to focus on with a general negative narrative."⁷

Mr. Landreth addresses each photo and disputes the track conditions to which attention is called. Regarding Photo # 1 of my August 7, 2006 Verified Statement, while Mr. Landreth states correctly that the rail seen in the photo is commonly known as a Dutchman and that as far as broken rails are classified, it is not as serious as some other conditions, it is still considered a broken rail. Given that SAW track is now

⁶ Carr August 4, 2006 Verified Statement, page 37.

⁷ Landreth September 6, 2006 Verified Statement, page 6, part E.

classified as FRA Class 1, many (though maybe not all) FRA inspectors will write a Dutchman rail up as a broken rail and require it to be replaced. At the minimum, each inspector will attempt to pull the rail head to see if it is loose and/or can be removed. If the Dutchman's rail head can be removed, the track must be repaired immediately or taken out of service.

If the STB staff desires a better example of rail approaching the end of its useful life, please refer to Photo # 1 of the Photo Log at the end of this statement. As described in both my first, second and this statement, many locations (both curved and tangent) scattered throughout the main, yard and industrial lead tracks exhibit rail with serious rail flow. While not quite as serious as some other rail defects, according to Sperry Rail Service flowed rail is⁸:

Description – Flowed rail is a rolling out of the tread metal beyond the field corner, with no breaking down of the underside of the head.

Origin – Flow is due to distortion of the rail metal under repeated loads. This gradual change of the head contour does not damage the metallic structure of the metal.

Growth – Flowed rail is a change in shape rather than a growth. It occurs, predominately in curved track, under repeated service. The extent of the change is usually proportionate to the length of service of the rail. Rail in tangent track may also become flowed, although at a slower rate than in curved track.

Appearance in Track – 1. Surface metal on the head flowed toward the field side, giving a creased appearance on the running surface near the field. 2. A smooth protruding lip, which may extend the length of the rail. 3. In advanced stage, flow becomes blade-like, jagged, or non-uniform, and may hang down or separate from the rail head.

Hazard – Flowed rail is not a serious defect.

Again referring to Photo # 1 of this statement, while the open deck bridge and the rail seen in the photo are contained near the end of a spiral of a curve, the jagged edge on both the field and gage sides indicate that the subject rail is in advanced stages as

⁸ Rail Defect Manual Compiled by Sperry Rail Service For the Use of the Railroads, 1999, pages 55 and 56.

described above and has been in service for a very long time. I reiterate my position that at some point in time, it becomes more economical to make wholesale changes to the track structure to overcome deferred maintenance.

Mr. Landreth next addresses Photo # 2 of my August 7 statement describing it as a bad tie. Photo # 2 of this Verified Statement is a zoomed-in view of the same photo and illustrates that this may (or may not) be a defective tie, however since the switch tie area is covered, one only can assume what conditions are actually present. In my expert opinion, what this photo represents is a swinging joint in the turnout area whose track bolts need to be properly tightened, switch ties need to be raised tight against the rail and/or replaced as necessary. While this is likely not an FRA defect under FRA Class 1 guidelines, it represents the same minimal approach to maintenance that is prevalent in SAW tracks.

Photos # 3 and 4 of my August 7 Verified Statement are again zoomed-in and illustrated as Photos # 3 and 4 of this Verified Statement, both of which deal with switches. Mr. Landreth states that I do not comment on the compliance of SAW switches with FRA guidelines. He is correct because at the time, the track was classified as Excepted; however since the SAW tracks are now classified as FRA Class 1, both turnouts should be taken out of service if the conditions shown are still present and were not corrected before reclassifying the track. For the reader's ease, following is a copy of the applicable FRA guidelines, Section 213.135 - Switches⁹:

- (a) Each stock rail must be securely seated in switch plates, but care shall be used to avoid canting the rail by overtightening the rail braces.
- (b) Each switch point shall fit it stock rail properly, with the switch stand in either of its closed positions to allow wheels to pass the switch point. Lateral and vertical movement of a stock rail in the switch plates or of a switch plate on a tie shall not adversely affect the fit of the switch point to the stock rail. Broken or cracked switch point rails will be subject to the requirements of Section 213.113, except that where remedial action C, D or E require the use

⁹ U.S. Department of transportation Federal Railroad Administration – Office of Safety, Code of Federal Regulations, Track Safety Standards Part 213, Subpart A to F, April 15, 2002, page 61 and 62.

of joint bars, and joint bars cannot be placed due to the physical configuration of the switch, remedial action B will govern, taking into account any added safety provided by the presence of reinforcing bars on the switch points.

- (c) Each switch shall be maintained so that the outer edge of the wheel cannot contact the gage side of the stock rail.
- (d) The heel of each switch rail shall be secure and the bolts in each heel shall be kept tight.
- (e) Each switch stand and connecting rod shall be securely fastened and operable without excessive lost motion.
- (f) Each throw lever shall be maintained so that it cannot be operated with the lock or keeper in place.
- (g) Each switch position indicator shall be clearly visible at all times.
- (h) Unusually chipped or worn switch points shall be repaired or replaced. Metal flow shall be removed to ensure proper closure.
- (i) Tongue & Plain Mate switches, which by design exceed Class 1 and Excepted track maximum gage limits, are permitted in Class 1 and Excepted track.

As is readily apparent, other than (i), those guidelines do not distinguish between FRA Class 1 through 5. Under FRA Class 1 guidelines, photo # 3 illustrates one defect (unusually worn switch point) as noted by (h) and photo # 4 demonstrates at least two defects in that the stock rail is not properly seated (a) due to defective headblock tie and on (f) account of missing keepers. The switch point in photo # 4 is only worn back about eight to ten-inches and is not quite as bad as the point in photo # 3 but still warrants attention.

Mr. Landreth states that the guard rail clamp missing in Photo # 6 of my August 7 Verified Statement is irrelevant because there were three on the switch of which two were effective¹⁰. If three guard rail clamps had been present as Mr. Landreth suggests, two in fact, would have been sufficient to hold the rail wheels from striking the frog point. However, as illustrated in the photo # 5 of this statement, each side only has one guard

¹⁰ Landreth September 6, 2006 Verified Statement, section E, p. 8.

rail clamp and the holding mechanism of the straight line side has fallen out and is not secure. This is an FRA defect under guideline Section 213.143.

Lastly, Mr. Landreth comments on photos # 7 and 8 of my August 7, 2006 Verified Statement regarding my suggestion to replace the rail girder bridge at the first opportunity. Contrary to what Mr. Landreth suggests, I am intimately familiar with this type bridge because I had to annually inspect four bridges of this type during my time as a Bridge Supervisor with NS in south Georgia. It was during one of those inspections that I determined the bridge had become silted in and decided to replace it with a concrete box culvert. After running the hydraulic analysis and receiving the proper authority, my employees and I replaced the bridge. Upon removal of the rail that act as the bridge span, three of the eleven rails fell completely apart. The rails had developed head and web defects that were not able to be noticed due to the configuration of the bridge type as seen in the close-up in photo # 6 of this statement. Visual inspection only can be accomplished on the outside and inside rails of each side and along the bottom and to a lesser extent on the top (in between ties). No inspection of the interior rails is possible. After discovering this situation, NS determined that it quickly would replace the other three rail girder bridges and upon replacement of two more found more broken rails in two of the other three replacements. The last bridge was scheduled for replacement after I was transferred to another location. It is specifically because of this experience that I suggest replacing the rail girder bridge east of the BNSF main track as quickly as capital money becomes available.

Also contrary to Mr. Landreth's assertion that this is a single span bridge¹¹, it is easy to see that it is a two span bridge, as I stated in my first Verified Statement.

As to Mr. Landreth's assertion that the two locations of wide gage that Mr. Sneed and I discover were not relevant because "... the practice for constructing curves some 60 to 70 years ago was to increase the track gage to 57 to 58 inches to reduce the track resistance for rigid steam locomotives,"¹² I didn't notice any steam locomotives switching during my inspection and would hope that sometime in the last 60 to 70 years,

¹¹ Landreth September 6, 2006 Verified Statement, Section E, p. 9.

¹² Landreth September 6, 2006 Verified Statement, Section E, p. 8.

ties had been replaced and/or the track had been gauged closer to the accepted standard of 56½ inches on that portion of track.

It is apparent that Mr. Landreth and I have different approaches to maintaining track as illustrated by his assertion numerous times that the SAW track in its current condition is suitable for FRA Class 1 track. I respectfully disagree that there exists numerous locations where the track is **NOT** compliant and if it has not already been corrected, it should be or immediately taken out of service. It is true that I am not from the west Texas area, however, I do know and understand FRA guidelines and portions of the SAW track that I inspected on July 24 and 25, 2006, if it had been classified as anything other than excepted track, would have been taken out of service that day or repaired immediately.

Mr. Landreth has determined that I have "limited" short line track experience¹³ simply because of all my railroad experience being with a Class I railroad. While it is true that all my railroad employment experience was with NS, Mr. Landreth must have failed to notice that I am an AREMA committee 18 member (Light Density and Short Line Railways) and a subcommittee co-chairman. For the last four years, I have been working closely with short line railroads and through participating in Committee 18 activities, feel that I have gained an appreciation for the intricate track structure maintenance complexities that are a daily challenge to short line operations.

Further, since joining RLBA nearly five years ago, I have had the opportunity to attend numerous American Short Line Railroad Association (ASLRRA) meetings and conventions. At each event, a topic of extreme interest expressed is always an individual short line railroad's ability to perform infrastructure upgrades capable of handling heavier 286,000 pound rail cars. As recently as August 4, 2005, ASLRRA's President, Richard F. Timmons addressed that same concern in a presentation to the FRA. Given that the ASLRRA's website shows SAW as a member, much has been said about how SAW is forward looking in its approach to business; however I do not believe that its track structure maintenance or projected future maintenance expenses reflected in Witness Plaistow's going concern valuations have benefited from that same approach.

¹³ Landreth September 6, 2006 Verified Statement, Section E, p. 9.

Mr. Landreth then provides a narrative stating that basically everything I suggest in the way of track upgrades is unnecessary. As stated in my September 27, 2006 Verified Statement, I propose to rehabilitate only the main track (except replacing the rail where 110 pound per yard rail is), all the SAW yard tracks and the more heavily used industrial leads. Within those limits, as the rail and/or ties are rehabilitated, the switches and at-grade, highway-rail crossings would be rehabilitated. My thought process to rehabilitation is simple, as stated in my second Verified Statement and is as follows: after the newly instituted annual internal rail flaw detection test, rehabilitate the fifteen percent of track that exhibit the overall worst conditions (combined rail, tie, turnout and, to a lesser extent, at-grade, highway-rail crossings). Replacement of the rail along with about 800 ties per mile and associated upgrades to the turnouts contained within that area would (over time) provide the necessary rehabilitation to overcome years of deferred maintenance. The process would continue until the entire property that needs rehabilitation is completed. If financial concerns limit the capital dollars available for investment into the track structure, the rehabilitation process could be extended, though I recommend a more aggressive approach because it is the least expensive in present value terms, if one is truly "forward looking."

Stice Statement dated August 26, 2006

Upon reviewing Mr. Stice's Verified Statement, I agree on some points with him and differ on others. While Mr. Stice states that ties are generally in good condition, he recommends replacement of about 2,000 to 3,000 with a maintenance program as needed. He goes on to state that SAW tracks and turnouts are sufficient to meet FRA Class 1 standards, however, need the initiation of a regular maintenance program.

Mr. Stice notes that three crossings need surface repair at an approximate cost of \$20,900 and that some rail exhibits signs of shelling on the head and recommends replacement at an approximate cost of \$56,315 for 1,000 feet of rail.

As to those statements, I agree that a regular maintenance program needs to be instituted; however, I believe that upgrading the track will be necessary to consistently keep the track up to FRA Class 1 standards before the routine maintenance program begins.

To install mud rails (flangeways) while not replacing any defective ties and/or rail in the at-grade, highway-rail crossings while the road surface is removed is not an efficient use of capital dollars in my opinion.

Pioneer Railcorp's President, CEO and CFO, Mr. Carr submitted a Verified Statement dated August 4, 2006 where he states that my rehabilitation estimates are not in line with figures with which he is familiar¹⁴. Since Pioneer Railcorp is the parent company of Keokuk Junction Railway Company (KJRY) at which Mr. Stice is employed, the rail replacement estimates should be in line with that with which Pioneer Railcorp is familiar. Multiplying the cost estimate supplied to Mr. Stice to an amount per mile equates to about \$297,343 per mile for rail replacement. This figure is greater than the price estimate I furnished (\$259,000) per-mile for rail, tie and ballast replacement. It appears that my per mile rehabilitation estimates are not as outlandish as they have been characterized by KJRY.

I believe that Mr. Stice recognizes that certain areas of rail need replacement. However, I believe that Mr. Stice stops short of replacing all the rail that exhibit signs of fatigue.

Conclusions

Relating to track structure, another word for preventative easily could be "precautionary" and, when combined with maintenance, provides "precautionary maintenance." Alternately, deferred can also be seen as "to put off." As I have stated in each of my Verified Statements, current SAW track structure exhibit signs of deferred maintenance. In my professional opinion, the best, most economical option to overcome the many years of deferred maintenance is to institute a process to rehabilitate the track and concurrently, a routine maintenance program to keep the upgraded track in a steady state of repair.

¹⁴ Carr August 4, 2006 Verified Statement, page 37.

Under 28 USC 1746, the following language converts any statement into a verified statement, equivalent to a statement made under oath, and evidentiary in all federal agency proceedings otherwise requiring affidavits or other verification:

"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 the foregoing is true and correct.

Executed on: October 18, 2006

Gene A. Davis, P.E.

[signature]

Photo 1



Photo 2

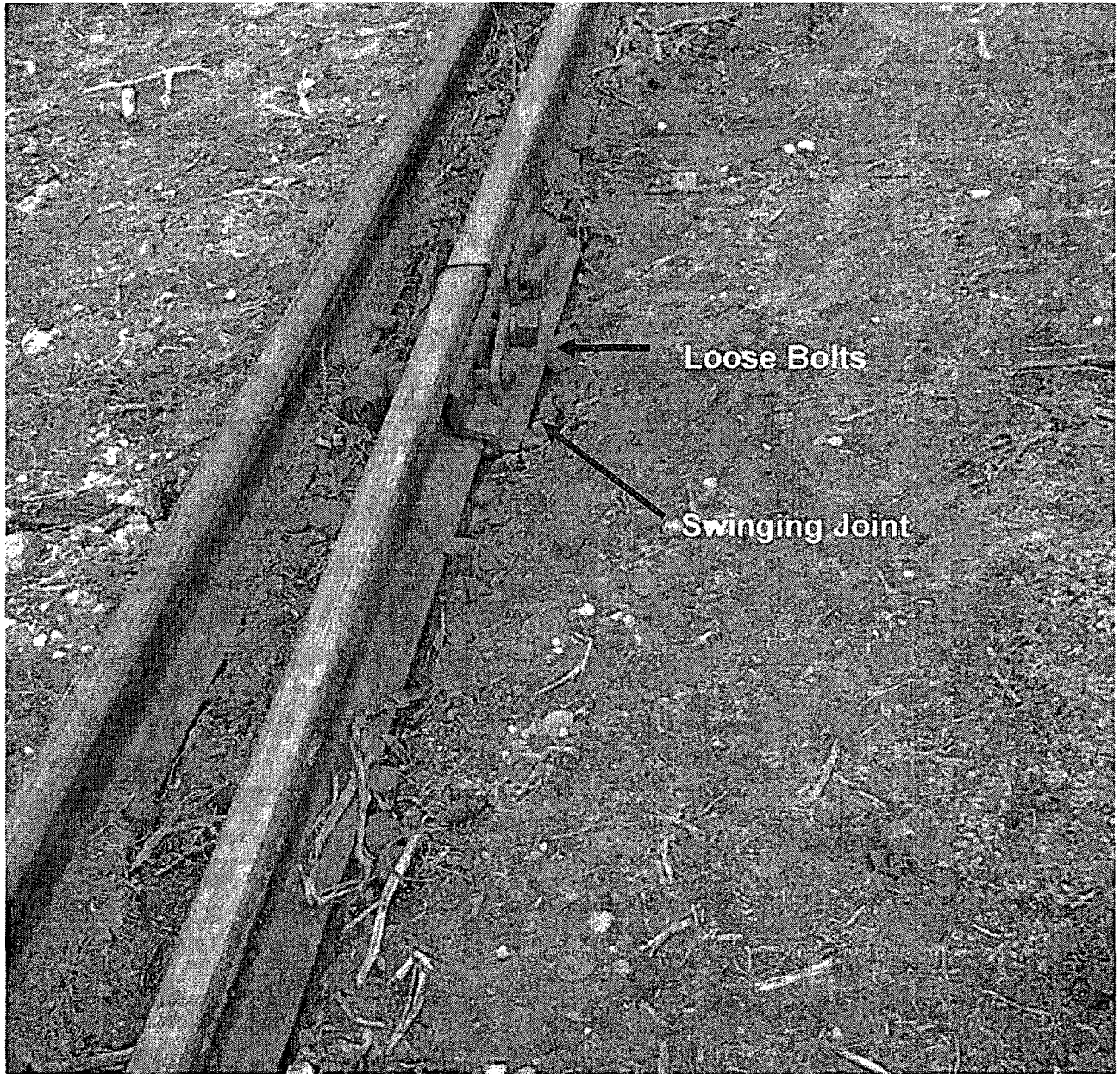


Photo 3

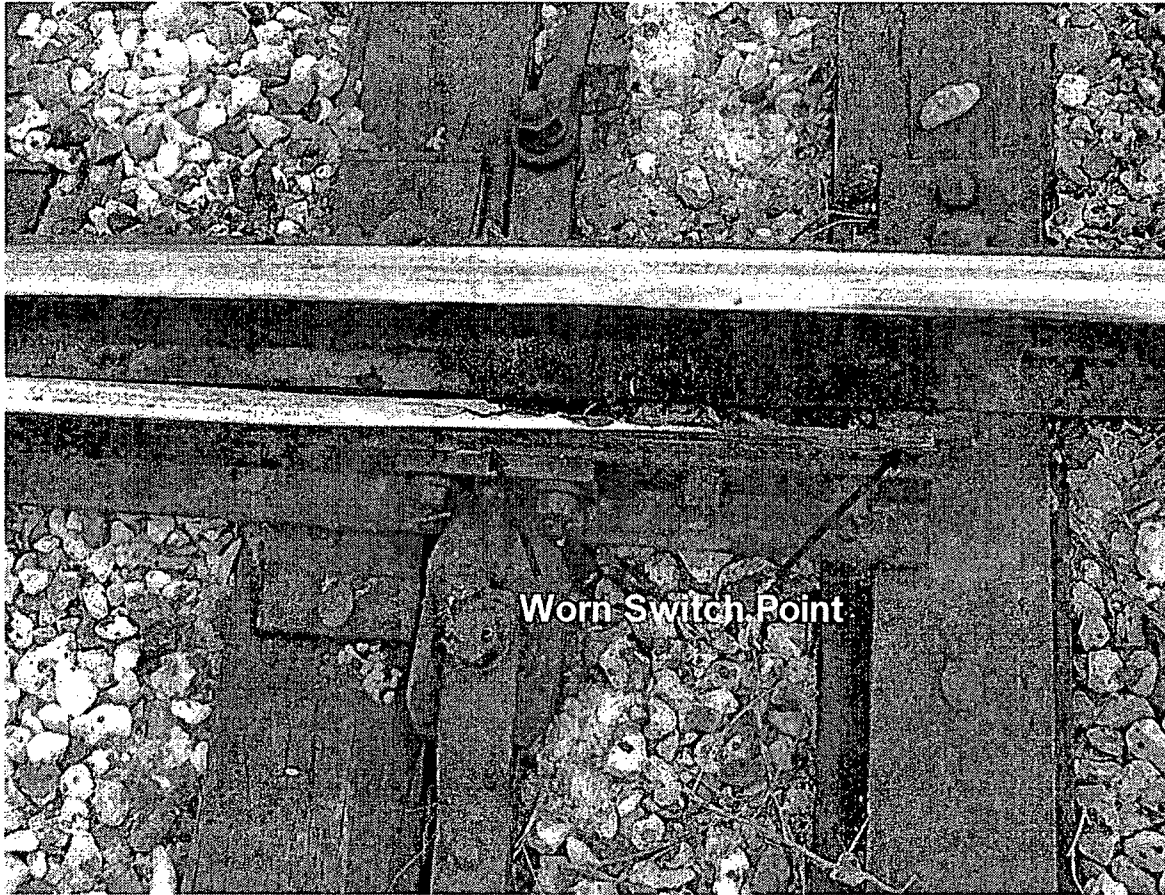


Photo 4

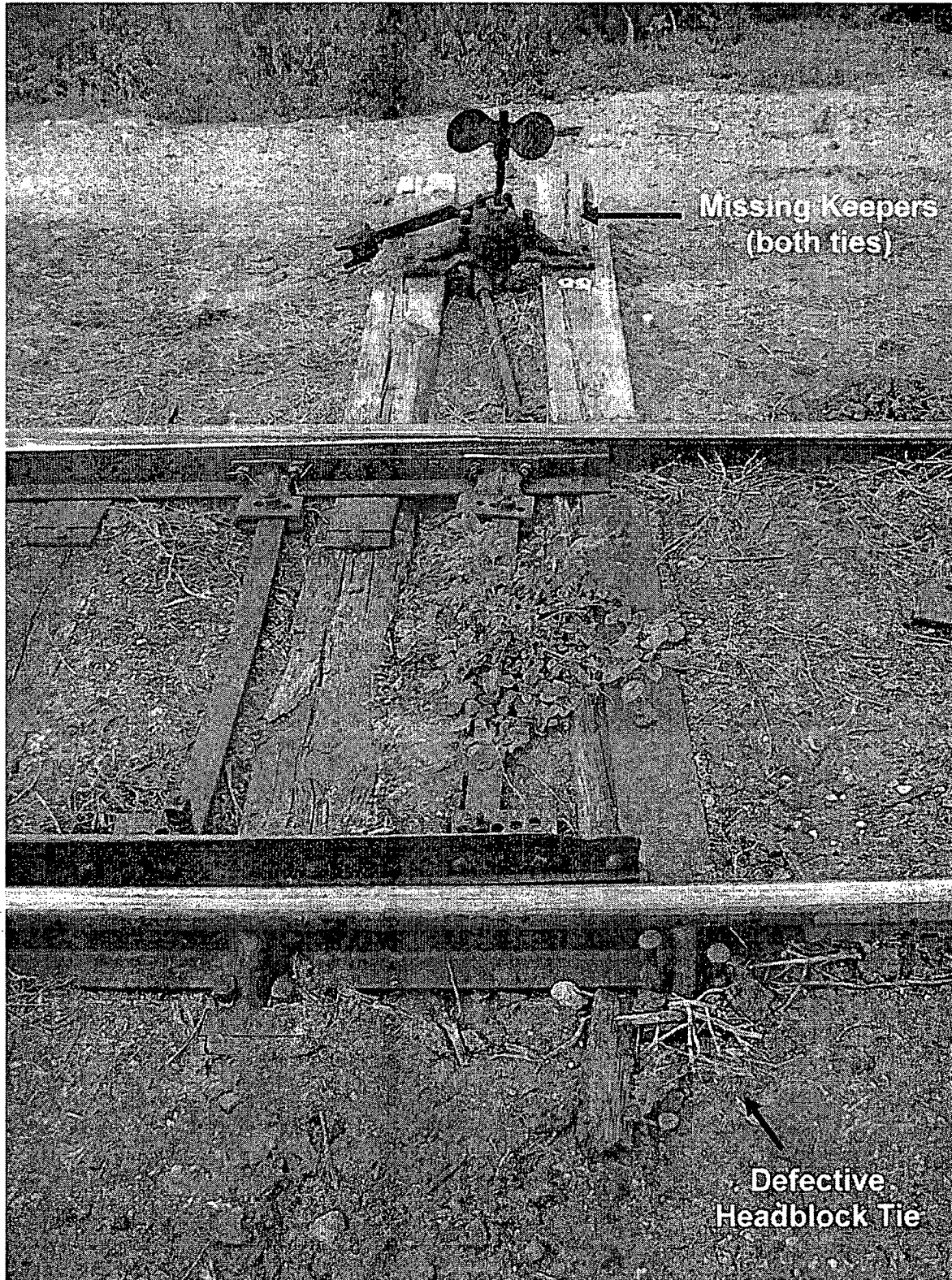


Photo 5

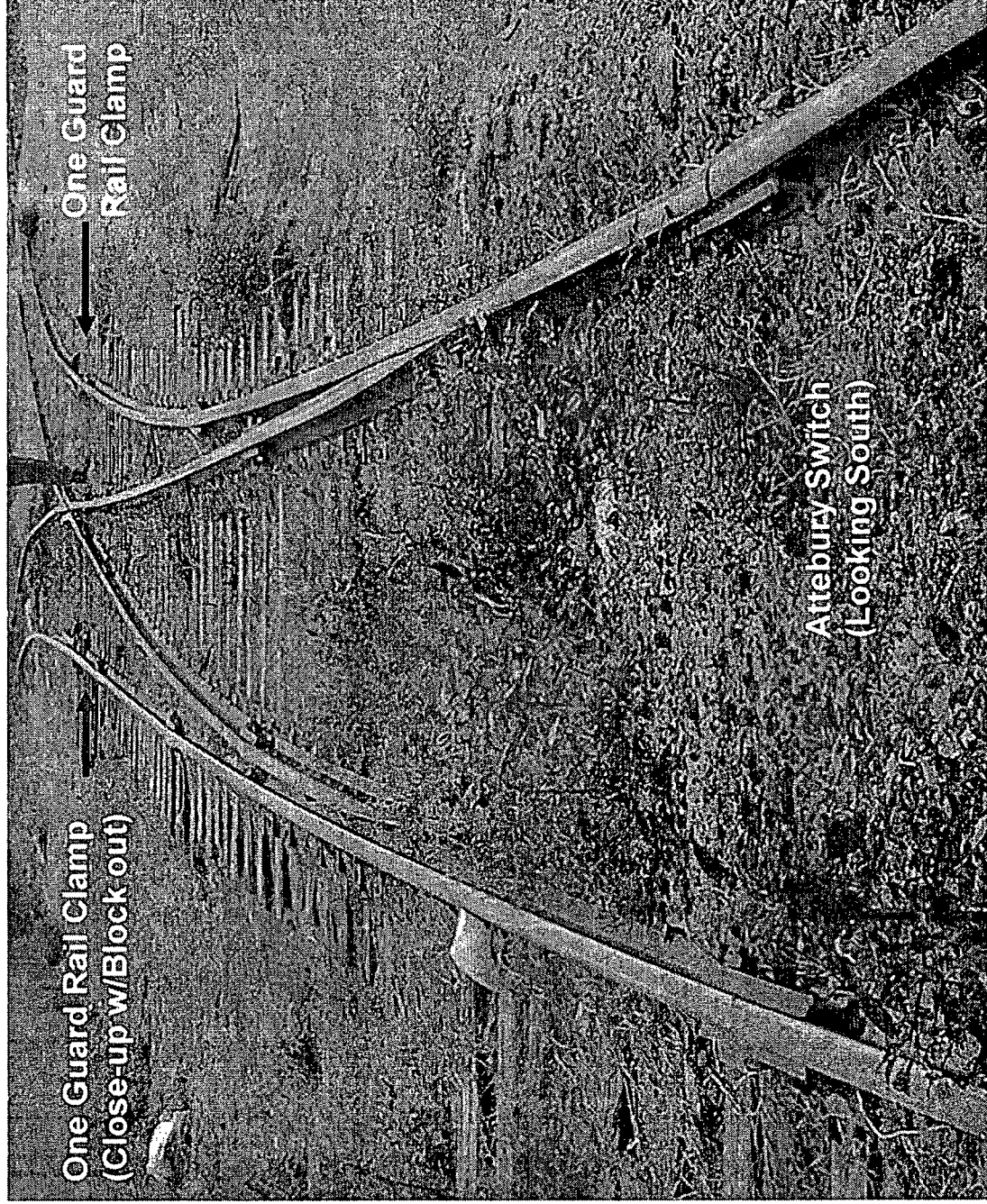


Photo 6

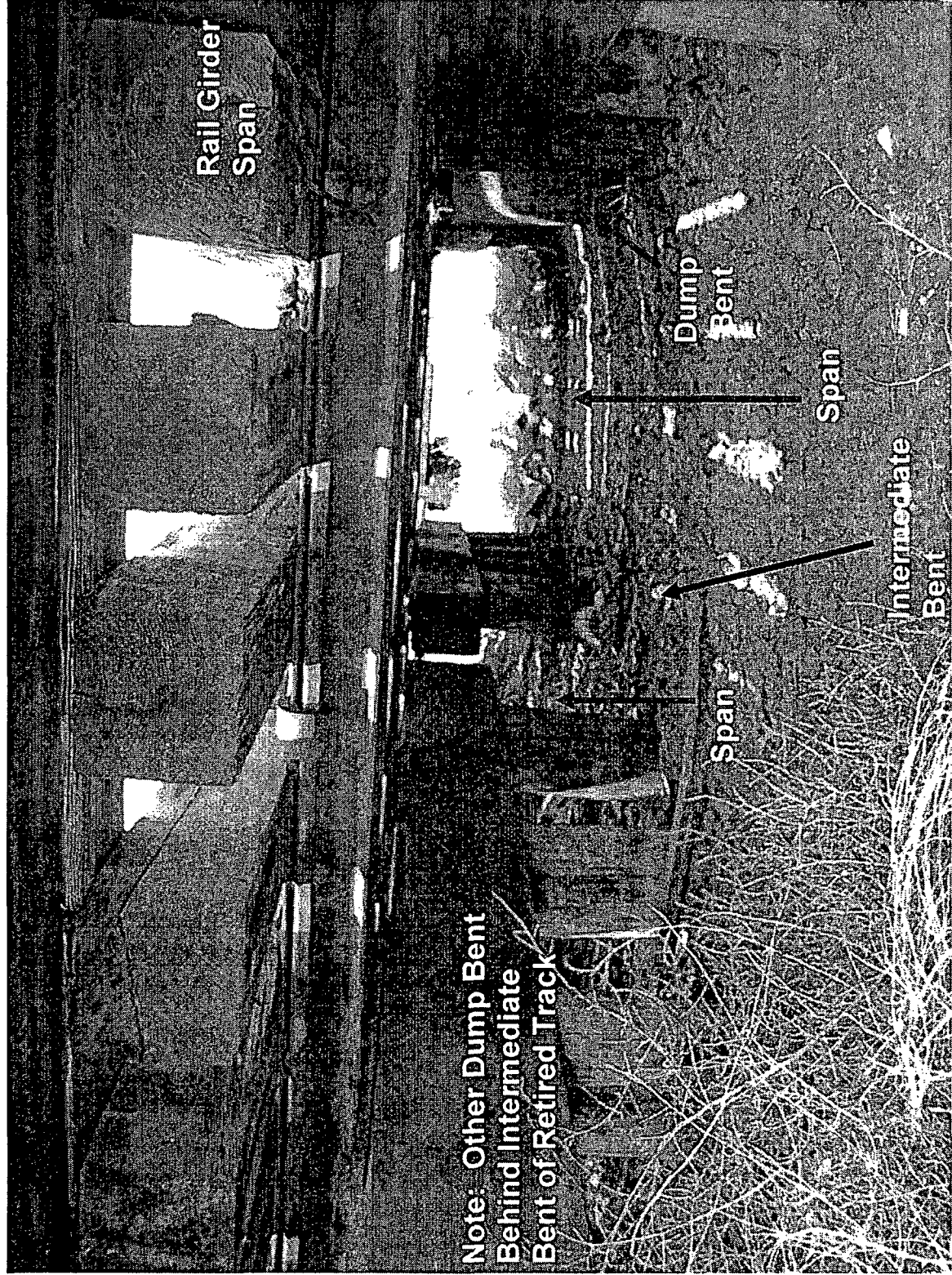


Exhibit F

PYCO financial information

HIGHLY CONFIDENTIAL

UNDER SEAL