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24 October 2006
by fax and 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
and related F.D. ~~34992~~

217834
Public
Vernon

FD 34922 217837
PYCO's Comments on KJRY: due 24 October
~~_____~~

Dear Mr. Williams:

On behalf of PYCO Industries, enclosed please find an original and ten copies of PYCO's comments on KJRY's competing application. These comments supplement and incorporate additional information contained in PYCO's initial comments of October 12 and Rebuttal of October 19.

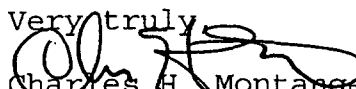
~~Please note that this entire filing is being submitted under seal pursuant to the applicable protective order. The cover memorandum makes reference to information designated for confidential treatment by Pioneer or KJRY, or in some instances by PYCO. Many exhibits have been designated highly confidential, or refer to information so designated.~~

PYCO is preparing a public version omitting any confidential information, or references thereto which would result in its disclosure. If that is not tendered with the express version of this fax filing, it will be supplied within 24 hours.

Copies of the sealed version 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.

Att. (cover memo and four exhibits)

Encls (with express version/original and 11)

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

Mr. McLaren

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

KEOKUK JUNCTION RAILWAY CO. --)
FEEDER LINE APPLICATION --) F.D. 34992
SOUTH PLAINS SWITCHING LTD.)

Public version

PYCO INDUSTRIES, INC.'S
COMMENTS ON KJRY
FEEDER LINE APPLICATION

On October 12, 2006, feeder line applicant PYCO Industries, Inc. (PYCO) filed initial comments on the "competing" feeder line application (FLA) filed by Keokuk Junction Railway Company (KJRY) in the above proceedings. However, because KJRY and its parent Pioneer Railcorp failed to make discovery, and because PYCO had to file a motion to compel, this Board afforded PYCO fourteen days from the date of receipt of KJRY/Pioneer's final response to make additional comments.¹

Summary

As indicated below, Pioneer and KJRY failed to make a discovery response which was complete in respect to this Board's

¹ Under this Board's procedural rules, parties must provide service by hard copy on another party unless the other party elects email service. 49 C.F.R. § 1104.12. PYCO has made it clear to all parties it does not elect email or fax service, especially for lengthy documents. PYCO did not receive the KJRY/Pioneer final response until October 11 by DHL express delivery (see exhibit A). Notwithstanding § 1104.12, the Board nonetheless directed PYCO to file comments on October 24.

order of October 5, 2006, on PYCO's motion to compel. As a result, PYCO seeks certain relief in the form of striking portions of KJRY's pleadings, prohibiting evidence by KJRY on certain issues, and holding PYCO and other shippers harmless from costs due to delay of proceeding.

Based on what information KJRY supplies in its pleadings to date, KJRY simply cannot be viewed as financially responsible for acquisition and operation of these lines. Based on its own (optimistic) projections, KJRY will not make enough from the SAW lines to pay its operating costs and debt service. This is wholly apart from KJRY's misleading claims that no substantial rehabilitation is required. If necessary rehabilitation is undertaken, even if spread over a period of years, KJRY will lack resources. As a result, the lines will continue to deteriorate. In short, KJRY's proposed shoe-string operation will certainly not be likely to improve service to shippers. While a majority of shippers support PYCO's FLA, no shipper has filed comments supporting KJRY's application, but many have opposed it. That is further corroboration of KJRY's inadequacy. PYCO is unaware of an instance in which a feeder line application has been granted in which the applicant has no shipper support and the only evidence of shipper attitude toward the applicant is hostility and skepticism. In the end, 49 U.S.C. § 10907 is a remedy for inadequate rail service, not a vehicle for an entrepreneur to propagate miserable service at shipper expense and over their objection.

For all these reasons, and as further detailed below and in PYCO's October 12 comments and October 19 Rebuttal, hereby adopted herein, KJRY's "competing" FLA for all of SAW must not be accepted, and if accepted, KJRY still must not be authorized to acquire the SAW lines because it fails to show that it is likely to improve service, and the vast majority of shippers in Lubbock do not believe it will.

KJRY tries to avoid BNSF's right of first refusal on a game theory argument that such a right will hamper feeder line applications. As PYCO explained in our October 12 comments, this is laughable. What will hamper feeder line applications is a holding that KJRY with no shipper support and a highly leveraged financial package can somehow trump a local shipper which in tandem with a local rail provider is offering to subsidize acquisition and to improve a line for the benefit of all. What KJRY's game theory overlooks is that shippers have an interest in good service; that interest is shared by BNSF but not necessarily by the local switch provider.

I. Pioneer/KJRY Failed to Respond to Order Compelling Discovery Response

A. Background

When PYCO moved to compel KJRY and Pioneer to respond to PYCO's discovery requests, PYCO specifically sought information relating to KJRY's sister and parent corporations. This Board granted PYCO's motion on October 5, and ordered KJRY and Pioneer to respond by October 10. The KJRY/Pioneer response which PYCO received on October 10 and 11 (the information arrived in two

packets) contained no responsive information concerning KJRY's sister corporations, and essentially no information concerning Pioneer, other than certain contracts and business transactions relating chiefly to [REDACTED]

[REDACTED]. The information provided concerning KJRY was also limited. The KJRY/Pioneer response lodged an objection as to all other information.²

Due to time constraints, we will focus on only a couple areas of Pioneer/KJRY's failure to be responsive.

To take one example, although PYCO legitimately sought such information, and understood STB's order to compel its production, Pioneer/KJRY refused to supply any information on the litigation in which Pioneer or its subsidiaries have engaged against Class I railroads, shippers, or communities relating to rail service.³ If Pioneer and KJRY were to have responded to discovery on this one point alone, PYCO would have shown that Pioneer and its subsidiaries have engaged in numerous instances of litigation against Class I railroads, shippers, or communities. In these cases, Pioneer or its subsidiaries were either accused of conduct contrary to the interests of shippers, or were affirmatively seeking to take actions contrary to shipper interests. This information would have shown that KJRY, as a Pioneer subsidiary, cannot be

² A copy of the written response is attached as Exhibit B.

³ See Exhibit B, p. 8.

expected to improve service to shippers in Lubbock. This information is not readily available to parties such as PYCO, particularly in the time frame necessary for an expedited STB proceeding. Pioneer and KJRY's obstreperousness thus harmed PYCO's ability to present its case.

There are other important examples of Pioneer/KJRY discovery failures: for instance, PYCO sought information from Pioneer and KJRY about Pioneer's consolidated financial statement, on which KJRY relied for its initial application and which was the basis for KJRY's entry into this proceeding in the first place. But Pioneer and KJRY essentially refused to answer most questions about the statement, on the round that KJRY no longer relied upon it for purposes of its FLA. See, e.g., Exhibit B at p. 23. Even if this were now so, KJRY continues to rely on a loan by Pioneer's bank to Pioneer, and the financial health of the parent is thus germane to that of the subsidiary. In that sense, KJRY is dependent still on Pioneer, and the overall ability of the Pioneer group to perform goes not just to financial responsibility but also to likelihood that KJRY can improve service to shippers and thus this Board's ability to find PCN allows KJRY to acquire SAW.

PYCO stresses again that this is an expedited proceeding. In Finance Docket (F.D.) 34802, PYCO is currently receiving service pursuant to an alternative rail service authorization under 49 C.F.R. Part 1146. This authorization expires as a matter of statute at 11:59 PM on November 22. The intent of the

expedited procedures has been to afford PYCO permanent relief from inadequate rail service effective upon the end of the alternative service authorization. The failure to make discovery by Pioneer/KJRY is thus simply an instance of perplexing gamesmanship by Pioneer and KJRY. On the one hand, their misconduct hampers PYCO's preparation of its case and furthermore flaunts STB's order. On the other hand, delay in the proceeding to compel further response will obviously render the feeder line proceeding an inadequate remedy.⁴ PYCO cannot afford delay, and PYCO should not be held captive to Pioneer and KJRY misconduct.

B. Law

This Board's predecessor has noted that discovery sanctions are particularly important to employ in expedited proceedings, such as those under statutory time deadlines. The Kansas Power & Light Company v. Burlington Northern, ICC No. 39386, June 223, 1984 (1984 ICC Lexis 423 at *21. As explained below, this proceeding is being conducted with an eye toward providing relief before expiration of alternative rail service on November 22 pursuant to a statutory time deadline.

Under 49 C.F.R. § 1114.31(b), this Board may adopt a

⁴ PYCO has petitioned for more permanent alternative service in F.D. 34889 pursuant to 49 C.F.R. Part 1147. Incumbent railroad South Plains Switching, Ltd. (SAW) has not substantively opposed that petition. If this Board does not issue an order such that acquisition can be accomplished and service commenced pursuant to the feeder line proceeding prior to November 22, then PYCO's Part 147 petition should be granted.

number of forms of relief when a party fails to make discovery ordered by this Board. The three remedies appropriate here are set forth in section 1114.31(b)(2)(ii)-(iv). These are as follows:

- refuse to allow the disobedient party to support or oppose designated claims or defenses, or prohibit him from introducing certain evidence;
- an order striking certain pleadings or portions thereof;
- an order requiring the payment of reasonable expenses, including attorneys fees.

Such relief is appropriate here. Accord, Missouri Pacific -- Abandonment -- In Desha and Chicot Counties, AR, ICC Dkt. AB-3 (Sub-no. 72), 1988 ICC Lexis 231 at *4, June 29, 1988 (striking protests from record).

C. Relief Sought

PYCO's discovery requests were based in large part on assertions made in KJRY's initial FLA (relating to Alternative Two) concerning KJRY's financial responsibility based on Pioneer's consolidated financial statements, and concerning KJRY's competency and fitness as an operator based on the experience of Pioneer and its various subsidiaries. Pioneer and KJRY have declined to respond to these requests.

It is therefore appropriate, and PYCO hereby requests, that this Board strike KJRY's initial FLA, or at least all portions in which KJRY argues it is financially responsible or competent in that initial FLA. Moreover, KJRY must be

prohibited from reliance on Pioneer or Pioneer subsidiaries in any way. In its FLA for all of SAW, KJRY purports to rely upon a loan by Pioneer's bank to Pioneer for the purposes of purchasing and operating SAW's assets in Lubbock. Since this is reliance on Pioneer for a showing of financial responsibility, all this evidence must be stricken. As stricken, KJRY's FLA lacks any showing of financial responsibility adequate for the SAW lines and must not be accepted.

Similarly, since KJRY and Pioneer have failed to respond to requests for information (e.g., litigation records, rehabilitation activities in the Pioneer system) germane to KJRY's ability, as a Pioneer subsidiary which shares the same president as Pioneer, to improve service, all evidence and claims presented by KJRY that it is likely to improve service to shippers in Lubbock must be stricken, and KJRY must be prohibited from presenting such evidence. Since KJRY thus cannot meet the requirements of 49 U.S.C. § 10907 for a finding of PCN, its application must be rejected.

In KJRY's limited response to PYCO's discovery and this Board's October 5 order, KJRY argues that evidence concerning Pioneer and its subsidiaries is not relevant because KJRY intends to rely only on itself. E.g., Exhibit B, p. 23. But this itself justifies striking KJRY's initial application, because KJRY no longer wishes to defend it. In any event, KJRY is really not relying only on itself. It is relying on a loan

by Pioneer's bank to Pioneer. Moreover, KJRY is owned by Pioneer, and the president of Pioneer and KJRY is the same man. Pioneer and KJRY may be separately organized for liability purposes, but for financial purposes they are joined at the hip. KJRY is attempting to hide reality behind a pretense. It is no more reasonable here than pretending Larry Wisener, Choo Choo Properties, and SAW are aliens to each other.

Pursuant to section 1114.31(b)(2)(iv), PYCO requests this Board award reasonable expenses to PYCO for all delays due to KJRY and Pioneer's failure to make discovery. Since KJRY's rebuttal (ostensibly the close of pleadings) would otherwise have been due on or about October 19, but now will be due on or about October 31, the delays will include at least the effect of 12 days time. But that is letting Pioneer/KJRY off too easily. Pioneer/KJRY has consistently followed a practice of seeking to delay this proceeding. In KJRY's FLA, KJRY admits that service to shippers and PYCO by SAW is inadequate. Since Pioneer/KJRY's practice is to delay the proceeding to pressure PYCO and shippers rather than to cooperate in securing an expeditious result to permit a new railroad to commence service on November 22, an appropriate remedy is to place on KJRY the risk of expenses caused by its delays, such as delays due to refusal to make discovery. In addition to increased attorneys fees and expert witness costs, the main expense incurred by PYCO and other shippers from delays in this proceeding will be exposure to retaliation by incumbent rail provider South Plains

Switching, Ltd. (SAW)⁵ when the alternative service order in F.D. 34802 expires on November 22. The best way to put this risk on the party causing it (KJRY) is to require KJRY to indemnify PYCO (and other shippers) for all expenses PYCO incurs after November 22 due to inadequate rail service or retaliation by SAW or entities like Choo-Choo Properties allied with SAW. PYCO requests this and such other relief as the Board feels just and appropriate.

II. Comments

A. Financial Responsibility

PYCO's showing of financial responsibility rests on the kind of operation PYCO envisions. PYCO does not pretend that SAW is "profitable" in the sense of having a GCV in excess of NLV (or for that matter a GCV above zero). PYCO's interest in SAW flows from the fact that unless PYCO receives adequate rail service, PYCO will go out of business. Since PYCO is a cooperative serving local farmers, it cannot simply move away or shut down without harming the entire Texas cottonbelt, and PYCO management has concluded that the cost of a local relocation costs would exceed the costs of buying SAW pursuant to 49 U.S.C. § 10907. Under the circumstances, it is economically rational for PYCO to subsidize purchase and, if necessary, all or a portion of the rehabilitation costs of SAW's decrepit physical plant. As a result of PYCO's intent to subsidize, all operating

⁵ SAW's retaliation is documented in filings by PYCO in F.D. 34802 and in F.D. 34890.

revenue is available to defray operational costs.

PYCO's consultants, and KJRY, all agree that operating revenue is likely to exceed operating costs, so long as rehabilitation costs are not taken into account.

Under these circumstances, PYCO need only demonstrate that it is able to pay the subsidy it says it is prepared to pay. PYCO in its Revised FLA demonstrated that it had available credit in excess of \$50,000,000. In our Exhibit F filed with our Rebuttal, PYCO provided its most current financial information. That information shows that PYCO continues to have this credit available, and in addition available cash in an amount well in excess of the amount needed to purchase SAW and to rehabilitate it. See Timothy Gannon statement, Exhibit C, circa p. 8. PYCO's available financial resources is many times greater than the estimated purchase price (NLV of \$2,274,000), plus the complete rehabilitation cost estimated by PYCO's experts (\$4 million to \$6.6 million), even if rehabilitation were undertaken all at once, notwithstanding the explanation of PYCO's experts that it would more likely be spread over a period of years.⁶ In short, PYCO has demonstrated it can do what it says it intends to do.

The situation is otherwise for KJRY. KJRY and its parent Pioneer have indicated that they intend to operate the SAW lines

⁶ For PYCO's NLV estimate, see PYCO's Modification to Valuation, F.D. 34890, September 28, 2006 at pages 4-10. For PYCO's position on rehabilitation costs (revised costs and also timing), see Gene Davis Verified Statement, Exhibit C to September 28 filing.

for a profit. They do not intend to subsidize operations, and KJRY states it does not intend to rely on a third party subsidizer.

In order to operate the lines for a profit, KJRY must show that they have a positive GCV. In addition, KJRY must show it has resources to buy and operate a line while paying that GCV without subsidy. We will focus on KJRY's alleged showing of financial responsibility to the extent necessary to purchase SAW, and to operate it for at least three years as a for-profit entity, taking into account recovery of the purchase price and only the rehabilitation costs that KJRY admits.

As we read the Pioneer/KJRY submissions, KJRY intends to rely on a \$3 million line of credit from Pioneer's bank to Pioneer to pay for the purchase.⁷ If "unforeseen need[s]" arise, KJRY proposes to draw further on that line of credit, or to rely on something it calls "free cash flow." What that is remains unclear. Other than Carr's assertion of such a thing, KJRY provided no evidence of \$1.5 million in free assets. According to the financial statements and bank commitments, all Pioneer and KJRY assets [REDACTED]. And as Mr. Gannon notes in Exhibit C, the KJRY financial statements which Pioneer and KJRY have furnished show a [REDACTED] in KJRY's financial health, with a dramatic [REDACTED]

⁷ In Part I above, PYCO indicated the Board should strike and prohibit such evidence and reliance due to the failure of KJRY and Pioneer's failure to make discovery notwithstanding this Board's order. The arguments in this section are in the event the Board does not grant the relief sought by PYCO.

[REDACTED] since 2004.

According to KJRY's FLA, KJRY's experts value SAW at an amount between \$2,486,779 (assuming no growth) and \$2,712,370 (assuming modest growth). KJRY FLA at 19. Since KJRY has only \$3,000,000 available for acquisition, obviously little money is left over to meet rehabilitation costs for this line. KJRY admits that approximately \$77,215 in rehabilitation is necessary "before KJRY begins operations."⁸ If one adds this figure to KJRY's projected purchase price, the range that KJRY must cover is \$2,563,994 to \$2,789,585. This is the minimum up front costs KJRY must borrow should its FLA be accepted at the valuation KJRY proposes.

For KJRY to be financially responsible, it must be able to show that it would be able to operate the SAW lines for three years while borrowing sums in the above range for its up front costs of acquisition.

KJRY's entire showing of financial responsibility in this regard rests on Exhibit 2 to Mr. Carr's Verified Statement. This Exhibit sets forth Mr. Carr's "pro forma" for three years of SAW operations by KJRY. There are three major problems with the pro formas.

First, Mr. Carr includes a charge of \$209,250 each year for "interest" as a deduction from cash flow. But this does not correspond to the terms of the loan on which KJRY purports to

⁸ Stice Verified Statement at unnumbered p.3, Exhibit C to KJRY FLA.

rely. Under the terms of the loan on which KJRY purports to rely, the actual charge for debt service each year ranges from \$350,489.64 per year (assuming a \$2,400,000 loan) to \$438,112.04 (assuming a \$3,000,000 loan). See Declaration of Tim Gannon, table 2, attached as Exhibit C. Given Mr. Brennan's optimistic revenue predictions and assumptions, SAW might basically break even at the level of \$2,400,000 in loans, assuming interest rates do not increase for the next five years, but for loans above that amount, or if interest rates increase, KJRY will have insufficient cash flow to cover debt service.

Unfortunately, the minimum amount KJRY will need to borrow exceeds \$2,400,000 on its own assumptions (KJRY projects a higher purchase price, and also necessary rehabilitation up front). KJRY thus will not be able to cover debt service on its own assumptions, and this indicates lack of financial responsibility.

Second, the terms of the loan commitment from Pioneer's bank base the interest rate on the LIBOR rate, to which is added 2.75%. But the LIBOR rate (currently about 5.31%) is a monthly rate for loans between financial institutions in London. KJRY is thus not borrowing its funds for acquisition and rehabilitation at a fixed interest rate, but instead at a variable rate. If interest goes up, then debt service costs will go up. Since the general expectation is that interest rates will continue to trend upward, KJRY's financial responsibility is additionally undercut.

Third, the revenue projections in Mr. Carr's pro forma for KJRY is unduly optimistic. The revenue in the "pro forma" is based on KJRY witness Brennan's assumptions leading to his GCV valuation on behalf of KJRY. In particular, the revenue appears to be based on the assumption of over 10,339 carloadings per year, which exceeds SAW's 8,678 car average over the past five years of data.⁹ Mr. Brennan appears to suggest in his statement that this carloadings figure favors SAW. But if the 10,339 carloadings overstates reality as Mr. Brennan suggests, then reliance upon it by Mr. Carr will overstate revenue in the pro formas, and this in turn means that less revenue will be available for debt service than Mr. Carr's calculations suggest.

If PYCO's carloadings for the fiscal year commencing October 2006 shrink to [REDACTED] as indicated in Mr. Lacy's Rebuttal Declaration, Appendix I (filed under seal) or even slide to only 2000, then Mr. Brennan's assumption of 10,339 carloadings is wildly optimistic, especially given everyone's concurrence that SAW's second largest shipper (Hanson with about 3000 carloadings in 2005) is no longer using SAW.¹⁰ If carloadings drop by 1000 carloads (at the single car rate division for PYCO carloadings under the BNSF/SAW contract), then

⁹ These are the numbers of KJRY's witness Brennan, at pp. 24-25 and Table IV of his statement, Exhibit B to KJRY's FLA.

¹⁰ Hanson says it will no longer use SAW's facilities due to hostile business practices by SAW. Hyer letter (in Declaration form), dated August 1, 2006. SAW's president acknowledged in her Verified Statement that Hanson was no longer a shipper but claimed Hanson was no longer competitive.

revenue and cash flow also drop by an amount in excess of \$100,000. This in turn means that KJRY's lack of financial responsibility grows even worse. KJRY at that level cannot even support a \$2.4 million loan. Indeed, KJRY faces a shortfall in revenue for each and every year if carloadings for the SAW lines return simply to their five year average as calculated by KJRY's witness Brennan.

Based on the analysis above, it is clear that KJRY lacks cash flow to do any rehabilitation of the SAW lines, or certainly any beyond the \$77,215 in rehabilitation which KJRY's witness Stice states is necessary before KJRY begins operations. Moreover, the bank loan on which KJRY will rely is secured on all the rail. This will make obtaining loans for rehabilitation from other sources more difficult.

The reason that KJRY denies any rehabilitation is necessary is tied to the analysis above. If KJRY admits that any significant rehabilitation is necessary, then its own financial statements indicate that it lacks resources to undertake it. KJRY admits that it should have access to sufficient funds for track rehabilitation. See Exhibit B, p. 16. If this Board finds that rehabilitation of the lines is necessary, as established in the statements filed by PYCO's expert (Gene Davis)¹¹ and in the statement filed by Mr. Gregory (based on the experience of WTL as PYCO's alternative service provider)¹², and

¹¹ E.g., PYCO modified valuation (Sept. 28), Exhibit C; PYCO Rebuttal (Oct. 19), Exhibit E.

¹² PYCO's Rebuttal (Oct. 19), Exhibit D.

Finally, Mr. Gannon in his analysis (Exhibit C) notes that KJRY's financial position appears to have [REDACTED] since 2004 based on the financial statements that KJRY supplied in discovery. Based on his analysis of the record and the discovery responses by KJRY and Pioneer, Mr. Gannon concludes that "KJRY cannot be deemed to be financially responsible." Ex. C, circa p. 8.

For all the reasons stated above and as Mr. Gannon, a CPA, concludes, KJRY lacks requisite financial responsibility, and this Board cannot find KJRY financially responsible for this acquisition and operation of rail lines.

B. Likelihood of Improving Service to Shippers

Under 49 U.S.C. § 10907(c)(1), this Board may find that PCN permits the sale of a line only if five specific conditions are met. One of those conditions, set forth in part (E) of section 10907(c)(1), is that the Board must find that "the sale of such line will be likely to result in improved railroad transportation for shippers that transport traffic over such line."

SAW has represented that it will not contest a finding of

PCN and raises no concerns under part (E). However, PYCO stands in a different position from SAW or KJRY. PYCO is not simply an applicant, but it also is a shipper. PYCO does desire a service improvement. While PYCO is certain it can improve service, PYCO is equally certain that KJRY will not. Thus KJRY fails to show PCN and PYCO objects to such a finding on the part of KJRY's competing application.

PYCO has demonstrated that its acquisition will improve service for all shippers in a variety of ways, including but not limited to the following: (a) PYCO is rooted in and committed to the Lubbock area and as an agricultural cooperative, its very purpose is to foster the economy of the Texas cottonbelt; (b) PYCO has the resources to subsidize purchase and rehabilitation; this in turn makes the operation of the rail line less subject to failure due to a dip in traffic; (c) PYCO's projected operator (West Texas and Lubbock, or WTL¹⁵) already operates locally, and this offers numerous economies and efficiencies; (d) additionally, WTL has extensive experience already operating on the lines pursuant to the alternative service order (F.D. 34802), and has improved service for PYCO in hostile conditions during a high-traffic year, while at the same time relieving congestion at the BNSF yard and mainline in Lubbock for the benefit of all shippers; (e) PYCO's expert (Mr. Davis) has already identified areas for track configurations to further improve service; (f) WTL and PYCO plan to improve service to

¹⁵ PYCO and WTL have signed a letter of intent.

PYCO (at PYCO's expense) by improving the yard and training PYCO employees in WTL rules so FRA compliant PYCO trackmobile switching can occur, freeing WTL assets to serve other customers.

In contrast, KJRY has presented no evidence that it is likely to improve service; it certainly offers no ideas in that regard. Moreover, as already explained, KJRY's own financial showings indicate that it will not be able to carry the debt it must assume to acquire the lines and to perform the minimal \$77,215 in rehabilitation it says is required before initiation of operations. Should interest rates go up, or should shipments go down from witness Brennan's projections (as the record indicates they will), then KJRY operations in Lubbock not only will begin in the red, but continue more and more deeply so. The SAW lines, which have so long been operated on a deferred maintenance basis, will continue to deteriorate, as will service. The "slow-motion" abandonment process which 49 U.S.C. § 10907 was to obviate¹⁶ instead will continue.

But the situation under KJRY is worse. Larry Wisener of SAW operated a track construction business, and thus SAW through Mr. Wisener had some capacity to run a deferred maintenance railroad: Mr. Wisener presumably was generally around to fix the tracks as they broke, if he chose to do so. In this sense, SAW was positioned to attempt to maximize short term profit by allowing its lines to deteriorate through deferred maintenance.

¹⁶ See PYCO Rebuttal in F.D. 34890 at pp. 13-14.

But KJRY does not have any local operations in Texas, much less a track maintenance crew on hand. It will have to contract out for everything, as it appears to admit in its FLA at p. 27 [last sentence of (15)]. Given KJRY's lack of resources to maintain and inability to fund rehabilitate, shippers will face sporadic service interruptions due to track failures or derailments to an even greater degree than they have faced with SAW. In other words, KJRY neither has funds or intent to do rehabilitation so the tracks are brought up to some kind of standard, nor does KJRY have any ability to operate any kind of efficient deferred maintenance program.

Even at this late date, KJRY has not presented evidence of a single shipper who supports its competing application. In contrast, a majority of shippers have filed comments supporting PYCO's application, and nine shippers have specifically opposed that of KJRY. See Compilation of shipper comments dated August 2, 2006, at p. 9, and attached shipper letters and statements, filed in F.D. 34890 and other dockets, and hereby incorporated into F.D. 34992. Many shippers have indicated they do not believe service by KJRY would likely be an improvement over SAW service. E.g., Stock Building Supply letter, Dodson Wholesale Lumber letter, Weaver Grain letter. PYCO specifically expects no service improvement from KJRY. Pioneer Railcorp subsidiaries have a reputation for litigation with Class I's, local communities, and shippers which is already manifest in KJRY's litigious approach to PYCO in this proceeding. Given the highly

leveraged nature of Pioneer, and of KJRY's proposed purchase of SAW, KJRY and Pioneer will lack the resources necessary to maintain and to operate the track. As a result, service will be no better than that of SAW, and almost certainly will be subject to demands by KJRY for subsidies and surcharges from its shippers.

In its FLA, KJRY claims that PYCO will have an incentive to discriminate against other shippers. PYCO is not seeking any contribution to the subsidy for the acquisition or rehabilitation of SAW's lines from other shippers. Moreover, as WTL has confirmed, WTL is already delivering SAW traffic from the BNSF yard to the SAW yard, and PYCO has instructed WTL to favor other shippers over PYCO in the event of resource limitations. There is not a shred of evidence of any discrimination or discriminatory intent to date, and PYCO flatly denies it.

PYCO intends to rehabilitate substantial portions of SAW's lines (including the SAW yard, which PYCO's plant no. 1 surrounds on three sides). WTL intends to train PYCO's trackmobile crew in WTL rules so that PYCO can perform much of its own switching out of that yard. PYCO expects an efficient operation in which it will rely on WTL less than it currently relies, and this means that WTL will have even more internal resources to devote to other customers and to growing the business of these customers. That is one of the reasons that other shippers prefer the PYCO FLA over KJRY's. KJRY is not

even close to offering the kind of concrete plans for service improvement and concrete showings of service improvement with WTL that PYCO and WTL have demonstrated.

C. Valuation/Rehabilitation

PYCO's "preliminary GCV" valuation (i.e., not taking into account rehabilitation) was approximately \$2.3 million. This was quite close to KJRY's range of \$2.4 to \$2.7 million.¹⁷ PYCO has no substantial objection to KJRY's methodology. However, for the reasons stated by Mr. Banks (his verified statement is contained in Appendix B at pp. 5-7 to PYCO Initial Comments filed October 12, 2006), Mr. Brennan's calculation of GCV for SAW overstates actual GCV for two reasons (leaving aside failure to take into account rehabilitation). Mr. Brennan failed to use the most accurate cotton adjustment factor, because he was evidently unaware of it. This results in an overstatement of GCV by about \$195,000. He also understated costs, resulting in an overstatement by about \$634,000. If both these errors are corrected, GCV as calculated by KJRY drops below NLV, just as it does for PYCO. But if NLV is less than GCV, then KJRY (which seeks the lines for a profit) is presumably no longer interested, and certainly not prepared to improve service, because the line by definition cannot be operated at a profit absent subsidization.

Contrary to KJRY's explanation based on Mr. Stice's limited

¹⁷ This puts the lie to KJRY's off-the-wall claims that PYCO is vastly undervaluing SAW.

visit, PYCO's outside experts have determined rehabilitation is necessary and appropriate based on several days of inspection,¹⁸ and this opinion has been corroborated by WTL,¹⁹ which has been operating on the lines since January. Indeed, as Mr. Lacy indicated in his Rebuttal Declaration, WTL has indicated that the lines are so deteriorated that the owner should consider an embargo on portions until they are repaired.²⁰ Any entity that acquires the SAW lines should have the resources to perform a substantial rehabilitation. That is necessary for safe, continuous and efficient operation.²¹

Conclusion

KJRY's FLA should not be accepted, or if accepted, KJRY should not be authorized to acquire the SAW lines. KJRY is not

¹⁸ Mr. Davis' main rebuttal of contentions that no rehabilitation is required is set forth in Exhibit E to PYCO's October 19 Rebuttal. See also PYCO's Modification to Valuation, September 28, 2006, at Exhibit C (Mr. Davis's discovery-related changes),

¹⁹ PYCO Rebuttal, Exhibit D (Gregory Dec.) at pp. 8-10.

²⁰ PYCO Rebuttal, Exhibit B (Lacy Dec. at pp. 14-15).

²¹ In its discovery response, KJRY states that it became interested in SAW when Mr. Mullins, Pioneer/KJRY's outside attorney, called the attention of Pioneer management (same as KJRY management) to the situation in early July, just days before competing applications were due. This is not what Pioneer's LaKemper represented to PYCO, but even if KJRY's most recent version of its belated interest were accepted, we believe that its cavalier and superficial nature as expressed in this expedited proceeding are themselves an indication that KJRY is interested in exploiting the SAW lines, not in improving service for shippers. There is no PCN in KJRY.

Any failure by PYCO to remark on a substantive aspect of KJRY's application should not be taken as agreement with that portion of the application; it more likely reflects lack of time.

financially responsible for this project, and is not likely to improve service over that shippers are experiencing from SAW. This Board cannot find PCN permits a KJRY acquisition. Finally, appropriate sanctions should be applied in response to the insufficient and dilatory response by Pioneer and KJRY to PYCO discovery, notwithstanding this Board's orders of October 5.

Respectfully submitted,



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for PYCO Industries, Inc.

Exhibit A -- DHL envelope and tracking list for document delivery

Exhibit B -- KJRY written response to PYCO discovery refusing to make discovery for Pioneer subsidiaries notwithstanding STB order

Exhibit C -- Declaration of Tim Gannon (analysis of KJRY pro formas and opinion on financial responsibility)
~~[Exhibit also contains KJRY financials reviewed by Mr. Gannon]~~ Omitted in public version

Exhibit D --



Omitted in public version

Certificate of Service

I hereby certify service of [REDACTED] of the foregoing Comments [REDACTED] upon the following counsel of record by express service, next business day delivery, this 24th day of October 2006:

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

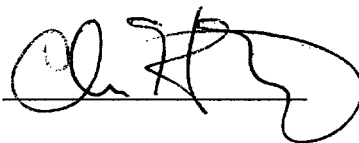
William Sippel, Esq.
Fletcher & Sippel
29 North Wacker Drive, Suite 920
Chicago, IL 60606-2832 (for US Rail Partners)

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) [REDACTED]
[REDACTED]

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

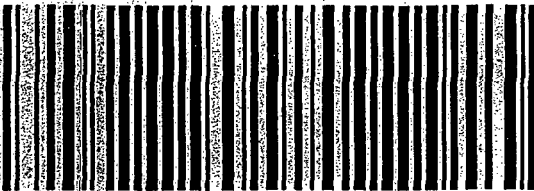
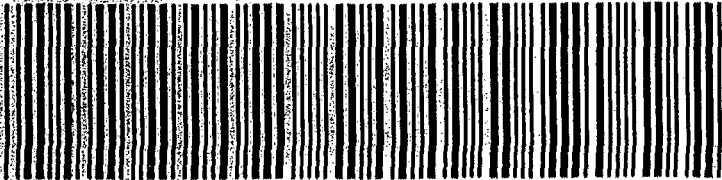


22 To date, PYCO has a record of receiving undertakings pursuant to the protective order only from counsel for Pioneer/KJRY (Messrs. Mullins and Wimbish). Because these comments have many references to information designated for confidentiality by KJRY and in one instance by PYCO, PYCO is providing only notice to other counsel of this filing pending receipt of signed undertakings.

Exhibit A

Private Carriage within the conditions of U.S. Administrative Regulations 39 CFR 320.6

DHL is not a shipper. Print waybill

	NAS	Pieces: 1/1
FM: BAKER & MILLER PLLC C. White 2401 PENNSYLVANIA AVE NW WASHINGTON, DC 20037 UNITED STATES Phone: 202-663-7820		ORIGIN: CBE Sender's ref.
To: CHARLES H. MONTANGE CHARLES H. MONTANGE 426 NW 162ND STREET SEATTLE, WA 98177 UNITED STATES		POSTCODE: 98177 TEL:
Description:		
Weight: Letter Date: 2006-10-10		
DHL standard terms and conditions apply.		
		BFIH 0Z
(2L)US98177		
		
WAYBILL: 18230990750		(Non-Negotiable)

Conte



DHL USA Home



Track results detail

Tracking results detail for 18230990750

Track

- ▶ Track by number
- ▶ Track by reference
- ▶ Get delivery signature
- ▶ Track DHL Same Day service

Tracking summary

Current Status	✓ Shipment delivered.	View Signature
Delivered on	10/11/2006 9:41 am	
Delivered to	Residence Door	
Signed for by	LD FD -426 162NW	What is this?

Log in to DHL

User ID Password ☐ Remember my User ID[Log in](#) ▶ [Forgot your Password?](#)

Tracking history

Date and Time	Status	Location
10/11/2006 9:41 am	Shipment delivered.	Seattle, WA Why is this?
7:31 am	Arrived at DHL facility.	Seattle, WA
12:41 am	Transit through sort facility.	Wilmington, OH
10/10/2006 7:31 pm	In transit.	Rockville, MD
6:47 pm	Picked Up by DHL.	Public Drop Box

Ship From: BAKER & MILLER PLLC Washington, DC 20037 United States	Ship To: CHARLES H. MONTANGE Seattle, WA 98177 United States	Shipment Information: Ship date: 10/10/2006 Pieces: 1 Total weight: 1 lb * Ship Type: Package Shipment Reference: Service: Next Day 3:00 Special Service: Description:
Attention: BAKER & MILLER PLLC	Attention: CHARLES H. MONTANGE	

Tracking detail provided by DHL: 10/18/2006, 9:15:52 am pt.

[Track new](#)

You are authorized to use DHL tracking systems solely to track shipments tendered by or for you to [use of DHL tracking systems and information is strictly prohibited.

* Note on weight:

The weights displayed on this website are the weights provided when the shipment was created. Actual weights may be different and will be provided on invoice.

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Exhibit B

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**STB DOCKET NO. 34890
STB DOCKET NO. 34922**

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

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

**RESPONSE OF KEOKUK JUNCTION
RAILWAY CO. TO DISCOVERY REQUESTS
OF PYCO INDUSTRIES, INC.**

Pursuant to 49 C.F.R. 1114 subpart B, Keokuk Junction Railway Co. ("KJRY") responds¹ to the discovery requests served by Pyco Industries, Inc. ("PYCO") on August 24² and August 30, 2006 (the "Requests") as follows:

GENERAL RESPONSES

KJRY hereby provides the following general responses to the Requests:

1. The use of "KJRY" in these responses shall include Keokuk Junction Railway Co.
2. The use of "Pioneer" in these responses shall mean Pioneer Railcorp.

¹ As per the Board's October 5, 2006 Order clarifying that the Protective Order issued in Pyco Industries, Inc. – Feeder Line Acquisition – Lines of South Plains Switching, Ltd. Co., STB Finance Docket No. 34890 (STB served Jul. 6, 2006) is also applicable to Finance Docket No. 34922, some documents attached hereto and made part hereof this Response are designated Confidential or Highly Confidential

² PYCO's first discovery requests include a certificate of service indicating service on "24 July 2006." That date is in error. The certificate should have stated "24 August 2006," which KJRY received on August 25.

3. KJRY is conducting a reasonable search for documents responsive to the Requests. Except as objections are noted in the general objections and in response to each respective request, KJRY has materially responded by producing all currently available responsive documents pursuant to this Request.

4. Production of documents or information does not necessarily imply that they are relevant to this proceeding, and is not to be construed as waiving any objection stated herein.

GENERAL OBJECTIONS

KJRY hereby provides the following general objections to the Requests:

1. KJRY objects to, and is not providing any information or documents in response to, requests that are vague, ambiguous, overly broad, unduly burdensome, irrelevant, not reasonably calculated to lead to the discovery of admissible evidence, require a special study, or are otherwise beyond the scope of permissible discovery.

2. KJRY objects to, and is not providing any information or documents in response to, requests that are otherwise protected under the attorney-client privilege or the work product doctrine.

3. KJRY objects to, and is not providing any information or documents in response to, requests that seek documents or information that is not within KJRY's custody or under its control.

4. KJRY objects to, and is not providing any information or documents in response to, requests that seek information or documents that are within the public domain, or are within the possession, custody or control of PYCO, and are thus as readily available to PYCO as KJRY. Notwithstanding this objection, KJRY may produce some responsive material of this kind, but KJRY will not attempt to produce all responsive material of this kind.

5. KJRY objects to, and is not providing any information or documents in response to, requests that seek information or documents that are drafts or proposals of contracts or agreements, as such materials may never be executed, and have no relevance to this proceeding.

6. KJRY objects to, and is not providing any information or documents in response to, requests that seek information or documents regarding negotiations of contracts or agreements on the grounds that a such request is overly broad, unduly burdensome, vague, ambiguous, and seeks documents and information that are neither relevant nor reasonably calculated to lead to the discovery of admissible evidence. Further, such requests seek information that is of a highly sensitive commercial and proprietary nature, and no showing of compelling need for such materials has been made.

7. KJRY objects to the "Definitions" and "Instructions" provided by PYCO on the grounds that they seek information and documents, or require efforts from KJRY, beyond that required by applicable regulations.

8. KJRY objects to the propounding of discovery upon Pioneer, a nonparty, absent clear Board directions that permit discovery against Pioneer. As per its agreement with PYCO, KJRY will respond to the Requests addressed below as if they were addressed to it, rather than Pioneer. KJRY objects to the definition of "Pioneer" contained on page one of PYCO's first requests for production of documents and interrogatories, not only because that definition would include information from Pioneer but also because it seeks information from or about Pioneer affiliates or subsidiaries other than KJRY, none of which are relevant to this proceeding. Consistent with these objections and where appropriate, KJRY has substituted itself for Pioneer where Pioneer has been named in a specific document request or interrogatory. KJRY's general objection notwithstanding and without waving it, KJRY may, in certain instances herein, include

information from or about Pioneer or may respond on behalf of Pioneer where it deems it sufficiently appropriate to do so in responding to a Request. Where a response contains the phrase "KJRY and Pioneer," that phrase indicates that KJRY and Pioneer are responding collectively to the request. Where it does so in its responses below, KJRY is not waiving its general objection as to the appropriateness of discovery against Pioneer, its affiliates or subsidiaries, but it hopes by doing so to facilitate the discovery process without further intervention of the Board.

9. KJRY objects to Requests that seek information extending back more than three years from the date of the Request.

Without waiver of the foregoing, KJRY responds to the Requests as follows:

DOCUMENT REQUESTS

1-a. All documents received from SAW by KJRY.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks irrelevant information. Notwithstanding its objections and without waving them, KJRY and Pioneer will provide all such documents in their possession, and they are attached hereto.

1-b. All documents delivered to SAW by KJRY.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks irrelevant information. Notwithstanding its objections and without waving them, KJRY and Pioneer state that there are no such documents.

1-c. All consultant reports prepared at the request of KJRY relating in any way to property currently owned by SAW in Lubbock, Texas.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks irrelevant information. Notwithstanding its objections and without waving them, the only document that may qualify under this request would be the Verified Statement of William J. Brennan, which was included with KJRY's expanded competing feeder line application filed in this docket on September 27, 2006 ("Expanded CFLA"). This is the only consultant that either KJRY or Pioneer retained in connection with this proposed transaction.

2. Any agreements, proposed agreements, or drafts of agreements or proposed agreements between SAW and KJRY.

Response: KJRY invokes general objection No. 5, above. That objection notwithstanding, KJRY and Pioneer state that there are no such documents.

3. All notes, records, reports or other documents bearing on meetings or telephone conferences between SAW and KJRY.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, seeks irrelevant information and information protected under the work product doctrine. Notwithstanding its objections and without waving them, KJRY and Pioneer state that there are no such non-privileged documents. Although there were telephone conversations between KJRY employees or representatives and SAW employees or representatives, neither KJRY nor Pioneer have created any non-privileged documents in connection with those contacts.

4. *All notes, records, reports or other documents bearing on inspection of the SAW lines in Lubbock by KJRY.*

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, seeks irrelevant information and information protected under the work product doctrine. KJRY notes that the only document responsive to this Request is the verified statement of Roger Stice in KJRY's Expanded CFLA.

5. *All notes, records, reports or other documents showing or arising out of communications with any shipper or potential shipper in Lubbock, Texas, and KJRY.*

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, seeks irrelevant information, and information protected under the work product doctrine. Notwithstanding its objections and without waving them, responsive documents are attached.

6. *From January 1, 1985 to the date on which KJRY responds to this document request:*

(a) All complaints filed in court or before a regulatory agency (e.g., Surface Transportation Board or Interstate Commerce Commission) by a shipper, a governmental entity owning a railroad, or another railroad naming KJRY (including one of its affiliates or subsidiaries or officers or directors) as a defendant or cross-defendant.

(b) All judicial and administrative decisions relating to any complaint provided in response to 6(a).

(c) All complaints filed in court or before a regulatory agency by KJRY against a governmental entity owning a railroad, a shipper, or another railroad for breach of contract or for failure to pay a tariff, surcharge and/or fee.

(d) All judicial and administrative decisions relating to any complaint provided in response to 6(c).

Response: KJRY objects to this interrogatory in its entirety. The document request and all of its subparts seek information that is not relevant to this proceeding, is available to PYCO outside of discovery as publicly available documents, is overly broad, and would unduly burden KJRY to produce. Moreover, KJRY also repeats its general objections 8 and 9 above. PYCO has neither established a need for such documents nor that the documents are not available except through discovery. Notwithstanding these objections, KJRY is providing some documents pursuant to this request for the past three years. KJRY is not providing any ICC or STB documents. ICC and STB documents are publicly available on the Board's website or in its reference room. KJRY may supplement its response hereto as additional documents are retrieved.

7. All documents relating to any informal complaints or objections made by governmental entities or shippers or potential shippers to the Interstate Commerce Commission or the Surface Transportation Board concerning KJRY.

Response: KJRY objects to this interrogatory in its entirety. The document request seeks information that is not relevant to this proceeding, is available to PYCO outside of discovery, and is overly broad. Notwithstanding these objections and without waving them, KJRY states that it has no such documents.

8. All documents showing the nature and scope of any proposed or possible rehabilitation of all or any portion of SAW lines in Lubbock, Texas, including all rehabilitation cost estimates.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks information protected under the work product doctrine. Notwithstanding its objections

and without waving them, KJRY notes that the document most responsive to this Request is the verified statement of Roger Stice in KJRY's Expanded CFLA, which addresses the issue of rehabilitation.

9. All documents showing expected costs of operations, including maintenance of way expenses, should KJRY acquire any or all of the SAW lines.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks information protected under the work product doctrine. Notwithstanding its objections and without waving them, KJRY and Pioneer state that there are no such documents other than the verified statements of J. Michael Carr (including the exhibits thereto), Shane Cullen, and William J. Brennan, each of which is contained in KJRY's Expanded CFLA.

10. All documents showing the source or possible sources of funds for acquisition, rehabilitation, and operation of the SAW lines should KJRY acquire such lines.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks information protected under the work product doctrine. Notwithstanding its objections and without waving them, KJRY states that the only relevant documents responsive to this Request are contained in the verified statements of J. Michael Carr in KJRY's original feeder line application for the Alternative Two lines and in the Expanded CFLA, which show and discuss the source of funds that KJRY would rely upon to acquire SAW.

11. All documents, including meeting notes, bearing on any contacts between KJRY and BNSF in connection with SAW property in Lubbock.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks information protected under the work product doctrine. Notwithstanding its objections and without waving them, KJRY and Pioneer respond that there are no such documents.

12. All financial projections and business plans prepared by KJRY or for KJRY in connection with possible purchase and operation of SAW's lines in Lubbock by KJRY.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks information protected under the work product doctrine. Notwithstanding its objections and without waving them, KJRY states that the only documents responsive to this Request are the verified statements of J. Michael Carr, Shane Cullen, Roger Stice, and William J. Brennan, each of which is included in KJRY's Expanded CFLA.

13. All title reports or information, and all appraisals or estimates of value, in the possession of KJRY relating to any real estate, fixtures, track or ties which KJRY has proposed to acquire from SAW, or intends to propose to acquire from SAW in Lubbock, Texas.

Response: Responsive documents are attached hereto. In addition to these documents, the only other documents responsive to this Request are the verified statements of J. Michael Carr, Roger Stice, and William J. Brennan, each of which is included in KJRY's Expanded CFLA.

14. All documents reflecting any agreement between KJRY and SAW should KJRY not acquire any of SAW's rail property in Lubbock from SAW.

Response: No such agreement exists, either as between KJRY and SAW or as between Pioneer and SAW. No such agreement was negotiated or discussed.

INTERROGATORIES

1. Deemed withdrawn pursuant to PYCO's Motion to Compel filed in this proceeding on September 26, 2006.

2-a. Identify all persons, including outside consultants, whom KJRY has employed or relied upon for purposes of estimating the value of SAW's assets in Lubbock which KJRY has proposed or contracted to acquire, the date of that employment, and summarize the estimate of value provided and the basis for that estimate.

Response: KJRY and Pioneer reply that the following individuals have devoted time to estimating the value of SAW's assets in Lubbock: Roger Stice, J. Michael Carr, Daniel A. LaKemper, Shane Cullen, and William J. Brennan, PhD. All other relevant information sought by this interrogatory is provided in full in the verified statements of these individuals in KJRY's original competing feeder line application filed on August 4, 2006 ("Original CFLA"), and in its Expanded CFLA.

2-b. Identify all persons, including outside consultants, whom KJRY has employed or relied upon for purposes of estimating the cost for rehabilitation of SAW's assets in Lubbock which KJRY has proposed or contracted to acquire, the date of that employment, and summarize the estimate of rehabilitation costs provided and the basis for that estimate.

Response: To the extent this interrogatory seeks relevant information, the individuals are: J. Michael Carr, Shane Cullen, and Roger Stice. Mr. Carr discussed rehabilitation in his verified statement accompanying KJRY's Original CFLA; Mr. Stice did so in his verified statement accompanying KJRY's Expanded CFLA. Mr. Cullen has assisted each in the

preparation of these verified statements. All other information relevant to this Request is contained in the verified statements of Messrs. Stice and Carr as described above.

2-c. Identify all persons, including outside consultants, with knowledge of how KJRY proposes to finance acquisition and rehabilitation of SAW's assets in Lubbock which KJRY has proposed or contracted to acquire; and summarize the knowledge that person has concerning such funding for KJRY.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks irrelevant information. Notwithstanding its objections and without waving them, KJRY and Pioneer answer: J. Michael Carr (for which all relevant information responsive to this request is contained in his two verified statements) and Michael A. Zeller, Senior Vice President of National City Bank (see Exhibit 1 to J. Michael Carr's verified statement in KJRY's Expanded CFLA). Mr. Carr and Mr. Zeller are the individuals who discussed and negotiated the commitment letter that constitutes Exhibit 1 to Mr. Carr's verified statement in KJRY's Expanded CFLA. Both are wholly familiar with the terms of that letter.

2-d. Identify all persons, including outside consultants, whom KJRY has employed or relied upon for purposes of contacting BNSF or shippers or potential shippers with respect to SAW's assets in Lubbock which KJRY has proposed or contracted to acquire; the date of each contact; and summarize the information supplied or received in connection with each such contact.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks irrelevant information. Notwithstanding its objections and without waving them, KJRY and Pioneer answer: J. Michael Carr and Daniel A. LaKemper. Mr. Carr recalls that he may have had one or more telephone discussions with representatives of BNSF in connection

with a possible acquisition of SAW's lines or a portion thereof. Mr. Carr has no documents memorializing or summarizing his discussions with BNSF, and he does not recall the particulars of those discussions.

Mr. LaKemper met with representatives of two of the shippers on or about August 30, 2006, to inquire about the adequacy of SAW service and the general service needs of each shipper. Mr. LaKemper also informed representatives of both businesses that KJRY intended to file a competing feeder line application covering all of SAW's lines. According to Mr. LaKemper's memory, both shippers expressed happiness with SAW's service. One expressed concern that PYCO would not serve smaller customers if it took over SAW's lines. One also expressed displeasure with PYCO's STB counsel because "he was a jerk." The only record of these contacts is a report prepared by Mr. LaKemper, KJRY's counsel, and tendered to Mr. Carr and to William A. Mullins (KJRY's counsel in this proceeding) in connection with, and in the furtherance of, the ongoing litigation. This document contains opinions and impressions of counsel. Accordingly, KJRY declines to produce this document pursuant to the attorney-client privilege.

3-a. Has KJRY received or prepared any report, appraisal, estimate, or information (oral or in writing) bearing upon the value of SAW's assets, or any portion thereof, in Lubbock, or the cost to rehabilitate such assets for rail purposes?

Response: Yes. See response to interrogatory 3-b, below.

3-b. If the answer to 3(a) is yes, please identify each such report by listing title, subject matter, person who prepared it, person who received it, date of preparation, date of receipt, amount

paid by KJRY for the information, and also provide a summary of the value or cost information set forth and the basis therefore.

Response: Neither KJRY nor Pioneer has prepared any such report, appraisal, or estimate beyond, as are relevant here, those contained in KJRY's Original FLA and its Expanded CFLA. KJRY has received information from SAW pertaining to the value of SAW's assets, which has been produced in response to Document Request 1-a., above.

4-a. Does KJRY have an agreement, orally or in writing, with SAW or any other person for reimbursement of KJRY should KJRY's efforts to acquire SAW's lines in Lubbock not be successful?

Response: Neither KJRY nor Pioneer have any such agreement with SAW or any other person, although both KJRY and Pioneer certainly wish that such an agreement existed.

4-b. If the answer to 4(a) is yes, please set forth the terms of the agreement.

Response: See answer to interrogatory 4-a, above.

5. State how KJRY first became aware of the possibility of acquiring the SAW assets in Lubbock.

Response: KJRY and Pioneer first became aware of the possibility of acquiring the SAW assets by way of their counsel, William A. Mullins, who chose on his own initiative to report upon his observations of the various ongoing proceedings at the Surface Transportation Board involving PYCO and SAW. KJRY and Pioneer believe that the first contact from Mr. Mullins suggesting that, under the circumstances, SAW might be available for purchase, if Pioneer or KJRY was interested, occurred on or about July 5, 2006.

6-a. *Should KJRY acquire rail assets from SAW in Lubbock for operation, state whether KJRY (1) intends to impose a surcharge or other charge or tariff (or increase in an existing charge or tariff) to obtain compensation from shippers in addition to what it receives from BNSF as a division of the line haul tariff, or (ii) is considering imposing such a surcharge or other charge or tariff, or increase, to obtain compensation from shippers in addition to what it receives from BNSF as a division of the line haul tariff.*

Response: KJRY and Pioneer state that the issue of surcharges is discussed thoroughly in KJRY's Expanded CFLA. In particular, KJRY directs PYCO's attention to the verified statement of William J. Brennan, PhD, of Transportation Economics, Inc., attached as Exhibit B to KJRY's Expanded CFLA. KJRY endorses Mr. Brennan's statements on the matter and submits that they speak for themselves.

6-b. *If the answer to 6(a) is yes, state (i) whether this issue has been discussed with BNSF and if so, who discussed it with BNSF and with whom at BNSF, and whether BNSF consented to any such surcharge or other charge or tariff; (ii) the identities of those shippers upon whom Pioneer is considering imposing a surcharge or other charge or tariff; and (iii) the amount of the surcharge or other charge or tariff to be imposed or under consideration for each shipper.*

Response: Neither KJRY nor Pioneer have had any discussions with BNSF on this issue. The balance of this interrogatory has been addressed in KJRY's response to interrogatory 6-a, above.

7. Deemed withdrawn pursuant to PYCO's Motion to Compel filed in this proceeding on September 26, 2006.

8. *If rail lines require rehabilitation, does KJRY agree that a railroad acquiring the lines should have the financial capability of paying for that rehabilitation? If the answer is no, please state all facts and arguments on which you rely for that answer.*

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, and seeks irrelevant information about KJRY's opinion. Notwithstanding its objections and without waving them, KJRY answers: KJRY does not understand the question, but believes that it is asking KJRY's view on a hypothetical situation. KJRY would agree, however, that a railroad should have access to the funds necessary to undertake needed track rehabilitation on the lines that it owns and acquires. KJRY possessed a similar view in acquiring certain lines of the Toledo, Peoria & Western Railway Corporation pursuant to the feeder line provisions in STB Finance Docket No. 34335.

9. Deemed withdrawn pursuant to PYCO's Motion to Compel filed in this proceeding on September 26, 2006.

10-a. *In KJRY's "Reply to Motion to Reject" dated August 16 at p. 11, KJRY claims that "SAW did not call Pioneer first." Why did Mr. Carr make a contrary representation to BNSF on or about August 2, 2006?*

Response: KJRY objects to this Request on the grounds that it is vague and seeks irrelevant information. Notwithstanding its objections and without waving them, answers: KJRY disputes whether Mr. Carr ever made such an allegedly "contrary representation." If he did, as is explained in KJRY's response to interrogatory 10-b., immediately below, then he was

mistaken in making such as assertion. Moreover, assuming *arguendo* that Mr. Carr did make such an allegedly “contrary representation,” it was not intended to mislead BNSF or any other party or nonparty to this proceeding.

10-b. Why did Mr. LaKemper make a contrary representation to PYCO’s Lubbock counsel (Mr. McLaren) on July 18, 2006?

Response: KJRY objects to this Request on the grounds that it is vague and seeks irrelevant information. Notwithstanding its objections and without waving them, KJRY answers: Mr. LaKemper made no such “contrary representation.” Mr. LaKemper originally contacted SAW’s attorney, Mr. Thomas McFarland, via email on Friday, July 7, 2006, to inquire about whether SAW would be willing to sell its lines in Lubbock. (Mr. LaKemper’s email to Mr. McFarland was precipitated by, and occurred shortly after, events described in KJRY’s response to interrogatory 5, above.) Mr. McFarland responded favorably to the inquiry later that day. This was the first contact between Pioneer and/or KJRY and SAW. Mr. LaKemper describes this exchange to some degree in his verified statement accompanying the Expanded CFLA. Subsequent to that original contact, SAW representatives other than SAW’s counsel, Mr. McFarland, have contacted Pioneer and/or KJRY in connection with a possible sale. PYCO’s apparent contention to the contrary – that SAW contacted Pioneer and/or KJRY first and that representatives of KJRY have so asserted – seems to be based on the mistaken assumption that Mr. LaKemper’s original overture to SAW’s counsel does not count as contacting SAW, but it certainly does. To the best of KJRY’s and Pioneer’s recollection, there was no relevant contact between SAW and KJRY or Pioneer prior to Mr. LaKemper’s inquiry to Mr. McFarland on July 7, 2006, which precipitated all other dialogue among KJRY, Pioneer, and SAW. This is why

KJRY has asserted on the record in this proceeding, and continues to assert, that SAW did not call Pioneer first. KJRY and Pioneer believe that PYCO may have misconstrued, or may misunderstand, the comments of Mr. Carr and Mr. LaKemper that appear to form the basis of this interrogatory.

10-c. When did SAW first contact Pioneer concerning possible sale of SAW assets in Lubbock to Pioneer?

Response: According to Mr. LaKemper's records, SAW (through its counsel, Mr. McFarland) first contacted Mr. LaKemper, counsel for KJRY and Pioneer, on July 7, 2006, approximately one half hour after Mr. LaKemper first inquired about the possible purchase of SAW's lines in Lubbock.

10-d. State the date of each subsequent contact between SAW and Pioneer concerning possible sale of SAW assets in Lubbock to Pioneer.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, seeks irrelevant information, and would require a special study. Notwithstanding its objections and without waving them, KJRY and Pioneer answer as follows: KJRY and Pioneer have not kept records of their respective contacts with SAW beyond those reflected in the documents produced in response to Document Request 1-a. As relevant to this interrogatory, contacts with SAW were, however, occasional and ongoing from the time that Mr. LaKemper initially contacted Mr. McFarland until such time as KJRY and Pioneer were informed that SAW's proposal to sell its lines in Lubbock was withdrawn because SAW preferred to proceed under an All-SAW feeder line application process.

10-e. For each date listed in response to (c) or (d), state the name of the person(s) involved for SAW and for Pioneer.

Response: Daniel A. Lakemper, J. Michael Carr, and William A. Mullins for, and on behalf of, KJRY and Pioneer; Dennis Olmstead, Delilah Wisener, and Thomas McFarland for, and on behalf of, SAW.

10-f. State the date of the contact referenced in KJRY's Reply at p. 11 n.6, the persons involved, who is referred to by the word "its" and whether KJRY disclosed it was considering filing a competing feeder line application.

Response: KJRY objects to this Request on the grounds that it is vague, overly broad, seeks irrelevant information, and is subject to the work product doctrine. Notwithstanding its objections and without waving them, KJRY and Pioneer answer as follows: The contact referenced above occurred as between Mr. LaKemper (and behalf of KJRY and Pioneer) and Mr. McClaren (counsel for PYCO) some time in late July or early August. (Mr. LaKemper does not recall the exact date and has no notes to consult on the subject.) "Its," as used in the passage quoted above could refer either to PYCO or to KJRY or to Pioneer or to all three. In retrospect, KJRY and Pioneer believe that the better term to use in that passage would have been "their respective" rather than "its," as this may have more accurately depicted the purpose behind the subject contact between KJRY's counsel and PYCO's counsel. Mr. LaKemper does not recall whether or not he indicated at that time about whether KJRY intended to file a competing feeder line application. According to the time frame that Mr. LaKemper believes the subject contact

took place, however, KJRY had already notified the Surface Transportation Board of its intention to file such a competing application, and PYCO would have been aware of this.

11-a. State all the facts on which KJRY relies for the claim that "PYCO knows the value of SAW's operations and appears to be trying to steal that value at artificially low NLV prices" as stated by KJRY in its "Reply to Motion to Reject" at p. 12.

Response: KJRY's statement was made on the basis of information and belief, informed by its review of PYCO's evidence on the issue up to that point in these proceedings, as well as KJRY's own assessment of the value of SAW's operations.

11-b. Describe in detail how PYCO can "steal" property that is valued by the Surface Transportation Board under 49 U.S.C. § 10907, as claimed by Pioneer in its "Reply to Motion to Reject" at p. 11.

Response: KJRY's comments reflect its view that PYCO has grossly understated SAW's going concern value. Neither PYCO nor any other feeder line applicant can "steal" a line under section 10907 any more so than anyone overlooking the obvious legal distinction between KJRY and Pioneer can change that fact by insisting stubbornly that they are the same entity.

11-c. Is KJRY contending that 49 U.S.C. § 10907 is an unconstitutional taking of property as applied to SAW?

Response: No.

11-d. If the answer to the forgoing is "yes," then please state all facts on which Pioneer relies.

Response: See answer to 11-c, above.

12. Deemed withdrawn pursuant to PYCO's Motion to Compel filed in this proceeding on September 26, 2006.

13-a and b. Is it Pioneer's contention that PYCO seeks to acquire SAW assets in order to create for itself an unfair competitive advantage? (b) If so, state the party or parties over whom KJRY so contends PYCO seeks to create an unfair competitive advantage, and state all the facts on which Pioneer relies for that allegation.

Response: KJRY does not contend that PYCO has initiated this feeder line application to obtain an unfair competitive advantage over any other shipper or shippers served by SAW. Rather, KJRY has indicated that a PYCO acquisition of SAW's assets would enable PYCO to attempt to exercise such an advantage if it wished to do so. KJRY cannot read the minds of PYCO's leadership, and therefore KJRY's comments focus on the potential for abuse and not on PYCO's intent.

14-a. Is it KJRY's contention that rehabilitation must be postponed if engages in rehabilitation would result in failure to make a reasonable profit from a rail line?

Response: KJRY does not understand the interrogatory. If PYCO is asking whether, following acquisition of SAW's lines, KJRY would, for the sake of profit, postpone track rehabilitation needed to operate those lines safely, then the answer is no.

14-b. Please state all facts and arguments on which Pioneer relies for its answer to (a).

Response: KJRY believes its answer to interrogatory 14-a speaks for itself. KJRY's answer to interrogatory 14-a (as KJRY understands it) flows from its understanding of a railroad's obligations to provide common carrier service on lines acquired under the feeder line provisions.

14-c. In KJRY's view, do rehabilitation costs increase or decrease over time if they are postponed?

Response: KJRY objects to this interrogatory as overly broad and irrelevant. KJRY is not aware that any party to this proceeding is arguing that necessary track rehabilitation will, could, or should be postponed, except possibly for PYCO itself. Notwithstanding its objections and without waiving them, KJRY states that postponed rehabilitation costs may increase or decrease over time, depending upon a variety of factors, including fluctuations in the cost of track materials needed, the economies of scale of larger-volume equipment purchases, technological advances, labor costs, weather conditions, etc.

14-d. Please state all facts on which Pioneer relies for its answer to 14-(c).

Response: KJRY's response to 14-c is based on its many years of operating experience as a railroad.

15. Please state in full KJRY's definition of "reasonable profit" (see KJRY's "Reply to Motion to Reject" at p. 12).

Response: KJRY objects to this interrogatory as irrelevant and immaterial. PYCO's interrogatory focuses on a statement or assertion made in support KJRY's Original CFLA which has since been supplemented by its Expanded CFLA. Notwithstanding its objections and without waiving them, KJRY submits that its Expanded CFLA includes evidence of KJRY's view of the line's profit potential as part of KJRY's system.

SUPPLEMENTAL REQUESTS

Supplemental Request 1. All loan agreements with National City Bank containing restrictive covenants and all documents relating to the covenant violation as of December 31, 2005, and waiver by the bank effective March 23, 2006 (see note 3 to consolidated financial statement furnished on August 22).

Response: KJRY objects to this interrogatory as irrelevant and immaterial. KJRY also objects to this Request under general objection 8, above, insofar as it seeks to obtain discovery from Pioneer. KJRY's objection notwithstanding and without waving it, KJRY responds that, in response to Requests, KJRY is providing extensive financial records for KJRY for PYCO's evaluation. These documents are attached. KJRY also encourages PYCO to consult the relevant evidence on KJRY's financial responsibility contained in KJRY's Expanded CFLA, which expanded on the evidence of KJRY's financial responsibility contained in KJRY's Original CFLA. The relevant evidence on KJRY's financial responsibility does not include, and KJRY does not rely upon, the combined financial statements of Pioneer which are the focus of this Request.

Supplemental Request 2. Copies of all agreements entered into on March 21, 2006, referenced in note 16 of the above referenced consolidated financial statements.

Response: See response to Supplemental Request 1, above.

Supplemental Request 3. Documents sufficient to show any changes since December 31, 2005, to date in the revolving line of credit, pledged assets, notes payable, and long-term debt of Pioneer Railcorp as set forth in note 3 to consolidated financial statements furnished on August 22.

Response: See response to Supplemental Request 1, above.

Supplemental Request 4. Identify the major customer referenced in note 9 to the consolidated financial statements furnished on August 22, and provide the revenues, carloads and commodities delivered to or received from this customer by KJRY for 2004 and 2005.

Response: KJRY objects to this request because it seeks irrelevant information, is unduly burdensome, and would require the disclosure of sensitive business information of an existing KJRY customer that is not located on the SAW lines that are the subject of the current feeder line proceedings. Notwithstanding its objections and without waiving them, KJRY will provide the identity of that shipper: Roquette America, Inc., 1417 Exchange Street, Keokuk, IA 52632. KJRY objects to, and for the sake of its customer, will not provide, any further information in connection with this request.

Supplemental Request 5. KJRY's estimate for its required cash on hand to operate its lines on an ongoing base.

Response: KJRY has provided financial records in connection with other Requests above that address this Request.

Supplemental Request 6. A list of the rehabilitation projects undertaken by KJRY at KJRY's expense in the last five years, including a statement of the work done and the nature of the rehabilitation, and how Pioneer financed or intends to finance the rehabilitation.

Response: KJRY objects to this Request because it is overly broad, unduly burdensome, seeks irrelevant information, and requires a study. KJRY's objections notwithstanding and without waiving them, KJRY will respond to PYCO's request, but will limit its responses to rehabilitation projects for the past three years. Accordingly, KJRY responds as follows: KJRY does not prepare or retain a record of projects categorized as "rehabilitation." Accordingly, it would take an unduly burdensome special study, particularly in light of the undefined term "rehabilitation," to answer this Request as PYCO might wish. Nevertheless, in the documents attached hereto, KJRY has included financial records referring to "capitalized expenditures," "capital expenditures," or "capital additions," some of which, though not all, would probably qualify under what KJRY understands would be "rehabilitation."

Supplemental Request 7. A list of the rehabilitation projects undertaken by Pioneer at the expense of a rail customer in the last five years, including a statement of the work done and the nature of the rehabilitation.

Response: KJRY objects to this Request because it is overly broad, unduly burdensome, seeks irrelevant information, and requires a study. KJRY's objections notwithstanding and without waiving them, KJRY will respond to PYCO's request, but will limit

its responses to rehabilitation projects for the past three years. Accordingly, KJRY responds as follows: none.

Supplemental Request 8. A list of all other rehabilitation projects undertaken by Pioneer in the last five years other than those stated in response to [6 and 7], including a statement of the work done, the nature of the rehabilitation, and how the rehabilitation was funded.

Response: KJRY objects to this Request because it is overly broad, unduly burdensome, seeks irrelevant information, and requires a study. KJRY's objections notwithstanding and without waiving them, KJRY states that Pioneer has undertaken no rehabilitation projects over the past three years. KJRY has, however, been engaged in state funded rehabilitation of a rail yard in Keokuk, IA – the Twin Rivers Yard. Funding for this project was loaned to KJRY from the State of Iowa. The funding arrangement, and the work conducted pursuant to that agreement, date back beyond the three-year time frame of KJRY's response. Nevertheless, the loan agreement, by its terms, is still active, insofar as KJRY is still servicing the debt under the loan agreement. Accordingly, records of this agreement are attached hereto.

Supplemental Request 9. Bank or brokerage statements sufficient to show KJRY's current cash on hand.

Response: See KJRY's response to Supplemental Requests 1 and 5, above.

Respectfully submitted,

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

William A. Mullins
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Suite 300
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Attorneys for Keokuk Junction Railway Co.

October 5, 2006

VERIFICATION

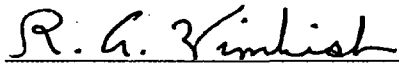
I, J. Michael Carr, declare under penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to provide the foregoing responses of Keokuk Junction Railway Co to the discovery requests of Pyco Industries, Inc. Executed this 5th day of October, 2006.

A handwritten signature in cursive script that reads "J. Michael Carr". The signature is written in dark ink and is centered on the page.

CERTIFICATE OF SERVICE

I hereby certify that on October 5, 2006, I have caused the foregoing Response of Keokuk Junction Railway Co. to Discovery Requests of Pyco Industries, Inc., to be served by overnight delivery on:

Charles H. Montange
426 NW 162nd Street
Seattle, WA 98177
TEL: (206) 546-1936



Robert A. Wimbish

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.**

**Verified Statement
of
Timothy J. Gannon**

October 24, 2006

**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.**

**Verified Statement
of
Timothy J. Gannon**

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

**Verified Statement
of
Timothy J. Gannon**

Qualifications

I am Timothy J. Gannon, CPA, a consultant and Director of Financial Analysis of the firm, R.L. Banks & Associates, Inc. (RLBA). My qualifications are detailed in Exhibit A of my statement. I appear in this proceeding on behalf of PYCO Industries, Inc. (PYCO).

Scope of Testimony

PYCO asked me to review and comment upon materials filed in this proceeding by counsel and various witnesses on behalf of the Keokuk Junction Railway (KJRY), with respect to the financial fitness of KJRY to operate South Plains Switching, Ltd. Co. (SAW).

KJRY's Estimate of Cash Flow

The application of KJRY to operate SAW contains the verified statement of J. Michael Carr which arrays KJRY's pro forma revenues, expenses, operating results and cash flow for three years. These results are based on the methodology contained in the Verified Statement sponsored by KJRY witness Mr. William J. Brennan, PhD. I have expanded these results to reflect the five year period over which KJRY will repay a loan

that it will use to finance the purchase of SAW. The cash flow that I have used is shown in Table 1 below.

Table 1			
Year	Revenues	Operating Expenses	Cash Flow
1	\$1,322,234	\$ 981,598	\$350,636
2	1,385,523	1,015,664	369,860
3	1,440,944	1,051,162	389,782
4	1,498,582	1,087,901	410,681
5	1,558,526	1,125,924	432,602
Source: Verified Statement of J. Michael Carr; Verified Statement of Mr. Brennan and RLBA.			

The revenues, operating expenses and cash flows shown in Table 1 for years 1, 2, and 3 were obtained directly from Mr. Carr's statement. I developed the revenues, operating expenses and cash flow for years 4 and 5 by adopted the methodology contained in Mr. Brennan's statement and reflected in the pro forma results sponsored by Mr. Carr as to years 1, 2 and 3. Specifically, I multiplied the revenues for Year 3 of \$1,440,944 by 1.04 to obtain Year 4 revenues of \$1,498,582 and the expenses for Year 3 of \$1,051,162 by 1.035 to obtain Year 4 expenses of \$1,087,901. I obtained the cash flow shown for Year 4 by subtracting expenses of \$1,087,901 from revenues of \$1,498,582, the result is cash flow of \$410,681 for Year 4. The same procedure was followed for Year 5 by applying the above factors to the revenues and expenses for Year 4.

KJRY's Ability To Service Loan Is In Doubt

Table 2 arrays the loan payment (principal and interest), cash flow available to make the loan payments, and cash surplus or shortfall after loan payments are made. The cash surplus, if there were one, would represent the monies available to rehabilitate or improve the property and provide a financial cushion of margin of safety. Loan payments are shown for two loan amounts (\$2,400,000 and \$3,000,000) since KJRY has said that it would expect the STB authorize KJRY to purchase for a price in this range. KJRY has further stated that it would borrow the necessary amount.

The monthly payments shown for each loan were calculated by using a 30 day LIBOR rate of 5.32% (this rate was obtained from Bank of America's web site as of October 23, 2006) plus a premium or markup of 2.75%. The loan payment amount is amortized over a ten year period but becomes due or "balloons" after five years. These are the same terms KJRY's cites in its application as coming from its lender.

Table 2

Loan Payments V. Projected Cash Flow
On Loans of \$2,400,000 and \$3,000,000 and Interest Rate of 8.07%
(30 Day LIBOR Rate of 5.32% Plus 2.75)

(Payments Made for 5 Years Based on 10 Year Amortization Schedule)

Original Loan of \$2,400,000 and Monthly Payment = \$29,207.47

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Cash Surplus (Shortfall)</u>
1	\$ 187,748.01	\$ 162,741.63	\$ 350,489.64	\$ 350,636.00	146.36
2	174,117.93	176,371.71	350,489.64	369,860.00	19,370.36
3	159,346.31	191,143.33	350,489.64	389,782.00	39,292.36
4	143,337.49	207,152.15	350,489.64	410,681.00	60,191.36
5	<u>125,987.94</u>	<u>224,501.70</u>	<u>350,489.64</u>	<u>432,602.00</u>	<u>82,112.36</u>
Total	\$ 790,537.67	\$ 961,910.52	\$ 1,752,448.20	\$ 1,953,561.00	\$ 201,112.80

Original Loan of \$3,000,000 and Monthly Payment = \$36,509.34

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Cash Surplus (Shortfall)</u>
1	\$ 234,684.99	\$ 203,427.05	\$ 438,112.04	\$ 350,636.00	(87,476.04)
2	217,647.41	220,464.63	438,112.04	369,860.00	(68,252.04)
3	199,182.84	238,929.20	438,112.04	389,782.00	(48,330.04)
4	179,171.87	258,940.17	438,112.04	410,681.00	(27,431.04)
5	<u>157,484.89</u>	<u>280,627.15</u>	<u>438,112.04</u>	<u>432,602.00</u>	<u>(5,510.04)</u>
Total	\$ 988,172.00	\$1,097,637.15	\$ 2,297,887.43	\$ 1,953,561.00	\$ (236,999.20)

Source: Table 1; RLBA.

Upon reviewing Table 2, it is evident that KJRY's own pro forma financial results will not provide adequate cash flow in the case of the \$2.4 million loan to both make loan payments, fund rehabilitation of the property and provide a financial cushion or margin of safety (The need for rehabilitation has been discussed extensively by my colleagues

Messrs. Banks and Davis in previous filings in this proceeding.). As to a loan in the amount of \$3 million, KJRY's own cash flow estimate is insufficient to make loan payments, as demonstrated by the cash shortfall in each year of the pro forma, let alone provide funds for rehabilitation or a financial cushion.

Should interest rates increase, as many analysts expect, KJRY's projected cash flow deteriorates as shown in Table 3 below.

Table 3

Loan Payments V. Projected Cash Flow
On Loans of \$2,400,000 and \$3,000,000 and Interest Rate of 9.07%
(30 Day LIBOR Rate of 6.32% Plus 2.75)

(Payments Made for 5 Years Based on 10 Year Amortization Schedule)

Original Loan of \$2,400,000 and Monthly Payment = \$30,493.18

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Cash Surplus (Shortfall)</u>
1	\$ 211,359.68	\$ 154,558.49	\$ 365,918.17	\$ 350,636.00	\$ (15,282.17)
2	196,743.52	169,174.65	365,918.17	369,860.00	3,941.83
3	180,745.17	185,173.00	365,918.18	389,782.00	23,863.83
4	163,233.92	202,684.25	365,918.17	410,681.00	44,762.83
5	<u>144,066.64</u>	<u>221,851.53</u>	<u>365,918.17</u>	<u>432,602.00</u>	<u>66,683.83</u>
Total	\$ 896,148.93	\$ 933,441.92	\$ 1,829,590.85	\$ 1,953,561.00	\$ 123,970.15

Original Loan of \$3,000,000 and Monthly Payment = \$38,116.48

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Surplus (Shortfall)</u>
1	\$ 264,199.59	\$ 193,198.11	\$ 457,397.70	\$ 350,636.00	\$ (106,761.60)
2	245,929.40	211,468.30	457,397.70	369,860.00	(87,537.70)
3	225,931.47	231,466.23	457,397.70	389,782.00	(67,615.70)
4	204,042.36	253,355.34	457,397.70	410,681.00	(46,716.70)
5	<u>180,083.29</u>	<u>277,314.41</u>	<u>457,397.70</u>	<u>432,602.00</u>	<u>(24,795.70)</u>
Total	\$ 1,120,186.11	\$ 1,166,802.39	\$ 2,286,988.50	\$ 1,953,561.00	\$ (333,427.50)

Source: Table 1; RLBA.

Table 3 arrays the loan payment (principal and interest), cash flow available to make loan payments, and cash surplus or shortfall in the same format as were the results on Table 2. The results in Table 3, however, assume a one percent increase in the 30 day

LIBOR rate to 6.32% which results in a total interest rate of 9.07% when the premium or markup of 2.75% is added to the LIBOR rate.

When the results shown on Table 3 are compared with the results shown on Table 2, it can be seen that a one percent increase in the LIBOR rate results in a decreased surplus cash surplus of nearly \$80,000 to \$124,000 as to the \$2.4 million loan and the cash shortfall increases by nearly \$100,000 to \$333,000 as to the \$3 million loan. Thus, even a minor increase in interest rates will further limit KJRY's ability to fund rehabilitation and provide a financial safety cushion.

KJRY's Performance Is Further Impacted By Traffic Reductions

As PYCO witness Mr. Robert Lacey has explained in his verified statements, PYCO will dramatically reduce its shipments in the upcoming season and for the foreseeable future. KJRY's witness Mr. Brennan has based his projections of revenue and expenses and thus KJRY's pro forma cash flows on a traffic base of more than 10,000 carloads. Table 4 demonstrates the impact of a modest decrease of 2,000 carloads from the unsustainable peak employed by Mr. Brennan in his analysis and utilized by Mr. Carr in his pro forma projections.

The cash flow lost and modified cash flow that is shown in Table 4 is the net result of revenue not earned (2,000 carloads at \$125.60 per carload in Year 1) reduced by expenses not incurred (2,000 carloads at 95.17 per carloads in Year 1). In subsequent years these results were increased in the same manner as were those shown in Table 1.

Table 4

<u>Projected Cash Flow</u>	<u>Revenues</u>	<u>Expenses</u>	<u>Cash Flow Lost</u>	<u>Modified Cash Flow</u>
\$350,636	\$ 251,200	\$ 190,340	\$ 60,860	\$ 289,776
369,860	261,248	196,946	64,302	305,558
389,782	271,698	203,829	67,869	321,913
410,681	282,566	210,953	71,613	339,068
432,602	293,869	218,326	75,543	357,059

Source: Table 1; RLBA.

Table 5 arrays the results of the cash flow reduction coming from a reduction of 2,000 carloads. The results shown on Table 5 employ the same inputs as were employed in Table 2 with the exception of cash flow which has been changed in Table 5 to reflect the effect of a modest decrease of 2,000 carloads as shown on Table 4. The results shown in Table 5 demonstrate that KJRY's ability to repay even the \$2.4 million loan is eliminated with the reduced carloadings that PYCO will have. The net result of the carload decrease over 5 years is a cash shortfall of over \$139,000 as to the \$2.4 million loan and a cash shortfall of nearly \$578,000 as to the \$3 million loan.

Table 5

Loan Payments V. Modified Projected Cash Flow
On Loans of \$2,400,000 and \$3,000,000 and Interest Rate of 8.07%
(30 Day LIBOR Rate of 5.32% Plus 2.75)

(Payments Made for 5 Years Based on 10 Year Amortization Schedule)

Original Loan of \$2,400,000 and Monthly Payment = \$29,207.47

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Cash Surplus (Shortfall)</u>
1	\$ 187,748.99	\$ 162,741.63	\$ 350,489.64	\$ 289,776.00	\$ (60,713.62)
2	174,117.92	176,371.71	350,489.64	305,558.00	(44,931.63)
3	159,346.31	191,143.33	350,489.64	321,913.00	(28,576.64)
4	143,337.49	207,152.15	350,489.64	339,068.00	(11,421.64)
5	<u>125,987.94</u>	<u>224,501.70</u>	<u>350,489.64</u>	<u>357,059.00</u>	<u>6,569.36</u>
Total	\$ 790,537.65	\$ 961,910.52	\$ 1,752,448.17	\$ 1,613,374.00	\$ (139,074.17)

Original Loan of \$3,000,000 and Monthly Payment = \$36,509.34

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Surplus (Shortfall)</u>
1	\$ 234,685.02	\$ 203,427.05	\$ 438,112.07	\$ 289,776.00	\$ (148,336.07)
2	217,647.44	220,464.63	438,112.07	305,558.00	(132,554.07)
3	199,182.87	238,929.20	438,112.07	321,913.00	(116,199.07)
4	179,171.90	258,940.17	438,112.07	339,068.00	(99,044.07)
5	<u>157,484.92</u>	<u>280,627.15</u>	<u>438,112.07</u>	<u>357,059.00</u>	<u>(81,053.07)</u>
Total	\$ 988,172.15	\$ 1,202,388.20	\$ 2,190,560.35	\$ 1,613,374.00	\$ (577,186.35)

Table 1; RLBA.

The negative financial impact of a reduction in carloads with an increase in interest rates is shown in Table 6 which was prepared with the same assumptions employed in Table 2 except for the cash flow which reflects the changes shown in Table 4. As can be seen the impact of the expected reduction in car loadings and a modest increase in interest rates produce a cash shortfall of over \$215,000 in the case of the \$2.4 million loan and over \$670,000 in the case of the \$3 million loan.

Table 6

Loan Payments V. Modified Projected Cash Flow

On Loans of \$2,400,000 and \$3,000,000 and Interest Rate of 9.07%
(30 Day LIBOR Rate of 6.32% Plus 2.75)

(Payments Made for 5 Years Based on 10 Year Amortization Schedule)

Original Loan of \$2,400,000 and Monthly Payment = \$29,207.47

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Cash Surplus (Shortfall)</u>
1	\$ 211,359.68	\$ 154,558.49	\$ 365,918.17	\$ 289,776.00	\$ (76,142.17)
2	196,743.52	169,174.65	365,918.17	305,558.00	(60,360.17)
3	180,745.17	185,173.00	365,918.17	321,913.00	(44,005.17)
4	163,233.92	202,684.25	365,918.17	339,068.00	(26,850.17)
5	<u>144,066.64</u>	<u>221,851.53</u>	<u>365,918.17</u>	<u>357,059.00</u>	<u>(8,859.17)</u>
Total	\$ 896,148.93	\$ 933,441.92	\$ 1,829,590.85	\$ 1,613,374.00	\$ (216,216.85)

Original Loan of \$3,000,000 and Monthly Payment = \$36,509.34

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Cash Flow</u>	<u>Cash Surplus (Shortfall)</u>
1	\$ 264,199.59	\$ 193,198.11	\$ 457,397.70	\$ 289,776.00	\$ (167,621.70)
2	245,929.40	211,468.30	457,397.70	305,558.00	(151,839.70)
3	225,931.47	231,466.23	457,397.70	321,913.00	(135,484.70)
4	204,042.36	253,355.34	457,397.70	339,068.00	(118,329.70)
5	<u>180,083.29</u>	<u>277,314.41</u>	<u>457,397.70</u>	<u>357,059.00</u>	<u>(100,338.70)</u>
Total	\$ 1,120,186.11	\$ 1,166,802.39	\$ 2,286,988.50	\$ 1,613,374.00	\$ (673,614.50)

Source: Table 1; RLBA.

KJRY Lacks PYCO's Financial Strength

The financial data provided by KJRY in discovery does not indicate a company which can provide strong additional support. For example, KJRY's balance sheet for December 31, 2005 shows



[REDACTED]

PYCO on the other hand possesses strong financial assets. For the year ended September 30, 2006 PYCO's ratio of liabilities to equity was [REDACTED]. In addition, as of September 30, 2006 PYCO had a cash balance of [REDACTED] through September 2010 that its cash position will never be less than [REDACTED]. In other words PYCO possesses now the ability to purchase the railway, fund rehabilitation and maintain a financial cushion or margin of safety.

Conclusions

After examination of the pro forma results presented by KJRY and the underlying materials, it is my opinion that KJRY cannot be deemed to be financially responsible party. KJRY will achieve its financial projections which, under the most favorable assumptions, provided only a marginal safety cushion and ability to repay the loan, let alone rehabilitate the railroad.

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:

Timothy D. Sarna

Timothy J. Gannon, CPA
Director, Financial Analysis

Education

BA Political Science, Pi Gamma Mu honorary society, Gannon University, 1973

Professional Certifications and Affiliations

Certified Public Accountant, District of Columbia; Member, American Institute of Certified Public Accountants; Member, D.C. Institute of Certified Public Accountants

Years of Transportation Experience

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Qualifications

Since joining the firm in 1980, Mr. Gannon has participated in scores of research projects involving transportation cost, revenue, rate and financial analyses for both freight and passenger rail systems, including numerous due diligence assignments. Other efforts undertaken on behalf of clients have included developing computer programs to quantify the probable traffic of prospective railroads, measure the economic impact of railroad operations and estimate railroad operating expenses as to specific movements. Mr. Gannon has directed or participated in many assessments of unit train coal and grain movements to utilities and grain elevators in the U.S. and Canada.

Relevant Project Experience

- **Kaiser Cement Corporation** Developed the variable costs associated with multi-carrier movement of coal in unit trains from mine to plant given varying delivery schedules and unit train configurations. This effort included estimation of the likely rail transportation rate as well as an assessment of the financial impact of leasing cars in lieu of railroad-supplied equipment.
- **Intermountain Power Agency (UT)** Assisted in the development of rail transportation rates, including estimating several Western railroads' operating and capital costs for the transportation of coal. Prepared an analysis of both the then-current and projected financial position of several trucking companies which might transport coal.
- **Keystone/Connemaugh Projects (PA)** Directed a study that assessed the feasibility of initiating the delivery of large volumes of coal to a coal-fired utility by unit coal train. Prepared an assessment of the likely impact of the movement on the delivering carrier's ability to provide reliable and consistent rail transportation services and projected rail transportation rates.
- **Monongahela Railway** As a contract employee of the railway, developed contract and rate proposals to shippers and connecting railroads, monitored shipper compliance with contract terms and tariffs, and provided other technical assistance to the carrier's managers. Designed computer applications to analyze rail dispatching and operating patterns, and to project rail traffic.
- **Board of County Commissioners, White Pine County (NV)** Participated in the development of rail transport of coal to a planned generating station. Estimated the cost to acquire and upgrade an existing rail line to efficiently handle coal unit trains, rail operating costs and financial and tax issues.
- **Bank of Boston, Bank of Montreal** Evaluated the reasonableness of financial projections advanced to obtain bank financing of I&M Rail Link. This was accomplished by integrating the findings of several professionals as to the reasonableness of proposed operating, maintenance, fleet adequacy and capital expenditure plans and related cost projections.

- **Central Trust Company** Directed the financial analysis aspects of this going-concern value of Chicago West Pullman Transportation Corporation (CWPT) railroad holding company as part of a bank loan review. Detailed analyses of historical and projected financial statements were performed and used to develop discounted cash flow going-concern valuations of each of the seven railroads owned by the CWPT as well as on a consolidated, holding company basis.
- **Berkshire Partners, Toronto Dominion Bank and New York Economic Development Authority.** Evaluated financial aspects of business plans of the Delaware and Hudson Railway Company, Wisconsin Central Ltd. and the Toledo, Peoria and Western Railroad.
- **Gainesville Regional Utilities (FL)** Participated in analyzing the economic feasibility of utilizing alternative transportation networks to deliver coal to GRU's Deerhaven Electric Generating Station in Hague, Florida. Assisted in the development of alternatives which included construction of a new rail line, rail-to-truck transfer movement and a rail-to-coal slurry combination.
- **States Rail Corporation** Analyzed the financial viability of a segment of the railroad for which abandonment was sought and the compensation offered by protestants. Developed evidence that the amount offered was non-compensatory and did not meet the STB's subsidy regulations.
- **NationsBank** Prepared the financial analysis concerning the viability of a short line railroad holding company with regard to its proposed refinancing of three properties and two properties it proposed to acquire. This effort included undertaking a detailed analysis of projected financial statements and the preparation of the going-concern value of each railroad.
- **South Orient Railroad** Analyzed the financial viability of a segment of the railroad on which abandonment was sought. Prepared financial and traffic exhibits required by STB regulations.
- **Westinghouse Electric Corporation** Calculated railroad variable costs and a range of rail transportation rates associated with movements of solid waste. Calculated the cost of moving waste in several different equipment types and at different daily volumes.
- **Several Class II Railroads** Calculated operating costs associated with numerous specific movements.
- **Refuse, Inc.** Prepared rail transportation cost estimates of waste-by-rail movements and estimates of the likely intermodal train contract rates which could be negotiated with railroad between multiple origin and destination pairs on behalf of this Nevada landfill operator.
- **Canadian Public/Private Advisory Committee** Developed a comparative analysis of rail transportation costs of Canadian and U.S. coal moving to Ontario, comprehending multiple origins and destinations. Estimated the cost to the railways of transporting coal over these routes, identified cost differentials and developed potential solutions to reduce the cost differences.
- **Utilities and Grain Terminals** Evaluated railroad unit train rate and service proposals. These analyses quantified the serving railroad's actual investments in asset as well as operating expense associated with the services to assess the reasonableness of proposed transportation rates.

Prior to joining RLBA, Mr. Gannon was employed as a financial manager and an accountant.

Publications and Presentations

Speaker, Annual Energy Outlook Conference, 1997; "Due Diligence: Business Plan Evaluation," 2nd Canadian Short Line Railroad Conference, Toronto, 1996.

Exhibit D

Omitted in
public version