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November 1, 2006

BY HAND DELIVERY

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

ENTERED
Office of Proceedings

NOV - 1 2006

Part of
Public Record

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

Dear Secretary Williams:

Enclosed are an original and eleven copies of the rebuttal in support of the expanded competing application of Keokuk Junction Railway Co. to acquire the lines of railroad that are also the subject of the expanded "All-SAW" application filed by Pyco Industries, Inc., in Finance Docket No. 34890.

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

Respectfully submitted,

William A. Mullins
Attorney for Keokuk Junction Railway Co.

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

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 34922

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

REBUTTAL



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Attorneys for Keokuk Junction Railway Co.

DATED: November 1, 2006

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SURFACE TRANSPORTATION BOARD**

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

REBUTTAL

On September 27, 2006, Keokuk Junction Railway Co. ("KJRY") filed its Expanded Competing Feeder Line Application ("Expanded CFLA") to acquire all of the rail assets of South Plains Switching, Ltd. Co. ("SAW") in Lubbock, TX – the so-called "All-SAW" option. On October 12, 2006, SAW and BNSF Railway Company ("BNSF") filed reply comments addressing, in part, KJRY's Expanded CFLA. Pursuant to a Board decision served October 5, 2006, Pyco Industries, Inc. ("PYCO") was given 14 days from the date it received final responses to its discovery that it had served on KJRY and its corporate parent, Pioneer Railcorp ("Pioneer"), to file reply comments on KJRY's Expanded CFLA. Pursuant to a decision served on October 17, 2006, the Board confirmed that the due date for PYCO's reply comments would be October 24, 2006. PYCO filed its reply comments to KJRY's Expanded CFLA on October 25, 2006,¹ behind schedule.² As the Board provided in a decision served in this proceeding on

¹ PYCO also filed what it styled as "initial comments" on KJRY's Expanded CFLA on October 12, 2006.

² It is not clear why PYCO failed timely to file its reply comments, but the Board's web site confirms that PYCO's reply comments were not deemed filed until October 25. It may be that PYCO opted to delay its filing because, as its reply comments clearly indicate, it is bitter over a Board decision served on October 17, 2006, wherein the Board disagreed with PYCO concerning the correct filing date for its reply comments to KJRY's expanded CFLA. It appears that PYCO attempted to file its comments by faxing a copy of them (over 200 pages in length) to the Board

October 5, 2006, KJRY was given 7 days after the filing of the latest comments to file its rebuttal. Because the last such reply comments to KJRY's Expanded CFLA were filed on October 25, 2006, KJRY hereby submits today its rebuttal to the reply comments of SAW, BNSF, and PYCO.

As KJRY has shown previously in this proceeding, and as it reaffirms below, the public convenience and necessity ("PC&N") warrant transfer of All-SAW from SAW to a financially responsible person. SAW has not contested that the PC&N test has been met and that the line qualifies for transfer under 49 U.S.C. 10907. KJRY has proven itself to be financially responsible under 49 U.S.C. 10907(a). It has the resources available to acquire All-SAW at its appropriate constitutional minimum value ("CMV"), and, unlike PYCO, has proven that it can and will operate All-SAW for a period of at least three years following its acquisition of the line. As such, the Board should grant KJRY's Expanded CFLA, reject PYCO's application, and order the line transferred to KJRY.

KJRY also responds again to BNSF's apparent claim that it may exercise an asserted right of first refusal to trump the ordinary and proper course of this feeder line proceeding. Finally, as will be shown, PYCO's obnoxious request to punish KJRY (by striking critical portions of KJRY's case-in-chief and imposing as yet unspecified sanctions against KJRY) is based on bogus, unsupported allegations and must be denied.

late in the day on October 24, 2006, but that it was unsuccessful. (The Board's rules governing filing methods do not provide for faxing as an appropriate method for accomplishing a filing – filings must be in paper form or accomplished by e-filing. See 49 CFR 1104.1.) PYCO also attempted later that day to fax its reply comments to KJRY, although that attempt also failed. PYCO did not request leave to late file its reply comments, and its late filing is in direct violation of a Board order. PYCO's reply comments are not timely and therefore should be stricken.

I. PUBLIC CONVENIENCE AND NECESSITY WARRANT TRANSFER OF ALL-SAW

The interested parties long have agreed that the relevant transaction (and, therefore, the relevant focus of the Board's assessment of the competing applications) is for All-SAW, as opposed to the so-called "Alternative Two" option involving the proposed transfer of only a designated portion of SAW's rail network in Lubbock. For that reason, KJRY has filed its Expanded CFLA and submits that the All-SAW acquisition proposed in that application would be required or permitted.

SAW, the proposed transferor of the lines in question, has stated that it does not oppose a Board finding that an All-SAW sale under the feeder line provisions is required or permitted. SAW's willingness to accept a PC&N finding to warrant transfer of All-SAW should be sufficient to allow the Board to proceed to an analysis of KJRY's financial responsibility. Nevertheless, in its own feeder line application ("FLA"),³ PYCO has developed an extensive record indicating that SAW has proven unable to provide adequate service to its shippers. The issue of SAW's inability to provide adequate service is further borne out by the Board's alternative service order – replacing SAW service over certain of its lines with a substitute rail carrier, West Texas & Lubbock Railway ("WTL") – in Pyco Industries, Inc. – Alternative Rail Service – South Plains Switching, Ltd. Co., STB Finance Docket No. 34802. Taken separately or together, SAW's position in the feeder line proceedings and the record of service problems developed by PYCO, establish that the PC&N test under Section 10907 has been met and that all of the lines owned and operated by SAW qualify for transfer under that section.

II. CONSTITUTIONAL MINIMUM VALUE FOR ALL-SAW

³ PYCO's FLA has been filed under STB Finance Docket No. 34890, which the Board has determined to be a proceeding related to KJRY's competing application in the subject STB Finance Docket No. 34922.

In providing for the transfer of All-SAW to a qualified applicant, the Board must establish the line's CMV, which is "presumed to be not less than the net liquidation value of such line or the going concern value of such line, whichever is greater." 49 U.S.C. 10907(b)(2). KJRY has put forth evidence that the line has a GCV between \$2,712,3700 and \$2,486,779 depending upon different traffic projections. To varying degrees PYCO and SAW have disputed this valuation evidence, asserting, respectively, that, among other things, All-SAW has a negative GCV and that the appropriate GCV is \$8,537,903 and in no event less than \$6 million. Having thoroughly assessed the entire record in this and its related proceedings, KJRY concludes that some of its previous calculations establishing that All-SAW possessed a going concern value ("GCV") greater than All-SAW's net liquidation value ("NLV") were incorrect; primarily due to the Board's recent decision revising the cost of capital calculation and the failure by Dr. Brennan to include URCS maintenance of way costs in his testimony. As a result, KJRY now agrees with PYCO and concludes that the lines possess a NLV that is *higher* than the line's GCV. Accordingly, the Board should find that NLV is the appropriate benchmark for setting the CMV for All-SAW. As discussed below, the correct NLV of All-SAW is \$2,274,000.

A. Net Liquidation Value

In its Expanded CFLA, KJRY asserted that All-SAW has an NLV of \$2,094,000. The factors involved in this NLV estimate are set forth in KJRY's Expanded CFLA at 10-13 and Exhibit C (Verified Statement of Roger Stice). Prior to its reply comments, SAW had asserted that All-SAW's NLV was \$6 million, based on offers that SAW claimed were sufficiently definite to be reliable evidence on the issue. On reply however, SAW now claims that this \$6 million figure should be considered a floor for purposes of computing GCV. Under the

circumstances, SAW has not provided any argument or testimony on NLV in its reply that KJRY could rebut.

KJRY had accepted and relied upon PYCO's NLV estimate and methodology in its Expanded CFLA. Since that time, PYCO has revised its estimate of NLV from \$2,094,000 to \$2,274,000, based on additional record evidence. See SAW Modified Valuation filed September 28, 2006, at 4-10. If the Board accepts PYCO's NLV evidence as the best evidence of All-SAW's value, and KJRY does not object to the Board accepting PYCO's evidence on this issue, then KJRY would be willing to acquire All-SAW for that price and is financially able to do so.

B. Going Concern Value

In its Expanded CFLA, KJRY maintained that All-SAW possessed a GCV of between \$2,712,3700 and \$2,486,779 depending upon projected traffic growth factors. Having re-examined its valuation evidence in light of the reply comments, especially in light of the Board's modification to the cost of capital component, which such modification significantly altered KJRY's GCV calculation, and in light of the testimony of R.L. Banks regarding Dr. Brennan's failure to include URCS maintenance of way costs, KJRY has concluded that its original GCV estimates are in error. The correct GCV for All-SAW is \$1,780,242.15. See Rebuttal Verified Statement of William J. Brennan, PhD. ("Brennan Rebuttal V.S."), attached hereto as Exhibit A. Because the All-SAW NLV is higher than KJRY's revised estimate of the lines' GCV, the appropriate CMV should be based on the liquidation value of All-SAW: \$2,274,000.

As discussed in the Brennan Rebuttal V.S., SAW's asserted GCV estimate of \$8,537,903 is based upon fundamentally flawed assumptions concerning future traffic and revenue. In fact, these same flaws in SAW's methodology were discussed at length in KJRY's Expanded CFLA and in Mr. Brennan's verified statement attached thereto. KJRY has been able to address the

issue before because SAW had introduced essentially the same evidence in its amended valuation figures for All-SAW on September 18, 2006. Of particular note, however, is SAW's continued reliance on surcharges that it has never actually assessed which impermissibly would inflate All-SAW's GCV.

Both KJRY and PYCO previously have discredited SAW's reliance on these wholly speculative (and, in some instances, punitive) surcharges in their respective cases-in-chief for All-SAW. To briefly revisit those points here, the fact that SAW claims to possess the right to assess such substantial surcharges, but has not exercised it, reveals that the surcharges are not reliable inputs for determining the value of All-SAW. PYCO insists not only that it could impose a \$60 or \$40 per car charge on all traffic, but also that its customers' demand for rail transportation is so inelastic that all of those customers would absorb the surcharge without reducing their demand for SAW's service one iota. SAW offers no empirical evidence for the latter proposition, but instead compares SAW shippers to captive unit train coal shippers. See SAW Reply Comments, Reply Verified Statement of Joseph J. Plaistow at 8.

SAW's surcharge tactic is sheer sleight of hand, a bogus construct. To begin with, all rail carriers not otherwise constrained by contract possess the legal "right" to charge shippers as much as they wish, subject only to the rate reasonableness limitations of 49 U.S.C. 10704 and market forces. Simply because such a "right" exists, does not mean that a GCV calculation needs to account for the fact that a rail carrier could raise rates or has the right to raise rates. Instead, GCV is properly based on what the carrier is in fact charging.

As confirmed in discovery and admitted by SAW, neither PYCO nor SAW are currently imposing surcharges, notwithstanding SAW's alleged right to do so. If SAW possesses both the contract right to impose a surcharge and the market dominance that it also claims, then it is

unclear why it has not imposed the \$40 to \$60 per car charge. Since it is not doing so, then it has either determined that it does not in fact have the ability to impose a surcharge or the demand elasticities of the traffic have prevented them from doing so. The bottom line is that the Board's NLV or GCV calculations must account for actual revenues being charged and collected, not phantom charges or alleged "rights" to impose surcharges.

Even if SAW is correct and that it has both the legal and market ability to charge a surcharge, it is unlikely that this asserted right to impose significant per car surcharges is a transferable asset with any saleable value. Because it is not assessing the surcharges, they cannot be considered revenue factors. Because the alleged right is being contested, and likely would continue to be contested, by BNSF and shippers, it is likely that such challenges would persist and might ultimately prevail under either a SAW regime or under a successor to SAW. It is also unclear what the ramification would be to SAW's business and the nature of its relationship with BNSF and shippers if the surcharges were imposed. It is therefore entirely unclear that SAW's alleged surcharge right would be of any measurable value upon a sale of the All-SAW assets. For these reasons, the alleged surcharge right is a nonfactor in All-SAW's valuation.

SAW's claim that the absolute minimum GCV for All-SAW should be \$6 million is equally meritless. Here also, SAW repeats arguments in its reply comments that it presented with its amended valuation evidence for All-SAW on September 18. These arguments have previously been discredited by KJRY and PYCO. See, e.g., KJRY Expanded CFLA at 11-13 and Exhibit D (Verified Statement of Daniel A. LaKemper). SAW does, however, introduce new evidence of a verbal offer from PYCO to SAW to purchase a portion of SAW's assets for \$5.5 million. See SAW Reply, Exhibit 1 (Reply Verified Statement of Delilah Wisener) at 2-3. This new evidence, like the other episodes SAW has related, spotlights another offer to negotiate

and nothing more. It, too, is an inadequate and unreliable basis upon which to set SAW's value. The cases that SAW claims support its position actually undercut it. The cited cases reaffirm that, to be reliable as a measure of a property's value, the purchase offer must constitute an *unqualified* commitment to purchase rather than a *preliminary* offer upon which further negotiation could be based. See SAW Reply at 5 (and cases cited therein). The offers by PYCO, Pioneer, and U.S. Rail Partner, Ltd. were all qualified offers and were based upon further due diligence and negotiation. As such, they are not reliable indicators of the line's value. SAW's introduction of these so-called purchase offers is merely an improper attempt to lure the Board away from the traditional assessments of value set forth in agency precedent and to influence the Board's findings on All-SAW value inappropriately.

Finally, while both KJRY and PYCO now agree that the lines have only net liquidation value, they do so for vastly different reasons. As noted, KJRY previously provided evidence that the lines had a going concern value and only required a minimum amount of rehabilitation. As explained in Dr. Brennan's rebuttal verified statement, KJRY no longer believes that its GCV calculations were correct. This is not due to the fact that KJRY now agrees with PYCO that the lines require such significant rehabilitation that the GCV value drops to below NLV, but rather due to recalculations due to the Board's change in the cost of capital and in an error in Dr. Brennan's calculations. Indeed, KJRY has proven that the lines require a minimal amount of up-front rehabilitation (\$77,215 worth). See verified statement of Roger Stice, attached as Exhibit C to KJRY's Expanded CFLA. KJRY stands by that evidence. This evidence is also basically consistent with SAW's conclusion that no rehabilitation is required at all and that the lines can be maintained as Class I status through normalized maintenance.

On the other hand, PYCO arrives at its conclusion that GCV is less than NLV due to its belief that All-SAW requires millions of dollars of rehabilitation to remain a viable operation. PYCO is simply incorrect in its assertions regarding the need for extensive rehabilitation. Both KJRY and SAW have already pointed out that all of SAW's lines are currently operational, proving that extensive rehabilitation is unnecessary to maintain the All-SAW property as a going concern ready and able to serve customers.⁴

Perhaps realizing that its assertions regarding extensive rehabilitation cannot be justified, PYCO now claims that the difference between KJRY's view of the necessary rehabilitation and PYCO's view may be a "problem of semantics." PYCO Initial Comments at 7. PYCO could not be more wrong. PYCO has not proven that rehabilitation is *necessary*. It has instead asserted a *preference*, based on the opinion of its expert, that the All-SAW lines be renovated. PYCO has never once proven that All-SAW would fail to function or could not adequately serve customers without the substantial renovation PYCO is promoting. In addition, the 7-year renovation program that PYCO embraces belies the sense of urgency in PYCO's argument and supporting testimony. Were that work essential, then it would have to be performed at a more accelerated pace than PYCO proposes.

Most importantly, however, the Board has precedent to resolve the question of whether to factor rehabilitation costs into its CMV analysis. That precedent is clear – in a feeder line application proceeding, where trains are operating over the lines in question, the Board will

⁴ KJRY believes that absent the Board's precedent requiring the use of URCS and the Board's newly issued cost of capital calculation in calculating GCV, the All-SAW alternative would clearly have a going concern value. KJRY is confident that it can acquire and operate All-SAW at a profit, especially because KJRY's cost structure is significantly less than those utilized in URCS. See Rebuttal Verified Statement of J. Michael Carr attached hereto as Exhibit B. ("Carr Rebuttal V.S."). Furthermore, if there is a revenue shortfall, Pioneer and KJRY have both indicated that sufficient resources exist to cover any such shortfall.

presume that the necessary rehabilitation will be minimal. See Caddo Antoine, et al. – Feeder Li. Acq. – Arkansas Midland RR, 4 S.T.B. 326, 341-342 (1999) (“Caddo Antoine”). Rather than openly attempt to distinguish precedent from the facts of this case or urge a reversal of policy, PYCO has merely ignored this decision. But the Board cannot ignore it. KJRY has already made the case twice for not factoring in PYCO’s rehabilitation expenses into All-SAW’s CMV, as has SAW. The facts, combined with Caddo Antoine, establish that PYCO’s extensive rehabilitation expenses should not be included in the Board’s CMV assessment here.

III. KJRY HAS THE RESOURCES TO ACQUIRE ALL-SAW AND OPERATE IT FOR THE REQUIRED THREE YEAR PERIOD

A. KJRY Has The Resources To Acquire SAW

To demonstrate its ability to fund its acquisition of All-SAW, KJRY has provided a commitment letter from National City Bank,⁵ establishing that bank’s commitment to fund the purchase (up to an amount of \$3,000,000) under terms set forth in the commitment letter. See KJRY Expanded CFLA, Verified Statement of J. Michael Carr, Exhibit 1. Neither SAW nor PYCO dispute that KJRY has the resources available to it to acquire All-SAW at what KJRY has asserted is the appropriate CMV for the lines. (PYCO, however, questions KJRY’s ability to fund the purchase only because it argues that, by excluding millions of dollars in rehabilitation costs (discussed above), KJRY has understated the *true* acquisition cost.)

Furthermore, in order to rebut any claims that Pioneer or KJRY could not repay the loan or fund any necessary rehabilitation or operation, National City Bank has advised Pioneer that it would be agreeable to committing another \$1 million to Pioneer for KJRY’s acquisition and

⁵ Unlike PYCO’s funding source, CoBank, National City Bank is completely independent of Pioneer and any of its subsidiaries. PYCO is a substantial shareholder of CoBank and two of PYCO’s principals sit on the CoBank Board of Directors. There is no evidence in the record that CoBank’s line of credit to PYCO’s can be used for the acquisition and operation of SAW or that CoBank is a legitimate independent funding source.

operation of All-SAW. The revision to National City Bank's commitment is an even more solid indication that KJRY has more than enough capital to acquire and operate All-SAW. See Exhibit 1 to the Carr Rebuttal V.S. These are the actions of an independent bank that obviously does not agree with PYCO's assertions regarding Pioneer's alleged financial inability to cover the acquisition and operation of All-SAW. Clearly, National City Bank, who knows more about Pioneer's and KJRY's financial situation than any other entity, believes that Pioneer and KJRY are financially responsible persons. In light of the \$4 million that KJRY may have at its disposal through Pioneer, KJRY has more than adequate funds available to purchase the line, assuming a CMV of \$2,274,000 for All-SAW. In addition, KJRY will have at least another \$1,726,00 left over to borrow against to rehabilitate the line and/or to cover other unanticipated costs.⁶

As it has explained in its Expanded CFLA, the funding arrangement that KJRY would implement to acquire All-SAW is nearly identical to the one that it employed to acquire lines in Illinois in Keokuk Junction Railway Co. – Feeder Railroad Development Application – Line Of Toledo, Peoria & Western Railway Corporation Between La Harpe And Hollis, IL, STB Finance Docket No. 34335 (STB served Feb. 7, 2005) ("KJRY-Feeder Line"), aff'd sub nom. Toledo, Peoria & W. Ry. v. Surface Transp. Bd., No. 05-1920, ___ F.3d ___ (7th Cir., Decided Sept. 7, 2006). None of the reply comments dispute the National City Bank commitment letter. Moreover, National City Bank has expressed no reservation with the subject line of credit. It would therefore be contrary to precedent to reject KJRY's funding source as inadequate.

⁶ Although KJRY has estimated that up-front rehabilitation would be only about \$77,215, it would have adequate funds available to it under the line of credit to fund additional track improvements if such improvements were later deemed necessary or to fund any necessary cash shortfalls.

B. KJRY Can Provide Rail Service For At Least Three Years Following Its Acquisition Of The Lines

In its Expanded CFLA, KJRY demonstrated its ability and commitment to provide adequate transportation over All-SAW for at least three years, and it included 3-year *pro forma* balance sheets in support. Those balance sheets presumed that the appropriate CMV of All-SAW was just over \$2.7 million. Based on its assessment of the reply evidence, KJRY now concludes that the appropriate CMV of the lines is \$2,274,000.

KJRY has already established that All-SAW could be operated profitably even if KJRY were required to pay \$2.7 million for the line. Obviously, if KJRY now acquires All-SAW for less, KJRY should likewise operate profitably. This is so even if one considers that the original *pro forma* may have understated costs because of Dr. Brennan's failure to include URCS maintenance of way expenses.⁷ In fact, as Mr. Carr's rebuttal statement confirms, KJRY is confident that All-SAW will be operated profitably. This is even confirmed by PYCO's own evidence that shows PYCO recovering operating and acquisition costs if one does not include the substantial rehabilitation costs.

Notwithstanding PYCO's own statements regarding the ability to cover operating and acquisition costs through All-SAW's revenue stream, PYCO's witness Gannon attempts to show that KJRY's operations would suffer heavy losses. But to make this showing, Mr. Gannon adjusted KJRY's traffic, revenue, interest rate, and cost assumptions. Mr. Gannon's assumptions are faulty, however, because, among other things, he has failed to consider that reducing KJRY's

⁷ The previously provided *pro forma* balance sheets derive from URCS costs which, in general, would be higher than KJRY actual costs to operate All-SAW. Likewise, the *pro formas* use the Board's cost of capital, which do not reflect Pioneer's or KJRY's costs of capital. See Carr Rebuttal V.S.

traffic projections also reduces the value of All-SAW and, in turn, the amount that KJRY would have to borrow to acquire the line. He also does not rely upon KJRY's actual costs.⁸

Nonetheless, to the extent that PYCO is correct that the lines could lose money even under KJRY's proposal, an assertion that KJRY does not agree with, Pioneer has already asserted that it has \$1.5 million of cash on hand that it would make available to KJRY to cover the acquisition and operation of the lines (see V.S. Carr, Original FLA, filed August 4) and notwithstanding that PYCO was given all financial information on Pioneer, it has not established that this assertion was unsubstantiated. Furthermore, as noted above, through the up to \$4 million line of credit that Pioneer will make available to KJRY, there will be at least \$1.7 million left over to fund any unplanned for costs or temporary revenue shortfalls.⁹ Certainly if PYCO is allowed to "subsidize" its losses through its line of credit, then KJRY should be allowed to do so as well. In the end, PYCO's jaundiced assessment of the viability of KJRY's future operation of All-SAW is unwarranted. All-SAW would add a valuable addition to KJRY's system. For these reasons, KJRY has reaffirmed that it has the means, commitment, and motivation to ensure that All-SAW customers receive service for at least three years.

In any event, it is not clear why PYCO's reply comments question Pioneer's or KJRY's ability to cover any possible losses in the first three years. In KJRY's Expanded CFLA, Mr. Carr clearly stated that KJRY had the funds to cover a shortfall. KJRY Expanded CFLA, Carr V.S. at

⁸ The attached Carr Rebuttal V.S. rebuts some of the assertions contained in PYCO's reply comments and in the Verified Statement of Timothy J. Gannon attached thereto.

⁹ Moreover, even under Mr. Gannon's assertions, it appears that the only reason KJRY loses money is because it has to make both principal and interest payments. This KJRY is willing to do because it would be building equity in a line that, in time, would be entirely self-sustaining and would be worthy of the investment that KJRY would be making to acquire it. See Carr Rebuttal V.S.

3-4.¹⁰ In connection with this issue, PYCO sought and obtained KJRY and Pioneer financial data. On reply, PYCO claims that it does not know how KJRY could cover a shortfall¹¹ (suggesting that Mr. Carr has not been truthful), but it does not explain why it lacks the ability to prove or disprove Mr. Carr's statement. If there was anything to PYCO's criticism, it could have substantiated it with information taken from KJRY's financial data, but PYCO did not do so. Evidently, PYCO wants the Board to believe that, as a general matter, Mr. Carr's verified testimony should not be trusted, even though PYCO cannot say why.

PYCO's focus on KJRY's cash flow and *pro forma* highlights the importance of such documents in feeder line cases and shows why the statute, the Board's regulations, and precedent require feeder line applicants to produce such information. Indeed, the attention PYCO devotes to KJRY's cash flow estimates and the *pro forma* KJRY has introduced is ironic, considering PYCO's failure to provide its own *pro forma* or any financial information regarding its chosen rail operator, WTL. PYCO's criticism of the *pro forma* underscores the astonishing double standard inherent in its attack. In fact, it would be arbitrary and capricious of the Board to grant PYCO's FLA, which depends upon use of line of credit from an affiliated bank to fund the transaction and which lacks the required *pro forma* and financial information required of both PYCO and WTL, but then deny KJRY's Expanded CFLA, which proposes a transaction using a line of credit funding from an independent bank and which included the requisite *pro forma* and financial information.

¹⁰ Pioneer, of course, has a vested interest in having KJRY's new investment succeed. It has every incentive to ensure that the line of credit it has secured for this transaction is serviced according to the terms of the loan and will provide KJRY with any necessary funds for KJRY to acquire, operate, and rehabilitate the lines. See Carr Rebuttal V.S.

¹¹ See PYCO Reply at 12.

Finally, in attacking KJRY's financial responsibility, PYCO draws comparisons to its own proposal for All-SAW. In particular, PYCO avers that it has demonstrated an ability to "pay the subsidy it says it is prepared to pay." PYCO Reply at 11.¹² This reference to a PYCO subsidy was introduced into the record impermissibly in PYCO's rebuttal. See KJRY's Motion to Strike filed October 24, 2006 at 9. PYCO's reply should address KJRY's Expanded CFLA, and should not to be used as a foil to introduce new or otherwise impermissible evidence in support of PYCO's own application.

As it noted in its motion to strike filed on October 24, 2006, KJRY lacks the opportunity under the Board's procedures to respond to new evidence PYCO has introduced on rebuttal. Thus, KJRY cannot test the particulars of PYCO's vaguely-described subsidy arrangement, including how it impacts WTL's proposed operations of All-SAW. KJRY had considered whether, in this rebuttal, to respond to the new evidence included in PYCO's rebuttal filing in STB Finance Docket No. 34890. KJRY recognized, however, that doing so would be impracticable under the tight procedural timeframes. Moreover, had KJRY commented upon the impermissibly filed new evidence in PYCO's rebuttal, its comments would be beyond the scope of the issues appropriate for KJRY's rebuttal, and its comments could validate or preserve evidence in the record that should be stricken. KJRY will await a decision from the Board either striking that new evidence or, in the alternative, granting KJRY a fair opportunity to address that new evidence.

¹² As KJRY noted in its motion to strike, PYCO's new subsidy evidence is not presented in connection with a written operating plan, written financing plan, or 3-year *pro forma* balance sheet. PYCO never explains how the subsidy arrangement would correlate with WTL's proposed operations and its separate efforts to obtain capital. And finally, neither PYCO nor WTL has ever explained how, in light of WTL's current operation of portions of SAW's lines with WTL personnel (not SAW employees), they would comply with the provisions of 49 U.S.C. 10907(e) concerning the requirement, to the fullest extent practicable, to use SAW employees to operate All-SAW.

IV. KJRY WILL PROVIDE IMPROVED SERVICE TO ALL-SAW SHIPPERS

PYCO's reply comments do not begin to discuss the merits of KJRY's Expanded CFLA until after PYCO has devoted roughly 7 pages to arguing that the basic elements of KJRY's case-in-chief should be stricken from the record and that KJRY should be subjected to as yet undetermined financial sanctions. (These matters will be discussed below.) Of the roughly 15 pages that PYCO actually devotes to the merits of KJRY's application, PYCO commits about a third of those to its oft-repeated and ludicrous assertions that KJRY is somehow "unfit" to assume operation of All-SAW. As much as PYCO may revel in denigrating unfairly the respective corporate character of KJRY and Pioneer, these baseless attacks have no place in this proceeding. They do not prove that KJRY's acquisition of All-SAW would be unlikely to result in improved service to shippers.

KJRY is an existing short line railroad with a long history of providing quality service to its customers. See KJRY Expanded CFLA, Carr V.S. at 1-2. It can provide the service that All-SAW shippers want and expect. Indeed, as discussed in the Carr Rebuttal V.S., there is only one party in this proceeding who has a record of acquiring rail lines through the feeder line process, rehabilitating the lines, restoring service to shippers, and in fact growing and improving that service and that is KJRY, not PYCO or WTL. As Mr. Carr explains, KJRY has proven that it can improve service to shippers who have suffered service failures and it will use that experience here. Furthermore, contrary to PYCO's baseless claims, KJRY is not regularly involved in litigation with its existing customers, nor does it have any "track record" of providing inadequate service. There is no way that PYCO can argue with a straight face that "KJRY has presented no evidence that it is likely to improve service" (PYCO Reply at 20). KJRY has provided such evidence and it will deliver.

On closer examination, the main thrusts of PYCO's allegation that KJRY will not provide improved service are – (1) that KJRY will lack the financial resources to do so, (2) that KJRY and its corporate affiliates are litigious, and (3) that, because PYCO proposes to spend much more on rehabilitating All-SAW than KJRY would, PYCO would be a comparatively better choice for All-SAW shippers. According to PYCO these points are relevant to the Board's assessment of the public convenience and necessity under 49 U.S.C. 10907(c)(1)(E). They are not. The first part of PYCO's attack is nothing more than a misplaced, redundant argument relating to the financial responsibility standards of section 10907(a), which PYCO has addressed elsewhere in its reply comments. PYCO's second and third points of attack are irrelevant. Even if it were true that KJRY and/or its corporate affiliates were comparatively more litigious than other railroads (and PYCO offers no evidence to support its point), PYCO does not, and cannot, prove that litigation has inured to the detriment of shippers anywhere.¹³ The final point of PYCO's attack merely reflects PYCO's desire to continue its pattern of character assassination and convert the feeder line process into some sort of beauty pageant. Section 10907(c)(1)(e) is not a vehicle for either tactic.

V. BNSF'S CLAIMED RIGHT OF FIRST REFUSAL SHOULD NOT BE ALLOWED TO TRUMP THE ORDINARY COURSE OF THE FEEDER LINE PROCESS

In its reply comments, BNSF repeats arguments made previously that the Board must uphold BNSF's right of first refusal in the event that BNSF chooses to exercise that right during the course of an STB-mandated sale of All-SAW. BNSF has never been clear about what it means by its "right of first refusal" or what it is precisely that it desires the Board to clarify.

¹³ If PYCO has evidence that Pioneer and KJRY were as litigious as they claim, then they should have produced it. As litigation is a matter of public record, it is not an excuse for PYCO to complain that it was KJRY's burden to produce evidence necessary for PYCO to prove its point. At a minimum, PYCO could have produced the information on which it relied upon to smear Pioneer's and KJRY's character.

BNSF may be concerned about its revenue requirements under its agreement with SAW and/or SAW's successor or about other provisions in those agreements that BNSF might want to ensure continue to apply to the feeder line applicant that SAW selects. If this is BNSF's concern, it need not be concerned. As it has done in earlier responses to BNSF's stated concern, KJRY assures once again that its intent is to merely "step into the shoes" of SAW with respect to the BNSF/SAW agreement and would accept fully the terms of SAW's agreement with BNSF should KJRY be selected to operate All-SAW. KJRY does not object to the preservation of BNSF's contract rights *subsequent* to the transfer to a feeder line acquirer. KJRY is agreeable to allowing BNSF's rights to survive the sale to a successful feeder line applicant, so that they would apply in the event that a feeder line acquiror subsequently attempted to sell All-SAW to a third party. In this sense, BNSF would fully retain its contractual rights and its right of first refusal.

Another possible interpretation of BNSF's position in this proceeding is that BNSF claims to possess an absolute right to trump the normal processes of a feeder line acquisition so that it may re-acquire All-SAW notwithstanding an agreement between SAW and a successful feeder line applicant; thus making the entire feeder line process a nullity and giving BNSF the ultimate decision to operate All-SAW itself or sell it to PYCO, KJRY, or any other entity outside of the feeder line process. BNSF has never made clear that it would not use its asserted right of first refusal in such a fashion. If this is what BNSF wants to be able to do, then KJRY must object. KJRY has explained at length (KJRY Expanded CFLA, Brennan V.S. at 26-30) why BNSF's asserted right of first refusal, if left entirely unfettered, would be contrary to the purposes of the feeder line provisions, and, if upheld by the Board, would be bad economic

policy. If this is BNSF's intent, then the Board needs to make clear that its order preempt any such asserted BNSF contractual right.¹⁴

BNSF's arguments concerning its asserted right are noteworthy more because of what BNSF *doesn't* say than what it does. BNSF's arguments resonate with concealed ulterior motives and its explanation behind why it should be allowed to exercise its right to trump SAW's selection of a feeder line acquirer strains credulity. BNSF has been anything but forthcoming about its specific objectives in raising the issue, and its comments prompt more questions than they answer. Specifically, does BNSF intend to use its asserted right in a manner that would displace a successful feeder line applicant of SAW's choosing? If so, *why exactly* might BNSF ask the Board to allow BNSF to exercise its right of first refusal (if it wishes) to trump the normal course of the feeder line process? Under what circumstances would it do so? Does it intend to exercise its asserted right in the event that SAW selects a particular feeder line applicant, and, if so, which one?¹⁵ Does BNSF have an agreement in principle with any shipper or with any party to this proceeding to use its asserted right ultimately to convey the property to

¹⁴ BNSF alleges, in passing, that the Board lacks jurisdiction to override BNSF's right of first refusal, although it does not articulate why this is so. Yet the Board has more than enough authority to override contractual commitments that would impede or frustrate the Board's orders. See generally New Eng. Cent. R.R. v. Springfield Terminal Ry. Co., 415 F. Supp. 2d 20 (D. Mass. 2006), 2006 U.S. Dist. LEXIS 4304 at **20-21 ("The plain language of the preemption provision [section 10501(b)] invokes the entire ICCTA, referring to remedies found in "this part"), San Luis Central Railroad Co. v. Springfield Terminal Railway Co., 369 F. Supp. 2d 172, 176-177 (D. Mass. 2005); Engelhard Corp. v. Springfield Terminal Railway Co., 193 F. Supp. 2d 385, 389-90 (D. Mass. 2002) (The concluding sentence of section 10501(b) is an unmistakable statement of Congress's intent to preempt state laws touching on the substantive aspects of rail transportation").

¹⁵ On the subject of BNSF's asserted right of first refusal, it is curious that PYCO is BNSF's biggest cheerleader. There is a reason, of course. BNSF's participation in this proceeding strongly suggests that BNSF is furthering an agenda to short circuit the feeder line process if need be (either because PYCO's application might be denied or because SAW might not choose PYCO) to ensure that All-SAW ends up in PYCO's hands regardless.

PYCO or to someone else? BNSF suggests that it would exercise its right to replace the incumbent SAW with a competent and ready Class I railroad (itself), but is BNSF truly willing and prepared to reinstitute service on a network of lines that disposed of for the sum of \$10? Does BNSF have the crews and motive power to provide service to All-SAW shippers if it opted to exercise its right?

The record does not suggest that BNSF truly intends to use its asserted right, if it were to use it at all, to retake All-SAW and operate it itself. BNSF has never manifested the desire or the wherewithal to do so. Much more likely, BNSF would invoke its right for the purposes of “flipping” the property to another would-be owner and/or operator in the interest of subverting the normal course of a feeder line transaction either to enrich itself or to curry favor with a shipper. Moreover, if BNSF’s right ensures the adequacy of service to All-SAW shippers (see BNSF Reply, Verified Statement of Weldon E. Hale at 7), then BNSF is already in a position to opine as to whether PYCO/WTL or KJRY are capable of providing the level of service required by All-SAW customers. But BNSF has not done so, and there is no reason to believe that BNSF finds either of the competing feeder line applicants here inadequate under its own standards.

Finally, BNSF is asserting an unprecedented right openly to interfere with and potentially to override the proper course of a feeder line transaction under section 10907. BNSF insists that its position is entirely consistent with the concept of the preservation of encumbrances discussed in Milford-Bennington Railroad Company, Inc. – Feeder Line Acquisition – Boston and Maine Corporation Hillsborough Branch, Finance Docket No. 31701 (ICC served Oct. 16, 1991) (“Milford-Bennington”). KJRY has already explained why that case is distinguishable from the facts here, but it is worth contrasting again the issues at play in Milford-Bennington and those involved here. Milford-Bennington clarified the scope of property rights and encumbrances that

a feeder line would inherit upon acquiring a line under section 10907. In that case, a transfer of the target lines to the feeder line applicant was presumed, and the disputed encumbrance would not preempt the acquisition of the line by the feeder line applicant. The issue here, on the other hand, is whether an otherwise successful feeder line applicant would be able to acquire the target lines *at all* due to an asserted “encumbrance.” Given the facts of that case, Milford-Bennington stands for the proposition that an “encumbrance” on a line of railroad may survive the transfer of the line to a feeder line acquiror (just as BNSF’s asserted right might, for example, survive KJRY’s acquisition of All-SAW); it should not be read to mean that a claimed contractual right can override or supersede the feeder line transaction itself.¹⁶

VI. PYCO’S REQUEST TO STRIKE CRITICAL PORTIONS OF KJRY’S APPLICATION AND RELATED FILINGS AND FOR SANCTIONS SHOULD BE DENIED

KJRY and its corporate parent, Pioneer, must be punished, insists PYCO. As spurious as that sounds and is, PYCO makes it with righteous indignation. According to PYCO, “Pioneer and KJRY failed to make a discovery response which was complete in respect to this Board’s order of October 5, 2006, on PYCO’s motion to compel.” PYCO Reply at 1-2. As will be shown, this allegation is utterly untrue, but PYCO, ignoring reality, insists that KJRY and Pioneer have been truly very naughty, so much so that the Board must strike essential elements of KJRY’s case-in-chief and impose as-yet-unspecified monetary sanctions against KJRY. Id. at 7-9.

¹⁶ Whether arranged as BNSF has done here or attempted by some other mechanism, there are numerous conceivable ways that a seller of a rail line in the ordinary course could insert a contractual provision that would, if allowed, block the application of the feeder line remedy if it were to be invoked in the future. Such “poison pill” provisions should not operate to override the ordinary application of section 10907 feeder line relief as BNSF has threatened that it may try to do here. Indeed, such a provision would be the ultimate paper barrier!

PYCO's allegation that KJRY and Pioneer have failed to respond properly to relevant discovery is as patently false. KJRY fully responded to PYCO's discovery on October 5, producing numerous documents and answering every single interrogatory with either a substantive response and/or a valid objection. KJRY responded notwithstanding the fact that PYCO's discovery was never properly directed and served on KJRY (it had been served on Pioneer, a non-party to the proceeding) and it did so as part of what it thought was a negotiated agreement with PYCO regarding KJRY's duties to respond. In so doing, notwithstanding its objection to discovery against Pioneer (including all of Pioneer's affiliates and subsidiaries), Pioneer explicitly also responded substantively to the vast majority of the interrogatories. Exhibit B to PYCO's Reply contains the full extent of KJRY's first response to all of PYCO's discovery requests (less the documents produced with them). As can be seen in that exhibit, Pioneer typically joined in the responses (where a response could be construed as relevant), and, in so doing, responded also for itself.

After issuance of the Board's October 5 decision, Pioneer likewise responded on October 10. KJRY had at first declined to produce information for Pioneer because Pioneer was not a party and KJRY had no authority to order it to produce the financial information PYCO sought. The October 5 Decision, however, settled the matter.¹⁷ In accordance with that decision, on

¹⁷ The Board ordered Pioneer to "respond to all of the discovery requests propounded by PYCO, to the extent Pioneer has responsive information to which KJRY does not have access, or that KJRY may not lawfully provide or produce." October 5 Decision at 3. The Board did not direct Pioneer or KJRY to forgo specific objections to discovery nor did it rule that all of PYCO's discovery requests were relevant. Rather, the only remark in that decision that could be construed as directed to any specific discovery requests was that Pioneer's responses about its financial status "may provide information reasonably calculated to lead to the discovery of admissible evidence." October 5 Decision at 2. Indeed, the Board's order specifically noted that PYCO did not have to submit its comments until 14 days after it received final responses to discovery, "including any responses compelled by the Board." *Id.* at 3. This gave PYCO complete freedom to determine if additional discovery was required and/or to file a motion to

October 10, 2006, Pioneer supplemented its responses to discovery where it had specifically declined previously to furnish information to PYCO. In particular, Pioneer provided all of the documents in its possession responsive to PYCO's supplemental requests 1 through 3, all of which related to Pioneer's financial status and the status of its relationship with lender, National City Bank. Accordingly, as of October 10, KJRY and Pioneer either had responded in full to each and every question contained in the discovery requests or in a few instances had provided some information and made specific objections to the remainder of the request.¹⁸ There was virtually nothing left to give, and absolutely nothing more that either KJRY or Pioneer could have supplied in response to PYCO's request for financial data. Indeed, PYCO does not point to a single piece of requested financial information that it did not receive by October 10.

Indeed, an examination of the specific facts clearly demonstrates that PYCO's inflammatory allegations are entirely untrue and misleading. As PYCO's Reply Exhibit B shows, PYCO originally propounded 38 separate, enumerated discovery items (documents requests, interrogatories, and "supplemental requests"). Of those 38 requests, 4 were

compel. In so doing, the Board's order did not require KJRY and Pioneer to give answers and produce documents to every single discovery request notwithstanding any objections KJRY and Pioneer may have otherwise asserted. The order merely required *Pioneer* (not KJRY) to respond, which Pioneer did by producing documents, answering interrogatories, and asserting some objections.

¹⁸ In its Reply, PYCO has already provided evidence of Pioneer's service of *all* of its responses to PYCO's discovery on October 10, 2006. Specifically, Pioneer furnished its responses by way of .pdf files sent by email to PYCO's counsel, with hard copies delivered the following day. PYCO cannot and does not deny that it received the emailed files. PYCO suggests, however, that it did not receive the full compliment of Pioneer's responses on the 10th, stating that the materials arrived in "two packets" over two days. PYCO is attempting to mislead the Board. It received everything on the 10th and again on the 11th. Having already seen through PYCO's smokescreen, the Board properly scheduled PYCO's reply comments for no later than October 24.

withdrawn.¹⁹ Of the remaining 34 requests, KJRY and Pioneer have responded in full to 28 of them and in part to the remaining 6 requests²⁰ despite their objections. With the exception of document requests 6 and 7 and supplemental requests 4, 6, 7, and 8, discussed below, KJRY and Pioneer have responded in full, and even in those instances where they did not, KJRY and Pioneer either responded in part or offered valid objections. If PYCO was uncertain about the scope of the responses of KJRY and Pioneer as of October 10, it should have consulted with KJRY to resolve the matter. In short, with the exception of document requests 6 and 7 and supplemental requests 4, 6, 7, and 8, there is nothing more that KJRY, Pioneer, or Pioneer's other subsidiaries or affiliates could supply even if they had been ordered to do so. If PYCO was unsatisfied with the responses and what it viewed as KJRY's and Pioneer's failure to respond, it should have filed a motion to compel responses to these individual requests. It did not and it should be forced to live with that decision.

Indeed, when one considers all of the facts, PYCO's arguments are full of sound and fury but lack substance. As to those few requests for which KJRY and Pioneer objected in total, KJRY and Pioneer issued valid objections in that the information sought was either publicly available or not relevant to the issues in a feeder line application. For example, the record shows that PYCO's document request 6 sought information concerning all instances since 1985 where KJRY, Pioneer, and/or Pioneer's various subsidiaries or affiliates were named either as a defendant or cross-defendant in civil court litigation or in proceedings before the Board or its predecessor, the Interstate Commerce Commission ("ICC"). Similarly, document request 7 seeks information concerning all instances, no matter how long ago, where KJRY, Pioneer,

¹⁹ Interrogatories 1, 7, 9, and 12.

²⁰ Document requests 6 and 7, supplemental requests 4, 6, 7, and 8.

and/or Pioneer's various subsidiaries or affiliates were the subject of an informal complaint to the Board or the ICC.

Pioneer and KJRY objected to these requests because, among other reasons given in its answer, the request sought information that was not relevant to this proceeding, and more importantly, the information was a matter of public record and could be obtained through a variety of research tools, including, among others, the Board's web site, Lexis/Nexis and Westlaw, and PYCO does not deny that this is so.²¹ Nevertheless, KJRY produced information as to itself, but only for the past 3 years. The litigation history of Pioneer (a noncarrier) and Pioneer's various affiliates and subsidiaries was not germane to this proceeding, but even if it were, this is information that PYCO could have, and should have, at least shown that it had made a reasonable attempt to obtain outside of discovery before it pressed KJRY for the information.

Supplemental request 4 concerned the identity of, and other particulars about, an existing KJRY shipper. KJRY identified that shipper, but has objected to the disclosure of the proprietary information that the balance of that request seeks. Supplemental requests 6-8 sought information concerning the track rehabilitation projects that KJRY, Pioneer, and/or Pioneer's various subsidiaries or affiliates have undertaken during the past five years. In each case, KJRY objected to the request for information with respect to anyone but KJRY and it objected to the

²¹ PYCO argues instead that the information was not "readily available" to it given "the time frame necessary for an expedited STB proceeding," and insists that the burden to produce this information therefore shifted to KJRY and Pioneer. PYCO Reply at 4-5. PYCO should not be rewarded for its own laziness. PYCO has made an issue of Pioneer's supposed litigiousness essentially from the moment KJRY indicated an interest in participating in this proceeding. Since the issue was clearly in PYCO's mind even before it tendered its discovery requests; it has had weeks to investigate the matter for itself. Under the circumstances, PYCO cannot now sit back and, with a straight face, blame KJRY or Pioneer for PYCO's own inability to make its case on this subject. Either PYCO did not find the information it hoped to present on the issue or, outside of asking KJRY to do its work for it, PYCO never seriously tried.

time frame.²² Nevertheless, KJRY did produce documents and responses as to itself for any and all rehabilitation projects undertaken during the past 3 years, and as for Pioneer, there were no documents to produce because Pioneer has not undertaken any such projects. Any such projects, and they were relatively few, were done under the legal authority of the relevant subsidiary, none of which were parties to this proceeding.

In fact, in its request to punish KJRY, PYCO mischaracterizes its own discovery and KJRY's responses to it. For example, although PYCO's document requests 6 and 7 clearly seek information in which KJRY, Pioneer, and/or Pioneer's various subsidiaries or affiliates have been *defendants and/or the subject of an informal complaint* to the Board or to the ICC, PYCO falsely claims that it also asked for information concerning litigation that these entities had initiated as plaintiffs. Specifically, PYCO claims that it sought to show where Pioneer and/or its subsidiaries "were affirmatively seeking to take actions contrary to shipper interests" and that it intended to show that "Pioneer and its subsidiaries have engaged in numerous instances of litigation *against* Class I railroads, shippers, or communities." PYCO Reply at 4 (emphasis added).

PYCO also accuses Pioneer of refusing to provide financial information related to the loan it would obtain to fund KJRY's acquisition of All-SAW. This might have been true prior to the October 5 Decision, but it is anything but true thereafter. Nevertheless, PYCO maintains that Pioneer *never* provided the requested financial data, even though, as of October 10, 2006, that is completely false. As noted above, PYCO's false witness in these proceedings is especially galling because PYCO fails anywhere to identify with specificity the discovery request or

²² Pioneer is not a rail carrier, and thus has no lines to rehabilitate. The rehabilitation projects of Pioneer's other subsidiaries are not relevant to this proceeding and would have been burdensome to produce.

requests to which Pioneer or KJRY failed fully to respond. PYCO refers, for example, to KJRY's refusal to respond to "most questions" on the issue of Pioneer's financial status, ignores the fact that Pioneer provided full and complete information in response to PYCO's requests on this issue on *October 10*, and cites KJRY's original reply to supplemental request 1 on *October 5* as "proof" that Pioneer has failed to respond. This problem is typical of PYCO's unsubstantiated allegations of KJRY wrongdoing.²³

PYCO seems to believe that the October 5 Decision contained a blanket finding that all of PYCO's discovery was relevant and appropriate with respect to Pioneer, KJRY, and all of KJRY's corporate sisters, but as discussed above in footnote 17, that was not the holding of the Board's decision. (A careful reading of the decision reveals that the Board did not "grant" PYCO's motion or "compel" substantive responses to all of PYCO's discovery requests but merely directed *Pioneer* (not KJRY) to respond to the discovery and in fact even contemplated PYCO's right to file a subsequent motion to compel if it felt that Pioneer's responses were not adequate.) Once it received Pioneer's responses to discovery on October 10, PYCO could have sought clarification from the Board concerning the scope of the October 5 Decision, consulted informally with KJRY to explore a resolution to the matter, or filed a motion to compel limited to the handful of requests where KJRY and Pioneer declined to provide complete responses. PYCO chose none of the above.

²³ PYCO suggests that KJRY's tactics in responding to PYCO's discovery were intended to impose hardship on PYCO and put pressure on All-SAW shippers. *Id.* at 9. PYCO cannot prove this of course, and KJRY flatly denies the accusation. As a company intending to provide service to All-SAW shippers in the future, such behavior by KJRY would be illogical. PYCO has spun KJRY's frustration with PYCO over PYCO's continued, wrongheaded insistence that KJRY and Pioneer are one and the same for purposes of the feeder line application process (which prompted KJRY's initial handling of PYCO's discovery) into something that it is not.

PYCO claims that it is so constrained by the timeframes of this proceeding that it had no choice but to request that KJRY be punished for alleged discovery-related misdeeds. That, also, is entirely untrue. At some point after it had sifted through the detailed responses and documents that it received from KJRY and Pioneer, PYCO had both the time and opportunity to seek a Board determination on whether in any instance the KJRY and Pioneer responses were inadequate. Moreover, there is no persuasive evidence that any harm would befall PYCO²⁴ or other All-SAW shippers if PYCO had chosen to file a motion to compel, and sought an extension to the procedural schedule, after receiving Pioneer's responses to discovery on October 10. The Board possesses the ability to ensure that no harm would befall shippers on All-SAW, and PYCO as much as admits it. See PYCO Reply at 6 n.4. Thus, PYCO has offered no reasonable excuse for its failure to proceed according to the appropriate channels for resolving discovery disputes here. It did not file a motion to compel addressing with specificity how KJRY and/or Pioneer have failed to respond to relevant, appropriate discovery requests, and it certainly did not do so with respect to the only six requests to which Pioneer and KJRY did not provide all of the information sought by PYCO. For all of these reasons, PYCO's request to strike critical portions of KJRY's feeder line application case-in-chief and for sanctions against KJRY is unsupported and unwarranted and must be denied.²⁵

²⁴ PYCO stresses its dependence on direct rail service. It has never once indicated that it is incapable of trucking its traffic to or from an alternative railhead in Lubbock, which would seem to be a distinct possibility, given the expenses PYCO insists it would be willing to incur to ensure the flow of traffic to and from its Lubbock plant. Moreover, PYCO has never resolved whether it could or might transfer its Lubbock production to its plant in Greenwood, MS, even though it has said the opposite could happen and in fact actually did, at one point, mothball its Greenwood plant and moved all of its product to Lubbock; proving that PYCO has the ability to shift production among its plants to account for transportation inadequacies and changes in the marketplace.

²⁵ PYCO has not pointed to any precedent indicating that the STB has the authority to impose the type of sanctions requested by PYCO nor could it because no such precedent exists.

CONCLUSION

With this rebuttal, the record on KJRY's Expanded CFLA to acquire All-SAW is complete. That record establishes that the public convenience and necessity warrants the transfer of All-SAW, and that the constitutional minimum value of All-SAW is \$2,274,000. KJRY has proven itself to be financially responsible to acquire and operate All-SAW, just as it has done in a previous feeder line proceeding, KJRY-Feeder Line, involving KJRY's acquisition of a rail line in Illinois. KJRY has demonstrated that it has the resources to acquire All-SAW and that it has the means and the commitment to ensure service to All-SAW customers well beyond the minimum 3 years required under section 10907(a)(2). In addition, KJRY is a proven short line operator with a long history of serving its customers well, and it certainly would provide service to All-SAW customers that would be a clear improvement over what these customers lately had received from SAW. KJRY's effort to provide improved service to All-SAW customers, and indeed the processes of the feeder line statute itself, would be undermined if BNSF were permitted to use its asserted right of first refusal to trump the proper course of this proceeding, and the Board should not permit that to happen.

Not only has KJRY provided a complete record supporting approval of its Expanded CFLA, it has provided its opponent, PYCO, with all of the information necessary for PYCO to evaluate KJRY's application. Despite that, PYCO has requested that KJRY be punished, based on vague and ultimately baseless accusations concerning KJRY's and Pioneer's respective responses to discovery. KJRY has committed no wrongdoing here to warrant any adverse action against KJRY's application or to support sanctions. In fact, when PYCO's vague allegations are considered against the specific facts, PYCO's demand that KJRY be punished is as silly and wrong-headed as it is meritless.

For all of the above reasons, KJRY's Expanded CFLA shows that the feeder line provisions should extend to a transfer of All-SAW and that KJRY's application should be granted.

Finally, as KJRY recently pointed out in a motion to strike filed on October 24, 2006, PYCO has attempted to introduce new evidence in its own rebuttal filing in STB Finance Docket No. 34890, which is counter to the appropriate scope of rebuttal. KJRY had considered whether or not to respond to that new evidence in this rebuttal, but thought better of doing so. If PYCO's impermissibly filed new evidence is not stricken, however, KJRY urges swift action from the Board to permit KJRY a fair opportunity to respond substantively to this new record evidence.

Respectfully submitted,



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DATED: November 1, 2006

CERTIFICATE OF SERVICE

I, Robert A. Wimbish, hereby certify that on November 1, 2006, I caused a copy of the foregoing rebuttal to be served by first class mail, postage prepaid, or by more expeditious service, upon all parties of record in Finance Docket No. 34922.

R. A. Wimbish
Robert A. Wimbish

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 34922

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

REBUTTAL

EXHIBIT A

**REBUTTAL VERIFIED STATEMENT OF
WILLIAM J. BRENNAN, PhD**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 34922

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

REBUTTAL

EXHIBIT A

**REBUTTAL VERIFIED STATEMENT OF
WILLIAM J. BRENNAN, PhD**

I. Introduction

I am William J. Brennan, Managing Director of Transportation Economics, Inc. ("TEI"), an economic consulting firm. At the request of Keokuk Junction Railway Co., ("KJRY"), I have submitted testimony twice before in this proceeding and now submit this final verified statement to address criticisms of my past testimony presented on reply by South Plains Switching Ltd., Co. ("SAW"), PYCO Industries, Inc. ("PYCO"), and BNSF Railway Co. ("BNSF").

II. Rebuttal of SAW's Criticisms Related to my GCV Calculations

SAW and its chief witness, Mr. Plaistow, continue to argue that the constitutional minimum value ("CMV") of All-SAW is more than \$8 million. As I showed in my opening statement, this figure is deeply flawed and grossly overstates All-SAW's CMV. Two key factors

account for the bulk of the differences between SAW and KJRY: (1) the proper application of surcharges; and (2) the appropriate base level traffic volumes to attribute to All-SAW. In both cases, SAW adheres to positions that are simply untenable.

Surcharges

KJRY objects to the SAW's "surcharges" on four grounds.¹ First, these surcharges appear to be a naked attempt to boost All-SAW's going concern value ("GCV"). Second, the surcharge on PYCO traffic appears discriminatory and retaliatory in nature.² Third, it is not clear that SAW's right to apply these surcharges would convey under any sale of All-SAW. Fourth, SAW mistakenly assumes that application of its surcharges has no effect on the demand for its services. Both Dr. Mahle and I have demonstrated that this assumption violates the most ordinary assumption of economics – the Law of Demand. This law posits that when the price for a good or service increases, consumer demand for that good or service will decrease. Demand curves slope down! This is a point that has been empirically validated in hundreds of academic studies and every day at auction houses across the globe (as the bids increase in price, bidders drop out, until there is only one "winner").

Yet, when questioned about his extreme assumption that SAW's customer base is demand inelastic, Mr. Plaistow is reduced to arguing, "While Witnesses Banks and Brennan state the surcharge would drive away rail customers, they offer no evidence to support their claims."

¹ As I discussed in my verified statement accompanying KJRY's Expanded Competing Feeder Line Application filed on September 27, 2006, the type of surcharge that SAW proposes to assess is quite different from the fuel cost surcharges that carriers such as KJRY sometimes assess when fuel costs spike.

² Mr. Plaistow may argue otherwise (See SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application and (2) PYCO's Amended Valuation Evidence, Plaistow V.S. at p. 9), but PYCO repeatedly has asserted that this particular surcharge is discriminatory and was issued in retaliation to PYCO's efforts to address service problems. See, e.g., PYCO Feeder Line Application filed on May 5, 2006, at 3.

It is not incumbent upon PYCO or KJRY to demonstrate the law of demand applies here.

Rather, SAW should explain why its proposed surcharges would not drive away traffic.

Indeed, I think it particularly rich that Mr. Plaistow characterizes my initial discussion as “esoteric,” and then proceeds to imply that – in the real world – BNSF can double its rates of captive coal traffic with no loss of carload traffic. Mr. Plaistow draws no distinction – as I did – between the short and long term. If BNSF has been able to double its rates on captive coal traffic, it has done so in an environment of rising global energy prices. Yet, I’m sure even that Mr. Plaistow can see evidence that these rising energy prices have prompted a stunning response by producers and consumers. Higher gas prices have prompted consumers to turn away from the heavy SUVs and have increased the popularity of “hybrid” vehicles. Among producers, ethanol production is expanding at a rapid clip,³ a furious race is underway to attract new workers to Alberta in order to exploit the oil sands,⁴ and (as the Board is well aware) the Dakota Minnesota & Eastern railroad – attracted by the high rates that BNSF and UP charge captive coal customers – is attempting to expand into the Powder River Basin.

In addition to these efforts, new technologies may soon reduce the quantity of energy consumers require. For example, we are on the verge of a revolutionary change in lighting technology as light-emitting diodes (LEDs) will soon replace conventional light bulbs. According to *The Economist*, “Worldwide about 20% of all electricity generated is used for lighting. Several studies suggest that LEDs could eventually cut that amount in half.”⁵ A recent

³ See “Ethanol Reshapes the Corn Market,” *Amber Waves*, April 2006. *Amber Waves* is the flagship magazine for the U.S. Department of Agriculture’s Economic Research Service (ERS). *Amber Waves* contains articles by ERS researchers and their collaborators. This article can be viewed on-line at <http://www.ers.usda.gov/AmberWaves/April06/pdf/EthanolFeatureApril06.pdf>

⁴ See “Canadian Politicians Address Labor,” *Nickle’s Daily Oil Bulletin*, October 4, 2006. Also at : http://www.dobmagazine.nickles.com/article.asp?article=%5Cdob%5C061004%5Cdob2006_o40003.html

⁵ *The Economist*, “An Even Brighter Idea,” September 21, 2006.

pull-out section of the *Wall Street Journal* entitled, "Less Power to the People," listed 10 innovations that will reduce the amount of energy we consume.⁶ LEDs led this list as well, but the *Journal* also noted the role that more-efficient hardware, better sensors, new building codes, and variable pricing programs are expected to have in the near future. Just as "esoteric" economic theory would predict, higher prices are prompting widespread changes in the marketplace. There is no reason to suspect that application of substantial surcharges on the SAW's traffic base would not do the same.

I also note that Mr. Plaistow, rather than directly discrediting my estimate the surcharge would likely raise overall rates by 7.4 percent (implying a long-term reduction in SAW's traffic base of 14.1 percent), instead looks at the average BNSF rate for Oil Seed traffic and implies that a \$60 surcharge only represents a 2 percent increase. Of course, the typical BNSF movement is not interchanged with a Class III carrier. It would have been better for Mr. Plaistow to demonstrate why my initial estimate was wrong (if it was wrong) rather than to attempt this sort of apples-to-oranges comparison.

SAW's surcharges are a naked attempt to manipulate this proceeding. I question whether the asserted right to assess these surcharges is transferable, and doubt that BNSF, among others, would allow it to be. Moreover, there is no evidence that these potential surcharges would fall on demand inelastic traffic and so boost the SAW's CMV by more than 200 percent. I certainly do not believe that a seller should be allowed to make any claim, however fatuous, that boosts GCV and then – when confronted by evidence that contradicts his assertions – argue that the applicant is inappropriately determining the GCV to the buyer, not the seller. Such a position has as much merit as the claims of the proverbial miscreant who, after murdering his parents, begged the mercy of the Court on the grounds that he was an orphan.

⁶ *The Wall Street Journal*, October 16, 2006.

2006 Traffic Base

The second key factor that distinguishes KJRY's GCV from SAW's is our differences over the appropriate base year traffic volumes. No one disputes that 2005 was a very good year for SAW. The question the Board must decide is whether such good fortune was an anomaly, after which traffic would return to a trend-line or whether it represents a new beginning for SAW's fortunes. For Mr. Plaistow's arguments persuasive, the Board must look at the following time series, which comes directly from Table 1 of his October 12 Verified Statement (p. 12), and conclude that the 2005 carloads are not an outlier but a new beginning.

Table 1: PYCO Rail Traffic Levels

Year	PYCO Carloads
2000	1,607
2001	2,817
2002	1,941
2003	1,995
2004	1,920
2005	5,950

Source: SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application; and (2) PYCO's Amended Valuation Evidence, Plaistow V.S. at p. 12.

It is not a long time series, but a 2005 figure which is *more than double* the next largest year (2001) is certainly conspicuous. And SAW has presented no evidence to suggest that the 2005 traffic volumes were anything but extraordinary. Indeed, although Delilah Wisener now disputes my assumption that SAW's car count is related to the size of Texas Cotton crops, it was Ms. Wisener herself who stated, "[P]rivate trackage... was inadequate to accommodate the

number of railcars that would be required to be shipped each day in the event of a large cotton crop in the area. *It turned out that there was such a crop in 2005.* PYCO wanted to ship 24 cars per day from its Plant No. 1, but its private trackage at that Plant could accommodate only 13 cars at a time.”⁷ I can hardly be faulted for taking Ms. Wisener’s verified statement seriously and connecting SAW’s traffic volumes with the local cotton crop.

Indeed, it was after I first read Ms. Wisener’s above-quoted testimony that I consulted the data from the U.S. Department of Agriculture (“USDA”). These data make clear that 2005 was a banner year for production of upland cotton in Texas. Planting conditions and weather throughout the growing season had proved particularly favorable to cotton production. In light of this evidence, I concluded that the 2005 cotton traffic on SAW was, in fact, an aberration and that SAW has inappropriately used its 2005 volumes to exaggerate its future cash flows and the lines’ GCV. After all, notwithstanding any contractual commitments that PYCO may or may not have, it will to prove impossible to press cotton seeds that do not exist.

Having concluded that SAW’s 2005 cotton traffic volumes were outliers, I needed to establish a more reasonable base year from which to calculate cash flows. I decided to use USDA’s data for Texas cotton as a proxy for SAW’s cotton traffic. This seemed reasonable in light of Ms. Wisener’s testimony. I could have used a simple 5- or 10-year average, but, as the former freight railroad expert at USDA, I knew that agricultural yields are rising over time. Consequently, a simple average will understate the expected yield, often significantly. For example, say an area had 5 normal growing seasons in a row, and yields of a particular crop rose from 6 to 7 to 8 to 9 to 10 bushels per acre. A simple 5-year average would put the next year’s crop at 8 bushels per acre, but a trend line analysis would suggest that 11 bushels per acre is a

⁷ See SAW Statement in Opposition to Revised Feeder Line Application, Wisener V.S. at 3 (emphasis added).

better estimate. I therefore resolved to conduct a very simple, indeed “plain vanilla,” trend line analysis to determine the expected size of the 2006 SAW’s expected traffic levels.

I chose to employ regression analysis to estimate the size of the Texas cotton crop (and SAW’s expected cotton traffic). Regression analysis is a statistical method used to model the relationships between a dependent variable and explanatory variables. In this case, I posited the following relationship

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

where the dependent variable, *Bales*, is bales produced. My explanatory variables were *Acres* (acres planted), and *Year* (the crop year, which serves as a proxy for time). β_1 , β_2 , and β_3 are the estimated coefficients. I deliberately included *Year* to capture the rising yields trends over time. Similarly, acres planted seemed a logical explanatory variable. Using data from 1965-2005 (41 years in all), I reported the following results from my regression analysis.⁸

Table 2: Regression Results for Texas Upland Cotton Yields

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

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

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

⁸ See KJRY Expanded Competing Feeder Line Application, Brennan V.S. at 8-9.

From this I estimated that a yield of 5.286 million bales of cotton would be a better estimate of a "normal" Texas cotton crop. Although both the 2004 and 2005 harvests exceeded this level, I noted that one would have to go back to 1981, when considerably more acreage was planted, to find a larger crop of Texas cotton. I considered this a far better approximation of SAW's base traffic volumes than SAW's belief that the future would look like an endless series of that perfect weather year, 2005. Also note that the fact that the Year was statistically significant, confirming that a linear analysis of this sort will be superior to a simple average.

Mr. Plaistow also claims that my original regression equation "has less predictive value in forecasting Texas cotton production than the approach I [Mr. Plaistow] used." He is wrong. Mr. Plaistow has made a calculation error in his spreadsheet and, once corrected, his figures are not as "predictive" as mine. I place "predictive" in quotations because, frankly, Mr. Plaistow's approach is bizarre: He multiplies the USDA's Texas Cotton Production by the U.S. Cotton Production and then divides it by the previous year's U.S. production figure. There is no theoretical basis for this approach and much to recommend against it. Apparently, he fails to recognize that the U.S. national production is heavily influenced by Texas production. In fact, because Texas cotton production is roughly a third of the national total, it is hardly surprising that U.S. cotton production predicts Texas cotton production. In effect, Mr. Plaistow argues that Texas cotton production is a function of Texas cotton production. One can't argue with that proposition, but one can't use it to predict anything either.

Laying aside this fundamental methodological flaw, Mr. Plaistow calculations are in error. Specifically, in Exhibit 75 of his reply verified statement Columns 5, 7, 8 and 9 represent, respectively, Actual Texas Production, National Production, a LEPA Predicted Production, and

an Absolute Percentage Error. The LEPA Predicted Production is, according to footnote 5, "Col (5) x (Col (7) ÷ Col (7) year – 1)."⁹ I take this to mean that LEPA Predicted Production is Actual Texas Production (Col 5) multiplied by National Production (Col 7) divided by the previous year's National Production ((Col 7) year – 1). So calculating the LEPA predicted production for 1966:

1966 Actual Texas Production (thousands of bales) = 3,156

1966 National Production = 9,484

1965 National Production = 14,850

LEPA Predicted Production: $3,156 \times (9,484 \div 14,850)$ = 2,016.

Yet, Mr. Plaistow reports that LEPA Predicted Production is 2,958. The Absolute Percentage Error $|(2,016 - 3,156)| \div 3,156$ is, accordingly, 36 percent – not the 6 percent reported by Mr. Plaistow.

Mr. Plaistow also criticized my intercept term as not statistically significant. That is an interesting criticism and, upon further reflection, there is something amiss with my intercept term. Normally, we do not assign a particular economic meaning to the intercept term – it simply marks where the regression line crosses the Y-axis. Consider the following two figures. The first shows that an explanatory variable, X, and a dependent variable, Y, are positively correlated and that the regression line crosses the Y-axis in positive territory. The second also shows that X and Y are positively correlated, but this time the intercept term is in negative territory.

⁹ See SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application; and (2) PYCO's Amended Valuation Evidence, Plaistow V.S., Exhibit 75.

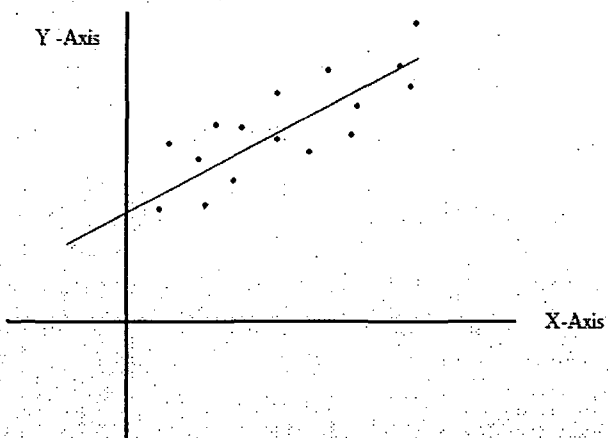


Figure 1

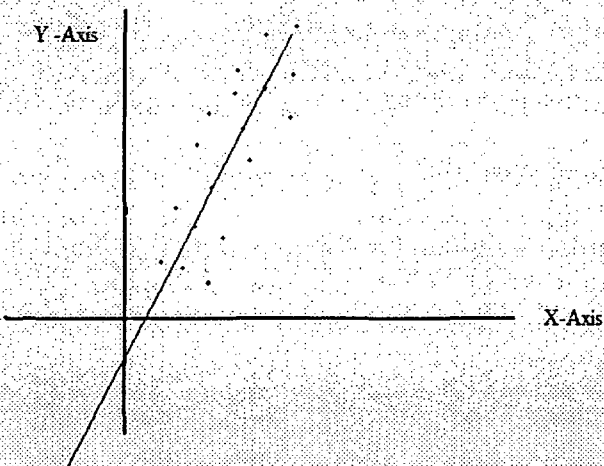


Figure 2

After one considers these two figures, it is clear why I shouldn't have included an intercept term. This is one of those rare cases when – on theoretical grounds – there are reasons

to believe that the regression line must run through the origin. After all, it seems fairly straightforward that *if you plant no cotton, you will harvest no bales*.

I have therefore rerun my regression results excluding the intercept term. I use the same data and the same explanatory variables. All that has changed is that, in response to criticism by Mr. Plaistow that the statistical significance of my intercept appeared questionable, I have omitted the intercept term altogether. My revised regression equation is therefore $Bales = \beta_1(Acres) + \beta_2(Year)$ and the Summary Output from this regression is as follows:

Table 3: Regression Results for Texas Upland Cotton Yields, No Intercept

<i>Regression Statistics</i>				
Multiple R		0.973746397		
R Square		0.948182046		
Adjusted R Square		0.921212355		
Standard Error		1012.167803		
Observations		41		

ANOVA				
	<i>Df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>
Regression	2	731107282.2	365553641.1	356.8174433
Residual	39	39954862.83	1024483.662	
Total	41	771062145		

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	0	#N/A	#N/A	#N/A
Acres Planted	0.565604109	0.058873725	9.607071945	7.86418E-12
Year	46.6889278	13.81189535	3.380341845	0.001655918

Mr. Plaistow also criticized my initial regression result because it did not reflect a strong relationship between acreage planted, year, and Texas cotton production.¹⁰ And it

¹⁰ See SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application; and (2) PYCO's Amended Valuation Evidence, Plaistow V.S., at 15.

is true that, when running my original regression with an intercept term, the adjusted R-squared was only 0.365. After eliminating the intercept term, however, the adjusted R-squared rises to 0.921 and the two explanatory variables (Acres and Year) remain statistically significant. Thus, bales harvested are, as one would expect, strongly correlated to acres planted and year. A modest change in my regression equation, based on solid *theoretical* grounds, fully satisfies Mr. Plaistow's criticisms.

Of course, it is now necessary to recalculate the conditional mean: the expected size of the 2006 harvest. Again holding constant *Acres* at its 2005 level (5.9 million acres), it is possible to estimate the conditional mean or expected value of the 2006 Texas Upland Cotton Crop. This equation can be written as follows:

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

$$= 0.566 * 5900 + 46.689 * 42$$

$$= 5,298 \text{ (thousands of bales)}$$

Thus, an estimate of 5.298 million bales is a more appropriate forecast of the 2006 Texas Cotton crop. Note that this is a *trivial* difference from the 5.286 million bales I had previously estimated using the intercept term. Once more, the predicted size of the "normal" 2006 Texas cotton crop is well below that estimated by SAW. And, based on these assumptions, one would have to go back to 1981 to find a larger Texas cotton crop.

As I noted, Mr. Plaistow criticizes my results on the grounds that they are “a made for litigation” forecast.¹¹ Yet, my forecast this is not the sort of “made for litigation” projection that the Board has spurned in the past. I simply regressed publicly available data from an authoritative source, the U.S. Department of Agriculture. I made normal and reasonable assumptions about the selection and treatment of this data and the explanatory variables. Under Mr. Plaistow’s standards, no regression analysis would ever be acceptable evidence before the Board.

Nor do I think Mr. Plaistow is on solid ground when he argues that USDA’s national forecast is superior to the results I obtained using USDA’s Texas-specific data. With respect to traffic volumes originating out of the Powder River Basin, government forecasts are likely to be very accurate. Yet, common sense suggests that it is unlikely that USDA’s forecast for U.S. cotton production will match the traffic volumes of a small Class III railroad in Lubbock, Texas.

Finally, it important to recall that all I was trying to establish through my regression analysis was what a normal 2006 base year would look like for SAW. After all, as SAW’s own evidence shows (see Table 1 above) PYCO’s traffic volumes in 2005 were double that of any other year. It would be patently unreasonable for the Board to impose a paltry downward adjustment in volumes based on a national forecast that, by its very nature, will prove much less volatile, much less variable than conditions in the Lubbock area. Such a downward adjustment based on national data will prove too small and, as a result, inappropriately inflate SAW’s GCV.

¹¹ See SAW Reply to (1) KJRY’s Expanded Competing Feeder Line Application; and (2) PYCO’s Amended Valuation Evidence, Plaistow V.S., at 10.

III. Rebuttal of Criticisms of GCV Raised by PYCO

Throughout this proceeding, my approach to calculating GCV and that taken by PYCO's economic witnesses are very similar. For example, Dr. Mahle and I wholeheartedly agree that Mr. Plaistow's claims that SAW's surcharges would fall on demand inelastic traffic is absurd. Similarly, Mr. Banks and I agree that the SAW's base traffic volumes need to be reduced to a more "normal" level.

Despite our agreement in most areas, there are a few issues upon which Mr. Banks and I do not harmonize. The most significant of our disagreements centers on All-SAW rehabilitation. On this issue, Mr. Banks and I must agree to disagree. No doubt, whoever owns the SAW's assets in the future will find that some minimal rehabilitation is required. In fact, KJRY's witness Mr. Stice noted that SAW requires \$77,215 in rehabilitation in order to remain a going concern; I have included this figure as a deduction from All-SAW's "preliminary" GCV. Any rehabilitation beyond what Mr. Stice has called for, however, is unnecessary, especially since SAW has presented credible evidence that the no rehabilitation is required. SAW's ability to handle its 2005 traffic is sufficient proof that it would, with only minimal rehabilitation expenses, handle the lower volumes that both Mr. Banks and I project going forward. Moreover, I question the approach that Mr. Banks and his firm take on this issue. According to Mr. Banks, he first determines:

the amount of routine day-to-day maintenance and program work necessary to keep a railroad in a steady state condition once a carrier is no longer in a deferred maintenance position and then characterize that amount as "maintenance" and the to characterize the amount necessary to eliminate maintenance as "rehabilitation."¹²

¹² PYCO's Initial Comments on Pioneer.KJRY Feeder Line Application, Banks VS at 7.

To me this is an engineering approach that ignores economic realities. A forward-looking firm will allocate its scarce resources in such a way to maximize profits; there are no brownie points for good looks in the world of short line railroading.

Previously in this proceeding, I testified that the path to success in the short line railroad industry is clear – maintain the property to handle on-going operations and make focused capital investments to satisfy future growth and profit opportunities.¹³ I suspect that the approach advocated by Mr. Banks could identify and prioritize the important future investments that a carrier should consider. Nevertheless, a carrier will only undertake a large capital investment if the returns available from this investment exceed the available and alternative use of its funds.

Consider the familiar homeowner's dilemma. When selling a house, the seller often considers upgrading the kitchen and bathrooms. Investing ten thousand dollars into a kitchen upgrade helps move a property faster, but no one expects that, after the upgrade, the value of the home would rise by ten thousand dollars. One has to weigh the benefits of a quicker sale against the difference between the increase to the sale price and the cost of the upgrade. For Mr. Banks' strategy to pay off, the rehabilitation investments must generate higher future cash flows. Yet, no evidence was presented to support the view that these higher cash flows will be forthcoming after the extensive program of rehabilitation recommended by Mr. Banks is concluded.

In the case of PYCO, which effectively seeks to vertically integrate its operations with SAW, the problem is further compounded. PYCO will be required to allocate its resources across two distinct business lines – agricultural processing and short line railroading. The rehabilitation expenses that Mr. Banks argues are necessary must compete not only with alternative railroad investments but the entire range of PYCO's investment possibilities.

¹³ See Reply of KJRY to the Amended Valuation Evidence of Pyco Industries, Inc., Brennan VS at 20-21.

PYCO's lack of short line railroad experience suggests it is more likely to err in these allocation decisions than KJRY. For its part, KJRY insists that only \$77,215 in immediate rehabilitation expenses are required, which I deducted from GCV.

Turning to the matter of base year traffic flows, I admit – as Mr. Banks suspects – that I indeed longed for data more narrowly tailored to the Lubbock area. The use of Texas data is far superior to national figures for the purposes of establishing the SAW's GCV, but Texas is a very big place, as Texans are themselves fond of pointing out. Specific regions within Texas likely will vary from the state averages, just as Texas itself can vary from the national totals. And, because Texas represents roughly one-third of the nation's total cotton crop, it is clear that some sub-regions within Texas are larger in size than some important cotton producing states.

I have reviewed the data from the High Plains Cotton Growers, Inc. that Mr. Banks submitted into evidence. I have no doubt that these are highly credible data. In fact, according to the newspaper article introduced into evidence by SAW, the source of these data appear to trace back to USDA's estimate of cotton production in two specific crop reporting districts.¹⁴ (Crop reporting districts are sub-regions within a state from which USDA collects specific statistical data). In asking the Board to take official notice of the revised upwards projections of the 2006 crop, SAW implies that the data presented by Mr. Banks are acceptable.

I have re-run my revised regression equation (lacking the intercept term) on these data for the period 1965 to 2005. The only difference between the results I will report below and those that I reported in Table 3 arise because the data is more specific to the Lubbock region of Texas.

¹⁴ See Letter from SAW, October 17, 2006.

Table 4: Regression Results, Lubbock Region Cotton Yields, No Intercept

SUMMARY OUTPUT

<i>Regression Statistics</i>	
Multiple R	0.954886721
R Square	0.91180865
Adjusted R Square	0.883906308
Standard Error	790.8791784
Observations	41

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>
Regression	2	252210179.2	1.26E+08	201.6101
Residual	39	24394105.12	625489.9	
Total	41	276604284.3		

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	0	#N/A	#N/A	#N/A
Acres	0.52888095	0.093685217	5.645298	1.61E-06
Year	33.48396429	12.6453143	2.647935	0.011627

Once again, *Acres* and *Year* are statistically significant and my adjusted R-squared is very high. Holding constant *Acres* at its 2005 level (3.7 million acres in the Lubbock area), it is possible to estimate the conditional mean or expected value of the 2006 Texas Upland Cotton Crop in the Lubbock region. This equation can be written

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

$$= 0.529 \cdot 3703 + 33.484 \cdot 42$$

$$= 3,365 \text{ (thousands of bales)}$$

Because the 2005 yield reported by the High Plains Cotton Growers was 5.677 million bales, my Cotton Adjustment Factor becomes 0.593. This is very close to the 0.572 figure reported by Mr. Banks in his testimony. Both of us agree that a substantial downward adjustment is warranted in SAW's "normalized" cotton traffic volumes.

At this point, however, two issues, one raised by PYCO and the other by SAW, must be considered. First, not only does my regression analysis generate a conditional mean, it also generates an implicit rate of growth. The variable Year captures the changes in traffic growth over time. To obtain a growth rate, we simply divide the coefficient of Year shown in Table 4 by the Conditional Mean. In this case, that growth rate is $(33.484/3365)$ or 1 percent. Yet, this is growth rate is well below the 3.3 percent cotton growth rate that PYCO's witness Mr. Banks suggests is appropriate.

The second point comes from SAW. In his letter to the Board dated October 17, 2006, Mr. McFarland asserts that it is possible for the Lubbock region to produce strong cotton crops "even when conditions are less than ideal, and that cotton production levels will not return to the low levels experienced before 2004." (Emphasis in original). Weather conditions in 2006 were less than ideal as USDA's Cotton and Wool Outlook has reported. Further, the article from the *Lubbock Avalanche-Journal* that accompanies Mr. McFarland's letter suggests that it is now believed that the 41-county region corresponding to USDA districts 1-N and 1-S will produce 3.8 million bales of cotton. (It would also appear that this 41-county region corresponds to the data presented by Mr. Banks). As a result, despite drought conditions that will drive down yields by 2.2 million bales from their 2005 levels – a fact also mentioned in the article – the expected yield from the Lubbock area is easily expected to top the 3.4 million bale conditional mean that I estimated. Yet, one would expect that the projected 2006 conditional mean should exceed the actual drought affected 2006 volumes.

Based on this information, my 1965-2005 regression analysis delivers a conditional mean and a growth rate that are *too low*. There is nothing wrong with the explanatory variables I have chosen; there are sound theoretical reasons to link time and acres planted to bales harvested and

my explanatory variables are statistically significant and my adjusted R-squared is very high. Rather, I believe that the problem arises because my period of analysis (1965-2005) is too long. The value of a regression is diminished if, within the period of analysis, there is a fundamental shift in the underlying relationships. The question that I must ask myself is whether there has been a fundamental shift in cotton markets over the last 40 years. The answer is yes. Two factors contribute to this shift. First, in recent years with the development of genetically modified varieties and enhanced cross-breeding techniques, yields on most agricultural products, including cotton, have risen above their long-term historical trend.¹⁵ Second, I believe that the most significant event over the last 40 years, indeed the most significant event since the industrial revolution itself, is the emergence of China as a major commercial power.

In 1965, the first year of my regression analysis, China was an autarkic nation, desperately poor, and about to enter one of the darkest periods in its long history, the Cultural Revolution. Today, China is a leading consumer and exporter of textiles and clothing. Clearly, something has changed. Yet, China did not begin to liberalize until 1979 and China's decisive move towards market reform was not finalized until 1992, the year that "Deng went South."¹⁶

In 1992, China became a major factor driving conditions in commodity markets ranging from soybeans to steel, petroleum to platinum, corn to cotton.¹⁷ We are in the midst of a world-wide commodity boom that is intensifying production, particularly in those critical "swing" regions where shifts in demand can produce a large supply response. The Texas high plains are just such a "swing" region for cotton production. Using the same explanatory variables and the

¹⁵ See *The Wall Street Journal*, October 31, 2006, p A-1, for a lengthy article describing this phenomenon.

¹⁶ In 1992, China's preeminent leader, Deng Xiaoping gave a series of speeches in Southern China signaling a renewed commitment to market reforms following the Tiananmen Square Protests of 1989.

¹⁷ See *The Economist*, October 28, 2006. On pages 53-56 of this issue appears an article entitled, "China in Africa: Never too late to scramble." This article notes the rising volumes of trade between China and Africa, especially in basic commodities including copper, cobalt, iron ore, platinum, timber, cotton, and oil.

Lubbock-region cotton data, I have focused my regression on the years 1992 and 2005. The regression results harmonize with both the views of Mr. McFarland with respect to the traffic volumes and the views of Mr. Banks with respect to traffic growth. And, they still show that a significant downward adjustment is warranted from the bumper 2005 traffic levels.

Table 5: Regression for Lubbock Region Cotton Yields, No Intercept, 1992-2005

SUMMARY OUTPUT				
<i>Regression Statistics</i>				
Multiple R	0.961219283			
R Square	0.92394251			
Adjusted R Square	0.834271052			
Standard Error	975.4418158			
Observations	14			
ANOVA				
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>
Regression	2	138703347.4	69351674	72.88769364
Residual	12	11417840.83	951486.7	
Total	14	150121188.3		
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	0	#N/A	#N/A	#N/A
Acres Planted	0.627807408	0.167067038	3.757817	0.002731763
Year	116.5799902	69.56366934	1.675875	0.11960065

The new conditional mean is $E(\text{Bales} | \text{Acres}, \text{Year}) = \beta_1(\text{Acres}_{2005}) + \beta_2(\text{Year}_{2006})$:

$$= 0.628 \cdot 3703 + 116.58 \cdot 15$$

$$= 4,073 \text{ (thousands of bales)}$$

This figure is well below the 2005 cotton yields, but above the drought-affected 2006 expectations. My finding here confirms that *something* has changed. Similarly, the implicit rate of growth is $116.58/4073$ or 2.85 percent. This, too, is much higher than my previous estimate and comparable to the 3.3 percent growth rate advocated by Mr. Banks. Thus, in light of the

reply comments of PYCO and SAW, restricting the period of analysis to the years 1992 through 2005 is fully justified.

The Cotton Adjustment Factor that I apply to SAW's traffic base rises from 0.6777 to 0.7175. The combined growth rate (two-thirds of the Cotton growth rate plus one-third the AEO forecast of ton-times) becomes 2.5 percent.

I continue to include revenues from the settlement that SAW and BNSF have entered into with respect to the Jarvis Metals traffic. Although this settlement does not assure SAW long-term revenues, unlike the surcharges that SAW insists it has the right to invoke, SAW is collecting these haulage fees and BNSF is willing to continue paying them for the foreseeable future. Because this fee is currently in place, it is the best evidence of record on this point.

IV. Criticism by SAW and PYCO on my use of URCS

Mr. Plaistow questions my ability to act as an expert witness on the Uniform Rail Costing System ("URCS"), because my qualifications statement did not explicitly mention familiarity with URCS.¹⁸ Yet, my qualifications statement mentioned that, while I was employed by the Board, I worked on maximum rate cases. In one of those cases, Texas Municipal Power Company v. The Burlington Northern Santa Fe Railway Company, STB Docket No. 42056, I served as the Board's variable costing analyst. I am very familiar with the Phase II and III programs as well as the data sources, R-1 filings, Uniform System of Accounts, and processing requirements that underpin URCS. And I continue to believe that URCS, the Board's approved costing system for regulatory purposes, is the appropriate tool to apply here.

¹⁸ See SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application; and (2) PYCO's Amended Valuation Evidence, Plaistow V.S., at 3.

In developing an estimate for URCS costs for this proceeding, I relied on those presented by Mr. Banks. I examined his figures and determined that they were reasonably and accurately developed. Mr. Banks states on reply that I failed to include \$100,463 in URCS maintenance of way costs. The Board will recall that Mr. Banks developed a "preliminary GCV" that *excluded* maintenance of way costs, which he dealt with separately in a latter section of his original verified statement. In that subsequent section Mr. Banks removed \$100,463 URCS maintenance of way costs in order to include other "site specific" maintenance of way and structure costs.

I have examined Mr. Bank's argument here and have determined that he is correct; I did not adjust All-SAW operating costs to reflect the URCS maintenance of way costs that Mr. Bank's omitted from the tables I relied upon. After reducing maintenance of way expenses to reflect the lower volumes of cotton traffic that can be expected going forward, I found it necessary to add an additional \$82,828 in URCS costs. (This is slightly larger than the amount Mr. Banks calculates is necessary, but his adjustment presumes significant site-specific maintenance expenses that are not necessary).

V. Determining the Constitutional Minimum

We now have all of the necessary information to calculate SAW's GCV and establish the appropriate constitutional minimum value. Before I do so, however, I would note that I continue to rely on the simple method which divides the "normalized" earning by the growth-adjusted pre-tax cost of capital. Mr. Plaistow's method is unduly complicated and burdensome. In fact, as I demonstrated in my opening statements these two methods are fundamentally equivalent. I stated:¹⁹

¹⁹ See KJRY Expanded Competing Feeder Line Application, Brennan V.S. at 3-4. Footnotes omitted.

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

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

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

I further noted that Mr. Plaistow himself uses a variant of this formula, $(C/(i-g))$, to calculate the terminal values of his cash flows ten years hence. (This variant calculates the present value of a growing stream of cash flows). Yet, Mr. Plaistow could just as easily have employed this formula from the first, as I did. In fact, Mr. Plaistow and I use the exact same, "forward looking" approach. Therefore, it is odd that SAW continues to maintain in its reply that "GCV must fully reflect a corporation's earning power, not just its historical earnings,"²⁰ (emphasis in original), given that Mr. Plaistow fails to offer a single word in response to my criticism of his approach.

Going Concern Value

In response to Mr. McFarland's argument that something has indeed changed in the Lubbock Region in the recent past, I have determined that, going forward, SAW can expect annual traffic volumes of 10,659 cars. This is higher than my initial estimate of 10,339 cars. As a result, I calculate SAW's revenues as \$1,372,392. This higher traffic base, together with the

²⁰ See SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application; and (2) PYCO's Amended Valuation Evidence, at 3.

inclusions of URCS maintenance of way costs, raises expenses to \$1,122,476. The resulting net revenues, or cash flows, are used to establish the SAW's GCV. Table 5 details the calculations. Note that I *include* the 2005 cost of capital which the Board released on Wednesday, September 20, 2006 and make a minor adjustment for the rehabilitation expenses per Mr. Stice.

Table 6: Going Concern Value

SAW Revenues 1/	\$1,372,392.15
SAW Expenses (incl. Maintenance of Way) 2/	<u>1,112,476.80</u>
SAW Cash Flows	\$259,915.35
2004 Pre-Tax Cost of Capital	17.1%
Percentage Growth Rate 3/	2.5%
Growth-Adjusted Cost of Capital / Multiplier Factor	14.8%
Preliminary Going Concern Value	\$1,780,242.15
Less: Minor Rehabilitation Expenses	<u>\$77,215.00</u>
Going Concern Value	\$1,703,027.15
Preliminary Going Concern Value (w/o Growth)	\$1,519,972.83
Less: Minor Rehabilitation Expenses	<u>\$77,215.00</u>
Going Concern Value (w/o Growth)	\$1,442,757.83

Net Liquidation Value

I understand that KJRY has accepted PYCO's estimates for NLV. In its Modified Valuation Evidence for All-SAW filed on September 28, 2006, PYCO asserts that All-SAW possesses an NLV of \$2,274,000, which I understand to be PYCO's most recent estimate. Accordingly, \$2,274,000 represents the figure against which All-SAW's GCV must be measured to determine the lines' constitutional minimum value.

Constitutional Minimum Value

The constitutional minimum is set at the higher of NLV or GCV. Here, the NLV of \$2,274,000 is appropriate. This reverses the position I took in my original testimony. The effect of a higher traffic base and growth level were more than offset by the higher cost of capital the

Board applied in its September 20, 2006 decision and the inclusion of URCS maintenance of way costs.

VI. Rebuttal of BNSF's Criticisms of my Analysis of a Right of First Refusal

Finally, I will respond to the criticisms raised by Mr. Steele in BNSF's reply. As the Board will recall, I argued that even though no applicant could predict the true *ex post* value of a line targeted under feeder line process it was likely the case that their forecasting errors would be clustered in the neighborhood of the "true" value.²¹ As a result, the revelation of the private knowledge possessed by feeder line applicants would permit BNSF (or any other 3rd party claiming a right of first refusal) to revise its own valuations in light of the applicants' estimates.

I further argued that a second mover will revise his expectations in the direction of the applicant's valuation. That is, if the applicant's valuation is lower than BNSF's, BNSF will lower its estimate of the true valuation. And, in the opposite case, if the applicant's valuation is higher, BNSF will raise its valuation. In either case, BNSF's revised valuation will be closer to the "true" estimate than either its original estimate or the feeder line applicants'. Finally, I submitted a simple, 2 x 2 matrix that revealed the *ex post* outcomes of such a game.

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

Note: (Payoffs to Applicant, Payoffs to BNSF)

²¹ See KJRY Expanded Competing Feeder Line Application, Brennan V.S. at 26-30.

In such a game, if BNSF believes that the applicant has undervalued the feeder line's value, it will exercise its right of first refusal. As shown in the matrix cell (Bid, Exercise Right), the applicant incurs a loss (-) because of the costs it incurs developing and presenting the information that supported its application. BNSF gains a positive profit (+). By contrast, when BNSF believes the applicant has overvalued the feeder line, it does not exercise its right of first refusal. As the matrix cell (Bid, Declines Right) shows, the applicant is now likely to suffer a loss (-) because it overpaid for the feeder line. (This is the familiar, "winner's curse"). In either case, if the feeder line applicant bids, it loses.

BNSF can only remark that my argument is "speculative."²² BNSF does not deny that feeder line applicants incur costs developing their evidence and testimony. Nor does it deny that, by waiting, BNSF can see how matters develop before choosing to intervene (if it chooses to intervene). BNSF simply seeks to dismiss this analysis as "speculative." But, the whole point of non-cooperative game theory is to "speculate." Non-cooperative game theory is a tool that policy makers can use to analyze whether the rules they put in place encourage private parties to behave in ways that conform to broader public policy goals. It is not enough to complain that a game theoretic model is speculative. Rather, BNSF should have demonstrated that my assumptions were incomplete or incorrect.

The purpose behind the feeder line statute is to encourage feeder line applications when they will improve rail service. Permitting a third-party right of first refusal in such cases would frustrate this objective. I further dispute Mr. Steele when he implies that even if a 3rd party right of first refusal chilled applications, "in any event, the purpose of the feeder line statute would be fulfilled since the lines will be returned to the rail carrier exercising the right of first refusal

²² Reply of BNSF Railway Company to PYCO's Revised Valuation Evidence and to KJRY's All-SAW Application at 15

(which will almost always be a Class I railroad).”²³ The point of the feeder line application process is to encourage economic development, and to ensure that the needs of the public for transportation services are met. I see nothing in BNSF’s argument to suggest that it desires to retake the All-SAW lines and operate them itself, contrary to the implications of its argument.

As I argued in my original statement, permitting BNSF an unfettered right of first refusal creates an unbalanced “heads, I win; tails, you lose” playing field. No matter how meritorious a feeder line applicant’s objectives may be or how much shippers may suffer under the inadequate service of an incumbent railroad, game theory shows that a would-be feeder line applicant’s financial best interest is not to initiate the feeder line process in the face of a non-applicant third-party’s right of first refusal. Such disincentive frustrates the wider goals of the Board and is contrary to the Rail Transportation Policy of 49 U.S.C. 10101.

²³ Reply of BNSF Railway Company to PYCO’s Revised Valuation Evidence and to KJRY’s All-SAW Application at 15.

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Table A-1: High Plains Cotton Growers Cotton Data

Year	Harvested (Thousands)	Planted (Thousands)
1965	2,301.1	2,273.3
1966	1,387.6	1,544.4
1967	1,236.0	1,450.6
1968	1,862.3	1,749.5
1969	1,418.6	2,174.0
1970	1,721.8	2,277.2
1971	1,279.2	2,499.7
1972	2,242.9	2,657.8
1973	2,888.7	2,825.1
1974	1,193.1	2,626.1
1975	1,420.2	2,712.6
1976	1,988.5	2,786.3
1977	3,215.4	3,749.6
1978	2,049.1	4,043.0
1979	2,750.8	4,565.8
1980	2,053.0	4,637.0
1981	3,522.0	4,644.9
1982	1,285.6	3,685.7
1983	1,348.5	2,488.8
1984	2,324.3	3,349.4
1985	1,893.9	3,051.8
1986	1,184.2	2,982.7
1987	2,668.6	2,819.8
1988	3,234.7	3,227.0
1989	1,608.2	2,812.7
1990	2,950.9	3,183.7
1991	2,327.7	3,481.9
1992	1,418.6	3,201.8
1993	3,458.8	3,243.1
1994	3,087.2	3,219.8
1995	2,629.3	3,621.9
1996	3,076.9	3,457.4
1997	3,415.5	3,543.7
1998	2,587.4	3,607.2
1999	3,008.4	3,826.3
2000	2,302.8	3,675.6
2001	2,492.7	3,681.8
2002	3,245.6	3,582.2
2003	2,180.3	3,525.0
2004	4,877.6	3,677.0
2005	5,677.0	3,703.0

Source: High Plains Cotton Growers, Inc.

Table A-2: Adjusted Traffic Levels

Total Carloads		
Customer Type	Carloads	Adjusted Cars
Cotton Customers		
PYCO 1/	6,233	4,472.2
Farmers Compress 1/	900	645.8
Southern 2/	900	645.8
	8,033	5,763.7
Non-Cotton Customers		
Attebury 1/	495	495.0
All Other 2/	4,400	4,400.0
	4,895	4,895.0
Total	12,928	10,658.7

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

2/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 8.

Cotton Traffic is adjusted by multiplying the number of 2005 Cotton carloads by the Cotton Adjustment Factor, 0.7175.

Table A-3: Revenue Per Car

First 5000 Cars	\$142.72
Cars after 5000	\$125.60

Cars in Blocks of 27 or More	\$45.67
------------------------------	---------

Source: SAW Statement in Opposition to Revised Feeder Line Application, Plaistow V.S. at 7.

Note: Cars moving at the \$45.67 do not count towards the 5000-car discount.

Table A-4 SAW Carloads

Total Carloads

Cotton Customers	Adjusted Cars
PYCO	4472.2
Farmers Compress	645.8
Southern	645.8
	<u>5763.7</u>
Non-Cotton Customers	Cars
Attebury	495.0
All Other	4400.0
	<u>4895.0</u>
Total Cars	10658.7

Source: Table A-2

Table A-5: Movements in Blocks of 27 Cars or More

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

Source: SAW Statement in Opposition to Revised Feeder Line Acquisition, Plaistow V.S. at 10.

Note: Mr. Plaistow's NEW carrier carried 549 cars in blocks of 27 cars or more. Since all of Attebury Grain's trains move in large blocks, this leaves 54 cars (2 trains of 27 cars), which I attributed to PYCO.

Table A-6: Movements in Blocks of Less than 27 cars

Cotton Customers	No. of Cars
PYCO	4418.2
Farmers Compress	645.8
Southern	645.8
	<u>5709.7</u>
 Non-Cotton Customers	 No. of Cars
Attebury	0.0
All Other	1631.0
	<u>1631.0</u>
 Total in Blocks of Less than 27 Cars	 7340.7

Source: Table A-4 and Table A-5

Table A-7: SAW Revenues

Haulage Revenues	Cars	Revenue Per Car	Revenue
First 5000 Cars	5,000.0	\$142.72	\$713,600.00
Cars After 5000	2,340.7	125.60	293,989.09
Cars in Blocks of Less than 27	7,340.7		\$1,007,589.09
Cars in Blocks of 27 or more	3,318.0	\$45.67	\$151,533.06
Total Haulage Revenues	10,658.7		\$1,159,122.15
 Non-Haulage Revenues			
Track Jobs			\$34,505.00
Car Storage			131,890.00
Jarvis Metals Settlement			46,875.00
Total Non-Haulage Revenues			\$213,270.00
 Total SAW Revenues			\$1,372,392.15

Table A-8: Per Car Expense for Cotton Traffic

Cotton Traffic on a Per Car Basis		
PYCO and Compress		
Expenses 1/		\$684,520.00
Carloads 2/		7,133.00
Expense per Car		\$95.97

Sources:

- 1/ PYCO May 5 Feeder Line Application, Banks V.S., Table 14.
- 2/ PYCO May 5 Feeder Line Application, Banks V.S., Table 1.
Does not include URCS MOW

Table A-9: Southern Expenses

Southern is a Cotton Shipper that Mr. Banks has included in his all other rail customer category. In order to properly reflect the "normalized" 2005 operating expenses, Southern's expenses must be reduced appropriately.

All Other Rail Customers	1/	\$151,949.00
Southern Carloads	2/	900
Per Car Cotton Expense	3/	\$95.97
Southern Expense		\$86,368.71
All Other Rail Customers		151,949.00
Less Southern		-\$86,368.71
All other Rail Customers (less Southern)		\$65,580.29

Sources:

- 1/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 14.
- 2/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 8.
- 3/ Table A-8
Does not include URCS MOW

Table A-10: URCS Maintenance of Way Adjustment

2005 URCS Maintenance of Way Costs	1/	100,463.00
Non-Cotton Expenses (% of Total 2005 Carloads)		38,038.86
Cotton Expenses (% of Total 2005 Carloads)		62,424.14
Less: Reduction in Cotton Expenses to reflect lower volumes		17,634.82
Normalized URCS Maintenance of Way Costs		82,828.18

Source:

- 1/ Source: PYCO May 5 Feeder Line Application, V.S. Banks, Table 32

Table A-11: SAW Expenses

Cotton Cars 1/	5,763.7
Per Car Cotton Expense 2/	95.97
Cotton Expenses	\$553,112.65
Non-Cotton Expenses	
Attebury 3/	\$20,550.00
Rock Movements 3/	242,783.00
All Other Rail Customers (less Southern) 4/	65,580.29
Total Non-Cotton	\$328,913.29
Maintenance of Way Expenses	82,828.18
Total SAW Expenses	\$964,854.12
Index Cost Adjustment 3/	1.153
2006 SAW Operating Expenses	\$1,112,476.80

Sources:

- 1/ Table A-2
- 2/ Table A-8
- 3/ PYCO May 5 Feeder Line Application, V.S. Banks, Table 14
- 4/ Table A-9

Table A-12: Growth Rate

AEO Growth Rate 1/	1.7%
Cotton Growth Rate 2/	2.9%
Overall Growth Rate (two-thirds Cotton + one-third AEO)	2.5%

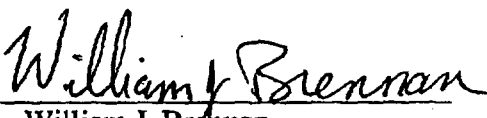
Source: 1/ U.S. Department of Energy, Energy Information Administration
Report No. DOE/EIA-0383(2006), Table 7

(Available on the internet at http://www.eia.doe.gov/oiaf/aeo/excel/aeotab_7.xls)

2/ See page 18

VERIFICATION

I, William J. Brennan, PhD, 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 file this Verified Statement. Executed this 1st Day of November, 2006.


William J. Brennan

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 34922

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

REBUTTAL

EXHIBIT B

REBUTTAL VERIFIED STATEMENT OF J. MICHAEL CARR

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 34922

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

REBUTTAL

EXHIBIT B

REBUTTAL VERIFIED STATEMENT OF J. MICHAEL CARR

My name is J. Michael Carr, and I am the President, CEO and Chief Financial Officer of Keokuk Junction Railway Co. ("KJRY"), and its parent company, Pioneer Railcorp ("Pioneer"). I have previously provided two verified statements in support of KJRY's application to acquire and operate the lines of South Plains Switching, Ltd., Co. ("SAW"). I have reviewed PYCO's reply comments filed on October 12 and 25, 2006, in opposition to KJRY's expanded feeder line application and in particular the Verified Statement of Timothy J. Gannon, which was attached to PYCO's October 25 reply comments. In general, I will rebut criticism questioning KJRY's financial responsibility to undertake the purchase and operation of All-SAW, and I will rebut empty attacks on KJRY's ability to provide improved service to customers located on All-SAW.

On the subject of KJRY's financial responsibility, I will explain why we consider the purchase of All-SAW a worthwhile investment. I will also show why both Mr. Gannon's

and PYCO's assumptions about KJRY and its financial condition are incorrect. To begin with, KJRY has more than enough resources at its disposal to buy All-SAW. Through a \$3 million loan to be provided to Pioneer from National City Bank,¹ which Pioneer will make wholly available to KJRY, KJRY will be able to acquire, rehabilitate, and operate All-SAW. In addition, Pioneer has previously indicated that it would also make \$1.5 million worth of free cash flow available to KJRY for KJRY to acquire and operate SAW's lines. In short, unlike PYCO, whose income statements reveal dramatic swings in cash flow and show operating losses at times, KJRY and Pioneer have more than sufficient funds available to acquire and operate SAW. Indeed, KJRY and Pioneer, unlike PYCO, have consistently been profitable for over twenty years.

Mr. Gannon tries to make much of the recent increase in KJRY's liability-to-equity ratio, which he suggests is a reflection of KJRY's diminished financial strength. In fact, KJRY is not a weakened, or weakening, company. The increase in KJRY's liabilities is directly tied to its recent acquisition of the west end of the Toledo, Peoria & Western Railroad ("TP&W") through the feeder line process. Thus, the increase in debt is offset by an increase in assets occasioned by the TP&W line acquisition. In fact, both the original KJRY segments, and the newly-acquired TP&W segment have been, and are being, operated profitably, and are generating cash flow that could support any unforeseen shortfall in operating All-SAW. Through its acquisition of the TP&W line via the feeder line process,

¹ National City Bank has already provided a commitment letter in the amount of \$3 million. Today, I have received a letter from a Senior Vice President of National Bank who states that the Bank would view favorably increasing its commitment from \$3 million to \$4 million. Pioneer is prepared to seek \$4 million if it is necessary to do so in order to implement the Board's order and to acquire and operate SAW's lines.

KJRY has demonstrated that it can acquire, rehabilitate, and profitably operate lines to the benefit of shippers who had suffered from inadequate service.

I have reviewed the rebuttal verified statement of Dr. Brennan, which accompanies KJRY's rebuttal filing, and I agree with it, particularly with respect to the constitutional minimum value of All-SAW. Pioneer, KJRY's parent company, is willing to loan KJRY up to \$4.5 million (\$3 million loan commitment from National Bank and \$1.5 worth of cash) for the acquisition and operation of SAW's lines, through the arrangements I have described above. As I have stated before, KJRY has more than adequate cash flow to make up for any contingencies, but Pioneer would grant KJRY additional working capital, if needed. Obviously, Pioneer has a strong vested interest in assuring that the line of credit used to purchase All-SAW is fully serviced. We would not allow KJRY to default on that loan, and would devote Pioneer's own resources to servicing that debt if ever it came to that.

I have reviewed Mr. Gannon's testimony and find unpersuasive his attacks on KJRY's showing of financial wherewithal to acquire All-SAW and operate it for at least three years thereafter. In an attempt to show that KJRY will lose money operating All-SAW, Mr. Gannon has composed his own version of KJRY's *pro formas*, but to make this showing, Mr. Gannon adjusted KJRY's traffic, revenue, interest rate, and cost assumptions. Mr. Gannon's assumptions are faulty, however, because, among other things, he has failed to consider that reducing KJRY's traffic projections also reduces the value of All-SAW and, in turn, the amount that KJRY would have to borrow to acquire the line. He also does not rely upon KJRY's actual costs. Moreover, Mr. Gannon also includes principal repayments where I did not. In fact, in the *pro formas* that I submitted earlier in this proceeding, we accounted

for interest payments but purposefully *excluded* principal payments. We did so for a reason – principal payments on debt are neutral with respect to owner's equity.

Although I understand that our valuation evidence, revised in accordance with evidence contained in reply comments, now shows that All-SAW has a net liquidation value ("NLV") of \$2,274,00, which is higher than what we now calculate All-SAW's going concern value ("GCV") to be, I remain convinced that KJRY can and will generate positive cash flow from its purchase of All-SAW. I believe that this is so, because the costs we incorporated into our previously submitted *pro formas* were based on URCS costs and also on assumptions concerning return on investment that are skewed against KJRY. In particular, KJRY's operating costs, like those of most short lines, are not on par with URCS which generally reflects the higher operating costs of Class I carriers. Accordingly, I would estimate that the URCS-based operating costs in our previously-filed *pro formas*, which I do not repudiate, might actually overstate KJRY's actual costs by as much as 4-5%.² If that had been taken into account before, I am confident that KJRY's *pro formas* would show positive net results for each year even with payments to principal and interest included in the balance sheets. Indeed, KJRY's positive cash flow should be even better if KJRY purchases the line at NLV rather than the higher and previously submitted GCV estimate. Even if All-SAW

² When preparing this feeder line application, we sought to ensure consistency between the *pro forma* and the constitutional minimum value calculated by Dr. Brennan. Dr. Brennan has relied on URCS costs to determine SAW's expenses. This seems an appropriate application of the Boards regulatory costing system, but I note again that Class III carriers tend to have lower cost structures than their Class I counterparts. That is why Class III carriers can keep lines in service that Class I carriers can not, and is probably why BNSF agreed to sell its Lubbock lines to SAW for \$10. When evaluating KJRY's *pro forma*, it is important to recognize not only are we easily covering our interest expenses, but also that we would have lower expenses than those presented therein. Therefore, the *pro forma* I submitted previously is perhaps conservative to a fault in depicting the lines cash flows that All-SAW would generate in the hands of a short line operator such as KJRY.

could not be operated on a positive cash flow basis and PYCO is correct, KJRY and Pioneer have sufficient resources to cover any shortfall and I commit them to doing so.

My view of KJRY's ability to operate All-SAW profitably is actually consistent with those of PYCO's own witnesses – who also have stated that All-SAW can and will be operated as a financially viable railroad. Where PYCO's sees losses, those are due to what PYCO claims are significant rehabilitation costs, costs that SAW and KJRY both recognize to be unnecessary. Likewise, even if there is a small operating loss during the first few years of operations as asserted by Mr. Gannon's incorrectly reformulated KJRY *pro formas* (which I am convinced would not be the case), we expect that All-SAW's financial fortunes will improve over time and that the lines will become profitable relatively quickly.

As noted, perhaps the largest difference between Mr. Gannon's views and mine involves his inclusion of principal payments as a "cost" of operating All-SAW. As noted, I did not include such payments because I am certain that All-SAW would generate positive cash flow as operated by KJRY and therefore the payments against principal that KJRY would make on the loan are net positive investments for KJRY and Pioneer. For us, every payment of principal simply increases our equity for which we will eventually recapture through cash-flow profits or through sale of the assets.

In this sort of case, where we expect that an asset will be generating positive cash flows over time, it is entirely appropriate that KJRY would want to capture this stream of payment by financing its acquisition, just as most of us arrange for the flow of housing services via a mortgage. However, when borrowing money to obtain a perpetual cash flow, it is not surprising that it is possible – perhaps likely – that one would initially generate a "negative" cash flow by including principal payments into a *pro forma* statement even

though nothing changes with respect to the fundamental strength of the acquiring firm. To see why this is the case, we need to remember the basic accounting equation that is the foundation for the double-entry book-keeping system:

$$\text{Assets} - \text{Liabilities} = \text{Shareholders's Equity.}$$

Let us assume that a firm with an initial asset base of \$3,000,000 and no liabilities decides to purchase a short line railroad for \$3,000,000 on the basis that this railroad can generate a free cash flow of \$300,000. Before its purchase of the short line railroad, its balance sheet is:

<u>Assets</u>		<u>Liabilities</u>	=	<u>Shareholder's Equity</u>
\$3,000,000		\$0	=	\$3,000,000

Now, let us further assume that the firm that in order to preserve a sufficient margin of safety (as Mr. Gannon suggests is appropriate), that the firm chooses to finance its acquisition. After borrowing \$3,000,000 to buy the short line railroad, the firms' balance sheet is simply:

<u>Assets</u>		<u>Liabilities</u>	=	<u>Shareholder's Equity</u>
\$6,000,000		\$3,000,000	=	\$3,000,000

Note that the equity of the firm is unchanged. We have simply added an asset (a \$3,000,000 railroad) and a corresponding liability (a \$3,000,000 loan).

Now, assume that the firm chooses to pay its loan back over a 3-year period, paying down its principal \$1,000,000 per year. In addition, the firm must pay \$240,000 in interest in Year 1, \$160,000 in interest in Year 2, and \$80,000 in interest in Year 3. (This is roughly equivalent to an 8-percent annual rate of interest). A pro forma with these assumptions will

show the firm losing money as its principal and interest payments exceed its cash flow. But, is the firm losing money or financially unfit? Of course not! The reason is quite simple: after making the first payment of 1,000,000 to reduce its debt, the firm has lowered both its *assets and its liabilities*.

	<u>Assets</u>		<u>Liabilities</u>	=	<u>Shareholder's Equity</u>
Year 1:	\$5,060,000		\$2,000,000	=	\$3,060,000
Year 2:	\$4,200,000		\$1,000,000	=	\$3,200,000
Year 3:	\$3,420,000		\$0	=	\$3,420,000
Year 4:	\$3,720,000		\$0	=	\$3,720,000

Note that the cash flow available after making interest payments is rising from \$60,000 to \$140,000 to \$220,000. In fact, this rising trend is seen even if we include the principal repayments, rising from (\$940,000) to (\$860,000) to (\$780,000) to \$300,000.

Admittedly, these figures are negative – for the first three years – but they simply measure reductions in both the assets and liabilities of the firm. Moreover, the earlier we pay off the debt's principal, the sooner we enjoy the full measure of the short line railroad's free cash flows. The true measure of a carrier's financial fitness is its shareholder's equity and ability to secure financing.

I note that, in offering his own version of KJRY's 3-year *pro forma* balance sheets, Mr. Gannon *understates* All-SAW's projected traffic levels, and, in the process *overstates* KJRY's debt service costs, but he cannot have it both ways.³ Specifically, Mr. Gannon has

³ Mr. Gannon devises multiple *pro formas* based on varying assumptions. In an attempt to gild the lily, however, he presumes at one point that the interest rate on the National City Bank loan will go up, and he has offered revised *pro formas* to reflect this asserted "certainty." He justifies this presumption (and revised *pro formas*) on the basis that it is "common knowledge" that interest rates will rise. There is just as much "common

downwardly adjusted KJRY's traffic projections based on PYCO's very pessimistic view of All-SAW's future traffic potential. (I understand that this issue is discussed and rebutted in the attached Rebuttal Verified Statement of William J. Brennan, who explains why PYCO's future traffic projections are wrong.) In the process, Mr. Gannon makes proportionate adjustments to KJRY's operating costs, which he would be right to do under his traffic assumptions. But what Mr. Gannon (incorrectly) leaves constant is the assumption that All-SAW – despite the reduced traffic levels he relies upon – would continue to have a constitutional minimum value of \$2,712,300. Naturally, if we assume that KJRY were incorrect in its traffic assumptions, then it would have overstated All-SAW's value, also. In short, taking PYCO's traffic assumptions as correct (and, of course, we do not), Mr. Gannon uses the wrong basis for debt service in his *pro formas* – he has KJRY overpaying for All-SAW, and so his principal and interest payments are too high. Thus, Mr. Gannon's competing *pro forma* balance sheets are inherently inconsistent and are unreliable.⁴

Turning now to PYCO's comments on KJRY's ability to provide improved service to All-SAW shippers, I can see that PYCO's attacks are unsupported and wholly inconsistent with KJRY's track record as a short line railroad. Consider, for example, KJRY's operation of the TP&W line. KJRY has initiated service to new on-line shippers and has restored

knowledge" that interest rates will fall, and at least an equal chance now exists for that to happen, but that would be an "inconvenient truth" for PYCO's Mr. Gannon, and so he ignores that possibility.

⁴ Another stretch in Mr. Gannon's testimony is his assumption that KJRY would have to pay back the loaned purchase money within five years. As Mr. Gannon admits, however, that loan is amortized over a ten-year term, but he does not follow that repayment structure. Before the "balloon" provision in the line of credit would be triggered, Pioneer and KJRY would quite naturally seek to refinance the loan. Although this is common business practice, Mr. Gannon unfairly ignores this aspect of corporate finance, and presumes that such an arrangement, to take place five years from now if not sooner, would not happen.

historic bridge connections to KJRY's previously-existing shippers, all in the span of less than two years. KJRY has also been able to work cooperatively with all of its connections, including, among others, BNSF Railway Company, Union Pacific Railroad, Norfolk Southern Railway, and even TP&W. KJRY therefore has a proven record of acquiring lines through the feeder line process and restoring essential services. Neither PYCO nor West Texas & Lubbock can make such a claim.

In fact, it is because of KJRY's resounding success on the TP&W line that we decided to seek to acquire All-SAW through the feeder line process, knowing that KJRY could restore quality service to All-SAW customers and do so profitably. Unlike PYCO, which would naturally be concerned first and foremost with its own business, and that of its affiliates and suppliers, KJRY would be an independent, neutral carrier that would provide the same superior service to all the shippers on SAW's lines. KJRY has no incentive to discriminate amongst the shippers.

PYCO, on the other hand, has a major competitor, Southern Cotton Oil Company ("SCO"), located on the line. Under the circumstances, PYCO has an economic incentive to favor its own service and rates over those offered to its competitors. Perhaps this is why SCO has filed comments asking that both KJRY and PYCO be given a full and fair opportunity to make their respective cases for the acquisition of All-SAW. SCO is a subsidiary of Archer Daniels Midland ("ADM"), who happens to be a major KJRY customer, and, as such, knows full well the value and level of service that KJRY can and does provide to its customers. As the only All-SAW shipper who can speak from a position of authority on the quality of KJRY's service, one would think that if KJRY and Pioneer were as bad as PYCO claims, SCO, ADM, and others with direct experience with KJRY service would have

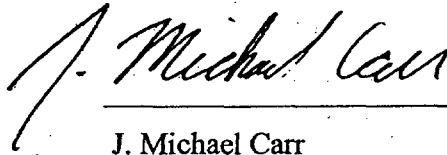
filed comments in opposition to KJRY's feeder line application, but SCO does not join PYCO's unwarranted attack, which, as it turns out is a combination of character assassination (directed against KJRY) and self-promotion.

KJRY has a long history of providing good service to its shippers. We provide service to certain customers 24-hours per day, all 365 days of the year. (PYCO is aware of the identity of one such shipper, having been given information about it, subject to the protections against the disclosure of highly confidential information, during the course of discovery.) Moreover KJRY has a solid working relationship with BNSF, which BNSF has not disputed. BNSF has not opposed KJRY's feeder line application, although it most certainly could have if it had misgivings about KJRY's ability to provide improved service or about KJRY's capacity to cooperate with BNSF.

KJRY provides reliable, reasonably-priced service to numerous customers on our line, both large and small. What is more, KJRY benefits from the collective experience of its numerous rail carrier affiliates, some of which operate over lines that are similar in scope and design to those that KJRY proposed to acquire through this feeder line proceeding. What I find most troubling about PYCO's attack on KJRY's ability to provide improved service to All-SAW customers is that PYCO has not once assessed KJRY's performance to date in operating the TP&W lines, and it has not once pointed to specific circumstances where KJRY has allowed service to its customers to deteriorate. To hear PYCO put it, KJRY is prone to offer inadequate service. But PYCO so alleges not on the basis of any historical "inability" on KJRY's part. Rather, PYCO's attack is mere speculation. Past is prologue, and KJRY would be a superior choice for All-SAW customers, just as it has been elsewhere.

VERIFICATION

I, J. Michael Carr, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 31st day of October, 2006.



J. Michael Carr

November 1, 2006

Mr. Vernon A. Williams
Secretary
Surface Transportation Board

Dear Secretary Williams,

As you are aware, National City Bank has committed \$3,000,000 in financing to Pioneer Railcorp for Keokuk Junction Railway's acquisition of South Plains Switching, LTD. (commitment letter dated September 22, 2006). Please know that we stand ready to proceed with funding of that commitment. As part of our discussion with Pioneer management regarding this potential acquisition, various commitment levels were discussed. If Pioneer would require \$4,000,000 of financing for this acquisition, I would expect the bank to favorably view funding to that level.

Pioneer has been a client of National City since 1991. Over the years, Pioneer has made a number of railroad acquisitions that we have had the privilege to finance for them. At every step in our banking relationship, management has acted in a very forthright manner and has always handled their responsibilities as agreed. In short, Pioneer Railcorp is a very good client of National City.

Sincerely,



Michael A. Zeller
Senior Vice President

MAZ/sz