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SERVICE DATE – AUGUST 31, 2007

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the STB printed reports at a later date.

SURFACE TRANSPORTATION BOARD

DECISION

STB Finance Docket No. 34890

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

STB Finance Docket No. 34922

KEOKUK JUNCTION RAILWAY CO.—FEEDER LINE APPLICATION—  
LINES OF SOUTH PLAINS SWITCHING, LTD. CO.<sup>1</sup>

Decided: August 30, 2007

Pursuant to 49 U.S.C. 10907, the Board orders South Plains Switching, Ltd. Co.  
to sell its rail lines in Lubbock, TX, to either PYCO Industries, Inc. or Keokuk  
Junction Railway Co. under the terms set by the Board in this decision.

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<sup>1</sup> These proceedings are not consolidated. They are being addressed together for administrative convenience.

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South Plains Switching, Ltd. Co. (SAW), a Class III rail carrier, owns various rail lines in Texas. PYCO Industries, Inc. (PYCO), a shipper on SAW’s lines dissatisfied with SAW’s rail service, has filed an application asking us to use our authority under the “feeder line provision” at 49 U.S.C. 10907<sup>2</sup> to order SAW to sell its Lubbock rail lines to PYCO. Keokuk Junction Railway Co. (KJRY), also a Class III rail carrier, has filed a competing feeder line application to purchase those lines. Each applicant opposes the other’s application. BNSF Railway Company (BNSF), SAW’s sole connecting carrier, has sought to intervene and protect its interests.

BACKGROUND

In 1999, BNSF sold to SAW 74,384 feet<sup>3</sup> of tightly configured rail lines in Texas.<sup>4</sup> These lines serve a number of shippers and receivers of freight in an industrial area of Lubbock. SAW serves as a switching carrier, hauling rail cars between these industries and the nearby yard of BNSF, the sole carrier to which SAW’s lines connect.<sup>5</sup>

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<sup>2</sup> When this provision was originally enacted in 1980, Congress gave it the title “Feeder Railroad Development Program.” See Staggers Rail Act of 1980, Pub. L. No. 96-448, § 401, 94 Stat. 1895, 1939. Feeder lines are branch lines that “feed” traffic onto the main lines. Congress projected that branch lines, rather than main lines, would be the likely subjects of applications under section 10907.

<sup>3</sup> Although previous decisions attribute different lengths to SAW’s relevant lines, the statement of SAW’s engineering specialist indicates that today SAW owns 133,884 feet of rail lines in Lubbock, or slightly over 25.3 miles. SAW Statement in Response to PYCO’s Feeder Line Application to Acquire “All-SAW,” filed Sept. 18, 2006 (SAW Statement), Second Verified Statement (V.S.) of Edward W. Landreth, Attachment 1 at 21. SAW indicated that it operated over 18 miles of rail lines at Lubbock in 2005, and that some of its trackage was used to store rail cars.

<sup>4</sup> The Board authorized SAW to purchase the BNSF lines at issue in South Plains Switching, Ltd. Co.—Acquisition Exemption—The Burlington Northern and Santa Fe Railway Company, STB Finance Docket No. 33753 (Sub-No. 1) (STB served July 15, 1999).

<sup>5</sup> In addition to its service at Lubbock, SAW provides switching service on a separate track at Slaton, TX, about 15 miles from Lubbock. BNSF owns the track between SAW’s Lubbock rail lines and the Slaton track. The Slaton track is not included in the feeder line applications before us here.

Under the terms of the sale agreement (the 1999 Agreement), SAW acquired the lines for a compensation package that included a cash payment of \$10 and a schedule for dividing revenues on interline movements. It also included a provision whereby SAW agreed that BNSF would establish the through routes and through freight rates for all traffic originating or terminating on these rail lines for 99 years. Finally, the agreement provided that BNSF would have a right of first refusal to repurchase the lines should SAW later attempt to sell all or a portion of the lines.

PYCO, a processor and shipper of cottonseed oil and related products, is the largest shipper on SAW's Lubbock lines, with two plants located on those lines. In 2004 and 2005, the Texas cottonbelt enjoyed excellent growing conditions, resulting in unusually large cotton crops. PYCO's rail shipments increased, as did SAW's overall traffic. In December 2005, after experiencing two periods of inadequate rail service from SAW, PYCO asked the Board to issue an emergency order, under 49 U.S.C. 11123 and 49 CFR 1146, directing SAW to allow West Texas & Lubbock Railway Company, Inc. (WTL) to operate over SAW's lines to provide PYCO with alternative rail service. The Board granted that request and authorized the emergency alternative rail service for an initial period of 30 days, which it later extended to the maximum period allowed under section 11123(c)(1).<sup>6</sup>

Seeking a permanent solution to the inadequacy of SAW's rail service, in May 2006, PYCO filed an application in STB Finance Docket No. 34844 to acquire either all of SAW's Lubbock rail lines (the "All SAW" option) or the portion needed to serve PYCO and two other nearby shippers ("Alternative Two"). PYCO filed that application pursuant to 49 U.S.C. 10907(b)(1)(A)(i), under which the Board may force the sale of a rail line to a financially responsible entity to remedy inadequate rail service. The Board rejected that application as incomplete, without prejudice to PYCO submitting a revised application containing the missing information.<sup>7</sup> PYCO submitted a new application, in STB Finance Docket No. 34890, that incorporated its earlier application and included additional evidence. In July 2006, the Board accepted that application as complete with respect to Alternative Two, but not with respect to the All-SAW option.<sup>8</sup> The Board found that PYCO had not submitted evidence to show that SAW's

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<sup>6</sup> PYCO Industries, Inc.—Alternative Rail Service—South Plains Switching, Ltd. Co., STB Finance Docket No. 34802 (Alternative Rail Service) (STB served Jan. 26, Feb. 16, Feb. 24, and June 21, 2006).

<sup>7</sup> PYCO Industries, Inc.—Feeder Line Acquisition—South Plains Switching, Ltd. Co., STB Finance Docket No. 34844 (STB served June 2, 2006) (June 2 Decision). See 49 CFR 1151.2(b)(2).

<sup>8</sup> PYCO Industries, Inc.—Feeder Line Acquisition—South Plains Switching, Ltd. Co., STB Finance Docket No. 34844, et al. (STB served July 3, 2006) (July 3 Decision).

rail service was inadequate for the majority of shippers on SAW's entire Lubbock lines, as required under 49 CFR 1151.3(a)(11)(i)(B).<sup>9</sup>

Three carriers responded to PYCO's Alternative Two application. SAW opposed the application. BNSF expressed no view on the merits of PYCO's application but asked that the Board condition any sale so as to recognize and protect BNSF's interests, including its ability to operate at Lubbock efficiently and its right of first refusal. KJRY submitted a competing application, in STB Finance Docket No. 34922, to buy the same portion of SAW's lines.<sup>10</sup>

In August 2006, a consensus emerged among the parties that it would be better for all of SAW's Lubbock lines to be operated by one rail carrier. Seeking to revive its application for the All-SAW option, PYCO submitted additional statements from shippers indicating that a majority of the shippers on SAW's Lubbock lines have found SAW's service to be inadequate. KJRY sought leave to submit an All-SAW application as well. And SAW itself informed the Board that splitting up its lines under Alternative Two would be the worst possible outcome for all concerned. In a decision served August 16, 2006, the Board accepted PYCO's All-SAW application, set a deadline for the submission of competing All-SAW applications, and amended the procedural schedule to afford both applicants and SAW the opportunity to submit evidence concerning the value of that entire system.<sup>11</sup> These proceedings have since focused on the All-SAW option.

In late August 2006, BNSF asked to intervene in the feeder line proceedings to protect its interests under the 1999 Agreement. Specifically, BNSF reiterated its request that the Board condition any feeder line sale so as to preserve BNSF's contractual right of first refusal. PYCO supported that request, but KJRY and SAW opposed it, arguing that it conflicted with the feeder line statute. SAW also opposed BNSF's request that BNSF's contractual right of first refusal apply to any subsequent sale of the Lubbock lines by PYCO or KJRY. SAW contended that, as the former owner, SAW would then have a statutory right of first refusal under section 10907(h). In a later filing, BNSF asked in the alternative that the Board direct the successful applicant to negotiate an agreement with BNSF that preserves BNSF's ratemaking authority. Neither PYCO nor KJRY objected to this alternate request, and both have indicated that they expect to be bound by those provisions of the 1999 Agreement.

In September 2006, KJRY filed a competing All-SAW feeder line application. SAW, PYCO, and KJRY then filed various replies and rebuttals relating to the two competing All-

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<sup>9</sup> Id. at 5.

<sup>10</sup> See 49 CFR 1151.2(c); Cheney R. Co.—Feeder Line Acq., 5 I.C.C.2d 250, 253-54 (1989), aff'd sub nom. Cheney R.R. Co. v. ICC, 902 F.2d 66 (D.C. Cir. 1990) (Cheney) (authorizing simultaneous consideration of competing feeder line applications).

<sup>11</sup> PYCO Industries, Inc.—Feeder Line Application—Lines of South Plains Switching, Ltd. Co., STB Finance Docket No. 34890, et al. (STB served Aug. 16, 2006) (August 16 Decision).

SAW applications. SAW no longer opposed a Board-ordered sale of all of its Lubbock rail lines, and focused instead on the appropriate valuation for the lines.

When it became apparent that there might not be sufficient time to complete a feeder line sale before the statutorily prescribed expiration of the Board's emergency alternative rail service order, PYCO asked the Board to replace that emergency relief with a temporary alternative rail service order under 49 U.S.C. 11102(a) and 49 CFR 1147.1 so that WTL could continue to operate over SAW's Lubbock lines during the pendency of these feeder line proceedings.<sup>12</sup> The Board granted that request.<sup>13</sup>

## PRELIMINARY ISSUES

1. SAW Motion to Reject PYCO's Revisions to the Length of Trackage in its Application to Purchase a Portion of SAW's Lubbock Rail System. In August 2006, PYCO filed modifications to the amount of trackage to be purchased under Alternative Two. SAW moved to reject that submission. SAW's motion will be denied as moot in light of the consensus among the parties that the All-SAW option is preferable to Alternative Two and our determination in this decision to require SAW to sell all of its Lubbock lines.

2. BNSF Request for an Order Regarding an Operating Protocol. Similarly, we deny as moot BNSF's request that, if the Board orders a partial sale, it require an operating protocol that would prevent undue interference with BNSF's operations at Lubbock.

3. Motions to Strike Pleadings as Unauthorized. There have been several motions filed in which the moving party claims either that another party's filing was not authorized under any procedural orders or constitutes an impermissible "reply to a reply." The genesis of many of these motions is the unusual circumstance that both applications were initially complete only as to Alternative Two and were later perfected for the All-SAW option, which necessitated the filing of additional rounds of evidence. Given these unusual circumstances, we will accept all of the pleadings that were filed prior to March 2007—by which time the parties knew that these proceedings were focusing on the All-SAW option and had had ample opportunity to submit evidence on that option.

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<sup>12</sup> The statute and the Board's regulations provide for both emergency alternative service, which may be ordered summarily but which is subject to a time limit (see 49 U.S.C. 11123; 49 CFR 1146), and for temporary alternative service, which involves a more robust evidentiary proceeding and is not limited in duration (see 49 U.S.C. 11102; 49 CFR 1147).

<sup>13</sup> PYCO Industries, Inc.—Alternative Rail Service—South Plains Switching, Ltd. Co., STB Finance Docket No. 34889, et al. (STB served Nov. 21, 2006) (Temporary Service). SAW's request to terminate temporary alternative rail service is pending. In a separate decision, the Board will set the compensation for WTL's use of SAW's rail lines if the parties cannot agree. See 49 U.S.C. 11102(a).

4. Motion for Sanctions Based on Noncompliance with Discovery Order. In a decision served on October 5, 2006, KJRY's parent corporation, Pioneer Railcorp (Pioneer), was directed to respond to PYCO's discovery requests to the extent Pioneer has responsive information that KJRY could not provide. PYCO contends that KJRY and Pioneer violated that order by failing to provide a complete response concerning (1) litigation involving Pioneer and all its related companies, which PYCO argues is relevant to KJRY's claim that its purchase of these lines would likely improve rail service to the lines' shippers, and (2) Pioneer's financial status. As a sanction for the alleged failure to comply with this discovery, PYCO asks us to disallow any evidence tendered by KJRY to support its claims of financial responsibility and improved service to shippers, strike any such arguments or evidence from KJRY's pleadings, and award reasonable expenses to PYCO arising from the alleged prolongation of the proceeding by KJRY and failure to provide full responses.

The discovery request regarding litigation was for "[a]ll complaints filed in court or before a regulatory agency . . . by a shipper, governmental entity owning a railroad, or another railroad naming Pioneer (including one of its affiliates or subsidiaries or officers or directors) as a defendant or cross-defendant" and all such complaints filed by Pioneer "for breach of contract for failure to pay a tariff, surcharge and/or fee."<sup>14</sup> KJRY objected to this request in its entirety, in part because the information is publicly available and PYCO did not state that it was unable to obtain this information from public sources. Nonetheless, KJRY provided documents covering the prior 3 years, except for STB documents, which are available on the Board's website and in its reference room. We find KJRY's objection valid, as the involvement of KJRY and related companies in litigation is a matter of public record. Indeed, PYCO was able to provide a summary of administrative and judicial proceedings involving various companies related to KJRY.

Concerning the request for information on Pioneer's financial status, KJRY asserts that, after the Board ordered Pioneer to provide discovery responses, KJRY and Pioneer provided complete responses to the discovery requests on this subject.<sup>15</sup> PYCO does not challenge that assertion, and indeed, in its renewed request for sanctions against KJRY, PYCO focuses on the response to its litigation discovery request and does not cite any deficiency in the financial information provided by KJRY and Pioneer. For these reasons, we will deny PYCO's request for sanctions.

5. Requests to Reconsider the Voiding of Certain Transfers of Property Interests in These Rail Lines. In a decision served on August 3, 2006, the Board voided SAW's attempted transfer of certain property interests in these rail lines to Choo Choo Properties, Inc. (Choo Choo) on the ground that the transfers were intended to prevent the sale of that property through

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<sup>14</sup> PYCO Motion to Compel, filed Sept. 26, 2006, Exhibit (Exh.) B at 3-4.

<sup>15</sup> KJRY Rebuttal, filed Nov. 1, 2006, at 28-29.

these feeder line proceedings. SAW asks us to reverse that order, which we will treat as a request to reopen the August 3 decision.<sup>16</sup>

A party seeking reopening must state in detail the respects in which the proceeding involves material error, new evidence, or substantially changed circumstances. 49 CFR 1115.4. SAW does not present any new evidence or changed circumstances. Rather, SAW appears to argue that the Board erred in voiding a particular property transfer that occurred on June 12, 2006, during the brief gap between when PYCO's initial feeder line application was rejected as incomplete (on June 2) and when PYCO filed a revised, complete application (on June 14). The timing of that transaction, as well as other factors, led the Board to conclude that SAW sold these property interests to prevent the property from being acquired in a feeder line sale. SAW has not demonstrated a material error with regard to that conclusion. Accordingly, the request to reopen the August 3 decision will be denied.

SAW also challenges a decision served on January 24, 2007, in which the Board voided (1) the attempted transfer to Choo Choo of track leased to one of the shippers that supports PYCO's feeder line application and (2) SAW's and Choo Choo's attempts to cancel that shipper's track lease.<sup>17</sup> The shipper at issue, Hanson Aggregates WRP, Inc. (Hanson), initially asked the Board to void the track transfer and lease cancellations in a letter filed on December 21, 2006, to which SAW submitted a reply on December 28, 2006. Hanson formalized its request in a motion filed January 12, 2007. Although SAW informed the Board that it intended to submit a second reply—this time, to Hanson's formal request—the Board did not await the further reply and granted Hanson's request. On January 26, 2007, SAW sought reconsideration of the January 24 decision, arguing that the Board had deprived it of procedural due process by not awaiting its formal reply to Hanson's motion.

We reject SAW's due process claim. The relief granted in the January 24 decision was the relief that Hanson had initially sought in its December 21, 2006 letter. SAW had an adequate opportunity to present its views concerning that proposed relief, and indeed, on December 28, 2006, availed itself of that opportunity. In any event, SAW has now had the opportunity to present any additional arguments in its petition for reconsideration.

In its reconsideration petition, SAW admits that the cancellation of Hanson's lease would have required Hanson to construct its own private track on its own property. In the August 3 order, the Board properly took action to bar retaliatory action by SAW to punish a shipper that supports a feeder line sale by rescinding an existing lease or agreement prior to the Board's consideration of the feeder line application. SAW does not claim that there was any other

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<sup>16</sup> SAW's request to "revisit and reverse" the August 3 decision was not filed within the 20-day time period provided for the filing of a petition for reconsideration under 49 CFR 1115.3. Therefore, we will treat the request as a petition to reopen submitted under 49 CFR 1115.4.

<sup>17</sup> Because this request was submitted within 20 days of the issuance of the January 24 decision, it is treated as a petition for reconsideration.

purpose for cancelling Hanson's track lease. Accordingly, SAW has not demonstrated material error as to this aspect of the January 24 decision.

SAW's other argument in its reconsideration petition has merit. As SAW points out, the January 24 decision ordered SAW to provide rail service to Hanson upon reasonable request. But all of Hanson's rail shipments consist of a commodity (aggregates) that the Board has exempted as a class from regulation under the Interstate Commerce Act, pursuant to 49 U.S.C. 10502. See 49 CFR 1039.11. Consequently, absent a revocation of that exemption as to Hanson's traffic, SAW had no common carrier obligation to provide rail transportation of aggregates. See, e.g., Pejepscot Industrial Park—Pet. For Declaratory Order, 6 S.T.B. 886, 891 (2003) (commodity exemption bars regulatory relief when it is in force). Accordingly, we will rescind the directive in the January 24 decision that SAW provide rail service to Hanson's transload facility upon reasonable request. We note, however, that should SAW, while it still owns these rail lines, unreasonably refuse to provide requested rail service to that facility, Hanson may seek a partial revocation of the exemption to obtain needed rail service.

6. Other motions denied. KJRY seeks sanctions for PYCO's alleged violation of the Board's protective order<sup>18</sup> when PYCO revealed the name of one of KJRY's shippers. As PYCO points out, however, KJRY did not designate the discovery answer in which it provided the name as "confidential" or "highly confidential," as required by the protective order. Accordingly, KJRY's request for sanctions will be denied.

In March 2007, SAW filed two requests to supplement the record well after it was clear that these proceedings concerned only the sale of all of SAW's Lubbock rail system. In the first request, SAW sought leave to file the verified statement of an employee who is also the son of SAW's owner. PYCO asked us to reject the statement as an impermissible "reply to a reply," which is not authorized under our rules of practice and would prolong these proceedings.<sup>19</sup> See 49 CFR 1104.13(c). Indeed, SAW acknowledged that its reply was not permitted under the rules. In light of the fact that there no longer was any reason for confusion about authorized pleadings, the request for leave to file the statement is denied and the statement will not be made part of the record.

SAW's second request is for leave to file a supplemental verified statement of its engineering specialist, in which SAW purports to correct clerical errors in its calculation of the length of the rail lines SAW owns at Lubbock. With this supplemental statement, SAW actually seeks to remove two short track segments from the rail lines subject to sale. After the commencement of these proceedings, however, SAW lacked authority to remove portions of the property subject to sale under the feeder line provision. Cf. Railroad Ventures, Inc. v. STB,

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<sup>18</sup> The protective order, served on July 6, 2006, protects the confidentiality of material that is designated or stamped as "confidential" or "highly confidential."

<sup>19</sup> PYCO also challenged the employee's competence to address factual matters that he did not observe personally and for which he has no expertise.

299 F.3d 523, 552 (6th Cir. 2002) (Railroad Ventures) (at the point of commencing a proceeding by filing an abandonment petition, the abandoning rail line owner cannot reduce or diminish the rail line or the nature of the property interests associated with the line to be sold under the analogous provisions of 49 U.S.C. 10904 (offers of financial assistance to avoid abandonment)). For this reason, the request for leave to file the supplemental statement will be denied.

7. SAW's Attempted Change of Position. Starting in September 2006, SAW has taken the position in this proceeding that it does not oppose a finding that the public convenience and necessity permits the sale of SAW's Lubbock lines under the feeder line provision.<sup>20</sup> In June 2007, however, SAW sought to change its position regarding whether the public convenience and necessity criteria are met. In particular, SAW sought to argue that PYCO cannot show that transportation over the lines was inadequate for the majority of SAW's shippers.<sup>21</sup> SAW justifies its about-face on the ground that it has been subject to an allegedly unlawful alternative rail service order in a different proceeding, STB Finance Docket No. 34889, since November 2006. Although SAW has challenged the lawfulness of the alternative rail service order (and that issue is now pending before us), the order's lawfulness is not one of the stated criteria for determining the public convenience and necessity in a feeder line application. For that reason, we will deny the petition for leave to supplement.

Even if we were to allow the requested leave, SAW's position in the supplementary material reflects a faulty reading of both the statute and the record. Concerning the statute, SAW claims that Penny Newman Grain Company is a necessary party that has failed to join in the feeder line application and attest to the quality of SAW's rail service.<sup>22</sup> The feeder line provision, however, does not require that any shipper join in a feeder line proceeding. As for SAW's misreading of the record, Penny Newman—a consignor of PYCO cottonseed—submitted a statement supporting PYCO's feeder line application and explaining that SAW's rail service was inadequate as to shipments destined for Penny Newman.<sup>23</sup> The Board relied in part on

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<sup>20</sup> SAW Statement at 2; SAW Reply to (1) KJRY's Expanded Competing Feeder Line Application; and (2) PYCO's Amended Valuation Evidence, filed Oct. 12, 2006 (SAW Reply), at 3.

<sup>21</sup> To approve a sale under the public convenience and necessity standard, we must find, among other things, that the transportation over the lines is inadequate for a majority of the lines' shippers. 49 U.S.C. 10907(c)(1)(B).

<sup>22</sup> In this petition, filed June 22, 2007, SAW seeks to supplement the record in STB Finance Docket Nos. 34890 (PYCO's feeder line application), 34889 (temporary alternative rail service proceeding), and 34802 (emergency alternative rail service proceeding). For reasons not explained, SAW has not sought to supplement the record in the proceeding on KJRY's feeder line application (STB Finance Docket No. 34922). Here, we address SAW's petition to supplement the record in STB Finance Docket No. 34890; we will address the petition as it relates to STB Finance Docket Nos. 34889 and 34802 separately.

<sup>23</sup> Specifically, Penny Newman noted that, from October 2005 through September 2006, SAW's inadequate rail service prevented the shipment of 150,000 tons of cottonseed (out of the  
(continued . . . )

Penny Newman's statement as evidence of the inadequacy of SAW's rail service for that traffic.<sup>24</sup>

In a letter filed on August 27, 2007, purportedly to clarify its position, SAW now attempts to collaterally attack the Board's findings in the alternative rail service proceeding regarding SAW's past conduct and the inadequacy of the service it provided to shippers. However, none of its assertions undermine those findings, which were based on a careful examination of a fully developed record.

In any event, SAW has neither acknowledged nor provided a reasonable explanation for repudiating its earlier statement that PYCO had presented evidence that a majority of SAW's shippers found SAW's service to be inadequate.<sup>25</sup> Thus, even if we were to permit the supplementation of the record, it would not alter our finding below concerning the adequacy of SAW's service.

Any pending motions not specifically discussed here have not been found to be meritorious and will be denied.

## DISCUSSION AND CONCLUSIONS

Congress established the feeder line forced-sale program to enable shippers and communities to rescue rail lines that are otherwise likely to be abandoned or over which rail service is inadequate.<sup>26</sup> For the latter category of lines, the Board is required to order the owner of a rail line to sell the line to a "financially responsible" applicant if the Board finds that the "public convenience and necessity" require or permit the sale. 49 U.S.C. 10907(b)(1)(A)(i), (B). When the Board orders a sale, it must set the price at not less than the line's "constitutional minimum value." 49 U.S.C. 10907(b)(1).

In this decision, we find that these lines meet the statutory "public convenience and necessity" criteria for a forced sale, see Part I below; that the "constitutional minimum value" of the lines is \$2.35 million, see Part II; and that both PYCO and KJRY are "financially

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( . . . continued)

500,000 tons normally shipped) from PYCO to Penny Newman, thus requiring the latter to find alternative sources. PYCO Original Application, Exh. K.

<sup>24</sup> See June 2 Decision, slip op. at 5.

<sup>25</sup> Letter from Thomas McFarland, filed Aug. 4, 2006 (McFarland Letter) at 1; see Conrail Abandonment in Chicago, IL in the Matter of an Offer of Financial Assistance, Docket No. AB-167 (Sub-No. 870N) (ICC served May 1, 1987) (disallowing attempt in rebuttal to reverse position taken in initial statement to agency).

<sup>26</sup> Cheney, 5 I.C.C.2d at 251; H.R. Conf. Rep. 96-1430, at 85 (1980), reprinted in 1980 U.S.C.C.A.N. 4110, 4116.

responsible” and thus eligible to purchase the lines, see Part III. We further find that BNSF is not eligible to purchase the lines under section 10907 and that section 10907 takes precedence over BNSF’s contractual right of first refusal, but that one of the terms for the sale should be the continuation of BNSF’s contractual right to set the routes and rates for traffic moving over these lines. See Part IV. Accordingly, we order SAW to sell its Lubbock lines to either PYCO or KJRY. See Part V. Finally, we prescribe other terms of the sale. See Parts VI, VII, VIII.

### I. Basis for Requiring the Sale of These Lines

To find that the public convenience and necessity require or permit the sale of a rail line, we must find that the five criteria set forth in 49 U.S.C. 10907(c)(1) are met:

- (1) the rail carrier operating the line has refused to make the necessary efforts within a reasonable time to provide adequate service to shippers who transport traffic over the line;
- (2) the transportation is inadequate for the majority of shippers who use the line;
- (3) the sale will not have a significantly adverse financial effect on the rail carrier operating it;
- (4) the sale will not have an adverse effect on the overall operational performance of the rail carrier operating it; and
- (5) the sale will likely result in improved rail transportation for shippers that use the line.

As explained below, we find that these criteria are met here.

A. Refusal to Provide Adequate Rail Service. The fact that SAW has been unresponsive to shipper requests for adequate rail service beginning in the spring of 2005 is set forth in considerable detail in the Board’s January 26, 2006 decision in Alternative Rail Service, and formed the basis for emergency alternative rail service authorized in that proceeding. We take official notice of the findings in that proceeding, which need not be repeated here. We also take notice of SAW’s subsequent actions to interfere with WTL’s ability to provide adequate rail service to PYCO, including declining to discuss safety issues, blocking certain tracks in a way that inhibited WTL from providing adequate service to PYCO, and depriving PYCO of access to its outdoor cottonseed storage.<sup>27</sup> SAW’s conduct clearly satisfies the first criterion of section 10907(c)(1).

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<sup>27</sup> See Alternative Rail Service, slip op. at 3 (STB served Feb. 16, 2006); slip op. at 3 (STB served Feb. 24, 2006); and slip op. at 5-6 (STB served June 21, 2006); Temporary Service, slip op. at 4-5.

B. Transportation Inadequate for a Majority of the Lines' Shippers. As explained in the July 3 Decision, slip op. at 5, affirmative statements by a shipper that it fears service-related retaliation for criticizing a carrier's rail service may be sufficient to show inadequacy of rail service as to that shipper. Adequate rail transportation involves more than just picking up or delivering a specific shipment in a timely manner on a given day. It entails rail service that is reliable over the long term so that shippers can prudently make contractual commitments that depend on future rail service for their fulfillment. Reliable rail service in this sense presupposes a business relationship that allows shippers to raise concerns about their service with the railroad (or with the Board) without fear of retribution by the carrier.

Here, in addition to the evidence of the inadequacy of SAW's service to PYCO, already discussed, the record contains statements from other shippers (including potential shippers) indicating that SAW has not provided them with reliable rail service in the sense discussed above. These statements indicate either that SAW threatened the shippers making the statements with service-related retaliation for criticizing SAW (or for supporting PYCO's application) or that they feared such retaliation based on the experiences of other shippers on the lines. Considered together, these statements indicate that SAW has engaged in a pattern of abusive behavior, including actual and threatened retaliation, against multiple shippers who voice concerns about their rail service.

Furthermore, the record shows that a majority of the shippers on SAW's Lubbock lines have said that they view SAW's rail service to be inadequate because of poor rail service, retaliatory actions, or threatened retaliation. We base this finding on SAW's statements to us specifying the number of shippers on the lines,<sup>28</sup> the statements submitted by PYCO from shippers and potential shippers concerning poor rail service and actual and threatened retaliation against themselves or other shippers on the lines,<sup>29</sup> SAW's admission that PYCO had presented evidence that a majority of SAW's shippers viewed its service as inadequate,<sup>30</sup> SAW's failure to

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<sup>28</sup> SAW Reply in Opposition to Petition to Allow Amendment of Feeder Line Application, filed June 28, 2006, in STB Finance Docket No. 34844, at 4 (stating that SAW had 19 shippers); SAW Rejection Motion at 6-7 & n.1 (stating that SAW had 23 shippers and would soon have a 24th); SAW Response to Motion for Enforcement of Protocol, Motion for Order Staying Retaliatory Actions, Motion to Stay Purported Sale of Property, Motion to Preserve Status Quo and Motion to Submit New Evidence in Support of Petition, filed July 31, 2006, at 2 (stating that "SAW serves nineteen (19) customers"). We do not regard Farmrail, which stores empty railcars on SAW's lines, as a "shipper" receiving transportation services for purposes of 49 U.S.C. 10907(c)(1)(B).

<sup>29</sup> Shipper Comments at 3 & Exhs. A through D; PYCO Revised Feeder Line Application, filed June 14, 2006, at 7, 9-10, & Exh. B; PYCO Original Application at Exh. H.

<sup>30</sup> For example, SAW conceded that "[i]t appears from [PYCO's] filing that a majority of shippers favor sale of SAW's rail lines." McFarland Letter at 1. SAW also said that "[a]lthough SAW denies the allegations of those shippers, it would be difficult for SAW to operate when a majority of its shippers do not favor its operation." Id.

dispute our preliminary determination that PYCO's evidence showed that a majority of shippers considered SAW's rail service to be inadequate,<sup>31</sup> and SAW's clearly stated determination throughout most of this proceeding not to oppose a finding that the public convenience and necessity permit the sale given the number of shippers who favor the sale and its failure to provide a reasoned explanation for its attempted last-minute about-face.<sup>32</sup>

For all of the foregoing reasons, we find that PYCO has shown that SAW's rail service is inadequate for a majority of the shippers on SAW's Lubbock lines.

C. Effect of the Sale on SAW's Finances. Notwithstanding the claim by SAW's owner and current general manager that SAW would suffer "devastating" financial harm if it were forced to sell its Lubbock lines for the amounts suggested by PYCO and KJRY,<sup>33</sup> SAW has offered no evidence or argument to back up this claim. Thus, so long as SAW will receive the full compensation prescribed by the statute, which is the level required by the Constitution, there is no reason to believe that the sale of the lines would have a significantly adverse effect on SAW. And because, as discussed below, we set the sale price at that required level, we find that SAW would not suffer financially from this sale.

D. Effect of Sale on SAW Operational Performance. Following the forced sale of its Lubbock lines, SAW would still have a short track at Slaton, TX, where it provides switching service to an unspecified number of customers. SAW's owner contends that the sale of SAW's Lubbock lines would "seriously hurt" SAW's ability to provide good service to those customers, but fails to provide any explanation of why this might be so. Because the Slaton line is physically separate from SAW's Lubbock lines, there is no apparent reason to believe that the Slaton operations would be hampered by the sale of the Lubbock lines. Indeed, the proceeds of the sale of its Lubbock lines should assist SAW in providing good service to its Slaton shippers.

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<sup>31</sup> August 16 Decision, slip op. at 2 (describing PYCO's evidence as indicating "that a majority of the shippers on SAW's entire rail system view SAW's service as inadequate") and 3 (noting that SAW was reevaluating its prior position on whether the public convenience and necessity permits the sale of the Lubbock lines "because a majority of shippers now favor the sale of the entirety of its rail lines").

<sup>32</sup> SAW Statement at 2. We note that, in this submission, SAW included an exhibit indicating that it had 34 "clients." Id., V.S. of Plaistow, Exh. 32. But SAW did not claim that this exhibit showed that less than a majority of its shippers and potential shippers viewed its service as inadequate. Rather, SAW included the exhibit as part of its valuation argument, specifically to show that, when compared against the first 6 months of 2005, SAW's shipments did not diminish in the first 6 months of 2006 (not counting PYCO's shipments, which WTL was handling). In any event, the exhibit shows that, during the time period covered by the exhibit, only 22 of the 34 listed "clients" had any shipments on SAW.

<sup>33</sup> SAW Reply, R.V.S. of Wisener at 10.

E. Improved Rail Transportation for Shippers. A sale of the lines to either PYCO or KJRY should lead to improved rail service for shippers on the lines. Although PYCO itself has no experience operating a railroad, it has signed a letter of intent with WTL to provide the rail service. WTL not only has experience operating its own rail lines in the Lubbock area, but also experience operating over SAW's rail lines as PYCO's alternative rail service provider. PYCO's rail service improved greatly under WTL.<sup>34</sup>

KJRY suggests that, as a shipper, PYCO would have an incentive to discriminate against other shippers. But there is no evidence indicating that any shippers have such qualms. No shipper has opposed PYCO's application, and, indeed, PYCO has submitted letters from many shippers who support its application. Moreover, PYCO has plans to improve rail service over these lines by reconfiguring track and using PYCO's financial resources to rehabilitate these rail lines. PYCO also intends to train its employees to follow WTL rules when operating PYCO's trackmobile on these lines; this will free WTL workers and equipment to serve other shippers. Accordingly, we are satisfied that, under PYCO's ownership, rail service likely would improve for all of the shippers on these lines.

Similarly, there should be improved rail service in the hands of KJRY, an established rail carrier. PYCO points out that KJRY does not plan to rehabilitate these rail lines extensively. PYCO also argues that the lack of any shipper support for KJRY's application, coupled with the statements of three shippers that they have no reason to believe service would improve under KJRY, demonstrates that KJRY's service would not be an improvement over SAW's. Finally, PYCO asserts that the subsidiaries of Pioneer (of which KJRY is one) have a reputation for litigating against larger railroads, communities, and shippers. But there is no evidence that KJRY is not providing adequate rail service to its existing shippers or that it would not provide adequate rail service to PYCO or other shippers on these lines.

In sum, we find that the criteria of section 10907(c)(1) are met here with respect to each of the two feeder line applications before us.

## II. Valuation

In a feeder line case, we set the purchase price of a line at no less than its constitutional minimum value, which is statutorily "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). As explained below, we find that the net liquidation value of these lines is greater than their value as a going concern. Accordingly, we set the sale price at the net liquidation value, which we find to be \$2,350,918.

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<sup>34</sup> See Alternative Rail Service, slip op. at 3 (STB served Feb. 24, 2006) ("[S]ince WTL began providing service to PYCO, BNSF has been able to load a 70-car unit train every 3 days versus every 5 days when SAW provided service to PYCO.").

A. Net Liquidation Value (NLV). The NLV of a rail line typically consists of the net salvage value of the track and related materials plus the value of the underlying land.

1. *SAW's NLV Estimate*. SAW did not present a typical NLV analysis. Instead, SAW argues that the NLV of its Lubbock rail lines is demonstrated by offers of purchase it received. According to SAW, Pioneer offered to purchase the lines for \$6 million in an email sent July 31, 2006, conditioned only upon standard due diligence and regulatory approval. SAW claims that US Rail Partners, Ltd. (USRP) similarly made an unconditional offer for the same amount in July 2006. On rebuttal, SAW also relies on a purported verbal offer from PYCO to buy the lines for \$5.5 million.

The only other NLV evidence tendered by SAW was limited to the portion of SAW's rail lines that comprised Alternative Two. That evidence is insufficient to calculate the NLV for all of SAW's Lubbock lines. However, because PYCO's NLV estimate relies in part on SAW's estimate for Alternative Two, we will address SAW's evidence, as needed, in that context.

2. *PYCO's NLV Estimate*.

a. Net Salvage Value (NSV) of Track and Materials. PYCO calculated the NSV of SAW's Lubbock lines<sup>35</sup> based upon SAW's evidence of the weight, grade, and quality of materials in Alternative Two. SAW's engineering specialist had set forth the weight of the rail, divided according to the potential use of the rail as relay, reroll, or scrap.<sup>36</sup> To extrapolate the SAW evidence to the remainder of the Lubbock track, PYCO assumed that the remainder was 90-pound rail of reroll quality—an assumption favorable to SAW because some of the remaining track likely is only 85-pound rail and only of scrap quality.

As for ties covered by Alternative Two, SAW had divided its estimate into relay (reusable for a rail line), landscape, and scrap. PYCO treated the ties on the remainder of the lines as having no net value, i.e., that the amount for which the reusable ties could be sold would be no greater than the cost to remove them. Concerning rail-highway crossings, PYCO determined that 15,000 square feet needed to be repaired or replaced, at an average cost of \$10 per square foot. PYCO also assumed a 15% charge to compensate a contractor for overseeing the project. Using SAW's evidence and these further assumptions, PYCO estimated the NSV of the track and materials in the Lubbock lines at \$806,468.

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<sup>35</sup> PYCO included the trackage as to which SAW's attempted transfers were voided.

<sup>36</sup> For a description of these categories, see Keokuk Junction Railway Company—Feeder Line Acquisition—Line of Toledo Peoria and Western Railway Corporation Between La Harpe and Hollis, IL, STB Finance Docket No. 34335, slip op. at 11-12 (STB served Oct. 28, 2004) (KJRY I).

b. *Real Estate Value.* As is customary in feeder line cases, PYCO valued the real estate based on the sale of comparable parcels of land.<sup>37</sup> When PYCO submitted its initial real estate valuation, SAW had not yet furnished its estimate of the land area involved in Alternative Two. Consequently, PYCO initially relied upon a witness from the Center for Geospatial Technology of Texas Tech University to calculate the land area based on right-of-way maps.

Taking that witness's land-area calculation, PYCO's real estate witness, a licensed real estate appraiser in Texas, divided SAW's land into two categories: west of Martin Luther King Boulevard (MLK Blvd.) and east of that road. For the land west of the boulevard (2,921,901 square feet), composed of small- to medium-sized industrial sites, the land area is expressed in square feet to facilitate comparison with sales that are expressed as dollars per square foot. For the eastern portion (52.537 acres), the land area is expressed in acres to facilitate comparison with sales of that portion's larger industrial sites, expressed in dollars per acre. PYCO assumed that SAW holds marketable title to all of the real estate.

Based on eight comparable sales, PYCO determined a unit value of \$0.55 per square foot west of MLK Blvd. East of the boulevard, it determined a unit value of \$4,000 per acre, based on seven comparable sales. Applying these figures to the area calculations described above, PYCO initially computed the total value of real estate at \$1,817,000 (rounded).<sup>38</sup> That estimate did not include any discount factor to reflect the time and costs of marketing the real estate.<sup>39</sup>

After SAW later submitted evidence of the land area comprising Alternative Two, PYCO reduced its calculation of the number of acres owned east of both MLK Blvd. and the BNSF main line (a portion of the total of 52.537 acres owned east of MLK Blvd.) from 36.647 to 22.6 acres. PYCO also added a 15% discount factor to reflect the costs involved in selling the real estate. With these revisions, PYCO's final valuation of the real estate for SAW's Lubbock lines was \$1,467,270.

c. *Total NLV Estimate.* Adding PYCO's NSV of \$806,468 and final real estate valuation of \$1,467,270 yields a NLV estimate of \$2,273,738, which PYCO rounded up to \$2,274,000.

KJRY has adopted PYCO's NLV estimate and analysis.

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<sup>37</sup> See, e.g., KJRY I, slip op. at 17-18 (traditional real estate valuation uses sales comparison method).

<sup>38</sup> West Sector: 2,921,901 square feet x \$0.55 = \$1,607,046  
 East Sector: 52.537 acres x \$4,000.00/acre = 210,148  
 \$1,817,194 total

<sup>39</sup> Such costs typically reflect the length of time it takes to sell the real estate and fees for attorneys and appraisers. See, e.g., KJRY I, slip op. at 18-20 (discussing discount for costs of the sell-off period).

### 3. Board's Calculation of NLV.

The purchase offers on which SAW relies do not provide evidence of the Lubbock lines' NLV because there is no evidence that any of the three offerors planned to liquidate the assets of SAW's Lubbock lines. Nor do they establish a fair market value for the lines (whether conceptualized as the NLV or the going concern value). A signed sales contract or firm bid that would be binding upon its acceptance can be convincing evidence of the fair market value of a rail line or segment.<sup>40</sup> But here SAW has not shown that any of the offers was an unqualified offer to buy these lines.

The Pioneer email message stated that a Pioneer subsidiary “would like to enter into a letter of intent” to buy SAW, but that the letter would be “contingent” on events in the feeder line proceeding as well as on standard due diligence. Pioneer's general counsel, who made the offer, verifies that it was only a preliminary offer and that it included the purchase of additional SAW assets beyond the rail lines—such as locomotives, vehicles, materials, and tools. Although SAW claims that it does not own any locomotives, Pioneer's evident belief to the contrary when it made the offer is further indication of how preliminary the offer was. Thus, we cannot base our valuation of the rail lines on Pioneer's email.

Although SAW has furnished a statement by USRP's president claiming that USRP made a formal offer on May 5, 2006 to purchase SAW's rail lines, SAW has not submitted into evidence the offer itself. A later email message from USRP's counsel to SAW's counsel states that the offer was revised on July 6, 2006, but SAW has not furnished a copy of the revised offer either. Without having these documents before us, we cannot ascertain exactly what SAW assets were included,<sup>41</sup> on what assumptions USRP's offer was predicated,<sup>42</sup> or whether this was a firm offer. For these reasons, we cannot base our valuation on this claim.

PYCO denies having made the purported verbal offer to purchase an unspecified portion of SAW's rail system for \$5.5 million. PYCO claims that SAW approached PYCO and offered to sell it the lines for \$5.5 million, but that PYCO asked that any contract include a due diligence clause so that it could determine the extent and condition of the property and whether the lines

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<sup>40</sup> See Railroad Ventures, Inc.—Aban. Exem.—Youngstown, OH & Darlington, PA, 5 S.T.B. 283, 297 (2000), aff'd sub nom. Railroad Ventures.

<sup>41</sup> For example, USRP's president states that he was going to recommend to the board of directors that USRP make a formal purchase offer for SAW's lines and four locomotives. See SAW Statement, V.S. of Howell at 3. We cannot determine whether USRP intended to purchase these locomotives from SAW or another entity.

<sup>42</sup> USRP's president states that USRP's offer was based on “the full amounts of a surcharge we understood was available to SAW and available to a new purchaser.” Id. We cannot determine from this statement whether USRP based its offer on projected revenues from the \$40 or \$60 surcharges that SAW claims it had the right to charge, but which, as we explain below, should not be included in assessing the lines' value as a going concern.

were worth \$5.5 million, at which point discussions ended.<sup>43</sup> To the extent that PYCO made an offer, the offer was contingent on due diligence, and we cannot base our valuation on it.

We presume that, had Pioneer, USRP, or PYCO performed due diligence—including determining realistic base year traffic levels and revenue streams—they would have concluded (as we do here) that the lines' fair market value (whether determined through an NLV or GCV method) falls well short of \$6 million. For this reason, we find that the three purchase offers on which SAW relies do not constitute reliable evidence of the Lubbock lines' NLV.

We turn to PYCO's NLV evidence. We find PYCO's estimation of NSV credible because it relies upon SAW's own evidence concerning the track length of all of the Lubbock lines and the track weight and quality for the portion of the system comprising Alternative Two. PYCO's assumptions about the weight and quality of track in the remainder of SAW's rail system are reasonable. Indeed, in its final evidentiary submission, SAW did not contest any part of PYCO's NSV calculation.

PYCO also used a sound approach for calculating the value of the real estate, based on the accepted sales-comparison method. PYCO's 15% reduction to reflect sell-off costs likewise is reasonable and comports with SAW's own use of the same reduction for estimating the value of the real estate in Alternative Two.

We find, however, that the other revision PYCO made to its initial real estate valuation—reducing the acreage by about 14 acres—is not acceptable. PYCO relied on evidence submitted by SAW, indicating that SAW owns only 22.6 acres of land east of the BNSF main line that would be sold under Alternative Two. There is, however, some SAW track to the east of BNSF's main line that was not part of Alternative Two, as shown on a map in PYCO's original feeder line application.<sup>44</sup> Specifically, the SAW track to the east of the BNSF main line, marked in yellow, was not part of the trackage at issue in Alternative Two, which was marked in red. The maps PYCO used to calculate land area for the entire Lubbock lines confirm that PYCO included land east of the BNSF main line underlying tracks that were not part of Alternative Two.<sup>45</sup> For this reason, we reject PYCO's reduction in the land area.

Accordingly, we have recalculated PYCO's real estate valuation, restoring the amount of land owned east of both the BNSF main line and MLK Blvd. to the original 36.657 acres. The

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<sup>43</sup> PYCO Rebuttal, filed Oct. 19, 2006 (PYCO Rebuttal), Rebuttal Declaration (R. Dec.) of Robert Lacy at 2-4; see also Alternative Rail Service, slip op. at 2-3 (STB served Jan. 26, 2006).

<sup>44</sup> See PYCO Original Application, Appendix A, map labeled "Alternative Two."

<sup>45</sup> Id., Appendix D-2, SAW Track Maps 2 and 3. These tracks lie both east of the BNSF main line and south of 50th Street. In describing the 36.657 acres comprising "Area Two" in his appraisal, PYCO's expert stated that it included all of the land lying east of Southeast Drive (id., Appendix D-1 at p. 21), which also includes land to the south of 50th Street.

resulting real estate value is PYCO's original value of \$1,817,000,<sup>46</sup> less 15% for sales cost, or \$1,544,450. Adding the latter figure to the NSV of track and related materials (\$806,468) yields a total NLV of \$2,350,918.

B. Going Concern Value (GCV). GCV is the worth of a rail line as an operating business. We measure the worth to the seller, not the worth to the buyer.<sup>47</sup> Under Board precedent, GCV is calculated by dividing the owner's net revenues from operating the line by the railroad industry's pre-tax cost of capital.<sup>48</sup> The net revenues (or cash flows) are determined by subtracting the variable costs of operating the line from the gross revenues earned.<sup>49</sup>

1. *SAW's GCV Calculation*. SAW did not use this method to calculate GCV. Instead, SAW relied upon its Federal income tax returns and Texas Franchise Tax Public Information Reports to create a series of profit and loss statements for the years 2000 through 2005.<sup>50</sup> Taking growth into account, SAW projected the 2005 cash flow forward 10 years (2006-2015), and calculated a terminal value based on the expected cash flows beyond 2015. SAW primarily earns revenue by switching rail cars, for which SAW earns a "division" (or share) of the linehaul rates that its shippers pay to BNSF. The 1999 Agreement provides that SAW's division will change annually by 50% of the change in the Board's Rail Cost Adjustment Factor – Unadjusted (RCAF-U).<sup>51</sup> SAW relied on a forecast from Global Insight, an economic forecasting firm, to predict future changes in the RCAF-U figure.

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<sup>46</sup> In PYCO's revised valuation filed on September 28, 2006, at 9 n.7, PYCO further reduced its land value to reflect a sale of a line segment to Choo Choo. This reduction is inappropriate, as the Board voided that sale, in part, because of the close connection between SAW and Choo Choo. Thus, the amount of that sale is not credible evidence of the actual land value.

<sup>47</sup> Caddo Antoine et al.—Feeder Li. Acq.—Arkansas Midland RR, 4 S.T.B. 326, 340 (1999) (Caddo Antoine I).

<sup>48</sup> See Caddo Antoine I, 4 S.T.B. at 341; Caddo Antoine et al.—Feeder Li. Acq.—Arkansas Midland RR, 4 S.T.B. 610, 616 (2000) (Caddo Antoine II), aff'd in relevant part and rev'd on other grounds, GS Roofing Prods. Co. v. STB, 262 F.3d 767 (8th Cir. 2001) (GS Roofing).

<sup>49</sup> Caddo Antoine II, 4 S.T.B. at 616.

<sup>50</sup> SAW explained that the assets and cash flows of SAW, combined with those of South Plains Lamesa Railroad, Ltd. (another company owned by SAW's owners), flow through the books of the latter railroad, and are included in calculating SAW's GCV. SAW further explained that the only cash flows that appear on SAW's books are those related to operations at Slaton and therefore were not included in calculating SAW's revenues here.

<sup>51</sup> The Board publishes the RCAF-U quarterly. See, e.g., Quarterly Rail Cost Adjustment Factor, STB Ex Parte No. 290 (Sub-No. 5) (2007-3) (STB served June 19, 2007). "Unadjusted" refers to the lack of an adjustment for productivity.

To forecast the number of carloads that would be handled on SAW's lines in future years and the corresponding revenues, SAW used the 2006 forecast in the Upland Cotton Production Index of the United States Department of Agriculture for two-thirds of the total base year carloads and the 2006 forecast of railroad industry ton-miles prepared by the Energy Information Administration (EIA) in its Annual Energy Outlook for one-third of the total base year carloads. SAW explained that, historically, two-thirds of SAW's car loadings have been cotton related and one-third have not.

SAW discounted the projected future cash flows for 2006-2015 by dividing by the Board's 2005 after-tax cost of capital rate to derive a net present value of the future cash flows. Finally, SAW calculated the overall GCV by summing all of the discounted cash flows from 2006 to 2015 plus the terminal value.

Using this methodology, SAW presented four different GCV calculations, ranging from a high of approximately \$8.5 million to a low of approximately \$4 million. The results varied depending on the revenue streams included in calculating the future cash flows, as described below.

a. *SAW's Favored Scenario.* In its favored GCV scenario, SAW included the income it could derive from the future application of surcharges, in the amount of \$40 per car for shipments in blocks of 27 or more cars and \$60 per car for all other shipments, even though it has not applied those surcharges to date. (Beginning in late 2005, SAW did apply a surcharge of \$20 to PYCO shipments only.) According to SAW, the application of these surcharges would not cause any diversion of any of SAW's traffic to other rail carriers or other transportation modes because the surcharges would represent only 2% of the total freight charges on movements of rail cars from origin to destination.

This scenario also includes the future revenues from BNSF's agreed payment of \$75 per car delivered to Jarvis Metals, whose facility is located on a short track that SAW owns at Burris, TX. Even after SAW won in court the right to serve Jarvis Metals' facility, BNSF continues to deliver cars to that facility, but pays SAW \$75 for each carload that BNSF delivers there.

Also included in this scenario is predicted increased future revenue from serving Vulcan Materials Company (Vulcan), a receiver of carloads of aggregate (rock). The revenue from a Vulcan competitor, Hanson, is excluded because Hanson has stated that it would not continue to ship cars to its transload facility on SAW's lines. SAW claims that, because of Hanson's withdrawal from the market, Vulcan would require a higher number of carloads that would more than offset the loss of Hanson's traffic. Applying all of these assumptions about future revenues on its lines, SAW calculated a GCV of \$8,537,903.

b. *Second Scenario.* In its second scenario, SAW included the full surcharges of \$40 or \$60, depending on the number of blocked cars, but excluded the Burris traffic, resulting in a GCV of \$8,161,052.

c. *Third Scenario.* The third GCV calculation included the Burris traffic, but only the \$20 surcharge on PYCO's traffic and no surcharge for other shippers. The resulting GCV estimate is \$4,336,926.

d. *Fourth Scenario.* The final GCV calculation of \$3,958,547 excluded the Burris traffic and included only the \$20 surcharge on PYCO's traffic.

2. *PYCO's GCV Calculation.* Like SAW, PYCO provided four GCV calculations with varied revenue streams, and it employed the same method of summing the present value of cash flows projected over a 10-year period plus a terminal value. PYCO first calculated preliminary GCV figures and then subtracted rehabilitation expenses to derive its final calculations.

Concerning the number of carloads in the base year and the corresponding revenue, PYCO acknowledged that, in the usual case, it would be preferable to use the latest available full year of data (2005 in this record) to project the future traffic on a rail line, as SAW did. PYCO contends, however, that the number of carloads SAW handled in 2005 and SAW's resulting revenue that year were abnormally high and therefore are not a realistic base from which to project future revenues. PYCO reasons that the majority of carloads on SAW's lines are related to cotton production, and it shows that the amount of cotton produced in the Lubbock region in each of the years 2004 and 2005—crops whose products were handled by SAW in calendar year 2005—exceeded any previous year's production by a significant factor. Indeed, SAW's own evidence reveals that the number of carloads it transported for PYCO in 2005 was more than double its PYCO carloads in any of the preceding 5 years.<sup>52</sup>

To adjust the 2005 carloads/revenue to what it views as a more realistic number, PYCO reduced SAW's agricultural revenue by 42.8%, which is the degree to which the number of cotton bales produced in the Lubbock area (5,277,400) in crop years 2004 and 2005 exceeded the norm (a 5-year average of 3,694,640 bales). To this PYCO added the same non-agricultural revenue and "other revenues" used by SAW to derive total revenues. PYCO applied a growth rate of 3.3% to the SAW revenues derived from handling cotton-related shipments, but did not apply any growth rate to SAW's non-agricultural revenues. After subtracting expenses, PYCO divided the recalculated 2005 cash flows (which varied depending on which revenue streams were included) by the Board's 2004 pre-tax cost of capital rate. The resulting gross GCV estimates range from a low of approximately \$1.1 million to a high of approximately \$3 million. The included revenue streams and the resulting initial GCV figures are:

- a. exclude Burris revenue, all surcharges, and Hanson traffic: \$1,131,102;
- b. include Burris revenue and Hanson traffic; exclude all surcharges: \$2,300,745.
- c. include Burris revenue and PYCO \$20 surcharge; exclude Hanson traffic: \$2,795,624;

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<sup>52</sup> See SAW Reply, R.V.S. of Plaistow at 12, Table 1.

d. include Burris revenue, PYCO \$20 surcharge, and Hanson traffic: \$3,032,436.

PYCO argues that the second of these GCV estimates (\$2,300,745), which includes the Burris revenue that SAW is collecting from BNSF but excludes all surcharges, is the most realistic scenario because PYCO has challenged the lawfulness of the application of any surcharge to its traffic.<sup>53</sup> Nonetheless, PYCO provided two calculations (c. and d. above) that include the \$20 surcharge that SAW applied to PYCO traffic. None of PYCO's calculations include the \$40 and \$60 surcharges that SAW claims a right to charge, because PYCO argues that such a price increase would drive away SAW's other customers,<sup>54</sup> thus causing a reduction in traffic and resulting revenues.

PYCO then took rehabilitation costs into account. It estimated the cost of rehabilitation using 90-pound rail to be approximately \$4 million, and the cost using 112- and 115-pound rail to be approximately \$6.6 million.<sup>55</sup> After deducting either of these rehabilitation costs from PYCO's four initial GCV figures, the resulting net GCV for SAW's rail lines would be zero under any of the four scenarios.

3. *KJRY's GCV Calculation.* To develop a realistic revenue base, KJRY adjusted the unusually large number of carloads handled by SAW in 2005 to reflect a more typical amount of cotton-related traffic. KJRY used a regression analysis, a commonly used statistical tool that establishes a relationship between two or more variables. Using data from the United States Department of Agriculture, KJRY initially ran a regression analysis for the years 1965 through 2005 (41 years) to determine the size of a "normal" cotton crop for Texas. In its rebuttal statement, KJRY reduced the number of years in the regression analysis to 14 (1992-2005), to better reflect shifts in the cotton market since 1992 due to demand in China and the use of genetically modified crops.<sup>56</sup> Using this revised regression analysis, KJRY calculated a "normal" Texas cotton harvest for 2006 and divided it by the 2005 cotton harvest to yield a "cotton adjustment factor" of 0.7175, which KJRY then applied to SAW's actual 2005 revenue to derive a more realistic base figure.

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<sup>53</sup> In PYCO Industries, Inc. v. South Plains Switching, Ltd. Co., STB Finance Docket No. 34870, PYCO alleges that the application to its traffic of any surcharges that are not also applied to the traffic of SAW's other Lubbock shippers violates the anti-discrimination provision of 49 U.S.C. 10741, among other statutory provisions. That complaint is pending.

<sup>54</sup> PYCO asserts that it is highly unlikely that SAW's other business customers are "price inelastic" and would pay a higher price for rail service. See PYCO Modification to Valuation of Assets of SAW (PYCO Modification), filed Sept. 28, 2006, V.S. of Banks at 4.

<sup>55</sup> The heavier weights of rail are capable of handling 268,000-pound rail cars.

<sup>56</sup> Based on criticism from SAW, KJRY's revised regression analysis also eliminated an intercept term, a term in the linear regression equation that remains constant. KJRY's GCV witness, Dr. William Brennan, who is now an employee of the STB, has been recused from working on this case at the STB.

Using this method, KJRY calculated GCV in two ways—one that included a factor for projected growth rates in traffic volumes and a second that assumed that traffic volumes will remain at their historical averages. In the former calculation, KJRY initially used the same growth rate used by SAW: the percentage increase of 2015 cash flows over 2014 cash flows in Plaistow’s projections, or 1.2%. In its rebuttal statement, PYCO used a growth rate of 2.5%.

Like PYCO, KJRY did not include in the calculation of future revenues the never-imposed \$40 and \$60 surcharges, on the ground that application of the surcharges would drive away business and therefore reduce revenues. Nor did KJRY include a \$20 surcharge on PYCO traffic, which KJRY regarded as retaliatory because it was applied only to PYCO and not to SAW’s other shippers.

On the expenses side, KJRY used the Board’s Uniform Rail Costing System (URCS)<sup>57</sup> to estimate the expenses associated with future rail traffic, as did PYCO. On rebuttal, KJRY corrected the total expenses to include maintenance-of-way (MOW) costs<sup>58</sup> that had been omitted in its previous analysis. KJRY adjusted these total expenses to account for lower operating costs associated with the reduced base-year traffic volumes it had calculated. After subtracting these adjusted expenses from the adjusted revenues, the resulting cash flow was divided by the pre-tax cost of capital for the railroad industry to yield GCV. As a consequence, KJRY estimated the GCV of SAW’s rail system to be \$1,780,242, prior to deducting \$77,215 for rehabilitation,<sup>59</sup> yielding a net GCV of \$1,703,027.

4. *Board’s Analysis of GCV.* We discuss below the major issues on which the parties’ approaches differ, explain our resolution of the issues, and recalculate GCV accordingly.

Initially, SAW criticized the capitalization-of-earnings method used by KJRY, contending that it assumes that the future earnings being capitalized would continue unchanged in perpetuity. As explained above, however, KJRY’s use of a growth rate accounted for predicted changes in future earnings. As KJRY’s witness explained, both the SAW methodology and the KJRY methodology are forward-looking and account for growth, and SAW itself used the criticized approach to calculate the terminal value of SAW.<sup>60</sup>

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<sup>57</sup> See 49 CFR 1201. The Board regularly uses URCS to establish the variable costs of providing rail service in rate cases, abandonment proceedings, and feeder line acquisitions.

<sup>58</sup> MOW costs are those yearly maintenance costs required to have the line meet the Federal Railroad Administration (FRA)’s minimum (Class 1) safety standards.

<sup>59</sup> Unlike PYCO, KJRY believes that these lines can be operated safely and efficiently without extensive rehabilitation.

<sup>60</sup> See KJRY Expanded Competing Feeder Line Application, filed Sept. 27, 2006, V.S. of Brennan at 3.

We now turn to the specific assumptions used in the parties' GCV calculations.

a. *Base-year carloads/revenue.* SAW's GCV calculation is based on the revenues earned from traffic transported in 2005. We agree with PYCO and KJRY that the 2005 traffic levels and corresponding net revenues are not a realistic base from which to calculate GCV. The evidence convincingly shows that 2004 and 2005 were outlier years, reflecting near-perfect weather conditions for the cotton crop and resulting in a much higher number of carloads of cotton-related traffic handled on SAW's rail lines in calendar year 2005 than in prior years.<sup>61</sup> The weather in 2006 was less favorable, and the cotton harvest was much smaller; PYCO expects to ship 4,000 fewer rail carloads of cottonseed from the 2006 harvest than it shipped from the 2005 harvest.<sup>62</sup>

SAW does not dispute that its 2005 traffic levels greatly exceeded those of previous years. SAW maintains, however, that these elevated levels are an appropriate base year from which to project future traffic levels. SAW reasons that its traffic levels depend less on the size of the Texas cotton crop and more on its customers' contractual obligations. SAW's owner states that PYCO, the biggest shipper on SAW's Lubbock lines, "has contracts to fill. If the cotton crop in Texas is not good, PYCO . . . ship[s] in product in order to fulfill contracts. . . . PYCO has won large contracts for shipments of raw cottonseed that did not exist before 2004/2005."<sup>63</sup> However, SAW has provided no details of these PYCO contracts or how SAW would have knowledge of them.

In rebuttal, PYCO's senior vice-president for marketing explains that PYCO does not enter into long-term contracts to ship fixed volumes of cottonseed or cottonseed oil in or out of Lubbock, and that, indeed, PYCO's business is too weather dependent to make such contracts practical. Instead, PYCO contracts particular volumes on a year-to-year basis once it determines how the cotton crop is progressing. PYCO further explains that it is contractually committed to accept a certain percentage of the cottonseed produced by member gins in the Texas cottonbelt.<sup>64</sup>

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<sup>61</sup> For example, relying upon historical data for the Lubbock area cotton crop ("high plains cotton") from 1928 through 2005, PYCO shows that, in 2004, 41% more cotton crop was harvested in the region than in any single year before and, in 2005, 64% more crop was harvested than in any single prior year other than 2004. PYCO Modification, V.S. of Banks at 10. PYCO calculates that the average total bale production for the 2-year period 2004-2005 exceeded by more than 50% the highest previous 5-year bale production. Id. PYCO further explains that, because the cotton crop in the Lubbock area is harvested between October and January, all of the cotton-related traffic transported during calendar year 2005 was from the huge crops of 2004 and 2005. Id. at 6.

<sup>62</sup> PYCO Rebuttal, R. Dec. of Robert Lacy at 6.

<sup>63</sup> SAW Reply, R.V.S. of Wisener at 4.

<sup>64</sup> PYCO Rebuttal, R. Dec. of Robert Lacy at 4.

The senior vice-president's testimony, which we find credible, confirms that PYCO's shipments are largely dependent on the size of the Texas cotton harvest. Accordingly, we reject SAW's use of its abberationally high 2005 traffic levels (and its likewise abberationally high 2005 revenue levels) as the base from which to calculate GCV.

Given that it would not be realistic to base the GCV calculation on the actual 2005 revenues, the issue is how best to determine a reasonable base-year figure. PYCO and KJRY took different, but complementary, approaches to address this value. As explained above, PYCO relied upon the predicted (1 year) decline in the 2006 cotton harvest for the base-year revenues associated with handling agricultural (cotton-related) shipments. In contrast, KJRY used the previously described regression analysis that took into account 14 years of Lubbock area cotton harvests to determine a normal cotton harvest, from which it determined base-year traffic levels and, ultimately, realistic base-year revenues.

A regression analysis is well suited to determining a realistic base-year cotton harvest. Regression analysis is a technique commonly used in litigation (and other fields) for isolating the effects of multiple variables and determining how they influence a dependent variable.<sup>65</sup> Here, KJRY performed a regression analysis to determine what a "normal" base-year cotton harvest would be (e.g., in the absence of near-perfect weather conditions). The resulting analysis has a high correlation coefficient ( $R^2$  value) of 0.924, where a coefficient of 1.0 would be a perfect fit of the data to the mathematical model.<sup>66</sup> Given the high correlation between the data and KJRY's model over a significant period of time, we conclude that KJRY's analysis constitutes the best evidence of record concerning a realistic base-year figure for cotton production.<sup>67</sup>

Criticizing KJRY's initial regression analysis, SAW claims that using national cotton production statistics is a better way to predict Texas cotton production in a given year. SAW contends that its approach produced results that had a slightly smaller average percentage error from observed data. We find SAW's claim unconvincing. We see no reason to believe that national cotton statistics would yield more accurate projections of local cotton production than KJRY's approach, which relies on data from local harvests. Moreover, KJRY's revised regression analysis adheres much more closely to the data than did its initial regression analysis and, in any event, as KJRY notes on rebuttal, SAW's analysis of national cotton production statistics contained a significant computational error.

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<sup>65</sup> See Zenith Elec. Corp. v. WH-TV Broad. Corp., 395 F.3d 416, 419 (7th Cir. 2005).

<sup>66</sup> The  $R^2$  statistic always ranges between 0 and 1. The closer it is to 1, the better the results capture the relationship between the independent variables and the dependent variable. There are, however, no established criteria for deciding how high an  $R^2$  should be before concluding that the model fits the data well. See generally William H. Green, Econometric Analysis 154 (2d ed. 1993).

<sup>67</sup> Cf. Toledo, Peoria & W. Ry. v. STB, 462 F.3d 734, 746 (7th Cir. 2006) (affirming the STB's calculation of a rail line's NSV that used a 14-month average in the price of scrap steel due to high volatility in steel prices), cert. denied, 127 S. Ct. 1829 (2007).

SAW argues that the results of KJRY's regression analysis are inconsistent with SAW's actual 2006 traffic levels. According to SAW, its traffic levels did not drop in the first half of 2006 as compared to the first half of 2005,<sup>68</sup> meaning that 2005 was not an outlier year as suggested by KJRY's regression analysis. SAW's argument fails because it ignores the timing of the cotton harvest. Cotton crops are harvested and begin to reach processors in the fall. This means that the outbound rail shipments of processors like PYCO begin afterward, resulting in shipments the following calendar year.<sup>69</sup> So just as SAW's high traffic levels in 2005 reflected the near-perfect growing conditions in the Lubbock area in 2004, its high traffic levels in 2006 reflected the similarly good growing conditions that prevailed in 2005.

In sum, to avoid overstating SAW's GCV due to the abnormally good weather conditions in 2004 and 2005, we use KJRY's revised regression analysis to determine an appropriate base-year cotton-production figure, which we then use to determine realistic base-year traffic volumes and revenue levels.

b. Revenue Streams Used.

(1) *Surcharges.* We have not included either the \$40 or \$60 per-car surcharges that SAW claims it has the right to apply. SAW has made clear that, after securing the legal right to apply those surcharges in a Texas state court action,<sup>70</sup> it decided not to apply those surcharges for its own business reasons. SAW explained that, although it imposed a \$20 surcharge on PYCO, it elected not to impose the higher surcharges on any of its customers because, after the state court decision, BNSF cancelled certain agreements and made clear to SAW that implementing those surcharges "would be at SAW's peril."<sup>71</sup> As SAW's sole connecting carrier, BNSF evidently convinced SAW not to impose the higher surcharges despite its legal right to do so. Thus, the expected value to SAW of these revenue surcharges is \$0.

As for the \$20 surcharge that SAW applied to PYCO's traffic (from late 2005 until WTL began providing alternative rail service to PYCO), PYCO has challenged the lawfulness of this surcharge in a separate proceeding.<sup>72</sup> We are concerned about the potential for parties to engage

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<sup>68</sup> SAW Statement, V.S. of Plaistow, Exh. 32 (comparing traffic levels in first 6 month of 2005 and 2006, adjusting for loss of PYCO's traffic in 2006 due to the Board's emergency service order).

<sup>69</sup> PYCO Rebuttal, R. Dec. of Robert Lacy at 4.

<sup>70</sup> See The Burlington N. & Santa Fe Ry. Co. v. South Plains Switching, Ltd. Co., 174 S.W.3d 348 (Tex. App. 2005).

<sup>71</sup> SAW Reply, R.V.S. of Wisener at 9.

<sup>72</sup> PYCO has filed a complaint with this Board, claiming that the surcharge is retaliatory and discriminatory. PYCO Complaint, STB Finance Docket No. 34870, filed April 19, 2006. In the meantime, PYCO has apparently refused to pay this surcharge, and SAW has filed an

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in strategic behavior designed to influence the price that we set in a feeder line case. A railroad facing the prospect of a feeder line sale should not have an incentive to impose a surcharge for the purpose of boosting the GCV. Nor should a shipper bringing a feeder application have an incentive to challenge a surcharge for the purpose of minimizing the GCV calculation.

Because the record has not yet been developed in the complaint proceeding, we have not yet determined the validity of the \$20 surcharge charged to PYCO. Nor is it necessary to delay this feeder line proceeding until we can resolve that issue. That is because, even including the revenue stream from the disputed \$20 surcharge on PYCO's traffic, the GCV figure would be less than the NLV figure. Thus, no party would be prejudiced by the inclusion or exclusion of this surcharge, as either action would not affect the outcome. To illustrate that fact, we use a GCV number here that includes the surcharge. But our doing so should not be viewed as prejudging in any way the pending challenge to that surcharge.

(2) *Burriss traffic; Hanson traffic.* Our recalculation of GCV includes the revenue of \$75 per car that BNSF handles for Jarvis Metals at Burriss because SAW currently collects that amount under an agreement with BNSF.

We also include the revenue from the Hanson traffic. Hanson's request in January 2007 to intervene in this proceeding, so that it could continue to receive service from SAW on the track that Hanson leases from SAW, demonstrates its intention to continue receiving aggregate shipments on that track. Accordingly, we do not include SAW's projection of increased revenue (beyond the growth rate applied to all of SAW's revenues) from Hanson's competitor, Vulcan, which was predicated on Vulcan capturing business forgone by Hanson.

(3) *Growth rate.* As explained above, in projecting revenues, the parties applied different growth rates. Initially, KJRY agreed with SAW's growth-rate calculation of 1.2%, representing the percentage difference in SAW's projected cash flows for the ninth and tenth year after the base year (i.e., the projected 2015 cash flow exceeds the projected 2014 cash flow by 1.2%). PYCO criticized SAW's use of this growth rate, contending that it was based, in part, on the growth in railroad industry ton-miles as projected by the EIA, and pointing out that the recent growth in ton-miles has been largely in commodities that SAW does not handle (coal and intermodal shipments). PYCO therefore did not apply any growth rate to the one-third of SAW's revenue that derives from non-agricultural shipments. Despite PYCO's criticism that SAW's overall growth rate of 1.2% is too high, PYCO used a much higher growth rate (3.3%) for the agricultural portion of SAW's revenues (two-thirds of all shipments), without fully explaining how it derived that figure.<sup>73</sup>

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action in Texas state court to collect it. See South Plains Switching, Ltd. Co. v. PYCO Indus., Inc., No. 2006-534,401 (237th Judicial District of Texas).

<sup>73</sup> PYCO stated that the 3.3% rate was "derived from data for the Texas cottonbelt." PYCO Modification at 13; see also id., V.S. Banks at 15-16. Despite using a higher growth rate for revenue from agricultural traffic, PYCO's gross GCV estimates (prior to deducting for

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On rebuttal KJRY applied a growth rate of 2.5%, as mentioned above. KJRY explained that, to determine the growth rate for the two-thirds of SAW's carloads that are cotton-related, its witness relied on a revised regression analysis (discussed above), which showed an implicit growth rate of 2.85% in cotton-related shipments. To determine the growth rate of the remaining one-third of SAW's shipments, KJRY used the 1.7% growth rate in railroad industry ton-miles as forecasted by the EIA. The resulting adjustment yielded a growth rate of 2.5%.

We believe that the growth in SAW's traffic is best determined by analyzing it in two parts: agricultural traffic and non-agricultural traffic. Having accepted KJRY's revised regression analysis for determining a realistic base-year figure for cotton production, we also accept the growth rate of 2.85% implicit in that analysis for SAW's agricultural shipments.

Unfortunately, the record contains no similar analysis indicating the growth rate in SAW's non-agricultural shipments. But the record provides a satisfactory substitute, a government forecast for the growth in railroad ton-miles. Thus, we conclude that the best evidence of record for SAW's non-agricultural shipments is the government-projected growth rate of 1.7% in railroad ton-miles.<sup>74</sup>

In sum, we find that agricultural shipments, which constitute two-thirds of SAW's traffic, will increase in volume 2.85% annually and that non-agricultural shipments, accounting for the remaining third, will increase in volume 1.7% annually. Accordingly, we find that the composite annual projected growth rate for SAW's traffic and resulting revenues is 2.5%.<sup>75</sup>

c. *Projected Expenses.* The parties used different methods of calculating the normal expenses associated with operating SAW's rail lines. They also differed on whether to include the costs to rehabilitate SAW's lines and, if so, on the amount of rehabilitation needed.

(1) *Operating Expenses.* SAW relied on its accounting records to create profit and loss statements purporting to show its actual expenses in operating these rail lines in the years 2000

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rehabilitation) were lower than SAW's because PYCO used a lower base amount of revenue (reflecting fewer carloads) in its calculations.

<sup>74</sup> If we were to accept PYCO's argument that there would be little projected growth in railroad ton-miles if coal and intermodal traffic were eliminated, we would apply a zero growth rate to SAW's non-agricultural shipments. The resulting overall growth rate would be 1.9%  $[(2.85\% * 2/3) + (0\% * 1/3) = 1.9\%]$ , and the resulting GCV calculation would be \$2,117,327. But this would not change the ultimate finding here, that the constitutional minimum value is the higher NLV of \$2,350,918.

<sup>75</sup> Overall growth rate =  $(2.85\% * 2/3) + (1.7\% * 1/3) = 2.5\%$ .

through 2005. In contrast, both PYCO and KJRY calculated only the variable costs of operating SAW's rail lines.<sup>76</sup>

Including only variable costs (as calculated according to URCS) is consistent with Board practice.<sup>77</sup> It enables us to determine economic value, as opposed to accounting value, because the comparison of revenues to variable costs is a more appropriate comparison of the future flow of revenues and expenses of a railroad. As KJRY has pointed out, using variable costs should result in a higher GCV than if we were also to include properly calculated fixed costs, which should serve to lower the stream of cash flows and thereby reduce GCV.

We agree with SAW that PYCO's per-mile maintenance-of-way (MOW) figure of \$20,085 is unreasonably high.<sup>78</sup> SAW cites to Conrail—Aban.—Bet. Warsaw & Valp., Counties, IN, 9 I.C.C.2d 1299, 1304 (1993) (Conrail), where the ICC used normalized MOW costs of approximately \$6,500 per track-mile, noting that such costs appeared reasonable when compared to MOW costs in other abandonment proceedings.<sup>79</sup> PYCO's figure here is more than double the inflation-adjusted level of the figure from Conrail.<sup>80</sup> We also reject SAW's use of an approximately \$6,000 per-mile MOW figure. Having accepted URCS for calculating SAW's variable costs, it would be inconsistent to use a different approach for determining the MOW component of variable costs. Therefore, we use only the URCS normalized MOW variable cost figure, which is \$3,267 per mile. We note that the use of this figure works to SAW's advantage.

(2) *Rehabilitation Costs.* The rehabilitation of a rail line involves programmed replacement of materials. SAW did not include rehabilitation costs in its calculation of GCV. KJRY included a minor rehabilitation cost of \$77,215 (\$56,315 to relay 1,000 feet of track and \$20,900 to perform minor surface work at three rail-highway crossings), which it argues is all that would be needed to operate SAW's rail lines safely and efficiently at FRA Class 1 track standards (which permit train speeds of up to 10 mph).

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<sup>76</sup> The expenses of operating any business enterprise include both fixed costs and variable costs. A railroad's variable costs change with the amount of traffic it handles, whereas its fixed costs do not.

<sup>77</sup> See Caddo Antoine I, 4 S.T.B. at 342.

<sup>78</sup> Notwithstanding that criticism, SAW claimed that its actual per-mile MOW cost in 2005 was even higher, at \$22,728. SAW Statement, V.S. Plaistow at 21 and Exh. 34. Nonetheless, SAW calculated GCV by using a per-mile MOW cost of approximately \$6000. See id. at Exh. 43, Line 23 (MOW of \$100,697, which corresponds to \$5594 per mile when divided by the 18 miles of operated rail lines).

<sup>79</sup> SAW Statement at 8-9.

<sup>80</sup> Adjusting that 1993 figure using RSMeans Construction Cost Index, available at [www.rsmeans.com/calculator/indExh.asp](http://www.rsmeans.com/calculator/indExh.asp), yields a figure of \$9,653.

PYCO, however, contends that the property would need to be improved to bear the expected levels of future traffic. PYCO's witness states that a 7-year program of rehabilitation, estimated at a cost between \$4 million and \$6.6 million, would be needed to realize the full potential value of this property. The lower estimate is based on replacing the existing rail in key leads and tracks with 90-pound rail; the higher estimate is based on replacement with heavier 112- and 115-pound rail to handle heavy rail cars. Either amount would result in a net GCV of zero.

SAW and KJRY have both questioned why a rational purchaser would spend so much on rehabilitation that the lines could not be operated at a profit. PYCO has countered that, as a shipper dependent on these rail lines for its business, it must be assured of reliable rail service or it would have to either move its plant or cease business. PYCO asserts that it would be cheaper to acquire and rehabilitate SAW's rail lines than to move its plant. In short, PYCO claims that it cannot be assured of reliable rail service at its present location absent extensive rehabilitation of these lines.

We need not determine what the optimum level of rehabilitation would be. In August 2006, the track was found to meet FRA Class 1 standards, and the existing track accommodates current traffic levels.<sup>81</sup> Moreover, even without the inclusion of any rehabilitation costs in the calculation, the GCV for these lines is less than their NLV. Under our recalculations, which are set out in tabular form in Appendix A, the GCV of these rail lines without rehabilitation expenses is \$2,197,226.

C. Constitutional Minimum Value. SAW has argued that NLV (which is lower than SAW's calculation of GCV) cannot be the appropriate measure of compensation here because neither PYCO nor KJRY intends to salvage these lines; each seeks to operate them. But the statute specifies, in section 10907(b)(2), that the constitutional minimum value in a feeder line case is presumptively the higher of the GCV or the NLV. Thus, Congress contemplated the possibility that, as here, a rail line's NLV can be higher than its GCV.<sup>82</sup> Indeed, the courts have affirmed feeder line sale prices set at the NLV of a line.<sup>83</sup>

Because we find that the GCV of these rail lines is \$2,197,226 and the NLV is \$2,350,918, we find that the NLV figure is the constitutional minimum value of these lines, and we set the purchase price at that amount.

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<sup>81</sup> See Caddo Antoine I, 4 S.T.B. at 341-42 (where trains regularly use track, Board assumes that amount of rehabilitation needed will be minimal).

<sup>82</sup> Perhaps the reason NLV exceeds GCV here lies in the current high value of steel, which can be reused elsewhere, even if it is of scrap quality.

<sup>83</sup> See, e.g., Toledo, 462 F.3d at 736; GS Roofing, 262 F.3d at 774.

### III. Financial Responsibility

To be an eligible purchaser under the feeder line program, an applicant must show that it is financially responsible. 49 U.S.C. 10907(b)(1)(B). And to be considered financially responsible, the statute provides, in section 10907(a), that the purchaser must be able (1) to pay the constitutional minimum value for the line and (2) to cover the expenses of operations on the line for at least the first 3 years.

A. PYCO's Showing. PYCO has demonstrated that it has significant credit available through CoBank of Denver, CO, a rural cooperative bank: a special \$15 million line of credit for new capital spending, including the acquisition of SAW's rail lines, and existing loans (a \$50 million operating line of credit and a \$20 million term loan revolver) in which PYCO had \$54 million in available credit as of June 2006. PYCO has supplied a letter attesting to the bank's commitment of funds specifically for PYCO to purchase these rail lines, as well as PYCO's ability to use its other credit to meet additional expenses associated with operating these lines. This letter establishes that PYCO has a firm commitment for the funds to acquire SAW at the price we set.

Stating that PYCO is a substantial shareholder of CoBank and that, in 2006, two of PYCO's principals sat on CoBank's board of directors, KJRY has questioned whether the bank is a legitimate, independent funding source. CoBank has 22 members on its board of directors,<sup>84</sup> and KJRY provided no evidence that the two directors controlled CoBank's lending policies. Therefore, we do not believe that this connection between lender and borrower undermines PYCO's financial responsibility. In any event, evidence that PYCO submitted under seal indicates that it has the cash available to purchase these lines without relying on any lending source.

KJRY claims that PYCO's failure to provide pro forma income statements precludes a finding that PYCO has the financial ability to ensure 3 years of operations. KJRY relies on the initial regulations implementing the feeder line provision<sup>85</sup> and a series of decisions in which the agency either accepted applications that included such statements or rejected an application that did not include them. However, the ICC soon afterwards reversed its position and concluded that it was unnecessary to require pro forma income statements.<sup>86</sup> Thus, an applicant can demonstrate its ability to ensure 3 years of operations by means other than pro forma statements.

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<sup>84</sup> See CoBank press release dated January 5, 2007: CoBank Stockholders Elect Directors, Board Elects Officers and Appoints Outside Director, available on the bank's website at [www.cobank.com](http://www.cobank.com).

<sup>85</sup> See Feeder Railroad Development Program, 365 I.C.C. 93 (1981).

<sup>86</sup> See Feeder Railroad Development Program, Ex Parte No. 395 (Sub-No. 1), slip op. at 4 (ICC served Aug. 3, 1982) (proposing changes that eliminated unnecessary regulations including the requirement for pro forma statements); and 367 I.C.C. 261 (1983) (adopting the proposed changes).

In this case, there is a longstanding and assured revenue source for operating this rail line: the division of revenues that SAW currently receives as the switching carrier for all shipments that originate or terminate on its lines. PYCO states that it would enter into an arrangement whereby WTL would provide operations over the line in exchange for receiving the same division of revenue that SAW now receives. Because SAW was able to earn a profit each year with that revenue and WTL's costs of operation should be similar to SAW's, we are satisfied that WTL also likely would earn a profit.

KJRY nonetheless asserts that, under PYCO ownership, either these lines would need to be subsidized or the operator would need to place a surcharge on movements, in view of the extensive rehabilitation of the lines that PYCO apparently plans to undertake. Should a subsidy be necessary, PYCO has pledged to provide that subsidy itself, to ensure adequate service over these lines. And the evidence that PYCO submitted, under seal, demonstrates its financial ability to provide such a subsidy after purchasing these lines.

Finally, KJRY claims that PYCO has not demonstrated that it can afford to fund the rehabilitation that PYCO asserts is necessary. As discussed above, because these lines apparently can be operated without rehabilitation, it is not clear when that rehabilitation might be undertaken. But the evidence that PYCO has submitted under seal regarding its financial condition shows that PYCO could pay for the rehabilitation.

In sum, we find that PYCO has sufficiently demonstrated its financial responsibility.

B. KJRY's Showing. KJRY has submitted evidence that its parent, Pioneer, has a firm commitment from National City Bank of Michigan/Illinois to fund KJRY's purchase of SAW's lines in an amount up to \$3 million, which is higher than the price we set here. In addition, KJRY has submitted evidence of the same bank's willingness to commit an additional \$1 million toward operation of these rail lines.

Nonetheless, PYCO asserts that KJRY's pro forma income statements paint too rosy a picture of expected revenue, pointing to evidence that PYCO's carloads in 2007 will be substantially lower than in 2006. According to PYCO, KJRY would face a shortfall in revenue every year if the traffic on SAW's lines were to return to its 5-year average as calculated by KJRY's witness Dr. Brennan. PYCO also contends that KJRY's financial position has deteriorated since 2004, based on financial statements provided in discovery.

We reject PYCO's claim that KJRY would suffer a revenue shortfall from the Lubbock lines. PYCO has failed to show why PYCO would be able to operate the lines profitably but not KJRY. We note that PYCO's argument assumes traffic levels at SAW's 5-year average from 2001 through 2005. But in calculating traffic and revenue levels, we rely on KJRY's revised regression analysis, which projects higher traffic levels than that 5-year average.

We are satisfied that KJRY also has sufficient capital to ensure 3 years of operation, given the additional \$1 million that National City Bank is willing to provide to cover operation

of these rail lines. As KJRY notes, its funding arrangement here is very similar to what it used to support its ability to acquire and continue to operate another rail line under the feeder line process.<sup>87</sup> For all these reasons, we find that KJRY has also shown its financial responsibility.

#### IV. BNSF's Interests

BNSF has made three principal requests in these proceedings.<sup>88</sup> BNSF first asks that we condition any order for SAW to sell these lines to PYCO or KJRY on BNSF's ability to exercise its right of first refusal in the 1999 Agreement.<sup>89</sup> Alternatively, BNSF asks that we impose as a term of the feeder line sale that the purchaser enter into a contract with BNSF that preserves the ratemaking authority accorded to BNSF under the 1999 Agreement. Additionally, BNSF asks that we preserve its contractual right of first refusal in the event of any subsequent sale of the Lubbock lines by PYCO or KJRY. We address each of these requests in turn.

A. Right of First Refusal in a Sale to PYCO or KJRY. BNSF contends that, because the contractual right of first refusal was an integral part of its agreement to sell the Lubbock lines to SAW, BNSF should be allowed to exercise that right should we find that SAW must otherwise sell the Lubbock lines to PYCO or KJRY. We do not have the authority, however, either to direct SAW to sell the lines to BNSF or permit BNSF's contractual rights to take precedence over the feeder line provisions of our statute. Therefore, we must deny that request.

Once our powers have been invoked under section 10907, the statute commands that we order the sale of the line to a qualified purchaser if we find, as here, that the statutory requirements are met. See 49 U.S.C. 10907(b)(1) (the Board "shall require the rail carrier owning the railroad line to sell such line to [a] financially responsible person"). In this case, the only qualified purchasers are PYCO and KJRY. We note that the statute excludes a Class I or Class II rail carrier as a "financially responsible person" for the purposes of the feeder line provision. 49 U.S.C. 10907(a).

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<sup>87</sup> See KJRY I, slip op. at 20-23.

<sup>88</sup> In August 2006, BNSF sought leave to intervene in this proceeding to assert its interests. Under 49 CFR 1112.4, the Board will allow intervention if it would not unduly disrupt the schedule and would not broaden the issues raised. BNSF's petition and subsequent pleadings have not disrupted the procedural schedule and the issue of BNSF's contractual right does not unduly broaden this proceeding. Accordingly, we grant the petition to intervene.

<sup>89</sup> The contractual language at issue provides in relevant part: "Any subsequent agreement by [SAW] to sell all or any portion of the Rail Line (except to an affiliate of [SAW]) must contain the effective right for [BNSF] to purchase the Rail Line, or portion thereof, from [SAW], on the same, or substantially similar, basis as set forth in the subsequent sale agreement." See Agreement for the Sale of Certain Assets, Right and Obligations of the Burlington Northern and Santa Fe Railway Company to South Plains Switching, Ltd. Company, dated May 3, 1999, at Par. 7(b), attached to BNSF Reply to Revised Feeder Line Application, filed Aug. 2, 2006, and its Petition for Leave to Intervene, filed Aug. 31, 2006.

BNSF argues that SAW may only convey the property interests that SAW has in the Lubbock lines and that those interests are circumscribed by BNSF's contractual right of first refusal. In support, BNSF cites Milford-Bennington Railroad Company, Inc.—Feeder Line Acquisition—Boston and Maine Corporation Hillsborough Branch, Finance Docket No. 31701 (ICC served Oct. 16, 1991) (Milford) for the general principle that the purchaser in a feeder line sale receives the property subject to existing encumbrances.<sup>90</sup> But that cannot be the case where—as here—the encumbrance would conflict with or undermine the feeder line program.<sup>91</sup> To the extent that a provision of state law (such as a contract right) would conflict with federal law, the state law must give way. 49 U.S.C. 10501(b) (providing that the remedies provided under this part with respect to regulation of rail transportation are exclusive and preempt the remedies provided under state law).<sup>92</sup>

B. Ratemaking Authority. Neither PYCO nor KJRY opposes the request that BNSF's authority in the 1999 Agreement to establish through rates and routes for shipments moving on these lines be preserved. To the contrary, both applicants have indicated that they expect to be bound by the revenue setting and division provisions of the 1999 Agreement.<sup>93</sup> Accordingly, we impose this term.

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<sup>90</sup> In Milford, a feeder line applicant sought to acquire a rail line that the incumbent carrier had leased to another railroad. Opposing the application, the incumbent railroad had argued that the feeder line statute does not apply to leased rail lines. In rejecting that argument, the ICC reasoned that it is not uncommon for rail lines, like other pieces of real estate, to be subject to various encumbrances, including leases. The agency explained that there is nothing in the statute to suggest that those encumbrances pose a bar to feeder line applications and that, were the application to be granted, the applicant would acquire the incumbent's interest in the rail line, whatever that interest might be.

<sup>91</sup> Cf. Railroad Ventures, 299 F.3d at 561 (affirming STB's voiding of contract entered into between incumbent carrier and local government where contract intruded upon agency's authority to fix terms and conditions of sale under the offer-of-financial-assistance provisions of 49 U.S.C. 10904).

<sup>92</sup> See, e.g., Railroad Ventures, 299 F.3d at 561; Friberg v. Kansas City S. Ry. Co., 267 F.3d 439, 444 (5th Cir. 2001) (section 10501(b) preempted claim of negligence under Texas common law); City of Auburn v. United States, 154 F.3d 1025, 1031 (9th Cir. 1998) (section 10501(b) preempted state environmental review laws); Green Mountain R.R. Corp. v. State of Vermont, 404 F.3d 638, 643 (2d Cir. 2005) (section 10501(b) preempted state environmental permitting laws).

<sup>93</sup> See PYCO Rebuttal at 21 (PYCO intends to operate the lines based on the revenue streams derived from BNSF “under the BNSF/SAW agreement”); PYCO Reply to KJRY Motion to Strike Portions of PYCO's Rebuttal and Renewed Request for Sanctions Against KJRY, filed Oct. 31, 2006, at 9 (noting that PYCO had “demonstrated that the operating costs could be covered from revenue under the BNSF/SAW agreement”); KJRY Rebuttal, filed Nov. 1, 2006, at

(continued . . . )

C. Right of First Refusal in Any Subsequent Sale. BNSF's third request—that we preserve its contractual right of first refusal to apply to any subsequent sale of the Lubbock lines by either PYCO or KJRY to another party—conflicts with section 10907(h). That section affords the right of first refusal in a subsequent sale to the party who sold the line under the feeder line provision. Thus, by statute SAW would have the right of first refusal should PYCO or KJRY acquire the Lubbock lines under the feeder line provision and later seek to sell them.

#### V. Selection of Purchaser

In light of our finding that PYCO and KJRY have each demonstrated that it is financially responsible and able to provide adequate service, each applicant should notify SAW and the Board if it agrees to accept the terms we set here. In the event that only one of the applicants provides notice that it is willing to proceed under the terms set here, SAW will be required to sell its Lubbock lines to that carrier. If both PYCO and KJRY agree to the terms set here, SAW may select the applicant to whom it will sell the lines and must then sell the lines to that party under the terms set here.

#### VI. Exemptions, Trackage Rights, and Prescriptions

Under section 10907(g)(1), a feeder line purchaser may elect to be exempt from any provisions of the Interstate Commerce Act other than the joint rate provisions of chapter 107. Neither PYCO nor KJRY has indicated that it intends to elect any such exemptions.

A feeder line applicant may request trackage rights from the selling carrier, 49 U.S.C. 10907(d), and/or a prescription of joint rates and divisions, 49 U.S.C. 10907(f). Neither PYCO nor KJRY has sought any trackage rights over SAW (which would retain only physically separate, small lengths of track at Slaton and Burris) or a prescription of joint rates and divisions.

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( . . . continued)

20 (KJRY's intent is to merely "step into the shoes" of SAW with respect to the BNSF/SAW agreement and KJRY would accept fully the terms of SAW's agreement with BNSF).

## VII. Labor Protection

Under section 10907(e), the Board must require, to the maximum extent practicable, the use of the employees who would normally have performed work in connection with the railroad line sold under this section. PYCO has pledged that, if any SAW employee is released from service due to the sale of the Lubbock lines to it, PYCO (or its chosen operator) would, upon receiving an application for employment, grant the employee priority over equally qualified applicants, to the extent permitted by law. KJRY has made a similar pledge, indicating that it would need to hire additional operating employees but expected to use outside contractors to perform any rehabilitation that might be required.

As a term of the feeder line sale, we will require that, in the event that the purchaser or its chosen operator hires new employees to operate or maintain these lines, it offer employment on a priority basis to qualified SAW employees who previously worked on these lines.

## VIII. Closing Terms

To ensure a smooth transfer of SAW's Lubbock lines, the following additional terms (traditionally used in cases where the Board orders the sale of a line) will be imposed: (1) payment must be made by cash, certified check, or electronic transfer to an account designated by SAW at closing; (2) closing must occur within 90 days after the service date of this decision; (3) SAW must convey all property by quitclaim deed, including the property that was subject to the attempted transfers that the Board previously has voided; (4) SAW must deliver all releases from any mortgages and original documents conveying interest in the right-of-way to the purchaser within 90 days from closing; (5) all taxes must be prorated as of the date of closing; and (6) deed recording fees must be paid by the purchaser. Mortgage or lien release taxes or recording fees must be paid by SAW. SAW will be required to turn over to the purchaser, within 30 days after closing, all SAW records concerning the property being purchased, including any and all deeds, valuation maps, easement records, engineering drawings, contracts, bridge inspection records, and all other records related to the property purchased. The terms of sale may be modified by mutual agreement.

## IX. Environmental Finding

Because the purchase of these lines would merely replace the current rail carrier with another rail carrier to serve existing shippers, we conclude that the feeder line sale would not significantly affect the quality of the human environment or the conservation of energy resources. Also, because neither applicant's proposed operations over these lines would exceed the Board's thresholds for environmental review (i.e., an increase in rail operations of more than eight additional trains per day or an increase of 100% in rail traffic volume on these lines), no environmental documentation has been prepared. See 40 CFR 1500.4(p), 1501.4(a)(2), 1508.4; and 49 CFR 1105.6(c).

It is ordered:

1. BNSF's petition to intervene is granted.
2. SAW's motion to reject PYCO's revisions to the length of trackage in its application to purchase a portion of SAW's Lubbock rail lines, BNSF's request for a condition regarding operating protocols in the event of authorization of a sale of a portion of SAW's Lubbock rail lines, and SAW's motion to reject PYCO's revisions to the length of trackage in its application to purchase a portion of SAW's Lubbock rail lines are denied as moot.
3. SAW's petition for reconsideration of the January 24 decision is granted in part and that decision is amended by deleting the third full paragraph on page 6 and the third ordering paragraph on page 7.
4. All other motions are denied.
5. PYCO's and KJRY's applications to purchase SAW's Lubbock rail lines are granted.
6. The purchase price for SAW's Lubbock rail lines is fixed at \$2,350,918, and other terms of sale are prescribed as set forth in this decision.
7. KJRY and PYCO must each notify the Board and SAW by September 17, 2007, whether they wish to proceed under the terms prescribed in this decision.
8. If only one applicant indicates that it wishes to proceed, SAW must sell its Lubbock lines to that applicant. If both PYCO and KJRY indicate that they wish to proceed, SAW must select the applicant to whom it will sell those lines and notify the Board of its selection by September 20, 2007. A copy of the notice selecting the applicant shall be served on both PYCO and KJRY. SAW must then sell the Lubbock lines to the party selected under the terms prescribed in this decision.
9. This decision is effective on September 10, 2007.

By the Board, Chairman Nottingham, Vice Chairman Buttrey, and Commissioner Mulvey.

Vernon A. Williams  
Secretary

## APPENDIX A

## Board Restatement of Going Concern Value (GCV)

<b>Item</b>	
Revenues	\$1,461,836
Expenses	\$1,112,477
Net Revenues	\$349,359
2005 Pre-Tax Cost of Capital	18.4%
Growth Rate*	2.5%
Growth-Adjusted Cost of Capital Multiplier	15.9%
<b>Going Concern Value</b>	<b>\$2,197,226</b>