The Feasibility of Selling the South Orient Railroad
Report to the Legislature as requested by
the Sunset Advisory Commission

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Executive Summary

The Sunset Advisory Commission has directed the Texas Department of Transportation, as a management action, to determine the market value of the South Orient Railroad (SORR) and study the feasibility of selling the railroad to private interests, and report this information to the Legislature by February 28, 2009. If the State decides to sell the railroad, it must remain as a viable functioning railroad.

What is the market value of the SORR?

The estimated current market value of the line is $30.2 million. This figure represents the Net Liquidation Value (NLV) of the SORR, which is determined by estimating the value of the track and track materials and the value of the land, assuming that the State has a marketable title and not simply an easement, less the cost of salvage. Because the SORR is operating at a financial loss, it does not have a going concern value (GCV). This methodology is consistent with precedents of the Surface Transportation Board (“STB”) and its predecessor, the Interstate Commerce Commission.

In mid-2008, the NLV of the SORR was estimated to be $51.7 million. The decline in estimated value of $21.5 million is due to a reduction in the price of scrap steel.

Is it feasible to sell the SORR to private interests?

The lack of sufficient traffic to fund the rehabilitation of the SORR or the repayment of loans to be used to rehabilitate the line makes it unlikely that a prospective purchaser can be identified who would be willing to acquire the line from the
State at its current NLV. The estimated cost of rehabilitating the entire SORR is approximately $150 million.

If the State were to sell the line and the new owner is unable to realize a profit from operations within a relatively short period of time, the new owner would probably seek authority from the STB to abandon the SORR. If that were to happen, and no other railroad steps forward to acquire and operate the SORR, infrastructure on the rail corridor would be salvaged and right-of-way held in easement would revert back to adjoining land owners. In order to save the line, the State might again be asked to acquire the rail corridor.

In addition, if the State were to sell the line to private interests, it would lose its ability to oversee operations, investments and services on the SORR. That being the case, especially if the line were to be sold to an under-capitalized investor, it would be difficult, if not impossible, to require the new owner to make the large infrastructure investment that will be required to rehabilitate the line. As an example, a likely bidder for the SORR could be Grupo Mexico, parent company of the current lessee, Texas Pacifico Transportation, Ltd. (TXPF). If Grupo Mexico were the successful bidder for the SORR, the current situation would undoubtedly remain the same, with no oversight of operations or improvements by the State. Of course, if the SORR is not rehabilitated and thereafter maintained, the SORR will continue to deteriorate resulting in the eventual cessation of service.
If sold, is it possible for the South Orient to be a viable functioning railroad?

The South Orient will not be viable if it is sold in its present condition to a purchaser that lacks the financial ability to rehabilitate the line. The line is in poor condition, and a large infrastructure investment is needed immediately. The line cannot be operated profitably when (as is the current situation) many track segments are limited to operations at ten miles per hour or less.

However, if the line were to be upgraded through a state or federal grant that would be utilized to rehabilitate the segment of the line that is most heavily used to FRA Class 2 standards (which would permit operating speeds up to 25 mph and accommodate the heavier rail cars that are now being used), it could promote an increase in rail traffic and economic development. In addition, grant funds could be used to rebuild the International Bridge at Presidio that was destroyed by fire on February 29, 2008 and continue the rehabilitation of the portion of SORR between Presidio and Paisano Junction.

This study includes additional information concerning several other matters. It describes various issues that have adversely impacted TxDOT's efforts to promote service over the SORR. Such issues include the continuing deterioration of the Line and the excessive designation of segments of track by the current operator as excepted track which has resulted in the inability to provide rail freight service upon reasonable request. The study describes an unsolicited proposal that TxDOT received regarding the South Orient. The proposal tends to support the conclusion that the South Orient, if
properly rehabilitated and maintained, can be a viable railroad in the future. Finally, in order to provide a full understanding of the State’s efforts to preserve the line, the report provides information regarding prior owners and the circumstances that led to the State’s acquisition.
Introduction

The Sunset Advisory Commission has directed the Texas Department of Transportation (TxDOT) to determine the market value of the South Orient Railroad (SORR) and to study the feasibility of selling the railroad to private interests. In addition, if the State decides to sell the railroad, it must remain as a viable functioning railroad. This paper will examine those issues in the context of the line history and today’s fair market values, infrastructure condition and facility utilization.

The recent history of the Orient Lines before the Interstate Commerce Commission (ICC) and the Surface Transportation Board (STB) will also be considered. That history highlights the regulatory issues as well as the financial issues that have plagued operations over the South Orient line since the line was disposed of by the Atchison, Topeka and Santa Fe Railway Company (ATSF). It also provides insights into the feasibility of selling the railroad to private interests. In addition, it details the reasons for TxDOT’s involvement with the SORR, as well as the STB’s potential involvement with any future steps to modify ownership and operation of the line.

The map of the SORR (Appendix, Exhibit 1) reflects the classes of track designated by the current operator, Texas Pacifico Transportation Ltd. (TXPF). The class designations, whether Classes 1 and 2 or “Excepted”, reflect the quality of the track and the speed limits set by the Federal Railroad Administration (FRA). Excepted track is track that cannot meet the minimum safety standards established by the FRA under 49 CFR 213 - Track Safety Standards. Due to the potentially unsafe condition of excepted tracks, operations over excepted tracks are limited to ten (10) miles per hour.
with no more than five (5) carloads of Hazardous Materials in a train. Passenger operations are forbidden over excepted track.

The Background of TxDOT’s Acquisition of the South Orient

TxDOT’s involvement with the South Orient has its roots in an attempt to preserve the line from abandonment and scrapping in the early 1990’s. After ATSF’s sale of the line to potential scrappers was prevented, it was necessary to locate another operator. The sale price of the line was $5,500,000. The original solution had TxDOT acquire the right-of-way, while the South Orient Rural Rail Transportation District (SORRTD) acquired the track, track materials and related items from ATSF. The South Orient Railroad Company Ltd. (SORC), a newly formed shortline railroad, agreed to acquire the operating rights and the underlying common carrier obligation from ATSF. This arrangement unquestionably achieved the basic goal of preventing the destruction of the line and the permanent loss of rail service.

Original Funding for Acquisition

In December 1991, TxDOT entered into a Grant Funding Agreement with SORRTD that provided $3 million to SORRTD to use to acquire the SORR from ATSF. This funding was appropriated by the 72nd Texas Legislature. As part of the agreement, TxDOT acquired the railroad right-of-way (valued by TxDOT at $480,000) and a security interest in the rail system Improvements in an amount equal to $2,520,000.

The initial arrangement ultimately failed when SORC could not generate sufficient revenues to earn a profit from operations. In June 1998, SORC applied to the STB for authority to abandon the portion of the line south and west of San Angelo. The
abandonment was blocked as a result of protests filed by shippers and potential shippers, TxDOT, SORRTD, the Railroad Commission of Texas, the Texas Department of Economic Development, the Texas Comptroller of Public Accounts, members of Congress and the Texas Legislature, Ferrocarril Mexicano, S.A. de C.V. and others. The common theme of the protests involved the contention that preservation of the line was essential for future economic development of the region of Texas served by the railroad.

In 1999, after SORC expressed an interest in abandoning the railroad, the 76th Texas Legislature appropriated $6 million to be used to acquire SORC’s interests. The total purchase price for the South Orient was $9.5 million, of which TXPF paid $3.5 million.

On November 2, 2000, the STB, in its Finance Docket No. 33946, State of Texas Acting by and Through the Texas Department of Transportation—Acquisition and Operation Exemption—South Orient Railroad Company, Ltd., announced that TxDOT had filed a notice of exemption under 49 CFR 1150.31 to acquire and operate approximately 370.5 miles of rail line in Brewster, Coleman, Crane, Crockett, Irion, Pecos, Presidio, Reagan, Runnels, Tom Green, and Upton Counties, TX. As the STB explained, TxDOT would acquire the right to operate between milepost 1029.1 on the International Bridge, near Presidio, and milepost 956.7, at Paisano Junction, and between milepost 945.3, at Alpine, TX, and milepost 0 + 330 feet, near San Angelo Junction on the east, and Lampasas Subdivision milepost 373 + 4362 feet, near San Angelo Junction on the west. The STB also noted that “TxDOT already owns the underlying right-of-way and it would acquire ownership of the track and track materials
from the South Orient Rural Rail Transportation District ("SORRTD"). Pursuant to a Purchase and Transfer Agreement between the State and SORRTD, dated January 31, 2001, the State acquired the installed rails, ties, ballast, tracks, signals, switches, sidings, bridges, buildings, stations, communication facilities, and other structure, fixtures, and other improvements on the Line”.

In its Decision, the STB further observed TxDOT was in the final stages of negotiating a lease and operating agreement with TXPF, whereby TXPF would conduct freight operations over the above-described rail lines. Although the STB did not mention it in its Decision, the agreement with TXPF contemplated that TxDOT would retain the residual common carrier obligation that it was acquiring from SORC.

Shortly thereafter, the STB authorized TXPF to operate the South Orient line. (Texas Pacifico Transportation, Ltd.—Lease and Operation Exemption—State of Texas, STB Finance Docket No. 33944 {STB served Dec. 11, 2000}). In its Decision, the STB also noted that SORC, with the consent of UP, had assigned its trackage rights to TXPF to operate over the UP line between Paisano Junction and Alpine Junction.

**Rehabilitation Funding**

Since 2001, TxDOT has invested $6,437,368 of federal-aid discretionary and highway-railroad crossing funds in order to rehabilitate sections of the line and grade crossings. Between 2002 and 2007, TXPF has invested $7,988,349 in rehabilitation.
Market Value of the South Orient Railroad

The STB employs two valuation methodologies in contested cases in which it must determine the constitutional minimum value of lines of railroad - the net liquidation value (NLV) and going-concern value (GCV). In the case of a line that has no continuing transportation value, the STB will generally focus on the NLV. The NLV is determined by computing the current appraised market value of the railroad’s properties for other than rail transportation purposes, less all cost of dismantling and disposition of track and track materials and the cost of improvements necessary to make the remaining properties available for their highest and best use while complying with applicable zoning, land use, and environmental regulations.

If the line is profitable and it can be assumed that the rail line has a value for rail transportation purposes that exceeds its value for non-rail purposes, the STB (and its predecessor the ICC) have found that it can be valued at either its GCV or its NLV. However, an unprofitable line will always be valued at its NLV. (See, e.g., Chicago and North Western Transportation Company – Abandonment Between Ringwood, IL and Geneva, WI, 363 I.C.C. 956, 958, n1 (1981)). Because the SORR is unprofitable at present, STB precedent suggests that its value would be determined on the basis of the line’s NLV. If a potential sale could be arranged that would cause the line to be used for rail transportation services, consideration would be given to the appraised value of the land as an assembled transportation corridor if TxDOT has marketable title to the land.

In proceedings involving abandonment applications under 49 USC §10903 and so-called feeder line applications under 49 USC § 10907, the STB and the ICC before it have consistently held that if a railroad does not hold marketable title to the right-of-way,
which would cause ownership of the real property to revert to the prior owner, no value will be attributed to the land. Since TxDOT does not have marketable title to the land, it would be inappropriate for TxDOT to attribute value to the right-of-way in determining the South Orient’s NLV.

Consistent with STB precedent, the South Orient, which is experiencing substantial operating losses, has no current GCV. Its current NLV, however, is approximately $30.2 million (Appendix, Exhibit 2). The volatility of the scrap market is responsible for a decline in the NLV of approximately $21.5 million since June 2008. The $30.2 million figure does not attribute any value to land due to the absence of evidence that the railroad holds some type of fee interest in the real property. Should it be determined that all or a portion of the right-of-way is held in fee, then the real property could be valued at its appraised value.

If a decision were to be made to sell the SORR, TxDOT would, of course, be free to negotiate the price for the line that is unrelated to either its NLV or its GCV. If that were to be done, the STB would not get involved in the valuation process. It is only in the context of a sale where the parties cannot agree on the constitutional minimum value of a line of railroad that the STB would be asked to assist in the determination of the fair market value of a line of railroad.

**Feasibility of Selling the Railroad to Private Interests**

In addressing the feasibility of selling the line, including the residual common carrier obligation, the ultimate issue is whether the sale to a private entity will successfully ensure the future rehabilitation, development and operation of the line. Given the obvious need to rehabilitate the line and the high cost of doing so, it is
necessary to focus on the financial fitness of any prospective purchaser to acquire, rehabilitate and maintain the line. If that is not done, the recent cycle will likely be repeated.

A primary consideration is whether the State will agree to fund all or a portion of the cost of rehabilitation. Simply stated, if the line is not rehabilitated, there is little likelihood that profitable freight rail service will be achieved. A secondary consideration concerns the extent of the rehabilitation and the timing thereof. In other words, should the entire line be rehabilitated from the outset, or should the rehabilitation process initially focus on a particular segment or segments of the line.

Unless a potential purchaser can be identified who would be willing and able to fund the needed rehabilitation in the absence of sufficient, current traffic to cover the cost of such rehabilitation, the sale to a private purchaser would not be feasible at this time. If the State were to fund the rehabilitation of a significant segment of the line to FRA Class 2 track standards, it would be in the State’s best interest to negotiate an agreement with the operator to maintain the line to the track standards achieved in the rehabilitation and take future action to improve the track to Class III status (up to 45 mph).

An outright sale would likely eliminate the State’s ability to influence operating decisions through oversight. The progress made to date to rehabilitate the line may be attributed to ongoing efforts by TxDOT to ensure compliance with the Lease and Operating Agreement with TXPF (Appendix, Exhibit 3). In all likelihood, TxDOT’s limited ability to influence operations would be lost if the line were sold.
Sales Options Are Limited by Multiple Factors

There are multiple factors that will impact the feasibility of selling the line to private interests. In the first place, the current customer base is limited. Second, much of the line requires rehabilitation. Third, decisions must be made regarding the timing and need for restoration of the line. This includes the fundamental issue of whether the entire line should be rehabilitated or whether a particular segment should be the focus of immediate rehabilitation at the expense of other segments.

The Current Financial Situation

The financial outlook for the South Orient, as presently operated and as currently maintained, is bleak. As TXPF recently advised FRA in an October 13, 2008 letter to Mark Tessler:

Since 2001, TXPF has lost an average of 1.4 millions dollars per year due to the very limited revenue and high operating and maintenance costs. Revenues are generally restricted to the first 170 miles of the railroad between San Angelo Jct. and Rankin, Texas, with car load volumes approaching 200 loads per month. TXPF consistently loses (sic) approximately $140,000 monthly and continues to operate under sever (sic) financial hardship.

These financial losses are confirmed by TXPF’s Annual Reports to TxDOT.

There are a few new customers that may be counted upon for additional freight. It is our understanding that TXPF is working with local interests to develop additional customers along the rail line. Also, new customers are said to have located at Fort Stockton during 2008. In September 2008, the Martifer Corporation announced it would locate a wind turbine production plant in San Angelo. Martifer intends to ship wind tower components from San Angelo by rail. However, the truss bridge at Ballinger is
too narrow to accommodate these shipments and must be replaced so that the wind
tower components can be moved by rail. In addition, TxDOT conducted a shipper’s
meeting on December 11, 2008 to listen to current and potential shippers’ comments on
provided rail service. Shippers generally expressed dissatisfaction with the frequency at
which service is being provided and the limited speed of the trains due to existing track
conditions. The written surveys are still being collected and analyzed.

The potential customer base is also reduced by the need for significant track
rehabilitation. This is especially true with respect to the transportation of hazardous
materials. FRA regulations governing excepted track restrict the number of carloads of
hazardous materials that can be transported in a train. Because operating speeds
currently restrict the number of trains that can be operated in any give time frame,
potential shippers have not been able to utilize the line to receive needed hazardous
materials shipments. Unfortunately, this will not change in the absence of substantial
expenditures on rehabilitation that would permit higher speeds and lower operating
costs.

**Estimated Cost of Rehabilitating the South Orient Railroad**

If the decision is made to fund rehabilitation, a question remains as to whether
there is, or will be, sufficient rail traffic to warrant the expenditure of funds necessary to
rehabilitate the entire line. The problem is intensified if future traffic growth is
dependent upon international traffic. If it is, then the entire line must be rehabilitated. In
TxDOT’s 2006 Annual Inspection Report, the cost of rehabilitating the entire line to
achieve 45 mph operating speeds was estimated to be $100 million. A similar estimate
of $100 million is also found in a December 2007 study, prepared by Alliance Transportation Group, Inc. (ATG) for the Fort Stockton Economic Development Corporation, entitled *Potential Economic Impacts of an Improved South Orient Railroad* (Appendix, Exhibit 4). A recent *Unsolicited Proposals to the Texas Department of Transportation from the Pecos County Rural Rail District to Rehabilitate the South Orient Railroad* (Appendix, Exhibit 5) estimates the cost of rehabilitating the entire line to be “roughly $150 million” with annual maintenance expenditures of $3 to $8 million.

Viewed in more conservative terms, TxDOT has estimated that it would cost $20.8 million to rehabilitate the line from near Santa Ana to San Angelo to FRA Class 2 standards, which would permit 25 mph operations. This includes an estimated cost of $3.9 million to replace the bridge near Ballinger to facilitate Martifer wind tower movements by rail. Preliminary engineering and construction management for just these two projects will cost an additional $1.5 million. TxDOT has submitted an Exceptional Item Request to the Texas Legislature for funding the foregoing projects and for the rehabilitation of the line from San Angelo to Fort Stockton. The total estimated cost for these projects is $30,450,000.

The Pecos County Rural Rail District proposal suggests that “probably the most appropriate option [to secure the funds] for the SORR would be the Federal Rail Administration’s Rail Rehabilitation and Improvement Financing (RRIF) program.” As a cautionary note, if the projected volumes of freight in the Fort Stockton proposal do not materialize and a 3% carload growth is assumed along with only a $35 million loan, the revenues would never provide adequate funding for loan repayment (Appendix, Exhibit 6).
Projections do not guarantee future traffic. In this regard, attention is invited to the STB’s Decision in *South Orient Railroad Company, Ltd.—Abandonment and Discontinuance of Trackage Rights—Between San Angelo and Presidio, TX, AB-545* (STB served October 6, 1998). In denying SORC’s abandonment application, the STB relied on future rail traffic forecasts over the South Orient. The forecasted international and domestic traffic has never materialized. This includes international traffic as well as domestic movements. This is not to say that ATG’s estimated increase “from 7,233 rail cars during Year 1 to 64,712 rail cars during Year 5” is overly optimistic; however, as the recent global recession has demonstrated, anticipated growth may not always happen.

As TXPF’s experience has demonstrated (along with the experience of its predecessors – the SORC and the ATSF), there has been little demand for use of the Presidio gateway by shippers or rail carriers. This was explicitly acknowledged by TXPF in a letter dated August 27, 2007 addressed to Michael Behrens from Hilario Gabilondo. As was explained:

> We have also mentioned that regardless of our efforts to promote our services with connecting lines and other beyond, we have not been able to produce good enough traffic because, among other important factors, the poor condition of the line, which limits speed and imposes other restrictions, makes in not that attractive for our potential costumers (sic).

Our operation deficit continues to be in the area of $1,500,00.00 U.S. dollars per year and as explained in some many instances it is basically a direct result of the poor physical condition of the track, so it is imperative that such a condition be resolved if we want the Texas Pacífico line be (sic) successful as an attractive and competitive route that will well serve the commerce between the State of Texas – N.W. of Mexico and the Pacific rim.
Although the opening of the line to the International Border was completed in March 2005 at a cost of over $5 million, which was funded by a Federal grant, TXPF interchanged only 98 carloads with Ferromex at the Presidio border crossing in 2005 and a mere 51 carloads in 2006. TXPF did not move any cars over this segment in 2007 and 2008. Since the International Bridge was destroyed by fire in February 2008, it has been physically impossible to operate over the Presidio gateway since that date.

The limited use of the Presidio gateway is no doubt attributed to the lack of reliable rail service even before the segment of the International Bridge burned in February 2008. Nevertheless, it could be assumed that if Grupo Mexico had determined that the immediate rebuilding of the line would result in a significant increase in traffic, it likely would have moved forward with the rehabilitation of the entire line.

It is imperative that the continuing deterioration of the most active segment of the Line be immediately addressed. As noted in TxDOT’s 2008 Annual Inspection Report, the segment of the Line between San Angelo Junction and San Angelo “is the most heavily used and is generally in poor to fair condition.” It also explains:

The condition of the rail line limits operations between San Angelo Junction and San Angelo to 10 mph due to the deteriorated state of the infrastructure, with 5 mph speed limits in areas where ties are severely degraded. TXPF has repeatedly stated that speeds will be lifted to 25 mph when Phase 2 of the rehabilitation plan is completed, but no date has been set to begin or complete that phase.

As a result of the deteriorated condition of the track, TXPF has designated it excepted track (10 mph).
There is a Limited Number of Potential Purchasers

The feasibility of a sale to private interests is impacted by the lack of potential purchasers who have the current financial wherewithal to rehabilitate the line. If no Class I railroad expresses an interest in purchasing the line, TxDOT would have to sell the line to a smaller railroad. In all likelihood, a smaller railroad would be dependent upon State and/or Federal grants to fund the cost of rehabilitation.

Given the complexity of the situation and the potential cost of rehabilitating the line, or portions thereof, a sale to a rural rail transportation district (RRTD) would be problematic and would not appear to add any readily foreseeable value. In the first place, a RRTD would have to hire a railroad to operate the line for it. Second, as was the past situation with SORRTD, a new RRTD without any railroad experience would be dependent upon private consultants for the services that TxDOT now provides. Furthermore, a RRTD would have no revenue stream for activities and, with limited knowledge of state procurement and other procedures.

If the line were to be sold, or if it is necessary to change operators, the ideal candidate would be an experienced operating railroad that is positioned to encourage economic development along the line that will be dependent upon future rail service. In addition, the new operator should have a full understanding of, and appreciation for, American Association of Railroad and FRA requirements and procedures. If the State maintains ownership and provides revenue for line rehabilitation, the operator must be willing to submit to TxDOT’s oversight in order to ensure the proper maintenance of the line. In this regard, TxDOT recognizes the need to revise the Lease and Operating Agreement.
Selling the South Orient Railroad under the Current Lease

The Lease and Operating Agreement with TXPF does not address the issue of whether TxDOT may sell the line without terminating the agreement. The agreement neither prohibits the sale nor authorizes the sale of the Line. Paragraph 1.5(g) provides that “the State has no rights to the Rail Line or other property subject to this Agreement except as provided herein.” However, Paragraph 3.1 says that “the parties acknowledge and agree that the State has and shall continue to have during the term of this Agreement the complete and exclusive ownership of the Rail Line, including the exclusive right to commence abandonment proceedings for the Rail Line or any portion thereof, following the termination of this Agreement pursuant to Section 7.”

Given the absence of language prohibiting the sale of the line, the acknowledged, exclusive ownership of the line would permit the sale of the line during the term of the agreement. Unless the agreement is terminated, TXPF would continue to have the right to operate the Line. Any change in operators will require the prior approval of the STB, which can be obtained through an exemption. Generally speaking, a change in operators is exempt from regulation under 49 CFR 1150.3(a)(3). If the transaction involves a Class II carrier (such as TXPF), the transaction becomes effective 45 days after the notice of exemption is filed with the STB. In addition, to comply with the STB’s regulations, a notice of intent must be filed and served on certain parties no later than 14 days before the notice of exemption is filed with the STB.
Summary

The estimated current market value of the line is $30.2 million. This figure represents the Net Liquidation Value (NLV) of the South Orient Railroad.

The South Orient Railroad will not be viable if it is sold in its present condition to a purchaser that lacks the financial ability to rehabilitate the line. The line cannot be operated profitably when many track segments are limited to operations at ten miles per hour or less. If the line were to be upgraded to permit operating speeds up to 25 mph, it could promote an increase in rail traffic and economic development.
Appendix
## NET LIQUIDATION VALUE OF TRACK

**South Orient Rail Line**

23-Feb-09

M.P. 0.00 to 74.00 = 74.00 TRACK MILES
M.P. 712.00 to 945.30 = 233.30 TRACK MILES
M.P. 956.70 to 1029.00 = 72.30 TRACK MILES

MISCELLANEOUS SIDINGS & YARDS = 19.06 TRACK MILES

398.66 TOTAL T.M.S

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</table>

Total: 398.66 69116.01 17226.99 224.72 86587.71

### TIES

<table>
<thead>
<tr>
<th>Ties Type</th>
<th>Quantity</th>
</tr>
</thead>
<tbody>
<tr>
<td>SWITCH TIES</td>
<td>3680 EA</td>
</tr>
<tr>
<td>CROSS TIES</td>
<td>1191073 EA</td>
</tr>
<tr>
<td>TOTAL TIES</td>
<td>1191073 EA</td>
</tr>
</tbody>
</table>

**VALUE OF TRACK COMPONENTS**

**MAIN & SIDE TRACKS:**

- 41,769.31 N.T. x $485.00 /N.T. = $20,258,117 Reroll Rail
- 13,251.93 N.T. x $200.00 /N.T. = $2,650,385 Scrap Rail
- 14,094.77 N.T. x $485.00 /N.T. = $6,835,963 No.2 SH CWR
- 17,451.71 N.T. x $200.00 /N.T. = $3,490,342 Scrap Material

**SWITCH & CROSS TIES:**

- 119,107 ea. x $9.00 ea. = $1,071,966 Reusable Ties
- 416,876 ea. x $5.00 ea. = $2,084,378 Landscape Ties
- 297,768 ea. x $3.00 ea. = $893,305 Landscape Ties
- 357,322 ea. x $0.00 ea. = $0 Scrap Ties

Total: $37,284,456

**TOTAL TRACK VALUE**

$37,284,456

**REMOVAL COSTS**

- TRACK REMOVAL: 398.66 T.M.s @ $8.550 Per Mile = $3,408,543
- SWITCH & CROSSSTIES: 1191073 Ea. @ $3.00 Ea. = $3,573,219

Total Removal: $6,981,762

**NET LIQUIDATION VALUE**

$30,302,694
LEASE AND OPERATING AGREEMENT

between

THE STATE OF TEXAS
acting by and through the
TEXAS DEPARTMENT OF TRANSPORTATION

as Lessor

and

TEXAS PACIFICO TRANSPORTATION, LTD.

as Lessee

REGARDING THE RAIL LINE BETWEEN SAN ANGELO
JUNCTION AND PRESIDIO, TEXAS

January 31, 2001
LEASE AND OPERATING AGREEMENT

THIS LEASE AND OPERATING AGREEMENT ("Agreement") is entered into this 31st day of January, 2001, by and between the STATE OF TEXAS, acting by and through the Texas Department of Transportation ("State"), and TEXAS PACIFICO TRANSPORTATION, LTD. ("Lessee").

RECITALS

WHEREAS, pursuant to: (1) a Grant Funding Agreement for the Use and Operation of Railroad Property between the State and the South Orient Rural Rail Transportation District ("SORRTD"), dated December 30, 1991 (the "Grant Funding Agreement"), the State acquired the real property portion of that certain Rail Line, as defined in Section 1.1, located between San Angelo Junction, Coleman County, Texas and Presidio, Presidio County, Texas; (2) an Agreement to Purchase Lease and Assets between the State and the South Orient Railroad Company, Ltd. ("SORC"), dated January 31, 2001 (the "SORC Agreement"), the State, subject to the authorization of the Surface Transportation Board of the U.S. Department of Transportation, acquired all rights, titles, and interests of SORC in the Rail Line, including SORC's leasehold interest in the Rail Line, which leasehold has been cancelled and the lease agreement creating such leasehold as well as certain other rights has been terminated and cancelled, the operating rights and the rail freight transportation business conducted by SORC on the Rail Line, including interchange agreements related to railroad operations, intellectual property rights, and certain hardware and tangible personal property used in connection with railroad operations on the Rail Line (but excluding the railroad operating easement, which will be assigned to the State on the Effective Date and the Trackage Rights as herein defined); and (3) a Purchase and Transfer Agreement between the State and SORRTD, dated January 31, 2001 (the "SORRTD Agreement"), the State acquired the installed rails, ties, ballast, tracks, signals, switches, sidings, bridges, buildings, stations, communication facilities, and other structures, fixtures, and other improvements on the Rail Line;

WHEREAS, pursuant to the SORRTD Agreement, SORRTD has released all its rights to the Rail Line, including without limitation its right to lease the Rail Line;

WHEREAS, (1) Union Pacific Corporation, by letter dated February 11, 2000, has consented to the assignment by SORC to Grupo México or a wholly owned affiliate of Grupo México of the trackage rights granted pursuant to that certain Trackage Rights Agreement dated February 26, 1992, as amended, by and between SORC and the Southern Pacific Transportation Company ("SPT") regarding the rail line (the "SP Section") between SPT's Mile Post 608.46, in the vicinity of Alpine Junction, Texas, and SPT's Mile Post 619.64 in the vicinity of Paisano, Texas (the "Trackage Rights") and (2) SORC will assign the Trackage Rights to the Lessee on March 2, 2001 (the "Effective Date"): 

...
WHEREAS, SORC will permit Lessee to observe the rail transportation service operated by SORC on the Rail Line until the Effective Date;

WHEREAS, SORC will allow Lessee to assume the insurance policies of SORC presently in force as described on Addendum Three to the SORC Agreement ("SORC Insurance Policies");

WHEREAS, the option held by San Angelo Industries regarding the purchase of certain property constituting a portion of the Rail Line has been cancelled;

WHEREAS, pursuant to the SORRTD Agreement, all obligations and duties of SORRTD under the Grant Funding Agreement described above have been cancelled, the Grant Funding Agreement has been cancelled and Lessee has no obligation with respect to such Grant Funding Agreement;

WHEREAS, the State has advised the Lessee that the transactions contemplated by this Agreement, the SORC Agreement (including, without limitation, the Closing, as defined therein) and the SORRTD Agreement have been consummated simultaneously on the date first set forth above (the "Closing");

WHEREAS, from and after the Effective Date, Lessee desires to lease the Rail Line, as hereinafter defined, from the State, and to occupy, rehabilitate, use, maintain, and manage the Rail Line and improvements thereon, for the purpose of operating a rail freight transportation service;

WHEREAS, the State desires to lease the Rail Line to Lessee, provided the Lessee operates a rail freight transportation service on the Rail Line in accordance with the terms and conditions of this Agreement; and

WHEREAS, the Texas Transportation Commission, by Minute Order No. 108240, dated June 29, 2000, authorized the Executive Director of the Texas Department of Transportation to negotiate and enter into agreements necessary for the continued operation of the Rail Line.

NOW, THEREFORE, in consideration of the premises, the mutual covenants contained herein, and other good, fair, and valuable consideration, the receipt, adequacy, and reasonable equivalency of which are hereby acknowledged, the parties hereto agree as follows:

1. LEASED PROPERTIES AND LEASE TERM

1.1. From and after the Effective Date, the State agrees to lease, demise, and let to the Lessee and by these presents, does hereby lease, demise and let to the Lessee, and Lessee hereby leases
and accepts from the State (i) the rail line running between San Angelo Junction, Coleman County, Texas and Presidio, Presidio County, Texas, consisting of those lands and premises, rights-of-way, and easements situated in the counties of Brewster, Coleman, Crane, Crockett, Irion, Pecos, Presidio, Reagan, Runnels, Tom Green, and Upton, in the State of Texas, that is the line extending between Mile Post 1029.1 on the International Bridge near Presidio and Mile Post 956.7 at Paisano Junction and between Mile Post 945.3 at Alpine Junction and Mile Post No. 0 + 330 feet near San Angelo Junction, on the east, and Lampasas Subdivision Mile Post No. 373 + 4362 feet near San Angelo Junction, on the west, and that is more particularly described on Exhibit A attached hereto and made a part hereof for all purposes, save and except those lands covered by the leases and agreements listed on Schedule I hereto, together with any and all installed rails, ties, switches, ballast, track structures, sidings, bridges, buildings, stations, communication facilities, fixtures, improvements or appurtenances located thereon (the entire length of the foregoing rail line and all lands, improvements, and interests being collectively referred to herein as the "Rail Line"); (ii) all equipment, hardware, books, records, uninstalled rails and ties and other tangible personal property used in connection with railroad operations on the Rail Line acquired by the State from SORC pursuant to the SORC Agreement; and (iii) any and all patents, trademarks, trade names, service marks, copyright registrations, any and all registrations and applications therefor, and any licenses under any proprietary rights used or held for use in connection with the Rail Line and acquired by the State from SORC pursuant to the SORC Agreement.

1.2. **Primary Term.** Unless this Agreement is terminated earlier in accordance with Section 7 hereof, this Agreement shall continue in full force and effect for a primary term commencing on the Effective Date and expiring on the date which is forty (40) years thereafter.

1.3. **Renewal Options.** Lessee shall have five (5) options to renew and extend the term of this Agreement, such option to follow consecutively upon the expiration of the last month of the primary term and each succeeding term. Each renewal option shall be for a term of ten (10) years. Such option shall be exercised by Lessee's giving written notice of its intention to renew and extend the term of this Agreement to the State at least one hundred and eighty (180) days before the expiration of the then effective term. The renewal and extension of this Agreement shall be on and under the same terms, provisions, and conditions as the primary term. Any termination of this Agreement pursuant to the terms hereof and after the occurrence of an event of default and the expiration of the applicable grace or curative period shall terminate all rights of renewal or extension set forth herein.

1.4. The State agrees that it shall be responsible for all leases, subleases, easements, crossing agreements, and all other agreements with third parties assigned to the State under the SORC Agreement, including without limitation those listed in Schedule I hereto (the "Third Party Agreements"). The State agrees that it shall enforce such Third Party Agreements so as to facilitate Lessee's operation of the Rail Line. The State hereby appoints Lessee and Lessee accepts such appointment to administer on behalf of the State such Third Party Agreements. The
1.5. The State hereby represents and warrants that: (a) the State will own at Closing and will lease, demise and let to the Lessee the same right, title and interest in the Rail Line and other property that the State received from SORC pursuant to the SORC Agreement free and clear of all liens, charges, pledges, security interests and other encumbrances, other than permitted encumbrances in any lease, sublease, easement, license or crossing agreement, and any other agreement with a third party affecting the use and occupancy of the Rail Line that were assigned to the State under the SORC Agreement; (b) the Lessee will receive full use and enjoyment of the Rail Line for the full term of this Agreement in accordance with the terms hereof; (c) the State has full authority to execute and deliver this Agreement and to perform its obligations hereunder, and this Agreement constitutes a legal, valid and binding obligation of the State enforceable against the State in accordance with its terms; (d) to the best knowledge of the State no other party has any rights to the Rail Line or other property subject to this Agreement; (e) the State has not and will not hire any SORC employees for purposes related to the operation of the Rail Line; (f) to the best knowledge of the State no claims exist (or with the passage of time will exist) related to any event, condition or transaction regarding the Rail Line; (g) the State has no rights to the Rail Line or other property subject to this Agreement except as provided herein; (h) all active railroad-highway traffic control systems, including signals and gates, will be in good condition and fully operational no later than one hundred twenty (120) days after the Closing; (i) each lease, sublease, easement, license and crossing agreement related to the Rail Line is a customary and usual agreement entered into in the ordinary course of operating a rail freight transportation service on the Rail Line, is in full force and effect, has been fully performed by the parties thereto through the Closing, is not the subject of any claim or demand, and will not result in any obligation or other liability for the Lessee; (j) executed and acknowledged counterparts of (i) the Deed Without Warranty from Santa Fe to SORRTD dated December 30, 1991 in the form of Exhibit A-1 to the Agreement for Sale of Certain Assets, Rights and Obligations of the Atchison, Topeka and Santa Fe Railway Company to SORC and SORRTD dated December 30, 1991, (ii) the Deed Without Warranty from Santa Fe to SORRTD dated December 30, 1991 in the form of Exhibit A-2 to the Agreement for Sale of Certain Assets, Rights and Obligations of the Atchison, Topeka and Santa Fe Railway Company to SORC and SORRTD dated December
30, 1991, (iii) the Deed Without Warranty from Santa Fe to SORC dated December 30, 1991 in the form of Exhibit A-3 to the Agreement for Sale of Certain Assets, Rights and Obligations of the Atchison, Topeka and Santa Fe Railway Company to SORC and SORRTD dated December 30, 1991, (iv) the Deed Without Warranty from SORRTD to TxDOT dated December 30, 1991, and (v) the Lease Agreement between SORRTD, as lessor, and SORC, as lessee, dated as of December 30, 1991, or a memorandum thereof, were recorded in the real estate records of the counties of Brewster, Coleman, Crane, Crockett, Irion, Pecos, Presidio, Reagan, Runnels, Tom Green and Upton in the State of Texas; and (k) the lands and improvements conveyed by the Quitclaim Deed dated November 15, 1993 from the State of Texas to the City of San Angelo, Texas do not encroach upon and will not interfere with the operation of the approximately 381.9 mile railroad described in Exhibit A hereto.

1.6. The State will cause SORC to provide the Lessee with access (with an opportunity to make copies at Lessee’s expense) to all records relating to the Rail Line that are retained by SORC pursuant to the SORC Agreement (other than records constituting privileged and confidential attorney-client communications or work product).

1.7. The State will cause SORC to take such commercially reasonable action to transfer to the State for the benefit of Lessee all of the assets covered by the SORC Agreement as contemplated therein.

1.8. The State and the Lessee intend that the lease and the related rights and obligations of the parties contemplated by this Agreement shall become effective as of the Effective Date. Notwithstanding any provision herein to the contrary, (a) the Lessee shall have the right to terminate this Agreement at any time on or prior to the Effective Date in the event that (x) subsequent to the date of this Agreement there is any change in or any event occurs that has an effect on the business, assets, condition (financial or otherwise) or operations of the Rail Line that is or is reasonably likely to (i) materially impair the ability of the Lessee to operate the Rail Line or (ii) otherwise be materially adverse to the business, assets, condition (financial or otherwise) or operations of the Rail Line (a “Materially Adverse Event”), it being understood, however, that the State shall have the right to cure such Material Adverse Event if such cure is completed and Lessee is provided with a full written explanation of such cure not later than five (5) days prior to the Effective Date, (y) prior to the Effective Date, the parties to the documents referred to in the Recitals hereto and in the Index of Closing Documents for the transactions contemplated therein and herein (including, without limitation, the Assignment of Union Pacific Trackage Rights by SORC to the Lessee) shall have failed to execute and deliver all such documents to Lessee, in form acceptable to counsel for Lessee, or (z) the transaction contemplated by the SORC Agreement (including, without limitation, the State’s payment obligation under Section 9 of the SORC Agreement) is not consummated on or before the date of this Agreement (b) if the Lessee elects to exercise such right, it shall notify the State on or prior to the Effective Date, and (c) from and after such notification, neither party hereto shall have any further rights or obligations under this Agreement.
2. **LEASE PAYMENTS**

2.1. Lessee agrees to pay an annual fee in the amount of Ten Thousand Dollars ($10,000) to the State to cover administrative and legal costs incurred by the State through ownership of the Rail Line, including costs incurred by the State in carrying out the inspection and oversight responsibilities set out in Section 4. The annual fee shall be reduced by fifty percent (50%) during the first eight (8) years of this Agreement to reimburse the Lessee for the sum advanced under Section 2.4. The initial fee shall be paid one (1) year in advance upon the Effective Date, and on each anniversary thereof until this Agreement is terminated. The annual fee is subject to review and adjustment every five (5) years based upon increases of the Texas Consumer Price Index during the five (5) year period. All payments due to the State hereunder shall be paid by the Lessee to the State at the address of the State set forth hereinafter, or to such other person and/or at such other address as the State may direct by notice to Lessee.

2.2. Payment of the annual fee shall be considered delinquent if not paid within thirty (30) days of the date the payment is due to the State. If the Lessee fails to pay any fee installment and such payment shall become delinquent, simple interest at the rate of ten percent (10%) per year shall be added to any such overdue payment from the due date to the date of payment.

2.3. In addition to the annual fee, the Lessee agrees to pay the State, upon the Effective Date, the sum of Three Million Five Hundred Thousand Dollars ($3,500,000), minus the Holdback Amount (as defined in Section 5.6), and minus the Storage Amount (as defined in Section 5.7), which amount, minus the Holdback Amount and the Storage Amount, shall be paid by the State to SORC on or before noon, CST, on the third (3rd) business day after the Effective Date. This amount is subject to reimbursement pursuant to the provisions of Section 7.2.

2.4. In addition to the annual fee and the payment made under Section 2.3, the Lessee agrees to pay SORRTD, upon the Effective Date, the sum of Forty Thousand Dollars ($40,000) in consideration of SORRTD’s release of all of its interests in the Rail Line.

3. **RIGHTS AND OBLIGATIONS OF LESSEE**

3.1. Subject to compliance with the terms and conditions of this Agreement, the State hereby grants and Lessee hereby acquires and assumes as of the Effective Date the exclusive right to provide rail transportation service on the Rail Line during the term of this Agreement, and to be the common carrier for the rail freight service provided on the Rail Line. It is Lessee’s intention to conduct freight operations on the Rail Line. Lessee shall be entitled to provide passenger service at Lessee’s discretion. Lessee, to the extent required by statute or regulation, at its sole expense, shall prepare and file such documents as may be required to secure exemption from approval by the Surface Transportation Board (“STB”) or other governmental authority of Lessee’s acquisition of the leasehold interest and operations on the Rail Line. Lessee, at its
discretion and at its expense, shall have the right to record this Agreement in the land record office of each of the counties through which the Rail Line runs. The parties acknowledge and agree that the State has and shall continue to have during the term of this Agreement the complete and exclusive ownership of the Rail Line, including the exclusive right to commence abandonment proceedings for the Rail Line or any portion thereof, following the termination of this Agreement pursuant to Section 7. Lessee shall have the right to obtain approval to discontinue rail service. For all purposes relating to the ownership of the Rail Line, including all filings with or appearances before the STB or any other federal or state authority, the State shall be shown as the owner of the Rail Line.

3.2. Upon the commencement of rail freight service, the State hereby grants and the Lessee hereby acquires, subject to the State’s inspection and oversight responsibilities set out in Section 4, the right to manage the Rail Line, and agrees to do so in compliance with all applicable federal and state laws and regulations, and with all generally accepted industry standards, including those standards promulgated by the Association of American Railroads (“AAR”). All revenues and expenses therefrom shall accrue to the Lessee. All contracts for freight transportation over the Rail Line shall be in the name of the Lessee or that of any connecting railroad with which it participates in through transportation over the Rail Line and Lessee shall be responsible for the operating policies, billing rates, and scheduling of transportation over the Rail Line and the relationship with all shippers and connecting rail carriers. Lessee shall not discriminate unreasonably with respect to rates, transportation, and services against any shipper and shall provide transportation or service on reasonable request. Lessee shall be responsible for negotiating directly with all connecting railroads with respect to switch charges, divisions of revenue, car hire agreements, interchange agreements, and clerical/data exchange agreements. Lessee shall be responsible for promptly remitting to the State as received all revenues collected by or credited to Lessee subsequent to the Closing that are attributable to operations prior to the Closing.

3.3. With regard to the rail freight service and its management of the Rail Line, the Lessee agrees to furnish all equipment, machinery, manpower and support services, make such improvements to the Rail Line, establish such rates, tariffs, and other commercial arrangements, provide rail freight service to shippers within the State of Texas, and maintain the Rail Line in the condition necessary to comply with all applicable federal and state laws and regulations, and with all generally accepted industry standards, including those standards promulgated by the AAR. The parties understand and agree that there is no intent by this Agreement to create any unique regulations. Lessee shall have management and control of the operation and maintenance of the Rail Line, which shall be carried out at the Lessee’s sole cost and expense.

3.4. Subject to this Section 3, Lessee agrees to provide the following services as reasonably necessary for the efficient operation of the Rail Line and the transportation of freight thereover: routine marketing consistent with the business goals of Lessee; routine inspection and maintenance of the Rail Line (including railroad bridges and trestles, culverts, structures, signs,
road crossing signals, crossings, and lighting); equipment maintenance, repair, and supply, car
repair and maintenance, and sufficient motive power, including fuel and supplies, and
establishing a routine system in order to facilitate compliance with industry rules, regulations and
practices. All operating personnel of Lessee, prior to operating any locomotive or other track
mounted equipment, shall be qualified in accordance with applicable Federal Railroad
Administration ("FRA") rules and regulations.

3.5. Lessee shall have the right to erect, construct or install any structures, guards, devices,
rails, ties, ballast, tracks, sidings, bridges, buildings, stations, communication facilities or other
improvements upon the Rail Line for any lawful purpose. During the term of this Agreement,
the improvements shall remain the property of the Lessee, and Lessee shall have the sole right to
all tax benefits that may be derived from or by virtue of the improvements. Lessee agrees to
cause all new improvements to be constructed in compliance with all applicable laws,
ordinances, rules, and regulations of any political subdivision, agency, or instrumentality having
jurisdiction over the Rail Line. Upon termination of this Agreement, such improvements shall
become the property of the State.

3.6. The inspection, maintenance and rehabilitation of the tracks and other improvements of
the Rail Line, the repair and servicing of locomotives, cars and other equipment and the erection
or repair of any bridges, buildings or other structures within the Rail Line’s right-of-way, at the
discretion of the Lessee, may be performed by contractors engaged by it for such purposes.

3.7. Lessee may, with the written consent of the State, which shall not be unreasonably
withheld, allow the use of the Rail Line by other railroads for rail freight operations, and may
enter into agreements with other railroads for such use.

3.8. If during the term of this Agreement, any rails, ties, switches, ballast, track structures,
sidings, bridges, buildings, stations, communication facilities, fixtures, improvements or
appurtenances, now or thereafter situated on the Rail Line, or fixtures or personal property
therein or thereon, be wholly or partially destroyed or damaged by any cause whatsoever, the
State shall have no liability or responsibility to repair or restore the same (unless the damage was
a result of negligent or willful misconduct of the State). The cost of repairing and restoring the
same shall be the responsibility of the Lessee, except as to the SP Section.

3.9. Notwithstanding anything to the contrary contained herein, with regard to any obligation
or duty of Lessee to improve, repair, maintain, or rehabilitate the Rail Line, the State agrees and
acknowledges that such obligations and duties of the Lessee shall not require Lessee to take any
action to improve or rehabilitate the Rail Line to a better condition than the condition of the Rail
Line as of the date of this Agreement.

3.10. (a) Lessee and the State agree that if all or substantially all of the Rail Line is taken
(which term as used in this Section 3.10 shall include any conveyance in avoidance or settlement
of condemnation or eminent domain proceedings) by any governmental authority under the right of eminent domain or other similar proceedings, then this Agreement shall terminate as of the date of the taking of possession by such governmental authority, and any award made by any governmental authority shall belong to and be the property of the State, subject to the Lessee’s rights of reimbursement hereunder.

(b) Lessee and the State agree that if less than all or substantially all of the Rail Line is taken by any governmental authority under the right of eminent domain or other similar proceeding, then this Agreement shall nevertheless continue in effect as to the remainder of the Rail Line unless, in Lessee’s judgement, evidenced by notice by Lessee to the State, so much of the Rail Line has been taken or condemned as to make it economically unsound to attempt to use the remainder thereof for the uses and purposes contemplated herein, in which latter event this Agreement shall terminate in the same manner as if the whole of the Rail Line had been taken or condemned upon possession of such portion of the Rail Line by the condemning authority, and any award made by any governmental authority shall belong to and be the property of the State, subject to the Lessee’s rights of reimbursement hereunder.

(c) The State agrees that it shall not use its condemnation or eminent domain authority to take any property constituting a part of the Rail Line during the term of this Agreement.

4. RIGHTS AND OBLIGATIONS OF THE STATE

4.1. Upon a decision by the Lessee to discontinue providing rail freight service, a failure by the Lessee to exercise a renewal option, or termination of this Agreement pursuant to Section 7, exclusive operating rights on the Rail Line shall revert to the State as the owner of the Rail Line (the “residual common carrier obligation”). The residual common carrier obligation retained by the State, and the State’s complete and exclusive ownership of the Rail Line includes the exclusive right to commence abandonment proceedings for the Rail Line or any portion thereof following the termination of this Agreement pursuant to Section 7.

4.2. The State and its agents or its authorized representatives, after three (3) days written prior notice to the Lessee (except in an emergency, which for purposes of this Section 4 shall mean an immediate risk to human life or of bodily injury or of material damage to the Rail Line), shall have the right to enter at all times the premises, workings or operations of the Lessee in order to inspect and examine the same for the purpose of ascertaining the conditions of the operation, the methods of operation practiced or any other lawful purpose; provided, however, that such inspections shall not unreasonably interfere with the Lessee’s operations. Additionally, responsible officers of the Lessee shall be available to consult with the State from time to time as may be necessary or required by the State in order to advise the State of ongoing activities and services performed by Lessee on the Rail Line. It is mutually understood and agreed that the State’s agents or authorized representatives, when in or on the Rail Line or any of Lessee’s operations for any purpose, shall not be regarded under the law or otherwise as employees of the
Lessee. During any such inspection, Lessee shall have the right to have appropriate personnel available to accompany the inspection party.

4.3. The parties shall, at least once annually, jointly inspect the Rail Line to determine whether the Rail Line has been maintained in accordance with Section 3.3 of this Agreement. The State and its agents or its authorized representatives shall have the right to inspect, at other times determined by the State and after three (3) days written prior notice to the Lessee (except in an emergency, which for purposes of this Section 4 shall mean an immediate risk to human life or of bodily injury or of material damage to the Rail Line), the Rail Line to ascertain whether it has been properly maintained by the Lessee, provided, however, that such inspections shall not unreasonably interfere with the Lessee's operations. To assist the State in its inspections, the Lessee shall provide the State with copies of all FRA track inspection reports within sixty (60) days of receipt.

4.4. If the State and the Lessee disagree concerning the condition of the Rail Line or any determination by the Lessee of the appropriate level of maintenance, it is agreed by the parties that an inspection by a qualified representative of the FRA shall be arranged and such representative shall inspect those segments or portions of track in dispute. The representative's findings in this regard shall be binding upon the parties.

4.5. The State reserves the exclusive right to grant easements for public road crossings. Lessee shall not be required to share in the cost and expense of providing the physical public road crossing surface or any associated warning devices on any such easement granted by the State unless agreed to, in advance and in writing, by the Lessee and the State. After installation, the Lessee shall maintain such crossings and associated warning devices as required by applicable Federal and State laws and regulations.

4.6. If the Lessee makes application for federal grant funding, federal loan assistance, or any other federal, state or local financial aid, redevelopment or other assistance program for rehabilitation of the Rail Line, the State shall, upon the request of the Lessee, provide reasonable assistance to the Lessee in the Lessee's application.

4.7. The State hereby covenants and agrees with Lessee and its successors and assigns that Lessee, upon observing and fulfilling the covenants on its part herein contained, during the lease term herein granted, shall and may peaceably and quietly have, use, occupy, possess and enjoy the full exclusive and unrestricted use and enjoyment of the Rail Line and receive and enjoy to its own use the earnings and income and all other benefits and advantages thereof, without and free from all manner of disturbance or interference.

4.8. Notwithstanding any other provision of this Agreement, the State reserves the right to grant easements for the installation of telecommunications or other utility facilities along, across, over, in, or on, the real property portion of the Rail Line, and to authorize a grantee to enter upon
the Rail Line for purposes of installation, adjustment, relocation, and maintenance of those facilities, provided that such installation, adjustment, relocation, and maintenance does not unreasonably interfere with Lessee’s operations.

5. INSURANCE AND INDEMNIFICATION

5.1. Lessee shall secure and maintain in effect at all times during the term of this Agreement a commercial railroad liability insurance policy or policies providing liability coverage in connection with its lease and operation of the Rail Line substantially similar to the coverage maintained by SORC as of the Closing. Insurance shall be placed with insurance companies authorized to do business in the State of Texas, and shall name the Texas Department of Transportation as an additional insured. Lessee shall use commercially reasonable efforts to furnish to and maintain with the State certificates of such insurance evidencing current coverage, each containing agreements by the insurers not to cancel or modify the policies without giving the State at least thirty (30) days prior written notice.

5.2. Lessee shall hold harmless and indemnify the State and its officers, agents, and employees against any liability, loss, claim, or expense the State incurs that relates to or arises out of the acts or omissions of the Lessee as the operator of rail services on the Rail Line. Lessee shall hold harmless and indemnify the State and its officers, agents, and employees against any liability, loss, claim or expense for damage to property or for personal injury or death if such property damage, personal injury or death shall arise out of any act or omission of the Lessee in its performance of its rights and responsibilities as the operator of rail services on the Rail Line.

5.3. Except to the extent prohibited by law, the State shall hold harmless and indemnify the Lessee and its officers, agents, and employees against any liability, loss, claim, or expense the Lessee incurs that relates to or arises out of the acts or omissions of the State as the owner of the Rail Line. Except to the extent prohibited by law, the State shall hold harmless and indemnify the Lessee and its officers, agents, and employees against any liability, loss, claim or expense for damage to property or for personal injury or death if such property damage, personal injury or death shall arise out of any act or omission of the State in its performance of its rights and responsibilities as the owner of the Rail Line. Except to the extent prohibited by law, the State shall hold harmless and indemnify the Lessee and its officers, agents, and employees, for a period of one hundred twenty (120) days after the Closing, against any liability, loss, claim, or expense the Lessee incurs that arises out of the absence of fully operational active railroad-highway traffic control systems, including signals and gates. Except to the extent prohibited by law, the State shall hold harmless and indemnify the Lessee and its officers, agents, and employees against any liability, loss, claim, or expense the Lessee incurs that relates to any event or transaction regarding the Rail Line occurring prior to the Effective Date. The State hereby assigns to the Lessee a joint interest in any indemnities from the Atchison, Topeka and Santa Fe Railway Company and from SORC acquired by the State pursuant to the Grant Funding Agreement, SORC Agreement, SORRTD Agreement, or any other agreement, including the
Indemnity Agreement executed by SORC on or about December 30, 1991, pursuant to which SORC indemnifies TxDOT and its successors and assigns with respect to claims for damages resulting from the operation of the railroad business on the Rail Line and related activities; the State agrees it shall not release or terminate any such indemnities during the term of this Agreement.

5.4. Lessee shall require all persons entering upon or performing work on the Rail Line under any agreement with the Lessee (including any other railroads allowed on the Rail Line under Section 3.7) to agree to hold harmless and indemnify the State and its officers, agents, and employees from and against any liability, loss, claim, or expense for bodily injury or death to any persons or damage to any property arising out of any act or omission of such contractor on or in connection with the Rail Line, irrespective of the fault, failure or negligence (other than sole negligence) of the State. Lessee shall also require any such person or entity to secure and maintain in effect at all times during the performance of such work on the Rail Line a contractual liability insurance policy insuring such person or entity from liability under this section. Lessee shall provide the State a copy of all such policies or certificates of insurance upon request.

5.5. Anything hereto to the contrary notwithstanding, it is the intention of the parties that the Lessee shall be an independent contractor with regard to any and all activities and services performed and conducted by it under and pursuant to the terms of this Agreement. All persons engaged by the Lessee for purposes of discharging its duties hereunder shall be deemed to be the employees, agents or subcontractors (as the case may be) of the Lessee and shall not be deemed to be employees, agents or subcontractors of the State. Lessee shall be solely liable for compliance with all laws and regulations of the United States and the State of Texas and any other proper authority relating to employee wages and benefits, FELA and worker’s compensation, unemployment compensation, social security, and all other employment laws and regulations, and Lessee shall hold harmless and indemnify the State from any and all liability for and on account of the aforesaid matters.

5.6. (a) Lessee shall withhold Eight Hundred Thousand Dollars ($800,000) (the “Holdback Amount”) from the payment provided for in Section 2.3. Lessee shall hold fifty percent (50%) of the Holdback Amount ("Retained Amount") for a period of three (3) years (the “Holdback Period”) beginning on the Effective Date and ending on the third anniversary of the Effective Date (“Termination Date”). Lessee shall deposit the remaining fifty percent (50%) of the Holdback Amount ("Deposited Amount") with the State for the Holdback Period. The State shall deposit the Deposited Amount in the state treasury.

(b) Lessee shall have the right to apply all or part of the Retained Amount to pay or settle from time to time: (i) any costs, damages, claims, expenses (including reasonable attorneys’ fees), losses and liabilities ("Claims") resulting from or relating to any event, condition or transaction regarding the Rail Line occurring prior to the Effective Date relating to environmental matters; and (ii) any costs and expenses (including reasonable attorneys’ fees) of any project ("Project") to remediate or abate conditions on the Rail Line which are reflected in
the Flash Report Environmental Site Assessment (South Orient Rail Line – San Angelo Junction to Presidio, Texas), dated January 17, 2000 prepared by Environmental Resources Management (the “Environmental Report”) and, if not so reflected, which Lessee has concluded in its reasonable discretion might result in a Claim relating to environmental matters; provided, however, in the event that Lessee has been notified of a Claim or begins work on a Project, it shall promptly provide the State (which the State will promptly provide to SORC) with a reasonably detailed description of the Claim or Project. Upon completion of each Project, Lessee shall promptly provide the State (which the State will promptly provide to SORC) with a reasonably detailed description of the work done in connection with such Project. An environmental matter shall be deemed to include, without limitation, the presence or release into the environment of any materials of environmental concern or circumstances forming the basis of any violation, or alleged violation, of any environmental law. Materials of environmental concern shall be deemed to mean any pollutant, contaminant, waste, toxic substance, hazardous substance or petroleum. Environmental laws shall be deemed to mean all federal, state and local laws and regulations relating to pollution or protection of human health or the environment, including, without limitation, laws and regulations relating to emissions, discharges, releases or threatened releases of materials of environmental concern, or otherwise relating to the use, treatment, storage, disposal, transport or handling of materials of environmental concern.

(c) Lessee shall have the right to apply all or part of the Deposited Amount to pay or settle from time to time any Claims resulting from or relating to any event, condition or transaction regarding the Rail Line occurring prior to the Effective Date relating to environmental matters; provided (i) the Claim is the subject of a claim, action or investigation initiated by an environmental agency or other individual, firm, corporation, partnership, trust or other entity of any kind; (ii) Lessee promptly provides the State (which the State will promptly provide to SORC) with a reasonably detailed description of the Claim; (iii) SORC shall have a reasonable opportunity to analyze such Claim and to express to the State and Lessee its opinion regarding the validity of the Claim; and (iv) SORC shall have consented to the payment or settlement of such Claim, provided consent shall not be unreasonably withheld.

(d) At the end of each calendar quarter during the Holdback Period, Lessee shall pay the State interest at the prime rate of interest for commercial banks quoted in the Money Rates Section (or other place) of The Wall Street Journal from day to day on the daily balance of that part of the Retained Amount on each such day during such quarter which has not been paid in respect of or allocated to Claims or Projects. The State shall promptly remit such interest to SORC.

(e) Promptly after the Termination Date, Lessee shall pay to the State that part of the Retained Amount that has not been applied to Claims and Projects, and the State shall pay to SORC (i) such balance of the Retained Amount and (ii) that part of the Deposited Amount that has not been applied to Claims; provided that Lessee may withhold and may direct the State to withhold an amount reasonably necessary to pay or settle any then unresolved Claims and
uncompleted Projects (with the balance of such withheld amounts to be paid to SORC after such resolution and completion are final).

(f) The payment obligations of Lessee under Section 5.6(d) and (e) will be unconditionally and irrevocably guaranteed by Nuevo Grupo Mexico, S.A. de C.V.

5.7. Lessee shall withhold from the payment provided for in Section 2.3 an amount equal to One Hundred Seventy Five Dollars ($175) times the number of rail cars that are still in storage on the Rail Line on the Effective Date ("remaining GE Rail Cars") under a Storage Agreement ("GE Agreement") between SORC and General Electric Rail Services Corporation ("GE") dated January 17, 2000 (the "Storage Amount"). Lessee shall deposit the Storage Amount with the State, which shall deposit the Storage Amount in the state treasury. At the end of ninety (90) days after the Effective Date, the Lessee will be entitled to payment from the Storage Amount of an amount equal to the Storage Amount minus any revenue received or receivable by the Lessee from GE as storage payments for or for the movement of the remaining GE Rail Cars to Alpine Junction, Texas or to Mexico during such ninety (90) day period (but not to exceed the Storage Amount). TxDOT will promptly remit the remainder of the Storage Amount to SORC. The State will cause SORC to terminate the GE Agreement effective as of the Effective Date, and to assist the Lessee in negotiating a new storage agreement with GE.

5.8. If requested by the Lessee prior to the Effective Date, the State shall cause SORC to transfer the SORC Insurance Policies to the Lessee.

6. EVENTS OF DEFAULT

6.1. The occurrence of any of the following events, in the absence of a Force Majeure Event (except as to Section 6.1 (a)), shall constitute a default by the Lessee hereunder:

(a) Failure to make payments of the annual fee when due, and such failure continues for sixty (60) days following written demand therefor;

(b) Failure to perform its duties in a manner required by law, rule, regulation, or ordinance or, in the absence of such laws, rules, regulations or ordinances, in a manner consistent with industry accepted practices and procedures and generally accepted railroad safety practices or procedures;

(c) Failure to provide transportation or service upon reasonable request to shippers located on the Rail Line in the absence of a lawfully filed and maintained embargo, and such failure continues for a period of sixty (60) days;

(d) The performance of its duties in such a manner that results in a cessation or closure order from any governmental agency, department, or bureau, including without
limitation any order from any agency, department, or bureau regarding the work environment of railroad employees;

(e) The breach of any other provision of this Agreement for a period of thirty (30) days after receipt of notice of such breach from the State;

(f) The filing of a petition for bankruptcy, reorganization or arrangement of the Lessee pursuant to the U.S. Bankruptcy Reform Act or any similar proceeding, and such petition is not dismissed or stayed within thirty (30) days; or

(g) The levy of a writ of execution, foreclosure or attachment or the filing of a mechanics' or materialmens' lien against the personal property of the Lessee located on the Rail Line or used in connection therewith that precludes the Lessee's ability to perform its duties hereunder unless Lessee has posted a surety bond therefor.

6.2 The occurrence of any of the following events shall constitute a default by the State hereunder:

(a) Failure to perform its duties in a manner required by law, rule, regulation, or ordinance or, in the absence of such laws, rules, regulations or ordinances, in a manner consistent with industry accepted practices and procedures and generally accepted railroad safety practices or procedures;

(b) The breach of any other provision of this Agreement for a period of thirty (30) days after the receipt of notice of such breach from the Lessee; or

(c) The levy of a writ of execution, foreclosure or attachment or the filing of a mechanics' or materialmens' lien against the personal property of the State located on the Rail Line or used in connection therewith that precludes the State's ability to perform its duties hereunder unless the State has posted a surety bond therefor.

7. TERMINATION

7.1. This Agreement shall terminate upon the occurrence of any of the following:

(a) Upon the expiration of the primary term or any renewal term without a renewal option having been exercised in accordance with Section 1.3;

(b) Upon the expiration of ninety (90) days following written notice given by the State of the occurrence or existence of any event of default as provided for in Section 6.1, unless such default has been cured or waived or such notice is withdrawn within such ninety (90) day period provided that if Lessee within such ninety (90) days period shall
have commenced action to cure such default but is unable, by reason of the nature of the performance required, to cure same within such period, and if Lessee continues such action thereafter diligently and without unnecessary delays, Lessee shall not be in default hereunder until the expiration of a period of time as is reasonably necessary to cure such default;

(c) Upon the expiration of ninety (90) days following written notice given by the Lessee of the occurrence or existence of any event of default as provided for in Section 6.2, unless such default has been cured or waived or such notice is withdrawn within such ninety (90) day period; provided that if the State within such ninety (90) days period shall have commenced action to cure such default but is unable, by reason of the nature of the performance required, to cure same within such period, and if the State continues such action thereafter diligently and without unnecessary delays, the State shall not be in default hereunder until the expiration of a period of time as is reasonably necessary to cure such default; or

(d) At any time by written mutual agreement of the parties hereto.

7.2. Except for termination of this Agreement based in whole or in part on a failure by the Lessee to make a payment of the annual fee when due, the State agrees that upon the termination of this Agreement by the State it will reimburse the Lessee, subject to the appropriation of funds, for sums paid the State under Section 2.3 or expended by the Lessee to improve the installed rails, ties, switches, ballast, other track structures on the Rail Line and any other improvements reasonably necessary for the continued operation or maintenance of the Rail Line (collectively “Rail Line Improvements”) on the following basis:

(a) If the Lessee improves the Rail Line to FRA Class 2 track standards or better, and service is terminated within five (5) years after the Effective Date, the State shall reimburse the entire amount paid under Section 2.3, and shall reimburse the Lessee for sixty five percent (65%) of the depreciated book value of the Rail Line Improvements as calculated in accordance with generally accepted accounting principles, with the amount of reimbursement for Rail Line Improvements not to exceed seven million five hundred thousand dollars ($7,500,000); or

(b) If the Lessee improves the Rail Line to FRA Class 2 track standards or better, and service is terminated more than five (5) years after the Effective Date, the State shall reimburse the Lessee for fifty percent (50%) of the depreciated book value of the Rail Line Improvements as calculated in accordance with generally accepted accounting principles, with the amount of reimbursement for Rail Line Improvements not to exceed five million dollars ($5,000,000).
7.3. In the event of termination during a period in which the Lessee has paid in advance the annual fee payment, the State shall reimburse the Lessee for a pro rata percentage of that payment.

7.4. In the event of any termination of this Agreement, the Lessee shall vacate the Rail Line in an orderly manner, and shall deliver to the State all occupation agreements, track and signal maps, structural, bridges and other drawings and plans in its possession, files related to maintenance history, a list of customers the Lessee has provided service to since the commencement of this Agreement, and any other data related to the continued operation and maintenance of the Rail Line. In the event of any termination of this Agreement, Lessee, with the written consent of the Union Pacific Railroad Company or its successor in interest, shall assign or otherwise transfer the Trackage Rights to the State or a rail carrier designated by the State to provide rail transportation service on the Rail Line. Notwithstanding any provisions herein to the contrary, the State may only terminate this Agreement if it has performed all its obligations hereunder to Lessee, including without limitation any payment to be made to Lessee. For example, no termination shall occur until funds for payment of amounts referred to in Section 7.2 have been appropriated and such amounts have been paid to the Lessee. Lessee hereby expressly waives the institution of legal proceedings to authorize the State's re-entry and repossession of the Rail Line pursuant to a valid termination of this Agreement.

7.5. In the event of termination of this Agreement pursuant to Section 7.1 (a), (b) or (d), the Lessee, at its sole cost and expense, will promptly seek any necessary authority to discontinue rail service from the STB or other governmental authority. If the Lessee fails to do so, the Lessee agrees that the State may seek such authority on behalf of the Lessee, and the Lessee shall reimburse the State for all costs (including filing fees and attorney's fees) incurred by the State. Following its having been authorized to discontinue providing service on the Rail Line, Lessee shall not oppose the efforts of any rail carrier designated by the State to operate rail freight services on the Rail Line to obtain authority from the STB or other governmental authority to provide rail service.

7.6. All accrued obligations and indemnity provisions shall survive the termination of this Agreement.

8. AUDITS AND REPORTS

8.1 Lessee shall file an annual report with the State in the form attached hereto as Exhibit B on or prior to May 1 of each calendar year during the term of this Agreement beginning on May 1, 2002, and covering the preceding calendar year. The financial statement will be unaudited and will fairly present the following information: (a) income from operating the Rail Line during the preceding calendar year, specifying freight revenue and all other revenue; (b) expenses incurred
by the Lessee in operating the Rail Line during the preceding calendar year, specifying transportation expense, maintenance expense, general and administrative expense, and all other expense; and (c) the depreciated book value of the Rail Line Improvements as of December 31st of the preceding calendar year.

8.2. Lessee’s business, financial and management data are highly sensitive, proprietary and confidential. Any and all information acquired by the State under the terms of this Section 8 shall only be divulged as may be required by law or in connection with any administrative or legal proceeding.

9. **TAXES**

9.1. Railroad properties owned by the State are currently exempt from ad valorem taxation of real property by the Texas Constitution. In the event that the Texas Constitution is amended or lawfully construed to permit ad valorem taxes to be assessed by any taxing jurisdiction authorized to assess and/or collect ad valorem taxes against the Rail Line properties, including right-of-way and other lands and improvements thereto, the Lessee shall be responsible for such taxes; provided, however, the State shall reimburse the aggregate of such taxes to the Lessee upon termination of this Agreement (except for termination based in whole or in part on a failure by the Lessee to make a payment of the annual fee when due).

9.2. Nothing herein shall be construed to relieve the Lessee from any liability to pay taxes assessed against its motive power, rolling stock or other equipment, or any other personal property owned by the Lessee.

10. **FORCE MAJEURE**

10.1. Lessee shall have no obligation to operate over any portion of the Rail Line or perform any of its other obligations hereunder (other than its obligations to make lease payments pursuant to Section 2 hereof) during any period when it is prevented or hindered from operating or performing such obligations by acts of God, public authority, strikes, riots, labor disputes, judicial or administrative order or decree, or any other cause beyond its control.

10.2. Events or conditions referred to in Section 10.1 are referred to herein as “Force Majeure Events”.

11. **OTHER USES OF THE RAIL LINE**

11.1. Lessee shall not make any use of the Rail Line, other than as provided herein, except with the prior consent of the State.
12. MISCELLANEOUS PROVISIONS

12.1. Entire Agreement. This Agreement expresses the entire agreement between the parties and supersedes all prior oral or written agreements, commitments or understandings with respect to the matters provided for herein, and no amendment of this Agreement shall be effective unless set forth in writing and duly executed by both parties.

12.2. Notices. Any notice, request or other communication required or permitted hereunder shall be in writing and shall be deemed to have been duly given: (a) upon receipt if personally delivered or by overnight courier; (b) on the date sent if made by facsimile transmission to the party to whom such notice or communication is directed to the facsimile number of such person stated on Exhibit C (or as otherwise provided to or obtained by the sending party) and if followed by a telephone call to such person at the same time to the telephone number stated on Exhibit C (or otherwise provided to or obtained by the sending party) advising such person that the facsimile transmission has been sent and a general statement about the contents thereof; or, (c) on the third business day after being sent by registered or certified mail, return receipt requested, postage prepaid, to the parties at their respective addresses set forth in Exhibit C. Any party by written notice to the other may change the address or the persons to whom notices or copies thereof shall be directed.

12.3. Binding Effect. This Agreement shall be binding upon and inure to the benefit of the State and the Lessee, and shall be binding upon the successors and assigns of the Lessee, subject to the limitations hereinafter set forth. Lessee may not assign its rights and obligations under this Agreement or any interest therein, or attempt to have any other person, firm or corporation assume its rights or obligations under this Agreement other than to any affiliate of the Lessee, without the prior written consent of the State, which consent shall not be unreasonably withheld. The State may not assign its rights and obligations under this Agreement or any interest therein, or attempt to have any other person, firm or corporation assume its rights or obligations under this Agreement, other than to another agency of the State of Texas, without the prior written consent of the Lessee, which consent shall not be unreasonably withheld.

12.4. Non-Collusion. The officer or duly authorized agent of the Lessee that has executed this Agreement on behalf of the Lessee warrants and affirms that: (a) the execution, delivery, and performance by the Lessee under the terms of this Agreement have been duly and validly authorized by all necessary action under applicable law, its governing documents and otherwise (none of which actions have been modified or rescinded and all of which actions are in full force and effect); and (b) he is fully aware of the facts and circumstances surrounding the making of this Agreement, and neither the Lessee, its partners, or anyone else subject to the Lessee’s direction and control has paid, given, donated or agreed to pay, give or donate any money or other thing of value, either directly or indirectly, to any officer or employee of the State in procuring this Agreement.
12.5. **Severability.** If any provision of this Agreement, or the application thereof to any person or circumstance, is rendered or declared illegal for any reason and shall be invalid or unenforceable, the remainder of the Agreement and the application of such provision to other persons or circumstances shall not be affected thereby but shall be enforced to the greatest extent permitted by law.

12.6. **Counterparts.** This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

12.7. **Waivers.** Any waiver by any party of any violation of, breach of, or default under any provision of this Agreement or any other agreements provided for herein, by the other party must be in writing and shall not be construed as, or constitute, a continuing waiver of such provision, or waiver of any other violation of, breach of, or default under any other provision of this Agreement or any other agreements provided for herein.

12.8. **Headings.** The headings herein are solely for convenience of reference and shall not be given any effect in the construction or interpretation of this Agreement.

12.9. **Governing Law.** All issues, claims, disputes or controversies arising out of or related hereto shall be governed by and resolved in accordance with the laws of the State of Texas, excluding the choice-of-law rules of the State of Texas. The dispute resolution process provided for in Chapter 2260 of the Texas Government Code shall be used to attempt to resolve all disputes arising between the parties under this Agreement.

IN WITNESS WHEREOF, the parties have caused their duly authorized representatives to execute this Agreement as of the date first above written.

STATE OF TEXAS  
DEPARTMENT OF TRANSPORTATION

Executed by the Executive Director for the purpose and effect of activating and/or carrying out the orders, established policies or work programs heretofore approved and authorized by the Texas Transportation Commission.

By: Charles W. Heald, P.E.  
Executive Director
TEXAS PACIFICO TRANSPORTATION, LTD.

By: TEXAS PACIFICO GP, LLC, its General Partner.

By: Sergio M. Ferrer De la Barrera
Manager
EXHIBIT A -- LEGAL DESCRIPTION OF RAIL LINE REAL ESTATE

ALL INTERESTS IN THE REAL ESTATE (INCLUDING, WITHOUT LIMITATION, FEE SIMPLE, LEASEHOLD [AS LANDLORD OR TENANT], EASEMENT, RIGHT-OF-WAY, LICENSE, REVERSIONARY AND OTHER REAL PROPERTY INTERESTS AND ALL IMPROVEMENTS AND FIXTURES THEREON AND APPURTENANCES THERETO) CONVEYED BY THOSE TWO CERTAIN DEEDS WITHOUT WARRANTY DATED DECEMBER 30, 1991 (WHICH DEEDS ARE RECORDED IN THE DEED RECORDS OF THE COUNTRIES MENTIONED BELOW) FROM THE ATKISON, TOPEKA AND SANTA FE RAILWAY COMPANY (HEREIN CALLED "SANTA FE") TO SOUTH ORIENT RURAL RAIL TRANSPORTATION DISTRICT (HEREIN CALLED "SORRTD"), SAVE AND EXCEPT THOSE LANDS AND IMPROVEMENTS THEREON LOCATED IN TOM GREEN COUNTY, TEXAS, WHICH WERE CONVEYED BY QUITCLAIM DEED DATED NOVEMBER 15, 1993 (WHICH DEED IS RECORDED IN VOLUME 410, PAGE 147 OF THE OFFICIAL PUBLIC RECORDS OF TOM GREEN COUNTY, TEXAS) FROM THE STATE OF TEXAS TO THE CITY OF SAN ANGELO, TEXAS, WHICH INTERESTS IN REAL ESTATE COMprise THAT CERTAIN APPROXIMATELY 381.9-MILE RAILROAD BEGINNING AT THE RAILROAD STATION OF SAN ANGELO JUNCTION, TEXAS (NEAR THE CENTER OF COLEMAN COUNTY, TEXAS) AND RUNNING IN A WEST SOUTHWESTERLY DIRECTION THROUGH OR NEAR THE CITIES OR TOWNS OF BALLINGER, SAN ANGELO, MERTZON, BIG LAKE, SANTA RITA, RANKIN, MCCAMEY, FORT STOCKTON, ALPINE AND PRESIDIO, TEXAS, ENDING IN THE MIDDLE OF THE INTERNATIONAL BRIDGE AT PRESIDIO, TEXAS AND WHICH CONSTITUTES THAT PORTION OF THAT CERTAIN LINE OF RAILROAD DESIGNATED IN THE RECORDS OF THE ATKISON, TOPEKA AND SANTA FE RAILWAY COMPANY AS THE SAN ANGELO SUBDIVISION OF THE SOUTHERN REGION, CONNECTING THE RAILROAD STATION OF SAN ANGELO JUNCTION, COLEMAN COUNTY, TEXAS AND PRESIDIO, PRESIDIO COUNTY, TEXAS, AND LYING IN THE COUNTRIES OF BREWSTER, COLEMAN, CRANE, CROCKETT, IRION, PECOS, PRESIDIO, REAGAN, RUNNELS, TOM GREEN, AND UPTON, IN THE STATE OF TEXAS, AND DESCRIBED MORE SPECIFICALLY AS FOLLOWS:

B. All of that certain 72 mile railroad described second in the deed dated August 1, 1965 from Kansas City, Mexico and Orient Railway Company of Texas, as grantor, to the Atchison, Topeka and Santa Fe Railway Company, as grantee, filed for record August 2, 1965 in volume 151 of deed records, at page 302 of the records of Brewster County, Texas;

C. That portion of that certain 70.8 mile railroad described fifth in deed dated August 1, 1965, from Gulf, Colorado and Santa Fe Railway Company, as grantor, to the Atchison, Topeka and Santa Fe Railway Company, as grantee, filed for record August 2, 1965 in volume 427 of deed records, at page 96 of the records of Coleman County, Texas, lying southwesterly of the southwesterly boundaries of those certain 100-foot wide strips of land described in deed from the estate of John Sealy, filed for record December 5, 1885, in volume "0" at page 175, and in deed dated October 5, 1885, from Coleman County, filed for record October 6, 1885, in volume "0" at page 60, both of the records of Coleman County, and northeasterly of San Angelo Subdivision Milepost 70 + 3715.3 feet, being the southwesterly terminus of that 70.8 mile railroad, at its connection with the above described 464 mile railroad at San Angelo Subdivision Milepost 715 + 1072 feet;

D. All other interests in real estate which is within 500 feet of the centerline of the said railroad in which the State of Texas (TxDOT) owns an interest in each of the eleven counties described in the first paragraph above;

E. Including all yard, spur, industrial, team, switching or side tracks springing from or connected with any and all of said lines of railroad and all of TxDOT's interest in and to the land, right-of-way, and other property interest, real, personal or mixed, in the rail line as defined in the lease and operating agreement to which this exhibit A is attached in the above named counties in the State of Texas owned by TxDOT;

F. Together with all lands, tenements, hereditaments, ways, and rights-of-way held for said railroad or for any purpose in connection with the construction, operating, working or maintenance of the same or any of the same together with all easements and appurtenances thereunto belonging or in any wise appertaining.

WHICH RAIL LINE REAL ESTATE IS ALSO THE SAME RAIL LINE REAL ESTATE DESCRIBED IN:


EXHIBIT B
Annual Report*

The report is divided into four sections as follows:

Section 1 -- Financial Statement
Section 2 -- Maintenance to the Rail Line
Section 3 -- Improvements to the Rail Line
Section 4 -- Carload Movements

* Note- all portions of the report are to be in the English language and submitted to TxDOT by May 1st of each year.
Section 1 – Financial Report for the calendar year beginning January 1, _______ through December 31, ________.

The Texas Department of Transportation requires the following financial information to be submitted annually:

1. Income from operating the Rail Line
   (a) Freight revenue
   (b) All other revenue
   (c) Total revenue

2. Expenses from operating the Rail Line
   (a) Transportation expense
   (b) Maintenance expense
   (c) General and administrative expense
   (d) All other expenses
   (e) Total expenses

3. Depreciated book value of Rail Line Improvements
   As of December 31, ______

* Note- all portions of the report are to be in the English language and submitted to TxDOT by May 1st of each year.
EXHIBIT B
Annual Report*

Section 2 – Maintenance to the rail line during the calendar year beginning January 1, _____ through December 31, ______.

Description of the maintenance work – provide a brief narrative including the locations, scope of work and what was being accomplished.

List of maintenance work accomplished:

<table>
<thead>
<tr>
<th>Type of maintenance work</th>
<th>Location</th>
<th>Costs**</th>
<th>Date Installed***</th>
</tr>
</thead>
</table>

* Note- all portions of the report are to be in the English language and submitted to TxDOT by May 1st of each year.

**Costs – provide the costs in US dollars itemized by: materials, labor and salvage value of any replaced items. Copies of documentation such as paid invoices, paid contracts, completed work orders, etc. shall be attached.

***Date work was completed.
EXHIBIT B
Annual Report*

Section 3 – Improvements to the rail line during the calendar year beginning January 1, _____ through December 31, _____.

Description of improvements installed on the rail line - provide a brief narrative including locations, scope and what was being accomplished.

<table>
<thead>
<tr>
<th>Type of improvement</th>
<th>Location</th>
<th>Costs**</th>
<th>Date of installation***</th>
</tr>
</thead>
</table>

* Note- all portions of the report are to be in the English language and submitted to TxDOT by May 1st of each year.

**Costs – provide the costs in US dollars itemized by: materials, labor and salvage value of any replaced items. Copies of documentation such as paid invoices, paid contracts, completed work orders, etc. shall be attached.

***Date work was completed.
EXHIBIT B
Annual Report*

Section 4 - Carload Movements during the calendar year beginning January 1, ______ through December 31, ______.

Provide the total number of carloads transported itemized by:

a) the total number of carloads originating in Mexico and crossing the border at Presidio into Texas. ______

b) the total number of carloads originating in the United States and crossing the border at Presidio into Mexico. ______

c) the total number of carloads originating in Texas and moved to another destination in Texas and/or interchanged with another rail company in Texas. ______

* Note- all portions of the report are to be in the English language and submitted to TxDOT by May 1st of each year.
### EXHIBIT 3

#### EXHIBIT C -- NOTICES

<table>
<thead>
<tr>
<th>STATE</th>
<th>LESSEE</th>
</tr>
</thead>
</table>
| Texas Department of Transportation  
Attn: Executive Director  
125 East 11th Street  
Austin, Texas 78701-2483  
Telephone: 512-305-9501  
Facsimile: 512-305-9567 | Texas-Pacifico Transportation, Ltd.  
Attn: Sergio Ferrer  
Piso 10, Ave. Baja California No. 200  
Col. Roma Sur  
Deleg. Cuauhtemoc  
Mexico, D.F. 06760  
Telephone: 011-525-574-8440  
Facsimile: 011-525-574-8442 |
| with a copy to:  
Texas Department of Transportation  
Office of General Counsel  
125 East 11th Street  
Austin, Texas 78701-2483  
Telephone: 512-463-8630  
Facsimile: 512-475-3070 | with a copy to:  
Jaime Serra  
SAI Law & Economics  
Edificio Plaza Reforma Prol.  
Paseo de la Reforma No. 600-103  
Mexico, D.F. 01210  
Telephone: 011-525-259-6618  
Facsimile: 011-525-259-3928 |
| and a copy to:  
Michael S. Moehlman  
Baker Botts L.L.P.  
One Shell Plaza  
910 Louisiana  
Houston, Texas 77002  
Telephone: 713-229-1370  
Facsimile: 713-229-7770 |
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EXHIBIT 3
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STATE OF TEXAS §

COUNTY OF TRAVIS §

LEASE AND OPERATING AGREEMENT
between
THE STATE OF TEXAS
acting by and through the
TEXAS DEPARTMENT OF TRANSPORTATION
as Lessor and
TEXAS PACIFICO TRANSPORTATION, LTD.
as Lessee
REGARDING THE RAIL LINE BETWEEN SAN ANGELO JUNCTION AND PRESIDIO, TEXAS
AMENDMENT No. 1

THIS AMENDMENT IS MADE BY AND BETWEEN the State of Texas, acting through the TEXAS
DEPARTMENT OF TRANSPORTATION, hereinafter called the State, and TEXAS PACIFICO
TRANSPORTATION, herein after called “Lessee.”

WITNESSETH

WHEREAS, the State and the Lessee executed a contract on January 31, 2001, to lease and operate the
rail line between San Angelo Junction and Presidio, Texas; and,

WHEREAS, it has become necessary to amend that contract;

NOW THEREFORE, in consideration of the premises and of the mutual covenants and agreements of the
parties hereto, the State and the Lessee do agree as follows:

AGREEMENT

Article 1. Description of Amended Items

Paragraph 3.3 is amended by substituting the following sentence for the last sentence of the paragraph:
“Lessee shall have management and control of the operation and maintenance of the Rail Line, which
shall be carried out at the Lessee’s sole cost and expense, subject to the improvements contained in
Attachment A.”

Paragraph 3.9 is substituted as follows: “Notwithstanding anything to the contrary contained herein, with
regard to any obligation or duty of Lessee to improve, repair, maintain, or rehabilitate the Rail Line, the
State agrees and acknowledges that such obligations and duties of the Lessee shall not require Lessee to
take any action to improve or rehabilitate the Rail Line to a better condition than the condition of the Rail
Line as of the date of this Agreement, except as provided in Attachment A.”

Paragraph 3.10(a) and (b) are amended by adding the following sentence to the end of the paragraphs.
“The Lessee shall not receive reimbursement for the project identified in Attachment A.”

Paragraph 5.1 is amended by adding the following paragraphs to the end:

“Once, the line is open, as indicated by the provision of freight rail service to the border at Presidio, the
Lessee shall maintain the track at the FRA track classification that is in place at the time of the opening of
the line. If an unexpected event occurs or the infrastructure is allowed to deteriorate to a lower FRA track
classification, the Lessee shall have seven (7) days to notify the State of the unexpected event or
deterioration to a lower FRA track classification. The lessee shall have thirty (30) days from the date of the
occurrence to present a preliminary plan for correcting the deficiencies reported. The lessee will present
to the State a specific, detailed plan for correcting the deficiencies reported within forty-five (45) days of
the unexpected event or deterioration to a lower FRA track classification. The lessee and the State will
work cooperatively to finalize and approve a specific, detailed plan for correcting the deficiencies reported
with sixty (60) days of the unexpected event or deterioration to a lower FRA track classification. The plan
shall include a liquidated damages clause which shall be assessed not as a penalty, but as
reimbursement for costs to the State. The liquidated damages will be assessed by: (1) determining the
number of loaded freight cars that would have moved over the line if the tracks had been in service; and
(2) subtracting the number of freight cars that would have been diverted from another rail line if the tracks
had been in service; and, (3) calculating the number of trucks that would be needed to move the net
carloads of freight from this calculation over the highways. The number of trucks will then be used to
calculate pavement maintenance costs necessary due to the increased freight on the highways utilizing
Federal Highway Administration cost allocation methodologies, currently set at 12.7 ¢ per mile. The
liquidated damages clause shall only be assessed if TXPF, as the result of negligence, fails to perform the
agreed upon plan for correcting the deficiencies reported.”

Paragraph 7.2 is amended by adding the following sentence to the end of the entire paragraph. The
Lessee shall not receive reimbursement for any part of the project identified in Attachment A without
regard to the date of termination.

The provisions of Attachment A are incorporated into this agreement.

All other provisions of the original contract are unchanged and remain in full force and effect.

Article 2. Signatory Warranty

The signatories to this amendment warrant that each has the authority to enter into this agreement on
behalf of the organization they represent.

IN WITNESS WHEREOF, THE STATE AND THE LESSEE have executed duplicate counterparts to
effectuate this agreement.

STATE OF TEXAS
DEPARTMENT OF TRANSPORTATION

Executed by the Executive Director for the purpose and effect of activating and/or carrying out the orders,
established policies or work programs heretofore approved and authorized by the Texas Transportation
Commission.

By: Michael W. Behrens, P.E.
Executive Director

LESSEE
TEXAS PACIFICO GP, LLC, its General Partner

By: Manager
EXHIBIT 3
ATTACHMENT A

State Project No. 1

A.1. The Project is described as the improvement of the Rail Line by rehabilitating the main line between Paisano Junction and Presidio, including the installation of approximately 32,500 ties with associated securement, ballast, surfacing and other necessary work; rehabilitating the Fort Stockton Railyard, including the installation of approximately 5,000 ties with associated securement, ballast, surfacing and other necessary work; and the rehabilitation of the Nelson Street highway/rail grade crossing and the 5th Street highway/rail grade crossing in Fort Stockton, including the installation of concrete crossing panels on the main track and sidings, with associated tie replacement, securement, ballast, subgrade, surfacing and other necessary work (the Project).

A.2. The State will perform the environmental review for, contribute $5.5 million towards, contract for, and oversee the Project.

A.3. The Lessee will contribute:

(1) $990,000 (nine hundred and ninety thousand) toward the improvements which may be made in either in cash and/or in services (such as transporting materials), or in additional improvements to the rail line. These improvements may credited against the $990,000 (nine hundred and ninety thousand) if they meet the following criteria:

   (a) the Lessee had not been and will not be reimbursed by any source for the services;
   (b) the improvements are not ordinary maintenance;
   (c) the improvements are performed within two (2) years subsequent to the final execution of this Amendment to the Agreement; and
   (d) a notice of completion of work on the improvement is delivered to the State no later than thirty (30) calendar days after work is completed.

(2) maintenance in accordance with Paragraph 5.1 of this agreement.

Written documentation, suitable for audit, of the structural or improvement work completed or contracted for by Lessee, in relation to the above paragraph, shall be kept on file by the Lessee for four (4) years after completion of work or claims, lawsuits, or audits related thereto, whichever is longer. All services and additional improvements shall be informed in writing to the State, and the services may not exceed a total amount of $135,000. The state shall approve the invoices within 30 days, and such approval may not be reasonably withheld. Copies of the Lessee's requests for proposal, scope of work documentation, bid documentation, and contractual documents for rehabilitation or maintenance of the rail line shall be provided to TxDOT as soon as possible, but no later than forty-five (45) days after creation or receipt.

The balance of the $990,000 (nine hundred and ninety thousand) in improvements will be paid on the date that is two (2) years subsequent to the final execution of this Amendment.

A.4. Since TxDOT will own the Project and any additional improvements, TxDOT is responsible for repayment of any loans used to obtain funds for the rehabilitation of the rail line, unless Lessee, directly, obtains any loan for rehabilitation and/or improvement of the rail line.

A.5. The State will require the contractor for the Project to warrant the rehabilitation for a period of one (1) year. For work performed by TxDOT or its contractors, and/or any other work of rehabilitation and/or improvement of the rail line, Lessee will inspect the project upon completion of the Project and the works, and accept the work or reject the work after the expiration of the one (1) year warranty. Such acceptance shall not be unreasonably withheld. After acceptance, Lessee shall hold harmless and indemnify the contractor, the State and its officers, agents, and employees against any liability, loss, claim, or expense incurred that relates to or arises out of the Project.
LEASE AND OPERATING AGREEMENT
between
THE STATE OF TEXAS
acting by and through the
TEXAS DEPARTMENT OF TRANSPORTATION
as Lessor and
TEXAS PACIFICO TRANSPORTATION, LTD.
as Lessee
REGARDING THE RAIL LINE BETWEEN SAN ANGELO JUNCTION AND PRESIDIO,
TEXAS AMENDMENT No. 2

THIS AMENDMENT IS MADE BY AND BETWEEN the State of Texas, acting through the TEXAS
DEPARTMENT OF TRANSPORTATION, hereinafter called the "State", and TEXAS PACIFICO
TRANSPORTATION, herein after called "Lessee."

WITNESSETH

WHEREAS, the State and the Lessee executed a contract on January 31, 2001, to lease and operate
the rail line between San Angelo Junction and Presidio, Texas; and,

WHEREAS, it has become necessary to amend that contract;

NOW THEREFORE, in consideration of the premises and of the mutual covenants and agreements
of the parties hereto, the State and the Lessee do agree as follows:

AGREEMENT

Article 1. Description of Amended Items

Paragraph 3.3 is amended by substituting the following sentence for the last sentence of the
paragraph: "Lessee shall have management and control of the operation and maintenance of the Rail
Line, which shall be carried out at the Lessee's sole cost and expense, subject to the improvements
contained in Attachment A of Amendment No. 1 and Attachment A of Amendment No. 2."

Paragraph 3.9 is substituted as follows: "Notwithstanding anything to the contrary contained herein,
with regard to any obligation or duty of Lessee to improve, repair, maintain, or rehabilitate the Rail
Line, the State agrees and acknowledges that such obligations and duties of the Lessee shall not
require Lessee to take any action to improve or rehabilitate the Rail Line to a better condition than the
condition of the Rail Line as of the date of this Agreement, except as provided in Attachment A of
Amendment No. 1 and Attachment A of Amendment No. 2."

Paragraph 3.10(a) and (b) are amended by adding the following sentence at the end of each of those
paragraphs. "The Lessee shall not receive reimbursement for the projects identified in Attachment A
of Amendment No. 1 and Attachment A of Amendment No. 2."
EXHIBIT 3

Paragraph 7.2 is amended by adding the following sentence to the end of the entire paragraph. "The Lessee shall not receive reimbursement for any part of the project identified in Attachment A of Amendment No. 1 and Attachment A of Amendment No. 2 without regard to the date of termination.

The provisions of Attachment A are incorporated into this agreement.

All other provisions of the original contract and Amendment No. 1 are unchanged and remain in full force and effect.

Article 2. Lessee’s Compliance with Amendment No. 1

The State and Lessee agree that Lessee’s obligation under Amendment No. 1 to contribute to the State in the amount of $990,000.00 has been reduced to $910,000.00 as stated in a letter from TxDOT to TXPF dated August 20, 2007. The State and Lessee agree that the Lessee’s obligation under Amendment No. 1 shall be satisfied when Lessee submits to the State an executed copy of this Amendment No. 2 and payment of $910,000.00 (nine hundred and ten thousand dollars) by check or warrant. The Lessee agrees to continue to comply with the remaining requirements in Amendment No. 1.

Article 3. Signatory Warranty

The signatories to this amendment warrant that each has the authority to enter into this agreement on behalf of the organization they represent.

IN WITNESS WHEREOF, THE STATE AND THE LESSEE have executed duplicate counterparts to effectuate this agreement.

STATE OF TEXAS
DEPARTMENT OF TRANSPORTATION

Executed by the Executive Director for the purpose and effect of activating and/or carrying out the orders, established policies or work programs heretofore approved and authorized by the Texas Transportation Commission.

By: Amadeo Saenz, Jr., P.E.
Executive Director

Date: 10/31/07

LESSEE
TEXAS PACIFICO GP, LLC, its General Partner

By: [Signature]
Manager

Date: 10/10/07
AMENDMENT NO. 2
ATTACHMENT A

A. 1. The State shall improve the Rail Line by additional rehabilitation of the railroad infrastructure (the "Project"). The Project shall consist of installing ties with associated securement, ballast, surfacing and other work. The State shall first consult with Lessee prior to selecting the work to be performed, but otherwise the nature and termini of the work shall be determined by the State.

A. 2. The State shall perform the environmental review for, contribute $212,355.58 towards, contract for, and oversee the Project.

A. 3. The Lessee shall pay $910,000.00 (nine hundred and ten thousand dollars) by check or warrant to the State upon executing the Amendment. The check or warrant shall be made payable to "Texas Department of Transportation Trust Fund." The State will deposit the funds in an escrow account to be managed by the State, to be applied only to the Project.

A. 4. The State will require the contractor for the Project to warrant the rehabilitation work for a period of one year, commencing upon the State's acceptance of the Project work. The Lessee will then be given the opportunity to inspect the work. The Lessee may accept or reject the work within the warranty period. Any disagreements or disputes regarding the condition of the Project or the acceptance of the work shall be resolved in accordance with Article 4.4 of the Lease and Operating Agreement. Upon the expiration of the warranty period, the Lessee will no longer have the right to dispute the work. After the earlier of Lessee's acceptance of the work or the expiration of the warranty period, the Lessee shall hold harmless and indemnify the contractor, the State and its officers, agents, and employees against any liability, loss, claim, or expense incurred that relates to or arises out of the Project.
STATE OF TEXAS  §
COUNTY OF TRAVIS  §

AGREEMENT
between
THE STATE OF TEXAS
acting by and through the
TEXAS DEPARTMENT OF TRANSPORTATION
as Lessor and
TEXAS PACIFICO TRANSPORTATION, LTD.
as Lessee
REGARDING THE ESTABLISHMENT OF A VEGETATION CONTROL PLAN
AMENDMENT No. 3

THIS AGREEMENT IS MADE BY AND BETWEEN the State of Texas, acting through the TEXAS DEPARTMENT OF TRANSPORTATION, hereinafter called the State, and TEXAS PACIFICO TRANSPORTATION, herein after called "Lessee."

W I T N E S S E S T H

WHEREAS, the State and the Lessee executed a contract on January 31, 2001, to lease and operate the rail line between San Angelo Junction and Presidio, Texas; and,

WHEREAS, the Federal Railroad Administration has taken exception to excessive vegetation at various locations along the rail line on numerous occasions; and,

WHEREAS, on July 17, 2007, the State declared the Lessee to be in default of the Lease and Operating Agreement due to excessive vegetation along the rail line, as well as other issues of default; and,

WHEREAS, the State has agreed to allow the Lessee to correct the excessive vegetation issue of default by implementing an acceptable Vegetation Control Plan (the "Plan"); and,

WHEREAS, it has therefore become necessary to amend the contract between the State and the Lessee to provide for the acceptance of the Plan by the State and the Lessee;

NOW THEREFORE, in consideration of the premises and of the mutual covenants and agreements of the parties hereto, the State and the Lessee agree as follows:

A G R E E M E N T

Article 1. Description of Amended Items

Paragraph 3.3 is amended by adding the following at the end of the paragraph: “Lessee shall implement and comply with the Vegetation Control Plan (the "Plan"), as that term is defined in Attachment A of Amendment No. 3.”
Paragraph 3.4 is amended by adding the following at the end of the first sentence: "Lessee agrees to implement and comply with the Vegetation Control Plan (the "Plan") and to provide adequate routine inspection of existing and emergent vegetation and to provide for the control and removal of vegetation as provided for the Plan.

All other provisions of the original contract and Amendment No. 1 and Amendment No. 2 to the original contract are unchanged and remain in full force and effect.

Article 2. Signatory Warranty

The signatories to this amendment warrant that each has the authority to enter into this agreement on behalf of the organization they represent.

IN WITNESS WHEREOF, THE STATE AND THE LESSEE have executed duplicate counterparts to effectuate this agreement.

STATE OF TEXAS
DEPARTMENT OF TRANSPORTATION

Executed by the Executive Director for the purpose and effect of activating and/or carrying out the orders, established policies or work programs heretofore approved and authorized by the Texas Transportation Commission.

By: Amadeo Saenz, Jr., P.E.
Executive Director

Date: 12/14/07

LESSEE
TEXAS PACIFICO GP, LLC, its General Partner

By: Manager

Date: 14/12/07
The Lessee shall implement an annual Vegetation Control Plan in accordance with the following tasks:

1) The Lessee's roadmaster(s), track inspector(s), or other qualified personnel will inspect for excessive vegetation on the rail line, bridges, switch areas, train crew walking areas, city limit right of way areas, and roadway – rail grade crossing areas. An inspection of each such area shall occur no less frequently than once a week. The person making an inspection will report the vegetation conditions to their supervisor, and recommend the application of herbicides or cutting of vegetation as appropriate.

2) A supervisor shall promptly record the weekly inspection reports and forward them to the Lessee’s management;

3) Each year the Lessee shall apply herbicides along the entire rail line between March 15 and April 20;

4) Each year the Lessee shall spray herbicides and cut vegetation under bridges, and around switches and train crew walking areas, no less often than every 10 weeks, beginning with the second week of March and ending the third week of December;

5) The Lessee shall cut vegetation within city limits as required by city ordinances, or when a weekly inspection shows it is necessary for the safe operation of rail facilities or activities outside the rail right of way;

6) The Lessee will clear vegetation along the rail line within 250 feet on all sides of each roadway – rail grade crossing intersection. The vegetation clearing at an intersection shall be completed when a weekly inspection shows it is necessary for the safe operation of rail facilities or activities outside the rail right of way, but no less often than once per calendar year;

7) When a weekly inspection report shows that vegetation at a location prevents the safe operation of rail facilities or activities outside the rail right of way, the Lessee shall perform vegetation cutting and apply herbicides at the location no later than four weeks after the initial inspection;

8) The Lessee shall submit to the State records which show herbicide applications and vegetation cutting. The records showing such activities occurring in a calendar quarter shall be submitted to the State no later than ten days after the end of the quarter.
POTENTIAL ECONOMIC IMPACTS OF AN IMPROVED SOUTH ORIENT RAILROAD

Prepared for:
Fort Stockton Economic Development Corporation
P.O. Box C
1000 Railroad Avenue
Austin, Texas 79735

Prepared by:
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11500 Metric Boulevard, Bldg. M-1, Ste. 150
Austin, Texas 78758
Tel. 512-821-2081
www.alliance-transportation.com

December 30, 2007
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INTRODUCTION

Originally conceived to form the shortest connection between the central United States and Asia, the South Orient Railroad (SORR) has always been an idea that has generated interest and promise. Traversing through West Texas and northwestern Mexico to the Port of Topolobampo, construction on the SORR began in 1904 but its connection to the Pacific was not completed until 1961. Chronically low traffic volumes throughout much of its existence have challenged the SORR’s profitability and its attractiveness as a transportation corridor. This condition has been primarily due to its servicing remote locations of West Texas and Northwestern Mexico, while avoiding major gateway cities along the U.S.-Mexico border where economic activity is most concentrated. However, as the transportation infrastructure at these gateway corridors has become more congested, logistics planners have begun to consider alternate routes that would permit the faster movement of goods. Additionally, high levels of congestion at Pacific coast ports in the United States are leading carriers to consider new transportation corridors that will allow Asian trade to move relatively unhindered into the United States. Under such circumstances, the underutilized status of the SORR has become a growing asset rather than a detriment, but its aged infrastructure does not allow it to operate at desirable levels. The purpose of this study is to furnish evidence of the potential economic benefits that could accrue to the State of Texas, if infrastructure improvements were made to the SORR.

This report has been prepared by Alliance Transportation Group, Inc. (ATG) under the sponsorship and direction of the Fort Stockton Economic Development Corporation (FSEDC). With the FSEDC’s understanding and support, ATG has prepared the analysis in this report using conservative assumptions, so as not to inflate the project’s economic impacts. A sensitivity analysis was also performed to clarify the effect of certain assumptions on the baseline models’ results. In short, the FSEDC believes that an economic impact analysis based upon conservative assumptions will be a far more useful tool to policymakers than one with overly optimistic assumptions, which may exaggerate the project’s benefits.

METHODOLOGY

The economic impact analysis for this study consisted of four components. The first component was to identify the impact area of the proposed improvements to the South Orient Railroad. Second, identify which commodities might become cargo on the railroad and estimate the number of cars per year. Third, develop estimates of the direct economic impact of the various rail-related activities that the South Orient is expected to generate. Finally, enter these estimates into the economic impact analysis software called IMPLAN to generate estimates of the proposed project’s impacts. The following paragraphs describe the execution of each of these efforts.

Defining the Impact Areas

Two impact areas were defined for this study; a regional project impact area consisting of the 34 counties shown in Table 1 and a statewide impact area. IMPLAN databases were acquired for both impacts areas and models were constructed and estimated over five annual forecast periods starting in 2009 and ending in 2013. The estimates of direct output entered into the model were those activities which physically occurred in either the regional project impact area.
or within the state of Texas. The economic impact forecast did not account for economic activity related to the South Orient Railroad that might occur in other U.S. states or in Mexico.

Table 1: Counties Included in the Regional Project Impact Area

<table>
<thead>
<tr>
<th>Andrews</th>
<th>Irion</th>
<th>Rennells</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brewster</td>
<td>Jeff Davis</td>
<td>Schleicher</td>
</tr>
<tr>
<td>Brown</td>
<td>Johnson</td>
<td>Somervell</td>
</tr>
<tr>
<td>Coleman</td>
<td>Lipscomb</td>
<td>Sutton</td>
</tr>
<tr>
<td>Comanche</td>
<td>Martin</td>
<td>Tarrant</td>
</tr>
<tr>
<td>Concho</td>
<td>McLennan</td>
<td>Terrell</td>
</tr>
<tr>
<td>Crane</td>
<td>Midland</td>
<td>Tom Green</td>
</tr>
<tr>
<td>Crockett</td>
<td>Ochiltree</td>
<td>Upton</td>
</tr>
<tr>
<td>Ector</td>
<td>Pecos</td>
<td>Ward</td>
</tr>
<tr>
<td>Erath</td>
<td>Presidio</td>
<td>Winkler</td>
</tr>
<tr>
<td>Hansford</td>
<td>Reagan</td>
<td></td>
</tr>
<tr>
<td>Hood</td>
<td>Reeves</td>
<td></td>
</tr>
</tbody>
</table>

Identifying Future Cargoes
The future cargoes used for the impact analysis were identified from a variety of sources, but primarily from a 2005 report produced by the Center for Transportation Research (CTR) at the University of Texas at Austin (see Table 2). During this study, CTR researchers collected data on shippers who had enquired about shipping freight on the SORR and were provided a rate quote by the staff at the Texas Pacifico Railroad. Information on other possible cargoes was collected from FSEDC staff and its advisors. These data were updated once more during October 2007. Although the Texas Pacifico Railroad is moving cargo on the SORR, the absence of track improvements has meant there is no sure means to know exactly how much cargo would move, if improvements were made. Therefore, the estimates of future rail car activity were based upon these prior requests for price quotes. This snapshot view of the potential market for the railroad, along with additional traffic later identified by staff from the FSEDC, was used to create a proxy for future traffic volumes. Obviously, some of these cargoes will materialize and some will not, but there will also be future inquiries and users that are not captured by the current analysis. Thus, while the estimates of future use are speculative, they are assumed to reflect the likely rail volume on the South Orient, once improvements to the rail are made for it to operate at sufficient speeds and tonnage.

Cargo Volumes
As the cargo types were identified, estimates were also collected for the anticipated number of rail cars, which is expected to grow from 7,233 rail cars during Year 1 to 64,712 rail cars during Year 5. Table 3 shows the rail car traffic anticipated for the SORR by commodity by year. Grain from the Texas Grain railroad and automobile-related traffic were expected to become major components of the total commodity flow starting in Year 3, accounting for roughly 75 percent of the SORR’s total rail traffic. Other important contributors to the total rail car volume are expected to be hot house tomatoes and vegetables grown in Mexico, scrap metal, limestone aggregate, cottonseed, drilling fluids, and wind turbines.
Table 2: Projected Commodities on the SORR

<table>
<thead>
<tr>
<th>Commodity Transported</th>
<th>Direction</th>
<th>Description of Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limestone Aggregate</td>
<td>Northbound</td>
<td>Mined in Pecos County and railed to Fort Worth</td>
</tr>
<tr>
<td>Gravel</td>
<td>Northbound</td>
<td>Mined in Pecos County and railed to Fort Worth</td>
</tr>
<tr>
<td>Alfalfa Hay</td>
<td>Southbound</td>
<td>50% grown in Texas-50% grown outside of Texas railed to Mexico</td>
</tr>
<tr>
<td>Phosphorus</td>
<td>Northbound</td>
<td>Mined in Mexico and railed to San Angelo</td>
</tr>
<tr>
<td>Processed Livestock Feed</td>
<td>Southbound</td>
<td>Produced in Fort Worth and railed to Fort Stockton</td>
</tr>
<tr>
<td>Diesel Fuel</td>
<td>Southbound</td>
<td>Produced in Texas and railed to Fort Stockton</td>
</tr>
<tr>
<td>Bentonite/Humite</td>
<td>Northbound</td>
<td>Mined in Brewster County and railed to Houston for transhipment to barge</td>
</tr>
<tr>
<td>Whole Corn &amp; Milo</td>
<td>Southbound</td>
<td>100% grown in Texas and railed to Mexico</td>
</tr>
<tr>
<td>Cottonseed</td>
<td>Southbound</td>
<td>100% grown in Texas and railed to Mexico</td>
</tr>
<tr>
<td>Hot House Tomatos</td>
<td>Northbound</td>
<td>Grown in Mexico and railed to Fort Worth</td>
</tr>
<tr>
<td>Rubber</td>
<td>Southbound</td>
<td>Railed from Ohio to Chihuahua</td>
</tr>
<tr>
<td>Ceramic Tile</td>
<td>Northbound</td>
<td>Produced in Chihuahua and railed to Fort Stockton (50%) and Fort Worth (50%)</td>
</tr>
<tr>
<td>Masa</td>
<td>Northbound</td>
<td>Produced in Mexico and railed to Fort Worth</td>
</tr>
<tr>
<td>Feed Grains</td>
<td>Southbound</td>
<td>100% grown in Texas and railed to Mexico</td>
</tr>
<tr>
<td>Scrap Metal</td>
<td>Southbound</td>
<td>Consolidated in Fort Stockton and railed to Mexico</td>
</tr>
<tr>
<td>Drilling Fluids</td>
<td>Southbound</td>
<td>Produced in Fort Worth and railed to Fort Stockton</td>
</tr>
<tr>
<td>Clay</td>
<td>Southbound</td>
<td>Mined in East Texas and railed to Mexico</td>
</tr>
<tr>
<td>Calcium Carbonate</td>
<td>Northbound</td>
<td>Mined in Torreon and railed to Fort Worth</td>
</tr>
<tr>
<td>Assorted Vegetables</td>
<td>Northbound</td>
<td>Grown in Sinola, Mexico and railed to Fort Worth</td>
</tr>
<tr>
<td>Cement</td>
<td>Northbound</td>
<td>Sent from Mexico to Fort Worth for distribution</td>
</tr>
<tr>
<td>Food Products - South</td>
<td>Southbound</td>
<td>Consolidated in Fort Stockton (50%) and Fort Worth (50%) and sent to Mexico</td>
</tr>
<tr>
<td>Food Products - North</td>
<td>Northbound</td>
<td>Sent from Mexico to Fort Worth for distribution</td>
</tr>
<tr>
<td>Automobile Parts</td>
<td>Northbound</td>
<td>Landed at Topolobampo, Mexico and railed to San Antonio, Texas</td>
</tr>
<tr>
<td>Automobile Parts</td>
<td>Southbound</td>
<td>Origins unknown, sent to maquiladoras in Mexico</td>
</tr>
<tr>
<td>Automobiles</td>
<td>Northbound</td>
<td>Landed in Mexico and sent to distribution centers in the United States</td>
</tr>
<tr>
<td>Modular Homes</td>
<td>Southbound</td>
<td>Modular home components shipped for assembly in Fort Stockton</td>
</tr>
<tr>
<td>Solar Panels</td>
<td>Southbound</td>
<td>Solar panels shipped to Fort Stockton for installation</td>
</tr>
<tr>
<td>Windmill Blades and Towers</td>
<td>Southbound</td>
<td>Windmill blades and towers shipped to Pecos County for installation</td>
</tr>
<tr>
<td>Oilfield Pipe</td>
<td>Southbound</td>
<td>Shipped for oilfield use</td>
</tr>
<tr>
<td>Texas Grain Railroad</td>
<td>Southbound</td>
<td>Grain exported to Mexico from Texas and the Midwestern United States</td>
</tr>
</tbody>
</table>

Source: Derived from data reported by CTR, 2005 and FSEDC, 2005 and 2007.
Table 3: Projected Annual Rail Car Volumes on the SORR by Commodity - Year 1 through Year 5

<table>
<thead>
<tr>
<th>Commodity Transported</th>
<th>Rail Cars Year 1</th>
<th>Rail Cars Year 2</th>
<th>Rail Cars Year 3</th>
<th>Rail Cars Year 4</th>
<th>Rail Cars Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limestone Aggregate</td>
<td>650</td>
<td>650</td>
<td>650</td>
<td>650</td>
<td>650</td>
</tr>
<tr>
<td>Gravel</td>
<td>650</td>
<td>650</td>
<td>650</td>
<td>650</td>
<td>650</td>
</tr>
<tr>
<td>Alfalfa Hay</td>
<td>120</td>
<td>240</td>
<td>480</td>
<td>960</td>
<td>960</td>
</tr>
<tr>
<td>Phosphorus</td>
<td>3</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Processed Livestock Feed</td>
<td>150</td>
<td>175</td>
<td>200</td>
<td>225</td>
<td>250</td>
</tr>
<tr>
<td>Diesel Fuel</td>
<td>260</td>
<td>260</td>
<td>260</td>
<td>390</td>
<td>390</td>
</tr>
<tr>
<td>Bentonite/Humite</td>
<td>200</td>
<td>250</td>
<td>300</td>
<td>350</td>
<td>400</td>
</tr>
<tr>
<td>Whole Corn &amp; Milo</td>
<td>750</td>
<td>800</td>
<td>850</td>
<td>900</td>
<td>950</td>
</tr>
<tr>
<td>Cottonseed</td>
<td>500</td>
<td>700</td>
<td>900</td>
<td>1,100</td>
<td>1,300</td>
</tr>
<tr>
<td>Hot House Tomatos</td>
<td>150</td>
<td>150</td>
<td>1,500</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>Rubber</td>
<td>20</td>
<td>100</td>
<td>200</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Ceramic Tile</td>
<td>0</td>
<td>200</td>
<td>200</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Masa</td>
<td>0</td>
<td>0</td>
<td>50</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Feed Grains</td>
<td>500</td>
<td>600</td>
<td>700</td>
<td>800</td>
<td>900</td>
</tr>
<tr>
<td>Scrap Metal</td>
<td>200</td>
<td>275</td>
<td>350</td>
<td>425</td>
<td>500</td>
</tr>
<tr>
<td>Drilling Fluids</td>
<td>200</td>
<td>800</td>
<td>1,600</td>
<td>1,600</td>
<td>1,600</td>
</tr>
<tr>
<td>Clay</td>
<td>0</td>
<td>0</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Calcium Carbonate</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Assorted Vegetables</td>
<td>600</td>
<td>1,110</td>
<td>1,520</td>
<td>1,520</td>
<td>1,520</td>
</tr>
<tr>
<td>Cement</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Food Products - South</td>
<td>400</td>
<td>400</td>
<td>625</td>
<td>625</td>
<td>625</td>
</tr>
<tr>
<td>Food Products - North</td>
<td>400</td>
<td>400</td>
<td>625</td>
<td>625</td>
<td>625</td>
</tr>
<tr>
<td>Automobile Parts</td>
<td>0</td>
<td>0</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Automobile Parts</td>
<td>0</td>
<td>0</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Automobiles</td>
<td>0</td>
<td>0</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Modular Homes</td>
<td>80</td>
<td>80</td>
<td>80</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Solar Panels</td>
<td>0</td>
<td>300</td>
<td>350</td>
<td>400</td>
<td>450</td>
</tr>
<tr>
<td>Windmill Blades and Towers</td>
<td>200</td>
<td>400</td>
<td>600</td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td>Oilfield Pipe</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Texas Grain Railroad</td>
<td>0</td>
<td>0</td>
<td>33,800</td>
<td>33,800</td>
<td>33,800</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>7,233</strong></td>
<td><strong>9,746</strong></td>
<td><strong>62,746</strong></td>
<td><strong>64,156</strong></td>
<td><strong>64,712</strong></td>
</tr>
</tbody>
</table>

Source: Derived from data reported by CTR, 2005 and FSEDC, 2005 and 2007.
Commodity Prices
The commodity prices used in the economic impact analysis were derived from a variety of sources, which included: documents from the U.S. Geological Survey (USGS), the U.S. Department of Agriculture (USDA), the Wall Street Journal, the Mineral PriceWatch newsletter, and generalized estimates by the FSEDC and ATG staff. Table 4 provides the assumed value of each commodity in the study, as well as its unit of measurement. Commodity prices were kept constant throughout the forecast period, because of unpredictable fluctuations that normally occur due to supply and demand.

Table 4: Assumed Values of Commodities Transported on the SORR

<table>
<thead>
<tr>
<th>Commodity Transformed</th>
<th>Unit of Measurement</th>
<th>Assumed Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limestone Aggregate</td>
<td>Ton</td>
<td>$7.75</td>
</tr>
<tr>
<td>Gravel</td>
<td>Ton</td>
<td>$6.15</td>
</tr>
<tr>
<td>Alfalfa Hay</td>
<td>Bale – 4’x8’x4’</td>
<td>$160.00</td>
</tr>
<tr>
<td>Phosphorus</td>
<td>Ton</td>
<td>$27.78</td>
</tr>
<tr>
<td>Processed Livestock Feed</td>
<td>Ton</td>
<td>$104.00</td>
</tr>
<tr>
<td>Diesel Fuel</td>
<td>Gallon</td>
<td>$2.27</td>
</tr>
<tr>
<td>Bentonite/Humite</td>
<td>Ton</td>
<td>$47.00</td>
</tr>
<tr>
<td>Whole Corn &amp; Milo</td>
<td>Bushel</td>
<td>$3.05</td>
</tr>
<tr>
<td>Cottonseed</td>
<td>Ton</td>
<td>$187.00</td>
</tr>
<tr>
<td>Hot House Tomatos</td>
<td>Pound</td>
<td>$0.43</td>
</tr>
<tr>
<td>Rubber</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Ceramic Tile</td>
<td>Pound</td>
<td>$0.50</td>
</tr>
<tr>
<td>Masa</td>
<td>Pound</td>
<td>$0.22</td>
</tr>
<tr>
<td>Feed Grains</td>
<td>Ton</td>
<td>$97.56</td>
</tr>
<tr>
<td>Scrap Metal</td>
<td>Ton</td>
<td>$275.00</td>
</tr>
<tr>
<td>Drilling Fluids</td>
<td>Barrel</td>
<td>$336.20</td>
</tr>
<tr>
<td>Clay</td>
<td>Ton</td>
<td>$31.00</td>
</tr>
<tr>
<td>Calcium Carbonate</td>
<td>Ton</td>
<td>$135.00</td>
</tr>
<tr>
<td>Assorted Vegetables</td>
<td>Pound</td>
<td>$0.35</td>
</tr>
<tr>
<td>Cement</td>
<td>Ton</td>
<td>$98.00</td>
</tr>
<tr>
<td>Food Products - South</td>
<td>Pound</td>
<td>$.50</td>
</tr>
<tr>
<td>Food Products - North</td>
<td>Pound</td>
<td>$.50</td>
</tr>
<tr>
<td>Automobile Parts</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Automobile Parts</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Automobiles</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Modular Homes</td>
<td>Dwelling Unit</td>
<td>$90,000.00</td>
</tr>
<tr>
<td>Solar Panels</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Windmill Blades and Towers</td>
<td>Windmill</td>
<td>$350,000.00</td>
</tr>
<tr>
<td>Oilfield Pipe</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Texas Grain Railroad - Corn</td>
<td>Bushel</td>
<td>$3.05</td>
</tr>
</tbody>
</table>

Note: Commodities that are denoted with an “n/a” are only transshipped through Texas.

Estimating the Direct Economic Impacts
The estimation of the SORR’s future economic impacts required the consideration of various factors that produce direct impacts on economic growth. Because the IMPLAN model only accounts for a project’s backward linkages to the economy and not its forward linkages, it is the responsibility of the analyst to identify and predict these forward linkages so that they can be entered into the IMPLAN model. In the case of the SORR, the activities forecasted to produce
forward linkages were commodity production stimulated by new demand, the storage and
distribution of goods, rail transportation, truck transportation, and new facility construction.
Given the difficult and seemingly infinite assertions that could be made about forward linkages,
this study chose not to extend these linkages any further than the immediate activities prior to or
after a shipment. The sections below provide a brief explanation of how the direct impacts were
measured.

New Production
New production was defined as economic activity directly stimulated by the improvements to the
SORR, but which would not exist without it. The analysis assumed that only a portion of the
commodities carried on the SORR would be stimulated by the railroad’s improvement, with the
remainder being a redirection of existing supply. In the case of limestone aggregate, gravel,
bentonite, and scrap metal commodities, their production is almost entirely dependent upon the
railroad being improved, so the entire value was included. However, the new output for goods
already in production, namely agricultural products, was assumed at a rate of 20 percent of the
total amount shipped.

Consolidation, Distribution, and Storage
Many of the commodities imported from Mexico or shipped to and from Fort Stockton will
require consolidation, storage, and distribution. These activities require physical infrastructure,
namely warehouses or yards and equipment, as well as staff to operate and maintain the
facilities. The study assumed between 1 and 5 percent of the commodities’ total estimated value
would account for this expense and this figure was entered into the model as an additional direct
economic impact.

Rail Transportation
Rail transportation costs were entered into the IMPLAN model as a direct economic impact and
as a single figure for each forecast year. The cost of rail transport for the individual commodities
obviously depends upon the distance they must travel. For rail cars traversing the SORR
trackage, the cost of doing so is relatively straightforward. During 2007, the Texas Pacifico
Railroad’s tariff divided the track into the three zones: San Angelo Junction to San Angelo, San
Angelo to Alpine Junction, and Alpine Junction to Presidio. The charge for moving between
zones varies with the distance and the type of cargoes moved. The cost for moving general
cargoes within or between zones ranged from $612 to $859 per rail car. The cost for moving
grain cars was slightly lower, $550 to $773. Rail car movements along any segment of the Fort
Worth & Western Railroad (FWWR) between San Angelo Junction and Fort Worth were $1,000
during its 2007 tariff. Shipments moved between Presidio and Fort Worth (the entire distance)
had a discounted rate of $1,404. For points beyond, estimates were gathered from the Union
Pacific Railroad’s online rate finder, with the assumption that cars would be transferred at Alpine
Junction (although this currently does not happen). The Union Pacific Railroad’s rates for short
hauls within Texas tended to be very high, which is not surprising since railroads are generally
not competitive with trucks for distances less than 500 miles. However, given the difficulties of
parsing out which economic impacts of these fees belong in Texas and which in other states, this
analysis only considered rail expenditures on the SORR and FWWR. Finally, the estimates of
rail transportation costs did include fuel surcharges ($0.16 per mile per car), but did not include
switching charges or any other fees that a shipper might typically accrue during rail transport.
Truck Transportation
The complete movement of a good from producer to customer frequently requires that it be transferred several times between modes. Many goods moved by railroad must be carried short distances by truck to and from the railhead. Firms specializing in local drayage frequently serve this need, but short haul trucking tends to be expensive. This is especially true when compared to long haul trucking, because there are fewer miles to spread out the operators’ fixed costs. This analysis assumed that short haul truckers would charge $5.00 per mile for deliveries to and from the railhead. Much higher rates were assumed for the movement of solar arrays and wind turbines, because of their size and the complexities of moving them. Estimates of the distance were made according to the type of commodity being moved, with finished products being transported to warehouses assumed to travel short distance, while raw materials or products being delivered directly to customers were often assumed to travel longer distances.

New Facilities
Some of the cargoes that were assumed to be carried on the South Orient Railroad will require the construction of new facilities for the distribution and consolidation of goods and the purchasing of new equipment to handle them. There are also plans to construct a solar panel manufacturing facility in Ft. Stockton, if adequate rail service can be obtained. Table 5 shows which commodities were assumed to need facilities and equipment for consolidation or distribution and the estimated cost of these facilities. The direct impact of $22,000,000 was applied to the first year of analysis. The cost of improving the railroad, which is estimated at to be at least $100.0 million, was also applied to the first year model although these expenditures would actually occur during an earlier period.

Table 5: Assumed Consolidation and Distribution Facilities Required for the SORR’s Traffic

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Facility</th>
<th>Estimated Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limestone Aggregate/Gravel</td>
<td>Equipment and Consolidation Yard</td>
<td>$500,000</td>
</tr>
<tr>
<td>Diesel Fuel</td>
<td>Fuel Distribution Facility</td>
<td>$250,000</td>
</tr>
<tr>
<td>Ceramic Tile</td>
<td>Regional Distribution Center</td>
<td>$375,000</td>
</tr>
<tr>
<td>Scrap Metal</td>
<td>Equipment and Consolidation Yard</td>
<td>$500,000</td>
</tr>
<tr>
<td>Food Products-Southbound</td>
<td>Regional Distribution Center</td>
<td>$375,000</td>
</tr>
<tr>
<td>Solar Panels</td>
<td>Manufacturing Facility</td>
<td>$20,000,000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$22,000,000</td>
</tr>
</tbody>
</table>

Estimating Total Economic Impact using the IMPLAN Model
The IMPLAN software is a frequently used tool for estimating the economic impacts of projects by government agencies, academic institutions, and the private sector. The software was originally developed for the U.S. Forest Service but has since become proprietary and is now distributed by the Minnesota IMPLAN Group, Inc. The IMPLAN software is a computerized input-output model, which predicts the impacts of new economic activity on the remainder of a study area’s economy.

To perform the economic impact analysis, the direct economic impacts identified above were entered into the IMPLAN software. Additional adjustments were made to deflate the figures to 2006 prices, to assume IMPLAN’s estimates of local consumption, and to assume that all direct
impacts were categorized as commodities. Once entered, the model produced estimates of direct, indirect, induced, and total output, employment, and tax revenue.

**STUDY FINDINGS**

Compared to the $100 million construction cost of upgrading the South Orient Railroad, the IMPLAN model predicted that the proposed investment would quickly pay for itself in terms of economic output and jobs. The sections below show the results of the IMPLAN model for the 34-county region and the State of Texas.

**Regional Impact**

The direct economic impact of the project on the 34-county region was predicted to be $153.7 million during Year 1 (see Table 6). This impact includes all the expenditures related to upgrading the SORR and constructing the facilities described in Table 5, in addition to rail and truck expenditures and stimulated economic activity. During Year 2, prior to the anticipated automobile-related rail traffic and the Texas Grain Railroad's operations, the direct impact of the SORR dips to $48.1 million. However, starting in Year 3, the direct output jumps to $105.8 million and then grows modestly to $113.0 million during Year 5. Total regional output was expected to be $233.7 million during Year 1, falling to $67.3 million in Year 2. By Year 5, the total regional output of the SORR is expected to be $158.8 million.

*Table 6: Estimated Regional Economic Impact of the Improved South Orient Railroad – Direct, Indirect, Induced, and Total Output*

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct Output</th>
<th>Indirect Output</th>
<th>Induced Output</th>
<th>Total Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$153,774,368</td>
<td>$29,540,551</td>
<td>$50,474,483</td>
<td>$233,789,403</td>
</tr>
<tr>
<td>2</td>
<td>48,152,169</td>
<td>7,737,545</td>
<td>11,417,036</td>
<td>67,306,750</td>
</tr>
<tr>
<td>3</td>
<td>105,823,506</td>
<td>17,710,433</td>
<td>25,920,585</td>
<td>149,454,523</td>
</tr>
<tr>
<td>4</td>
<td>111,871,411</td>
<td>18,632,615</td>
<td>27,367,140</td>
<td>157,871,166</td>
</tr>
<tr>
<td>5</td>
<td>113,082,835</td>
<td>18,582,560</td>
<td>27,168,035</td>
<td>158,833,429</td>
</tr>
</tbody>
</table>

The proposed rail improvements are expected to create more than 1,100 jobs within the region during Year 1; falling to approximately 218 jobs during Year 2 (see Table 7). Year 5 direct employment is anticipated to be almost 440 jobs. Total regional employment, including direct, indirect, and induced employment, is predicted to be approximately 1,800 jobs during Year 1, falling to roughly 370 jobs during Year 2. During Year 5, total employment is anticipated to increase to more than 800 jobs. Readers should note that after Year 3, the number of jobs generated by the project is relatively constant and represents more or less permanent employment.
Table 7: Estimated Economic Impact of the Improved South Orient Railroad on the Study Area – Direct, Indirect, Induced, and Total Employment

<table>
<thead>
<tr>
<th></th>
<th>Direct Employment</th>
<th>Indirect Employment</th>
<th>Induced Employment</th>
<th>Total Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>1,146.8</td>
<td>213.7</td>
<td>443.0</td>
<td>1,803.4</td>
</tr>
<tr>
<td>2</td>
<td>218.7</td>
<td>54.5</td>
<td>100.2</td>
<td>373.4</td>
</tr>
<tr>
<td>3</td>
<td>406.3</td>
<td>124.4</td>
<td>227.5</td>
<td>758.2</td>
</tr>
<tr>
<td>4</td>
<td>440.8</td>
<td>131.0</td>
<td>240.2</td>
<td>812.0</td>
</tr>
<tr>
<td>5</td>
<td>438.6</td>
<td>130.6</td>
<td>238.4</td>
<td>807.6</td>
</tr>
</tbody>
</table>

Improvements to the South Orient Railroad are also expected to create positive impacts to the local, state, and national tax base. The model anticipates that the total local, state, and federal tax revenue generated within the region will be $23,901,457 during Year 1, falling to $6,009,626 in Year 2 and increasing to $15,125,017 by Year 5 (see Table 8).

Table 8: Estimated Economic Impact of the Improved South Orient Railroad on the Study Area – Federal, State, and Local Taxes

<table>
<thead>
<tr>
<th></th>
<th>Employee Compensation</th>
<th>Proprietary Income</th>
<th>Household Expenditures</th>
<th>Corporations</th>
<th>Indirect Business Tax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>$7,425,823</td>
<td>$808,197</td>
<td>$8,101,205</td>
<td>$2,197,927</td>
<td>$5,568,305</td>
<td>$23,901,457</td>
</tr>
<tr>
<td>2</td>
<td>1,820,079</td>
<td>131,960</td>
<td>1,831,758</td>
<td>759,699</td>
<td>1,466,130</td>
<td>6,009,626</td>
</tr>
<tr>
<td>3</td>
<td>4,336,662</td>
<td>225,546</td>
<td>4,157,720</td>
<td>2,176,196</td>
<td>3,656,062</td>
<td>14,552,186</td>
</tr>
<tr>
<td>4</td>
<td>4,546,646</td>
<td>249,734</td>
<td>4,389,907</td>
<td>2,233,587</td>
<td>3,811,987</td>
<td>15,231,862</td>
</tr>
<tr>
<td>5</td>
<td>4,513,185</td>
<td>248,056</td>
<td>4,357,971</td>
<td>2,215,940</td>
<td>3,789,864</td>
<td>15,125,017</td>
</tr>
</tbody>
</table>

State of Texas

Table 9 shows the results of the proposed project’s impacts on the state of Texas. Based upon the methodology and assumptions described above, the IMPLAN model predicts that improvements to the SORR will produce a direct output of $170.9 million during Year 1, falling to $78.3 million during Year 2, and then rising to $186.1 million in Year 5. The total output figures for the state of Texas are also strong, starting at $272.2 million during the first year, falling to $120.0 million during Year 2, and then growing to $281.0 million by Year 5.
Table 9: Estimated Economic Impact of the Improved South Orient Railroad on the State of Texas – Direct, Indirect, Induced, and Total Output

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct Output</th>
<th>Indirect Output</th>
<th>Induced Output</th>
<th>Total Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$170,945,856</td>
<td>$39,493,665</td>
<td>$61,857,217</td>
<td>$272,296,738</td>
</tr>
<tr>
<td>2</td>
<td>78,334,957</td>
<td>17,722,663</td>
<td>23,985,759</td>
<td>120,043,379</td>
</tr>
<tr>
<td>3</td>
<td>166,606,261</td>
<td>37,520,516</td>
<td>47,769,643</td>
<td>251,896,421</td>
</tr>
<tr>
<td>4</td>
<td>184,965,351</td>
<td>41,496,156</td>
<td>53,969,444</td>
<td>280,430,950</td>
</tr>
<tr>
<td>5</td>
<td>186,165,793</td>
<td>41,384,416</td>
<td>53,511,897</td>
<td>281,062,103</td>
</tr>
</tbody>
</table>

The IMPLAN model predicted approximately 1,234 jobs created statewide during the first year as a result of direct expenditures and 720 additional jobs created due to indirect and induced employment (see Table 10). Following the dip in Year 2, direct employment is expected to rise from 900 jobs in Year 3 to 1,020 jobs in Year 5. Total employment between Year 3 and Year 5, is expected to grow from approximately 1,480 jobs to 1,669 jobs.

Table 10: Estimated Economic Impact of the Improved South Orient Railroad on the State of Texas – Direct, Indirect, Induced, and Total Employment

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct Employment</th>
<th>Indirect Employment</th>
<th>Induced Employment</th>
<th>Total Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,234.4</td>
<td>229.6</td>
<td>490.8</td>
<td>1,954.7</td>
</tr>
<tr>
<td>2</td>
<td>466.1</td>
<td>98.7</td>
<td>190.3</td>
<td>755.1</td>
</tr>
<tr>
<td>3</td>
<td>899.0</td>
<td>202.4</td>
<td>379.0</td>
<td>1,480.4</td>
</tr>
<tr>
<td>4</td>
<td>1,026.1</td>
<td>225.9</td>
<td>428.2</td>
<td>1,680.1</td>
</tr>
<tr>
<td>5</td>
<td>1,020.0</td>
<td>225.4</td>
<td>424.6</td>
<td>1,669.9</td>
</tr>
</tbody>
</table>

The effects of the improved South Orient on the State’s tax base will also be strong. Total local, state, and federal tax contributions from the project are predicted to be $27.0 million during Year 1, falling to $11.0 million during Year 2, and then rising to $25.7 million by Year 5 (see Table 11). Indirect business taxes and employee compensation taxes will contribute the greatest share of the total.

Table 11: Estimated Economic Impact of the Improved South Orient Railroad on the State of Texas – Federal, State, and Local Taxes

<table>
<thead>
<tr>
<th>Year</th>
<th>Employee Compensation</th>
<th>Proprietary Income</th>
<th>Household Expenditures</th>
<th>Corporations</th>
<th>Indirect Business Tax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$8,170,997</td>
<td>$963,199</td>
<td>$8,911,339</td>
<td>$2,652,151</td>
<td>$6,324,345</td>
<td>$27,022,032</td>
</tr>
<tr>
<td>2</td>
<td>3,243,064</td>
<td>346,238</td>
<td>3,455,495</td>
<td>1,291,042</td>
<td>2,728,465</td>
<td>11,064,304</td>
</tr>
<tr>
<td>3</td>
<td>6,603,788</td>
<td>636,665</td>
<td>6,881,980</td>
<td>3,155,266</td>
<td>5,977,761</td>
<td>23,255,461</td>
</tr>
<tr>
<td>4</td>
<td>7,407,128</td>
<td>738,904</td>
<td>7,775,134</td>
<td>3,401,624</td>
<td>6,598,453</td>
<td>25,921,243</td>
</tr>
<tr>
<td>5</td>
<td>7,340,054</td>
<td>734,200</td>
<td>7,709,215</td>
<td>3,379,040</td>
<td>6,555,543</td>
<td>25,718,051</td>
</tr>
</tbody>
</table>
Sensitivity Analysis

To assess the credibility of the IMPLAN model results and to account for potential contingencies, one sensitivity exercise was performed, which assumed no automobile-related or Texas Grain Railroad traffic within the forecast horizon. Because this traffic is not expected to materialize until Year 3, the impacts on output, employment and taxes do not begin until that period. The elimination of the automobile-related and Texas Grain Railroad traffic reduced economic output by roughly one-third at the regional level and roughly one-quarter at the State level (see Table 12 and Table 13). One might expect the decline to have been greater, since these cargoes account for 75 percent of the forecasted rail cars. However, because the automobile-related rail cars simply pass through Texas or to a factory in San Antonio, there are no opportunities for additional warehousing, short haul trucking, or value-added production. Likewise, much of the grain traffic was assumed to be pass-through freight and most of this volume was assumed to be existing supply that was redirected to new markets rather than new production.

Table 12: Comparison of Forecasted Output in the Study Region – Baseline Scenario vs. Scenario 1 Impacts

<table>
<thead>
<tr>
<th>Year</th>
<th>DIRECT OUTPUT</th>
<th>INDIRECT OUTPUT</th>
<th>TOTAL OUTPUT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Baseline</td>
<td>Scenario 1</td>
<td>Difference</td>
</tr>
<tr>
<td>1</td>
<td>$153,774,368</td>
<td>$153,774,368</td>
<td>--</td>
</tr>
<tr>
<td>2</td>
<td>48,152,169</td>
<td>48,152,169</td>
<td>--</td>
</tr>
<tr>
<td>3</td>
<td>105,823,506</td>
<td>65,650,753</td>
<td>-40,172,753</td>
</tr>
<tr>
<td>5</td>
<td>113,082,835</td>
<td>74,903,061</td>
<td>-38,179,774</td>
</tr>
</tbody>
</table>

Table 13: Comparison of Forecasted Output in the State of Texas – Baseline Scenario vs. Scenario 1 Impacts

<table>
<thead>
<tr>
<th>Year</th>
<th>DIRECT OUTPUT</th>
<th>INDIRECT OUTPUT</th>
<th>TOTAL OUTPUT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Baseline</td>
<td>Scenario 1</td>
<td>Difference</td>
</tr>
<tr>
<td>1</td>
<td>$170,945,856</td>
<td>$170,945,856</td>
<td>--</td>
</tr>
<tr>
<td>2</td>
<td>78,334,957</td>
<td>78,334,957</td>
<td>--</td>
</tr>
<tr>
<td>4</td>
<td>184,965,351</td>
<td>128,283,989</td>
<td>-56,681,362</td>
</tr>
</tbody>
</table>
Table 14 and Table 15 show a comparable effect on employment during the sensitivity test. Regional employment growth stimulated by the SORR drops by approximately one-third regionally and statewide employment increases are roughly 30 percent lower.

**Table 14: Comparison of Forecasted Employment in the Study Region – Baseline Scenario vs. Scenario 1 Impacts**

<table>
<thead>
<tr>
<th>Year</th>
<th>DIRECT EMPLOYMENT Baseline</th>
<th>Scenario 1</th>
<th>Difference</th>
<th>INDIRECT EMPLOYMENT Baseline</th>
<th>Scenario 1</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,146.8</td>
<td>1,146.8</td>
<td>--</td>
<td>213.7</td>
<td>213.7</td>
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**Table 15: Comparison of Forecasted Employment in the State of Texas – Baseline Scenario vs. Scenario 1 Impacts**

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<th>INDIRECT EMPLOYMENT Baseline</th>
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<td>164.2</td>
<td>-61.2</td>
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**CONCLUSIONS**

The economic impact analysis performed for this study demonstrates that improvements to the SORR will produce benefits that will significantly exceed the costs. These benefits will accrue to all segments of the economy, from workers to companies to government. The fairly consistent output after Year 3 at the regional and state level also means that the job creation and the expanded output is more or less permanent and is not simply the product of the initial investment. The sensitivity analysis also confirms that job creation and output will occur at desirable levels, even if important assumptions do not materialize. Thus, given the positive benefits that could accrue as a result of improvements to the SORR, funding the project now will
capitalize on existing prospects before potential users lose interest and this opportunity to promote economic growth in rural West Texas disappears.
REFERENCES


Harrison, R., Bomba, M., and Resor, R. Rail Capacity and Market Demand on the South Orient Railway. Center for Transportation Research, University of Texas at Austin. 2005.


Minnesota IMPLAN Group, Inc., IMPLAN System (data and software), 1725 Tower Drive West, Suite 140, Stillwater, MN 55082 www.implan.com

Texas Department of Transportation. Texas Rail System Plan. Texas Department of Transportation: Austin, 2005.


Williams, Roy. Personal communication. 18 November 2005.
Figure 1: Map of the South Orient Railroad and its Connection to the Pacific Ocean
Mr. Saenz,

Attached are the two unsolicited proposals per our earlier conversations. We appreciate this opportunity to continue our relationship with TxDOT to move the South Orient Rail forward.

Sincerely,

[Signature]

Ross Jones
President, Pecos County Rural Rail Transportation District
UNSOLICITED PROPOSALS TO THE TEXAS DEPARTMENT OF TRANSPORTATION FROM THE PECOS COUNTY RURAL RAIL DISTRICT TO REHABILITATE THE SOUTH ORIENT RAILROAD

The Pecos County Rural Rail District (PCRRD) is attempting to bring about timely improvements to the South Orient Railroad (SORR) so it can serve existing industrial expansion in Pecos County and serve as a catalyst for future regional economic development. Under the State of Texas's ownership, improvements to the SORR's deteriorated infrastructure have been delayed or deferred due to insufficient funds, which has led to lost economic development opportunities for the West Texas region and uncertainty for prospective clients. The PCRRD is leading a group of local governments that wish to assist an entity with the financial resources and intent to perform the needed rehabilitation of the SORR. This document contains two unsolicited proposals for the Texas Department of Transportation (TxDOT) that request either funding for the rehabilitation of the SORR or the disposition of the SORR to an individual or group of private investors, a public entity, or a public-private partnership with a contractual commitment to make the improvements. Both of these options are discussed below in greater detail.

Option A – The State of Texas Maintains Ownership of the SORR

Option A proposes a partnership in which the State of Texas, represented by TxDOT, maintains ownership of the SORR, but partners with a public or private entity either under a Comprehensive Development Agreement (CDA) or a long-term lease to rehabilitate and maintain the SORR. To date, TxDOT's stated preference for improving the SORR has been to enter into a CDA, since this option would use funds from the private sector or a public-private partnership to pay for rehabilitating the railroad while committing limited or no public funding. Under these conditions, TxDOT would enter into a long-term agreement with a developer (a maximum of 50 years but possibly extended to a longer period by the Texas Legislature). The developer would be responsible for upgrading the railroad and maintaining it and the developer would earn revenue from operating the railroad and any other revenue generated by its assets. While this type of agreement has worked fairly well for highway projects, there are concerns that it is not a feasible option for the SORR. This is primarily because the cost of rehabilitating the entire length of the SORR is relatively high (roughly $150 million) and will require maintenance expenditures of $3 to $8 million annually. Additionally, from the perspective of potential investors, the project is somewhat speculative with the primary benefits from improving the railroad accruing to the West Texas economy. In an attempt to measure the viability of a CDA arrangement, the PCRRD contacted a very large, international infrastructure investment firm with substantial rail experience about its possible interest in the SORR. The firm's feedback was a general interest in the railroad, but skeptical about the project's viability as a CDA. As a result, while it is most advantageous for TxDOT to develop the SORR under a
COA, it seems unlikely that any private investors will perceive the project as being feasible within an acceptable amount of risk. Additionally, even if an agreement could be reached, it is unlikely that a COA for the SORR would generate a cash windfall for TxDOT (or any windfall for that matter) comparable to the upfront cash payments generated by CDAs for highway projects.

As a result of these circumstances, the PCRRO believes the best option for developing the SORR is to acquire funds from state and federal sources as grants and loans. While a number of possible funding options for rail rehabilitation have been identified in the Texas Rail System Plan, probably the most appropriate options for the SORR would be the Federal Rail Administration's Rail Rehabilitation and Improvement Financing (RRIF) program. This program provides loans for rail rehabilitation and improvements for private and publicly owned railroads, such as the SORR. To access these funds, it would likely be necessary for TxDOT to become a guarantor to any loan, since the amount needed would likely exceed the value of the SORR’s assets. Other funding options would be loans from the State Infrastructure Bank (SIB) or ear-marked funds from the Texas Legislature. While pass-through payments could be considered as a partial funding mechanism for the railroad, it would not be feasible for the PCRRO or any other local government entity to sell enough bonds to improve the railroad on its own. It may also be possible to raise some funds under public-private partnerships from the firms that would benefit directly from the rehabilitation of the SORR, but this option has not yet been fully explored.

One opportunity for lowering the cost of improvements to the SORR is to implement the improvements in a piecemeal fashion, so the resources are allocated where the payback period would be the shortest. Originally, the goal was to upgrade the track of the entire railroad at once, so it would be possible to immediately pursue clients along the entire length of the SORR, as well as to develop linkages with customers in Mexico. However, since the burning of the SORR bridge crossing at Presidio earlier this year and no clear timeline for its replacement, it does not seem necessary to pursue improvements to the entire rail line immediately. Additionally, there is presently an urgent need to deliver cargoes by rail to Fort Stockton, but there is not an immediate need to service areas south of Fort Stockton. Therefore, the current proposal is to make improvements to the SORR in phases, based upon the demand for service, which would minimize the initial need for capital. Under this proposal, the first phase of the improvements would be for the rail segment between San Angelo Junction and Fort Stockton. The second phase of the improvements would be between Fort Stockton and Alpine (SORR’s intersection with the Union Pacific (UP) railroad). The third phase would be between Alpine and Presidio, which would include replacement of the international rail bridge.
Another opportunity for lowering the cost of improvements is to scrap outdated and inadequate sections of track and other assets to pay for the new improvements. By scrapping old steel track and equipment, TxDOT could make a direct cash contribution to the SORR's rehabilitation without directing funds from other needed transportation projects. Finally, it may also be possible to generate revenue from the SORR's right-of-way from activities outside of those directly related to the SORR's operations, such as providing a right-of-way for utilities. These funds could be used to pay back loans and offset ongoing maintenance costs.

With the rehabilitation of the track, the PCRRD could enter into a lease with TxDOT to market and operate the railroad. The PCRRD, in partnership with the Fort Stockton Economic Development Corporation (FSEDC), has a proven and long-standing interest in the SORR and has already raised $5 million in federal funds for improvements to the SORR. The PCRRD has also worked tirelessly to expand the SORR's customer base, as means of local economic development. The PCRRD would also be able to extract value from the SORR right-of-way and could hire additional rail expertise. The current operator of the SORR, Texas Pacifico Railroad, may or may not be maintained. It is presently delinquent in the performance of its duties, including replacement of the destroyed bridge over the Rio Grande River and providing cost quotes to potential customers on a timely basis. A different and more responsive operator would likely lead to an increase in the amount of revenue generated by the railroad and new customers.

**Option B – State of Texas Releases Its Ownership of the SORR**

If TxDOT is unable to acquire or commit to adequate funding for improvements to the SORR within a reasonable timeframe, then the PCRRD urges the State of Texas to sell or transfer ownership of the railroad to an entity with the desire and resources to begin immediate rehabilitation. Under this scenario, the SORR might be sold to a group of private investors, sold or transferred to the PCRRD, or sold or transferred to a public-private partnership. In such an agreement, the new owner would be required to make significant investments to upgrade the track and provide a high quality of service to customers along the SORR. In addition to providing their own funding, the new owner would have the option of scrapping old infrastructure to finance improvements and to generate income from other activities in the right of way. As an incentive to the State of Texas to sell or transfer ownership of the SORR, the purchaser would offer the State a modest royalty, based upon the railroad's realized annual car volume. Additionally, the contract could include a clause to return the SORR to the State of Texas, if rail service was halted.
Next Steps

Over the upcoming months, the PCRRO will maintain and strengthen its partnerships with existing and future shippers and local and state government entities. The PCRRO is presently working to develop more specific estimates of the SORR’s needs and opportunities. In the near future, an experienced rail consulting firm will be retained to develop more accurate estimates of rehabilitation and maintenance costs for the SORR. Additionally, estimates of operating costs will also be calculated, along with the estimated scrap value of the outdated track and equipment. These future activities reflect a continued commitment by the PCRRO to develop the SORR. The PCRRO-FSEDC partnership has already spent approximately $400,000 of local funds for the benefit of the SORR through marketing, consultant studies, and travel to meetings and conferences. In addition to building customer interest in and use of the SORR, these efforts have produced $5 million of federal funding. The PCRRO is committed to making the SORR a success and is vested in the railroad’s future. The PCRRO wants TxDOT to be our partner and is committed to the better of the two options described above that will bring about the timely rehabilitation of the SORR.
### Assumptions:

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<td>Monthly pmt =</td>
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| 10 yr total | $2,644,717 | $5,289,433.91 | $7,934,151 |
| 25 yr total | $8,411,152 | $16,822,304.56 | $25,233,457 |

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| 8,411,152 | $16,822,305 | $25,233,457 |

Operations on the SORR are currently unprofitable. This table determines revenues realized if a surcharge ($100, $200, or $300) was added to each car and used exclusively for repayment of a rehabilitation loan. A 3% reasonable traffic growth is assumed. Interest rates are set low at 3.5%. Year 1 carloads are based on the average of 2005, 2006, & 2007. Revenues are inadequate.