23. This Agreement shall be effective only upon approval by the ICC, and upon entry of an appropriate order by the ICC, the substance of which shall be satisfactory to KCT-DRC, finding and ordering that all expenses and liability incurred by KCT-DRC under or as a result of this agreement shall be compensable costs of directed service under 49 U.S.C. 11125.

KANSAS CITY TERMINAL
RAILWAY COMPANY as Directed
Rail Carrier of the Chicago,
Rock Island and Pacific Railroad

By:_____
President

ST. LOUIS SOUTHWESTERN
RAILWAY COMPANY

By:_____

FINANCE DOCKET NO. 28640 (SUB-NO. 5)

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY REORGANIZATION (PLANS OF REORGANIZATION)

Decided March 19, 1980

Plan of reorganization for the Chicago, Milwaukee, St. Paul and Pacific Railroad Company filed by (a) the debtor's trustee and (b) New Milwaukee Lines, and plan of liquidation for the debtor filed by Chicago Milwaukee Corporation and Chicago, Milwaukee, St. Paul and Pacific Railroad Company, found not to meet the requirements of section 77 of the Bankruptcy Act, 11 U.S.C. 205, and disapproved, without prejudice to continuation of the proceeding and submission of new or revised plans. Jurisdiction retained for such further action as may be necessary and appropriate.

Honorable Warren G. Magnuson, United States Senate (Washington).

Honorable John Melcher, United States Senate (Montana).

Honorable Max Baucus, United States Senate (Montana).

Honorable Thomas L. Judge, Governor, State of Montana.

Honorable William J. Janklow, Governor, State of South Dakota.

Honorable Thomas S. Foley, United States House of Representatives (Washington).

Honorable Ron Marlenee, United States House of Representatives (Montana).

Honorable Norman D. Dicks, United States House of Representatives (Montana).

Honorable Pat Williams, United States House of Representatives (Montana).

Honorable Neil Goldschmidt, Secretary, United States Department of Transportation.

Honorable Lowell B. Jackson, Secretary, Wisconsin Department of Transportation.

Jonn W. Rowe for Richard B. Ogilvie, trustee of the property of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

James Wickwire, O. Yale Lewis, Jr., Thomas J. Brewer, B. Gerald Johnson, R. Lawrence McCaffrey, Jr., Peter A. Gilbertson, Robert

H. Diaz, Jr., W. Stuart Parsons, and *Michael H. Schaalman* for the Milwaukee Lines.

James H. Falk, Jerome B. Simon, M. Michael Monahan, and *Leonard Gesas* for Chicago Milwaukee Corporation and Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

Leo Graybill, Jr., and *James C. Hardman* for Montana Citizens Freight Rate Association.

Linda Heller Kamm, Diane R. Liff, and *Lawrence A. Friedman* for the United States Department of Transportation.

T. Scott Bannister and *Martha Martell* for the Iowa Department of Transportation.

Warren Spannaus, Gilbert S. Buffington, and *Sherri Y. Alston* for the Minnesota Department of Transportation.

Mike Greely for the State of Montana.

James C. Wiles, and *Jacob P. Billig,* and *Mark J. Fritz* for the State of South Dakota.

William G. Mahoney for the Railway Labor Executives' Association.

Jerome A. Frazel, William J. Holloway, and *Michael J. Leech* for Chicago Title & Trust Company.

Susan Getzendanner for Continental Illinois National Bank and Trust Company of Chicago.

Edmund J. Kenny and *James A. Vroman* for The First National Bank of Chicago.

Robert B. Chatz, John J. Enright, John W. Costello, and *Jeffrey R. Liebman* for Girard Bank.

Wilbur C. Delp, Jr., and *George A. Platz* for Harris Trust and Savings Bank.

Earl Yaffe for Wayne Hummer & Co.

Dickson R. Loos for Aluminum Company of America.

Martin A. White for Western Energy Company.

Aden C. Adams for Ford Motor Company.

James Scott for Peavy Company.

George Lilley for Scott Paper Company.

H. E. Franklin for Puget Sound Traffic Association.

C. Barry Schaefer for Union Pacific Railroad Company.

Sander M. Bieber for PLM, Inc.

DECISION

BY THE COMMISSION:

On December 19, 1977, following losses (apart from subsidiary earnings) of approximately $105 million in the 3 preceding years,

the Chicago, Milwaukee, St. Paul and Pacific Railroad Company (Milwaukee) filed a petition for reorganization pursuant to section 77 of the Bankruptcy Act, 11 U.S.C. 205. The petition was filed with the United States District Court for the Northern District of Illinois, Eastern Division (court), in proceedings designated No. 77 B 8999. On January 19, 1978, the court appointed Mr. Stanley E.G. Hillman as trustee for the Milwaukee, and we ratified the appointment on February 9, 1978. In June of 1979, Mr. Hillman indicated that upon qualification of a successor he would resign the trusteeship. The court appointed Mr. Richard B. Ogilvie trustee on July 13, 1979, and we ratified the appointment on August 20, 1979.

Several plans, each prescribing a different future for the Milwaukee, have been submitted. The matter was set for handling on a written record, statements and replies were filed, and oral argument was held. This decision sets forth our determinations regarding the various proposals.

BACKGROUND

Despite the protection of reorganization proceedings, the Milwaukee continued to suffer enormous losses after filing its petition, about $82 million in 1978 and $118 million in 1979 (both figures apart from earnings of subsidiaries). On April 23, 1979, the trustee petitioned the court to embargo all lines outside a "core" system which he believed to have the best potential for long-term viability. The court denied the embargo request on June 1, 1979, concluding that it lacked the power to authorize a cessation of service.

The trustee's "core" system had evolved from work performed by the consulting firm Booz, Allen & Hamilton, Inc. (BAH). In early 1978, the trustee commissioned BAH to conduct planning studies and evaluate rehabilitation requirements, work which would aid the trustee in determining whether all or part of the Milwaukee might become viable. BAH began with a preliminary analysis of 33 system configurations (constructed by dividing the Milwaukee into segments representing major gateways or traffic producing areas, and putting the segments together in various combinations). After reviewing the preliminary analysis, BAH recommended a detailed analysis of particular systems, subsequently conducted indepth studies on eight configurations. Those studies, set forth in BAH's three-volume report "The Milwaukee Road Stategic Planning Studies" (May 1979) (BAH Study), served as the primary guide for the trustee's plan of reorganization.

On August 10, 1979, the trustee filed his reorganization plan with the court, and for a second time requested embargo for all lines outside of his "core" system, now called "Milwaukee II." The trustee filed his plan with us on September 28, 1979, and on October 3, 1979, the Association to Save Our Railroad Employment (SORE, an association of Milwaukee employees working on the railroads' western lines) and New Milwaukee Lines (NewMil, a coalition of various Milwaukee employees and shippers, joined by representatives of several northern tier States) submitted separate plans to reorganize the railroad. Subsequently, indenture trustees for certain Milwaukee creditors filed a motion for a summary determination that the trustee's plan is prima facie impracticable.

The court granted the trustee's second embargo request on September 27, 1979, effective November 1, 1979. In response to the Milwaukee's critical financial situation, Congress enacted emergency legislation intended to provide temporarily for continued service over the railroad's entire system.[1] Despite the emergency congressional action, adequate funds were not provided to maintain operations over the Milwaukee's entire system beyond the November 1, 1979 embargo date. The railroad ceased all operations outside Milwaukee II on that date pursuant to an order of the court. We were prepared to, but because of pending congressional action did not, direct temporary service over the embargoed lines.

On November 4, 1979, the President signed into law the Milwaukee Railroad Restructuring Act (MRRA).[2] Section 6 of that act provided an opportunity for an association composed of representatives of national railway labor organizations, employee coalitions, and shippers (or any combination of these) to submit to us a plan to convert all or a substantial part of the Milwaukee into an employee or employee-shipper-owned company. The legislation required us to approve the plan if we found it feasible.

On December 1, 1979, NewMil submitted an employee-shipper ownership plan pursuant to section 6 of the MRRA. Pending action regarding that proposal, we held in abeyance any decision respecting proceedings in the instant reorganization. On December 31, 1979, in Finance Docket No. 29171, *Richard B. Ogilvie, Trustee of the Property of Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Submissions Under Section 6 of the Milwaukee Railroad*

[1]H. J. Res. 412, section 115, Public Law 96-86, 93 Stat. 656, 662 (1979).
[2]Public Law 96-101, 93 Stat. 736 (1979).

Restructuring Act (*MRRA* case), we found that NewMil's MRRA plan was not feasible, thereby revitalizing the previously filed reorganization plans.

Section 7(d) of the MRRA provides that the Secretary of Transportation shall guarantee trustee certificates in an amount necessary to finance operations over the entire Milwaukee system for 60 days after (a) an event described in section 22(b) of that act or (b) April 1, 1980, whichever first occurs. Our determination in the *MRRA* case was an event described in section 22(b), meaning that loan guarantees for continued operation of the entire Milwaukee system need only be made to finance service until March 1, 1980. Further, section 18 of the MRRA precludes us from directing service over the Milwaukee until April 1, 1981.

Recognizing the need to proceed expeditiously, on January 3, 1980, we established a procedure to govern our consideration of the Milwaukee reorganization proposals. The procedure provided for the filing of any reorganization plans not then before us, and for the submission of initial and reply statements. In the January 3, 1980, decision and notice we also denied the motion to find the trustee's plan prima facie impracticable.

NewMil filed an amended reorganization plan on January 17, 1980. Also on that date, the Chicago Milwaukee Corporation (CMC, a holding company which owns the vast majority of the Milwaukee's outstanding capital stock) and the Milwaukee submitted a plan to liquidate the railroad, and the Montana Citizens Freight Rate Association (MCFRA, a shipper organization) made a number of proposals which it believes may be useful. On February 1, 1980, the Section of Rail Services Planning of our Office of Policy and Analysis (RSP) released its independent study of the trustee, NewMil, and CMC plans.

On February 25, 1980, the court authorized a third embargo request by the trustee. The Milwaukee ceased operations over a large portion of its lines (including the northern tier mainline and appurtenant trackage west of a point near Missoula, MT) effective March 1, 1980. Most other lines outside Milwaukee II (including those between Miles City and Missoula) are to be embargoed effective April 1, 1980. A prolonged cessation of operations on the western lines is likely to preclude implementation of any restructuring proposals which would embrace the Milwaukee's northern tier route. Consequently, we have proceeded expeditiously to determine whether any of the reorganization plans presently before us meet the requirements of section 77 of the Bankruptcy Act, 11 U.S.C. 205.

Many members of Congress, several State Governors, the trustee, NewMil, CMC, MCFRA, the United States Department of Transportation, a number of States and State agencies, various creditor representatives, several labor organizations, and a variety of shipper and other interests have appeared at oral argument or filed statements or letters in this proceeding. Included in the trustee's initial statement are certain modifications to portions of his original reorganization plan. Included with NewMil's reply statements are motions to strike the RSP study and the amendments to the trustee's plan.

SORE has not prosecuted its reorganization plan and we shall not further consider that proposal. The MCFRA proposals, although potentially important, do not constitute a separate plan to reorganize the Milwaukee. Our inquiry thus focuses upon the trustee's reorganization plan, the NewMil reorganization plan, and the CMC liquidation plan.

PROCEDURAL MATTERS

RSP study.—By our order served January 21, 1980, we directed RSP to prepare an independent study of the plans to reorganize the Milwaukee. In its motion to strike, NewMil states that the study shows a bias for the trustee and an ignorance of the record, rendering it both valueless and prejudicial. NewMil argues that, because the RSP study was prepared after consultation with Milwaukee staff but no similar consultation with NewMil representatives, the results are tainted by ex parte communications of Commission employees expected to participate in the decisionmaking process.

NewMil has misconstrued the role of RSP, under both our January 21, 1980 order and our General Rules of Practice. Rule 101, 49 CFR 1100.101 (1978), provides that we may request RSP's assistance in evaluation, analysis, fact finding, planning, taking evidence, and receiving views and comments, and that we may "designate such additional procedures as *** necessary to insure the expedited resolution" of complex proceedings. Our order requested such assistance, and stated that the "study and findings *** shall represent only the conclusions of the Rail Services Planning Staff, and not necessarily those of this Commission."

The arguments of NewMil go to the weight rather than the admissibility of the study. RSP complied with both our order and rule 101, and has played no role in the decisionmaking process. Its study will remain in the record.

Trustee's amendments.—As noted above, we established a schedule for this proceeding on January 3, 1980. We directed that reorganization plans not previously submitted be filed by January 17; initial statements in support or opposition be filed by February 1; and replies be filed by February 11. Oral argument was subsequently set for and held on February 26.

As we also noted, the trustee's initial statement contains modifications to his original plan. NewMil's motion to strike argues that the modifications constitute amendments so substantial that admitting them and adhering to the schedule as originally set would deny the parties an opportunity to comment on the trustee's plan, and thus deny them due process.

NewMil points out that we have the discretion to dismiss any pleading for failure to meet prescribed time limits. See rule 102, 49 CFR 1100.102 (1978). We also have the responsibility to exercise our discretion in such a manner as to insure fairness to the parties and the public. We are determined to handle this proceeding expeditiously, but, because of the Milwaukee's dynamic circumstances, we have considered all material filed. It is imperative that the parties be able to present us with all pertinent information, including plans which are as complete, accurate, and current as possible. We shall deny NewMil's motion to strike the trustee's modifications to his reorganization plan.

LINES WEST ABANDONMENT PROCEEDING

In the late summer of 1978, the trustee announced his determination that the Milwaukee could no longer afford to operate as a transcontinental railroad. He intended ultimately to relinquish service on the railroad's western lines. The original cutoff point apparently was Butte, MT, but this subsequently changed to Minneapolis-St. Paul, MN, and eventually to Miles City, MT.

On August 8, 1979, the trustee filed an application seeking to abandon all lines and discontinue all operations west of Miles City (with the exception of trackage rights between Miles City and Billings, MT). The proceeding was designated AB-7 (Sub-No. 86) *(Lines West Abandonment)*. Determining that an early resolution of the matter was in the best interest of the public, we established an expedited procedure and conducted extensive hearings, endeavoring to reach a decision by early January 1980.[3]

[3]Finance Docket No. 29078, *Stanley E. G. Hillman, Trustee of the Property of Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Request for Expedited Handling of* (footnote continued on next page)

The MRRA changed our function regarding Milwaukee abandonments by transferring jurisdiction to the court and according an advisory role to us. Rather than issue a decision in the *Lines West Abandonment,* we were to provide the court with both the record of our proceeding and a report of our findings.

On January 29, 1980, we concluded that the presently structured Milwaukee could continue its operations west of Miles City only by incurring a massive rehabilitation outlay (conservatively estimated at $91 million) and significantly increased maintenance expenses, costs which would not be borne by anticipated revenue growth. We also found, however, that a differently structured system, with access to different capital sources, market opportunities, or cost efficiencies, might operate the involved lines without an unreasonable burden. Since certain restructuring plans (those of SORE and NewMil) would embrace the lines west, we recommended that, to permit full consideration of all proposals, the court should withhold authorization for abandonment (and, if operations become impossible, authorization for sale or dismantlement) of the track pending disposition of reorganization.[4]

In establishing an expedited procedure for and instituting an investigation of the *Line West Abandonment,* we announced our intention to consider the evidence presented in that proceeding in evaluating the various reorganization plans.[5] The extensive record developed in the *Lines West Abandonment* includes much information relating to the entire Milwaukee system, and thus valuable to this proceeding. We have used that record in reaching our decision here.

THE MILWAUKEE SYSTEM

Until recently, the Milwaukee operated approximately 9,800 route miles of track in 16 States. Its sprawling system extended from Chicago, IL, north through Milwaukee, WI, to Ontonogan, MI: south and east to Louisville, KY; south and west to Kansas City,

(footnote 3 continued)
Abandonment, and AB-7 (Sub-No. 86), *Stanley E. G. Hillman, Trustee of the Property of Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Abandonment—Portions of Pacific Coast Extension in Montana, Washington, and Oregon* (not printed), decided August 22, 1979, 44 F.R. 50974 (1979).

[4]AB-7 (Sub-No. 86) *Richard B. Ogilvie, Trustee of the Property of Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Abandonment—Portions of Pacific Coast Extension in Montana, Idaho, Washington, and Oregon* (not printed), decided January 29, 1980.

[5]Finance Docket No. 29078 and AB-7 (Sub-No. 86) (unprinted decision of August 22, 1979) at p. 6, 44 F.R. 50974, 50976 (1979)

MO; west to Omaha, NE, and Rapid City, SD; and north and west to Minneapolis-St. Paul, MN. From the Twin Cities, the Milwaukee's lines reached north to Duluth, MN; south to Kansas City; and west across the northern tier to Seattle and Tacoma, WA, and Portland, OR.

Through the 1960's and 1970's, the Milwaukee did not adequately maintain its physical plant. Crosstie renewal declined from 800,000 in 1975 to 500,000 in 1958, 400,000 in 1960, and 300,000 through the remainder of the 1960's. By December 31, 1978, deferred maintenance on the railroad had reached $578.4 million. In its analysis of the system, BAH estimated that, excluding light density lines, rehabilitation of the Milwaukee trackage would cost $482 million (1977 dollars). At the time of the partial embargo, much of the Milwaukee's system was subject to slow orders, was at or below Federal Railroad Administration (FRA) class I (maximum 10 miles per hour) track safety standards,[6] was weight restricted or restricted against hazardous materials, and had inordinately (and uncompetitively) high transit times.

The Milwaukee's locomotive and car fleets have also fallen into deep disrepair. Its locomotive bad order ratio (the ratio of locomotives prohibited from operating to the total owned or leased) is about 21 percent for road locomotives and 13 percent for yard engines; its car bad order ratio is about 12 percent. BAH found that for adequate service systemwide (excluding light density lines), locomotive rehabilitation costs and car rehabilitation and acquisition costs would be $105 million and $627 million (1977 dollars), respectively. Although the Milwaukee has now rehabilitated about 116 locomotive units and 907 cars with Federal funds available under the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act),[7] and about 3 locomotives and 224 cars through shipper assistance, it has continued to suffer (prior to embargo) severe power and car shortages.

To rehabilitate track and repair or acquire equipment necessary to normalize systemwide operations on the Milwaukee would require an enormous and, on this record, unjustified investment. A full-system refitting and refurbishing program would entail, if not create, extraordinary supply problems, and could so unpredictably drive materiel costs as to render expense projections meaningless. Further, the Milwaukee's severely eroded, and probably unrecoverable, traffic base in many areas might not justify even the

[6]Track safety standards are set forth at 49 CFR 213 (1979).

[7]Public Law 94-210, 90 Stat. 33 (February 5, 1976).

most conservatively forecasted investment requirements. Cognizant of those problems, no party has proposed or suggested continuation of the entire Milwaukee system as a single operating entity.

Financial and Statistical Data

As of October 31, 1979, the Milwaukee had cash and temporary cash investments totaling $5.8 million and a working capital deficit of $12.3 million. Total assets stood at $835.6 million and total liabilities (including capitalized leases and accumulated deferred income taxes) at $717.2 million (both figures including intercompany receivables and payables, and the original investment plus retained earnings of principal subsidiaries). Book shareholders' equity was $118.4 million. A detailed balance sheet as of October 31, 1979, is set forth in appendix A.

During 1979, the Milwaukee lost $117.8 million, apart from subsidiary earnings. The railroad's loss including earnings of subsidiaries was $105.2 million. That performance followed a loss of $81.9 million in 1978, and accumulated losses of $105 million for the years 1975-1977.[8] An income statement for 1979 is set forth in appendix B.

Properties and investments.—The trustee, in consultation with Ford, Bacon & Davis Construction Corporation (FBD), estimated the liquidation value of the Milwaukee's assets as of December 31, 1977 (excluding intercompany amounts) to be $832,166,000 inclusive and $720,633,000 exclusive of subsidiaries. The estimate, and the assumptions and methodologies used in deriving it, are contained in FBD's report to the trustee dated November 29, 1978.[9] A summary of the estimate is set forth in appendix C.

The liquidation estimate is the sum of the valuation of Milwaukee assets independent of one another, without consideration for sale as assembled property. No incremental value attributable to going concern value or social value was included. Further, the estimate was not adjusted or discounted to reflect the time value of money. FBD believed that correctly applying a discount factor would have entailed making several assumptions,[10] resulting in a highly speculative conclusion.

[8]Figures for 1978 and 1979 are not directly comparable to those of earlier years because of accounting changes.

[9]Ford, Bacon & Davis Construction Corporation, Liquidation Value of the Chicago, Milwaukee, St. Paul & Pacific Railroad (1978) (FBD Report).

[10]Among the assumptions identified were proper discount rate; timing of property dispositions; increase in property values from inflation and other market factors; earnings generated from land, locomotive, and freight car rentals; earnings from invested funds; and earnings generated by the Milwaukee Land Company during the liquidation period. FBD Report at p. 5.

The Milwaukee has two principal wholly owned subsidiaries. The Milwaukee Land Company, which has holdings in timber properties, industrial real estate, and railroad locomotives and freight cars,[11] was valued at $110,203,000. The primary asset of The Milwaukee Motor Transportation Company, a motor carrier, was its equipment (tractors, trailers, and trailer-on-flatcar loading equipment); the company was valued at $1,330,000. Schedules of the liquidation values of the Milwaukee's land and motor companies are set forth in appendixes D and E, respectively.

The Milwaukee's investment in affiliated companies (mostly terminal and switching railroads) owned jointly with other rail carriers was not included in the FBD liquidation valuation. Because the Milwaukee lacked control, and the market for those investments was considered limited, no attempt was made to value them. Appendix F sets forth the companies, the Milwaukee's ownership percentage, and its present investment and advances book value, as reflected in the railroad's 1978 Annual Report.

Claims Against the Estate

Expenses of Administration

Expenses of administration.—In his original reorganization plan, the trustee estimated that as of June 30, 1979, the costs and expenses of administering the estate and developing a reorganization plan, including deferred wages, was $16,132,000. These costs were estimated in the trustee's *MRRA* case initial statement to be $16.2 million as of April 1, 1980. His initial statement in this proceeding indicates that such claims (which exclude any expenses of parties in interest allowed under section 77(c)(12) of the Bankruptcy Act) were expected to total approximately $19.3 million by March 1, 1980. Included in the $19.3 million is $6.8 million in respect of Milwaukee II employees' deferred back pay.

First priority ERSA trustee's certificates.—The trustee identified in his original plan, and as of June 30, 1979, $5.1 million in claims arising from first priority trustee's certificates guaranteed under the Emergency Rail Services Act of 1970 (ERSA).[12] In his *MRRA* case

[11]The Milwaukee Land Company owns the Washington, Idaho and Montana Railway Company, a short-line railroad operating between Lairds (near Palouse), WA, and Bovill and Purdue, ID. It also owns the M.L.C. Equipment Company.

[12]45 U.S.C. 661 *et seq.*

initial statement, he estimated that these claims would amount to $25.1 million by April 1, 1980. His initial statement in this proceeding estimates these claims to be $55.1 million as of March 1, 1980.

State and local taxes.—The trustee's original plan indicated that as of June 30, 1979, State and local tax claims totaled $15,563,000. His *MRRA* case initial statement estimated that these claims would total $17.0 million by April 1, 1980. In his initial statement here, he has estimated State and local tax claims to be $19.5 million as of March 1, 1980.

Personal injury claims and certain expenses of administration (and priority funding of employee protection agreement).—In his original plan, the trustee stated that personal injury claims and all expenses of administration not included in the claims set forth above amounted to $12,835,000 as of June 30, 1979. His initial statement in the *MRRA* case estimated that these claims would be $11.3 million by April 1, 1980. His initial statement here has increased this class of claims to include federally guaranteed obligations (in the amount of $75 million) to fund the employee protection agreement entered under section 9 of the MRRA. The trustee now expects this class of claims to total $86.6 million as of March 1, 1980.

Secured Debt

Milwaukee first mortgage bonds.—The trustee's original plan estimated that as of June 30, 1979, claims of bondholders secured under the first mortgage of Chicago, Milwaukee, St. Paul and Pacific Railroad Company (dated January 1, 1944) totaled $52,634,000.[13] In his *MRRA* case initial statement, he stated that by April 1, 1980, these claims would amount to $54.1 million. His initial statement in this proceeding estimates that first mortgage claims would total $53.9 million ($48.7 million principal and the balance accrued interest at 4 percent from July 1, 1977) as of March 1, 1980.

Bedford Belt first mortgage bonds; Southern Indiana first mortgage bonds; CTH&SE first and refunding bonds; CTH&SE income bonds.—In his original plan, the trustee estimated that as of June 30, 1979, claims of bondholders secured under (a) the Bedford Belt Railway Company first mortgage; (b) the first mortgage of

[13]Indenture trustees for first mortgage creditors have indicated that the principal amount of their claim is approximately $48,735,300. The Milwaukee's balance sheet also carries the bonds at that amount.

Southern Indiana Railway Company (dated February 1, 1901); (c) the first and refunding mortgage of Chicago, Terre Haute and Southeastern Railroad (dated December 1, 1910, supplemented and assumed by the Milwaukee by an agreement dated December 31, 1948); and (d) the income mortgage of Chicago, Terre Haute and Southeastern Railway Company (dated December 1, 1910, supplemented and assumed by the Milwaukee by an agreement dated December 31, 1948), totaled $19,139,000.[14] His *MRRA* case initial statement indicated that these claims would amount to $19.5 million by April 1, 1980. His initial statement here also estimates the claims to be $19.5 million ($17.2 million principal plus fixed interest, contingent interest, and litigation settlement) as of March 1, 1980.

General mortgage bonds.—The trustee's original plan estimated that as of June 30, 1979, claims of bondholders secured under the general mortgage of Chicago, Milwaukee, St. Paul and Pacific Railroad Company (dated January 1, 1944) totaled $66,959,000.[15] In his *MRRA* case initial statement, he indicated that these claims would approximate $67 million by April 1, 1980. His initial statement here indicates that general mortgage bondholder claims totaled $67.5 million ($56.3 million principal[16] plus $7.6 million contingent interest and $3.6 million litigation settlement) as of March 1, 1980. The indenture trustee under the general mortgage, however, asserts that the total claim as of November 1, 1979, was $73,437,847 (including $57,114,700 principal; $11,343,816 interest due as of December 19, 1977; $4,797,635 interest due after December 19, 1977; $7,000 for administrative expenses; and $174,696 for expenses and compensation).

4R Act trustee's certificate.—In his original plan, the trustee indicated that as of June 30, 1979, claims secured by certificates issued under sections 505 and 511 of the 4R Act totaled $38,399,000. His *MRRA* case initial statement estimated these claims to be $45.9 million by April 1, 1980. His initial statement here estimates these claims to be $46.4 million ($24.4 million

[14]The various indenture trustees for these claimants have indicated that the principal amount of claims by Southern Indiana first mortgage creditors is approximately $5 million; by CTH&SE first and refunding mortgage creditors, about $7,170,000; and by CTH&SE income mortgage creditors, about $6,335,800.

The trustee's balance sheet carries the Bedford Belt bonds at $148,000; the Southern Indiana first mortgage bonds at $5,102,000; the CTH&SE first and refunding mortgage bonds at $7,170,000; and the CTH&SE income mortgage bonds at $4,738,800.

[15]In their motion to find the trustee's plan prima facie impracticable, indenture trustees for general mortgage creditors stated that the principal amount of their claim was $55,812,100.

[16]General mortgage bonds are carried on the Milwaukee's balance sheet at $56,278,100.

principal and $0.7 million interest for section 505 certificates and $21.3 million principal for section 511 certificates) as of March 1, 1980.

Unsecured Debt

Debentures.—The trustee's original plan estimated that as of June 30, 1979, claims of 5 percent income debenture holders under the Chicago, Milwaukee, St. Paul and Pacific Railroad Company Indenture (dated January 1, 1955) totaled $55,604,000.[17] His *MRRA* case initial statement indicated $55.9 million by April 1, 1980, while his initial statement here states $55.6 million as of March 1, 1980.

Trade creditors.—In his original plan, the trustee estimated that, as of June 30, 1979, trade creditor claims were $38,552,000. His *MRRA* case initial statement placed these claims at $38.2 million by April 1, 1980. His initial statement in this proceeding likewise estimates trade creditor claims to be $38.2 million as of March 1, 1980.

Union Station bonds.—The indenture trustee under the first mortgage of Chicago Union Station Company (dated June 1, 1963), relating to the Chicago Union Station Company first mortgage 4-5/8 percent sinking fund bonds, has claimed that the full principal amount of the bonds has become due and payable by the Milwaukee pursuant to the Chicago Union Station Company Proprietors Agreement (also dated June 1, 1963). The indenture trustee states that the Milwaukee unconditionally guaranteed, jointly and severally with three other railroads,[18] all obligations on the Union Station bonds, on which the principal amount now aggregates $23 million. The trustee and NewMil plans do not mention the claim.

KCT notes.—The indenture trustee under an Assignment Agreement and a Guaranty Agreement (both dated March 20, 1975) relating to certain notes of the Kansas City Terminal Railway Company (KCT), has averred that 25 percent of the outstanding principal amount of the notes is an existing and allowable claim against the Milwaukee. The indenture trustee asserts that the Milwaukee, along with 11 other railroads,[19] guaranteed the KCT

[17]In the motion to find the trustee's plan prima facie impracticable, the indenture trustee for debenture holders averred that the principal amount of the claim was about $55,604,000, but in its initial statement has indicated that the aggregate principal amount is $55,800,000. The debentures are carried on the Milwaukee's balance sheet at $55,604,000.

[18]The other railroads are Chicago, Burlington and Quincy Railroad Company; The Pennsylvania Railroad Company; and The Philadelphia, Baltimore and Washington Railroad Company.

[19]The other railroads are Atchison, Topeka and Santa Fe Railway Company; Burlington Northern, Inc.; Illinois Central Gulf Railroad Company; Norfolk and Western Railway Company; (footnote continued on next page)

notes, with each guarantor obligating itself to pay up to 25 percent of the outstanding principal ($16,500,000 as of November 30, 1979). Thus, the claim is for $4,125,000. Neither the trustee's nor the NewMil plan mentions the claim.

Subordinated ERSA trustee's certificates.—In the trustee's initial statement in the *MRRA* case, he estimated that subordinated trustee's certificates guaranteed under ERSA pursuant to the MRRA would total $60 million by April 1, 1980. His initial statement in this proceeding estimates that these claims would amount to $50 million as of March 1, 1980.

Redeemable Preference Shares

The trustee's original plan indicated that $9 million of redeemable preference shares (1977 series) were issued to the United States Government under the 4R Act. His initial statement here states that these claims total $9.1 million (apparently rounded from $9,130,000 shown on the Milwaukee's balance sheet).

Other Equity Holders

Preferred stock.—The Milwaukee has 518,652 shares of ($100 par value) preferred stock issued and outstanding.

Common stock.—The Milwaukee has 2,179,892 shares of (no par value, stated value $100) common stock issued and outstanding.

PLANS OF REORGANIZATION

Trustee's plan.—The trustee's reorganization plan contemplates a restructured railroad with 3,200 route miles, serving Louisville, Chicago, Kansas City, Milwaukee, Minneapolis-St. Paul, Duluth, and Miles City. Certain additional lines in northern Iowa and southern Minnesota would be incorporated into Milwaukee II if determined to be viable. The Milwaukee Land Company and the Milwaukee Motor Transportation Company would continue as subsidiaries.

In his initial statement, the trustee has set forth two alternatives for the financial restructuring. Under his "Basic Plan," he would establish three divisions within the estate: the Milwaukee II

(footnote 19 continued)
Kansas City Southern Railway Company; St. Louis-San Francisco Railway Company; Chicago and North Western Transportation Company; Missouri-Kansas-Texas Railroad Company; Union Pacific Railroad Company; Missouri Pacific Railroad Company; and Chicago, Rock Island and Pacific Railroad Company.

Railroad, the Nonoperating Properties, and the Milwaukee Land Company. Prior to consummation of the plan, all cash flows from the Nonoperating Properties and the Milwaukee Land Company would be available to fund restructuring of the railroad. Upon consummation, transfers of cash flows and assets from the Nonoperating Properties and the Milwaukee Land Company would occur only to the extent permitted by provisions of the reorganized company's securities.

The trustee's "Modified Plan" would include a tender offer to certain secured creditors. The tender offer would be funded by FRA under section 511 of the 4R Act. Unlike the "Basic Plan," the "Modified Plan" provides that all debt securities of the reorganized company would be general obligations of the company. Thus, the assets and cash flows of the Nonoperating Properties and the Milwaukee Land Company would be available to serve all of the reorganized company's debt and redeemable preference stock. Under both alternatives, the consummation date is assumed to be December 31, 1984.

The *pro forma* income forecast filed with the trustee's initial statement indicates that Milwaukee II would expend $428.9 million and $479.8 million (both current dollars) in (programmed and nonprogrammed) maintenance of way and maintenance of equipment, respectively, during the years 1980 through 1984. The trustee anticipates a positive net railway operating income (NROI) in 1983, and expects a positive pretax net income in 1984. According to the original plan, a work force of 6,300 to 6,700, including employees engaged in rehabilitation, is contemplated for the years 1980 through 1984.

NewMil plan.—The NewMil plan anticipates the operation of a transcontinental railroad (the New Railroad) from Louisville through Chicago, Milwaukee, and Minneapolis-St. Paul, across the northern tier to Seattle, Tacoma, and Portland. The base system would consist of about 3,550 route miles, and would include up to 1,470 miles of contingent lines if those lines meet certain specified conditions.

Under the plan, the New Railroad would be an employee-shipper-owned company. NewMil would act as an interim organization obtaining funding and necessary licenses and certifications for the New Railroad; NewMil would also perform the primary role in selecting and recruiting management.

Execution of the plan would require the trustee to transfer to the New Railroad those assets necessary for operation of the system,

including all equipment now owned by the Milwaukee. In return, the New Railroad would assume certain liabilities and obligations, including equipment debt and about $105 million in Federal debt and redeemable preference shares, and would issue $22.5 million in certificates of contingent value to Milwaukee shareholders. The assets remaining with the estate would be transferred to a liquidating trust for disposal to satisfy creditors and compensate shareholders. Certificates of contingent value would also issue to creditors to ensure treatment in the event that assets in the liquidating trust are insufficient to satisfy all claims.

Implementation of NewMil's plan would occur in two phases. The first phase would invole the preparation and presentation to the reorganization court of an acquisition plan. The second phase would primarily entail those actions necessary to carry out the acquisition plan. NewMil estimates that a minimum of 4 years should be expected for creditors and shareholders to realize payment on their claims.

NewMil anticipates a plant rehabilitation program totaling $215.5 million, an equipment additions program equivalent to $553.6 million, an equipment rehabilitation program totaling $16.67 million, a boxcar rebuilding program totaling $63 million, and a capital expenditures program totaling $57.9 million (all figures in current dollars). It projects a positive net income (including an adjustment for productivity savings) in 1984. NewMil estimates that the New Railroad would require 7,905 employees in 1980 and 9,035 by 1982.

CMC plan.—CMC proposes liquidation of the entire Milwaukee system. Its plan calls for the Milwaukee to terminate all rail operations, and for the trustee to conclude all pending sales of operating assets, and actively to seek and conclude sales of the remaining operating and nonoperating assets, to accomplish the greatest return to the estate. The proceeds of such sales would be distributed to the Milwaukee's creditors and shareholders in the order of priority.

Positions of the Parties

Trustee.—The trustee has stated that the entire Milwaukee entity cannot be successfully reorganized, due to the massive track and equipment rehabilitation needs, heavy debt service, and a weak competitive position in the transcontinental market. He believes a small configuration in the Midwest to be workable, with a good

chance for viability and a minimum risk, assuming the availability of Federal funding. He defends the methodology used to estimate the earning potential of Milwaukee II, and submits that his plan accords fair and equitable treatment of creditors.

In response to the competing proposals, the trustee contends that NewMil has not corrected the system performance deficiencies which we found in its plan submitted in the *MRRA* case. He also avers that, because his plan details transfers of numerous non-Milwaukee II lines as operating rail property, NewMil's plan would preserve service to fewer shippers. Creditors would not receive the return anticipated by NewMil's plan, he asserts, because it understates the value of assets acquired, overstates the value of assets left to the estate, and neglects the administrative costs of liquidation. Regarding the CMC plan, the trustee notes that the basic objectives of section 77 of the Bankruptcy Act are conservation of the debtor's assets for the benefit of creditors and preservation of an ongoing railroad. Because of potential liabilities against the estate, he maintains, liquidation might not yield better returns that Milwaukee II.

NewMil.—NewMil asserts that, through the MRRA, Congress has indicated that maintenance of competitive transcontinental rail service across the northern tier is of vital importance to the public interest. It contends that its plan best serves the public interest, that its treatment of the Milwaukee estate is fair and equitable, that its forecasts are sound, and that the proposed railroad system would be viable. Employee-shipper ownership and new management, it insists, would help the New Railroad achieve the productivity goals. NewMil also maintains that the New Railroad would be an attractive investment for private funds.

NewMil believes the potential long-term NROI of its system to be twice that of Milwaukee II. It observes that any assumptions concerning revenue opportunities available to Milwaukee II should also apply to the New Railroad. NewMil further argues that the trustee's plan does not afford employees a real opportunity to gain an equity interest in the restructured Milwaukee.

Regarding CMC's plan, NewMil states that liquidation would not result in appreciable gain for the stockholders, and would harm the interest of the public in continued service on essential lines.

CMC.—CMC supports liquidation, believing neither the trustee's plan nor the NewMil plan to be viable, and feeling that continued operation of the railroad is a drain on Federal funds which would be better spent to aid healthier railroads. The holding company

commissioned Isabel H. Benham of Printon, Kane Research, Inc., to study the two proposals. Ms. Benham concludes that there is no reaslistic basis for reorganizing the Milwaukee. Finding (a) excess rail capacity in the northern tier and an availability of motor carrier service, (b) no prospects for labor contracts increasing productivity, (c) hugh capital investment necessary to provide sustaining and efficient service, (d) neither reorganization plan able to obtain an adequate return on investment, and (e) private sector reluctance to fund high risk operations and thus a continuing need for public funds, she determined that neither the trustee's nor NewMil's plan is financially or operationally feasible.

MCFRA.—The proposals submitted by MCFRA include the identification of a potential coal haul for the Milwaukee from eastern Montana to Bristish Columbia. The organization also states that certain coal shippers would be willing to exchange rehabilitation of Milwaukee western lines for coal hauling. A further suggestion would provide for the purchase of rail assets by relinquishing labor protection rights. MCFRA also submits that any Milwaukee entity operating in the West should receive trackage rights over Burlington Northern Inc., and rail bank its own right-of-way.

MCFRA opposes CMC's proposal, and supports a Milwaukee entity similar to NewMil or a modification of the trustee's plan. MCFRA wants to insure that local rail service and competition will be preserved in Montana, Idaho, and eastern Washington, especially for coal and grain which would be transportad to Pacific West Coast ports for export. It believes that rehabilitation could be accomplished with assistance from parties interested in the western coal hauls.

USDOT.—The United States Department of Transportation (USDOT) believes that the trustee's plan is potentially viable, although fragile. Assuming completion of rehabilitation, it opines that Milwaukee II should produce positive NROI at marginal levels following 1984. It avers that debt coverage, though adequate, would be marginal, but that with reductions in rehabilitation expenses in the late 1980's capital for investment in market opportunities would become available. USDOT believes that, once stabilized, Milwaukee II would be an attractive merger candidate for a larger rail system. The agency states that, because prospects for success of Miwaukee II are tied to the use of proceeds of sales of nonoperating properties and assets and revenues of the Milwaukee Land Company, those

proceeds, assets and revenues must be dedicated to the support of Milwaukee II, as a condition of further USDOT financial assistance.

USDOT posits that the NewMil proposal would not result in a self-sustaining railroad, due to substantial internal losses, an inadequate traffic base, and optimistic assumptions as to the availability of Federal financing.

The agency notes that the public interest is served by preservation of self-sustaining rail service, as well as conservation of the debtor's assets to the benefit of creditors. It asserts that, assuming liquidation as suggested by the CMC plan, statutory labor protection and other liabilities could increase the estate's liabilities to the detriment of creditors. USDOT therefore believes that Milwaukee II more adequately balances the interests here.

Creditors.—Continental Illinois National Bank and Trust Company of Chicago (Continental Illinois), indenture trustee under the Milwaukee first mortgage and the CTH&SE first and refunding mortgage, and Girard Bank (Girard), indenture trustee under the Southern Indiana first mortgage, filed a joint statement opposing the trustee's plan, contending that it would violate the constitutional rights of creditors and that Milwaukee II is not and cannot be made economically viable. The CMC and NewMil plans were supported as proposals to liquidate the Milwaukee estate and assure payment to creditors.

To substantiate their assertions concerning Milwaukee II, Continental Illinois and Girard presented financial studies by Richard J. Barber Associates, Inc. (Barber), and Professor Robert S. Hamada. The Barber report concludes that the Milwaukee II revenue projections are overly optimistic and cost improvement postulations unachievable, that the system would have virtually no chance to generate a positive NROI in this decade, that it would not realize a positive return on investment, and that liquidation would best preserve the public interest. Using the trustee's income and expense projections and assuming survival of Milwaukee II until the year 2000, Barber calculated the system's real internal rate of return to be -1.2 percent per year; using its own "optimistic" traffic scenario, Barber calculated the real internal rate of return to be -1.7 percent per year. Similarly, Professor Hamada found that Milwaukee II does not represent a feasible reorganization, determining that, based on the trustee's projected NROI, the net present value of the system's cash flows would be significantly less than the present value of the debt which would burden it upon reorganization. He calculated that the net present value of Milwaukee II operations and

liabilities would range from -$44.8 million to -$121 million assuming discount rates of 15 to 20 percent, respectively.

Following the trustee's proposal to include a cash tender offer for certain funds, Girard filed a supplemental statement indicating its continued opposition to the trustee's proposal and its continued support of the NewMil and CMC plans. Subsequently, the trustee amended his proposed tender offer to provide greater cash considerations. Continental Illinois has now withdrawn its opposition to the trustee's plan provided that the Federal Government finances the proposed tender offers and that the trustee issues an invitation for such tender offers before January 1, 1981.

First National Bank of Chicago (First National), indenture trustee under the CTH&SE income mortgage and the Milwaukee indenture, originally argued that neither the trustee's nor NewMil's plans offer assurance that the interests which it represents would receive compensation for their investment. On that basis, it supported neither plan. In its rebuttal statement, First National has made no comment on the NewMil proposal, but urges that Milwaukee II would not be in the public interest and would not be fair and equitable to creditors.

Harris Trust and Savings Bank (Harris), indenture trustee under the Milwaukee's general mortgage, contends that Milwaukee II would not be viable and that by preserving a financially unhealthy rail system in the Midwest would be contrary to the public interest. Harris maintains that the trustee's proposal would cannibalize estate assets and accordingly would be neither fair and equitable nor consistent with the public interest, and would violate constitutional rights of secured lien holders.

Harris engaged Professor Joseph A. Swanson to analyze the trustee's plan. Professor Swanson concluded that Milwaukee II cannot be successful, and that its failure would result in a substantial diminution of the estate's assets. He calculates that, based on the trustee's plan, the present value of all operating cash flows from Milwaukee II would range from 0 to -$80 million assuming discount rates of 12 to 24 percent, respectively. Under his own set of parameters for future (1980-84) cash flow projections, he calculates that the present value for those projections would be about -$455 million assuming a 12.5-percent discount rate. Professor Swanson further submits that total liquidation of the Milwaukee could increase the quality of freight service, and in the long run decrease the real cost of that service, for most shippers located in the Milwaukee II territory.

Harris believes that the NewMil plan comes closer to meeting the requirements of section 77 of the Bankruptcy Act than does the trustee's plan, but that NewMil's proposal is not fully consistent with the statute. The indenture trustee asserts that NewMil fails to supply adequate consideration for the rights of secured bondholders which would be extinguished, and it suggests certain mechanisms for resolving the problem.

In response to the trustee's revised tender offer, Harris contends that the proposal would unfairly discriminate against general mortgage bondholders. The indenture trustee argues that the difference in treatment between Milwaukee first mortgage and general mortgage bondholders is not justified. Harris also argues that the trustee's revised treatment of claims does not afford general mortgage bondholders full compensation and understates the value of those claims.

Chicago Title & Trust Company, indenture trustee under (a) the first mortgage of Chicago Union Station Company and (b) an Assignment Agreement and Guaranty Agreement relating to the KCT notes, objects to the reorganization plans. Noting that none of the plans makes provision for claims under the Union Station bonds and KCT notes, the indenture trustee maintains that no plan of reorganization may be approved or consummated without providing for treatment in full of those claims.

States.—The State of Minnesota Department of Transportation (MNDOT) supports the trustee's plan, because it deals more adequately with lines which the MNDOT considers to be of high priority. The MNDOT believes that, under optimistic circumstances, the plan could be viable.

The South Dakota Department of Transportation (SDDOT) believes that the trustee's plan has a good prospect for achieving its income projections and becoming self-sustaining. SDDOT believes that Milwaukee II is likely to attract additional local and overhead traffic as a result of the expected liquidation of the Chicago, Rock Island and Pacific Railroad.

The Iowa Department of Transportation (IDOT) believes that the trustee's plan involves substantial risks to both the public and private sector, is unlikely to be self-sustainable within 5 years, and would continue to require substantial outlays of public money. IDOT also believes that the NewMil plan is unlikely to succeed, and further opposes it because the likelihood of continued service in Iowa with NewMil is small.

The State of Montana supports those plans which will continue to provide competitive transcontinental rail service in the northern tier, and has expressed a willingness to aid this endeavor by providing low interest loans for rail rehabilitation in the State. If transcontinental service is not extended, Montana hopes to purchase the Milwaukee line from Miles City, to Marengo, WA.

The State of Washington would support a plan which promises continued rail service on those lines which it has identified as essential; however, NewMil has classified those lines as contingent.

Shippers.—A number of shippers have submitted statements concerning the reorganization plans before us; we also take notice of the statements of shippers which appear in the records in the *Lines West Abandonment* and the *MRRA* case. Substantial shipper support in all three proceedings has been expressed for the NewMil plan or for continued competitive rail service from the Midwest to the Pacific Northwest ports. The shipper interests in support of NewMil emphasized the need for rail service to transport coal and agricultural products, equipment and containerized cargo. The growing need for coal, in both national and international markets, increases the demand for reliable and competitive transcontinental rail transportation. Shippers have pointed out that the export of coal and grain through Pacific Northwest ports would help alleviate the Nation's balance of payments deficit, and several have indicated a willingness to encourage NewMil's turnaround program by making use of the service immediately. A substantial number of participating shippers have emphasized the great need for competitive rail service across the northern tier.

Those shippers which support the trustee's plan are generally engaged in manufacturing in the Midwest. Their businesses demand reliable transportation service both to receive raw materials and to ship finished products. Such shippers primarily seek assurance that the Milwaukee will continue to serve them, and that its prospects for viability are good; they believe Milwaukee II offers a good chance for continued, reliable service.

Labor.—The Railway Labor Executives' Association (RLEA) favors the NewMil plan because, if viable, it would provide a transcontinental system which would both preserve jobs of rail employees and continue a competitive rail service. It notes that most of NewMil's proposed productivity savings are subject to resolution by agreement between rail management and employee representatives. Although willing to negotiate those matters, it

points out that neither it nor any of its members has agreed to any of the specific items or the dollar amounts attributed to them. RLEA also insist that labor protection claims, rather than being a low priority unsecured claim, are expenses of administration.

Lloyd Hanson, United Transportation Union general chairman for Milwaukee Lines West, supports the NewMil plan. He states that employees are eager to begin to negotiate with new management for productivity agreements which would assist NewMil in its projections for productivity savings during the first year of operations. The general chairman believes that the only realistic alternative to liquidation is the NewMil plan, because Milwaukee management has not been effective, and the employees are unable to work with the present railroad management.

C. K. Clover, Brotherhood of Locomotive Engineers general chairman for Milwaukee Lines West, also supports the NewMil plan. He affirms that employees want to share in the ownership and success of the railroad, are willing to negotiate to achieve labor productivity improvements quickly, and are prepared to do whatever they can to assure a successful reorganization.

RSP Study

The RSP study concluded that, although ambitious, the trustee's plan could be achieved. It found that the 5-year period needed to achieve a positive NROI might be lengthened, however, if some essential elements of the plan were delayed and if reorganization were not initiated until after January 1, 1980.

Assuming a positive NROI of $18 million in 1985, in addition to Milwaukee Land Company earnings and The Milwaukee Motor Transportation Company earnings, RSP concluded that Milwaukee II would have the ability to cover its fixed charges. It considered the plan to be fair and equitable, finding that the proposal would compensate creditors with an equitable equivalent of the rights surrendered. RSP believes that, because the trustee's plan would preserve an ongoing transportation system (and if the assumptions made are valid), Milwaukee II would be compatible with the public interest.

RSP stated that it could not recommend NewMil as a viable plan because of deficiencies and uncertainties in the proposal. Upon reexamination, RSP found that, assuming NewMil's projected cash flow, NewMil would be able to cover its fixed charges as planned. RSP believes that NewMil's labor productivity assumptions are

optimistic, and that employees would have no equity commitment to the success of the plan.

RSP believes that, because the CMC proposal does not contemplate an ongoing transportation system, it is not in the public interest, and merely seeks to protect a class of claims.

Gellman Study

To provide additional disinterested study of the trustee's and NewMil's plans, we engaged Gellman Research Associates, Inc. (Gellman), to analyze the feasibility of those proposals. In its report "Comparisons of Traffic and Cost Assumptions Submitted by Milwaukee Trustees and New Milwaukee Lines" (as supplemented by the addendum dated March 12, 1980), the consultant compared the assumptions adopted by the trustee and NewMil in predicting the traffic, revenues, and costs of their respective systems. Gellman then defined the range of anticipated income under varying traffic assumptions, calculated the expected rates of return on investment of funds and property in the proposed systems, and calculated the expected fixed charge coverage under each proposal.

The consultant concluded that both the trustee's and NewMil's *pro forma* forecasts depend upon high traffic growth. It determined that, in general, the plan proponents' respective revenue and cost assumptions derive from detailed analysis, and that those assumptions appear to follow reasonably closely BAH's revenue and cost simulations. The specific results of Gellman's analysis are set forth in our discussion below, with certain additions and corrections made by us.

Discussion and Conclusions

Summary of findings.—The troubles of the bankrupt Milwaukee, of other unprosperous midwestern railroads, and of midwestern and northern tier rail patrons will not admit an easy or painless solution. Were we here presented with an acceptable plan to reorganize the Milwaukee, a plan which would preserve rail service and otherwise comply with the requirements of section 77 of the Bankruptcy Act, we might anticipate a more rapid alleviation of those problems. Unfortunately, neither of the restructuring plans tendered would create a viable railroad or fairly and equitably treat the Milwaukee estate, and the liquidation plan would blindly dismantle the Milwaukee system with no more than passing consideration for

continued service. We are compelled to disapprove each of the proposals.

The trustee's plan, although somewhat less precarious than NewMil's, is premised on overoptimistic performance forecasts which would at best produce a short-lived railroad. Since Milwaukee II would not provide an adequate rate of return, Milwaukee creditors forced to take its stock or securities in exchange for existing claims would not receive fair and equitable treatment. The NewMil proposal would potentially preserve northern tier transcontinental service, but could achieve only marginal success even through the attainment of unrealistic traffic and financial projections and the avoidance of attendant high risks. Further, the New Railroad would not adequately compensate the estate for the assets which it would acquire. CMC's liquidation plan does not begin to meet the explicit requirements or implicit objectives of section 77 of the Bankruptcy Act.

Section 77 permits us to modify plans of reorganization to comport with its requirements. Since we lack the raw traffic and financial data, simulation programs, facilities, and personnel to develop and test specific changes, we are unable to identify particular improvements which might make the proposed systems viable. We have attempted, however, to point out deficiencies and to give guidance in developing a plan which would meet the requirements of the statute. Our disapproval of the plans considered here is without prejudice to continuation of this proceeding and submission of new or revised plans.

By rejecting both reorganization plans we do not suggest that liquidation is the appropriate solution for the Milwaukee. The goals of any reorganization plan, regardless of what form that plan might take, should be maximizing rail service and assuring fair and equitable treatment of the estate. As noted above, conditional approval of either plan is not now possible, but our retention of jurisdiction to receive new or amended proposals should encourage continued movement toward a Milwaukee restructuring which comports with the public interest.

Traffic and financial projections—general.—As indicated above, both the trustee and NewMil used the BAH study as the starting point in developing their respective systems. BAH had simulated the operation of the eight candidate configurations, and had derived *pro forma* financial statements demonstrating performance at four traffic levels: 1977 (estimated from actual traffic in that year); market opportunities (1977 plus new business deemed currently available); market opportunities short-term (market opportunities plus projections based on Chase Econometrics, Inc., economic growth and production indexes for 1981); and market opportunities long-term (market opportunities plus projections based on forecasts for 1986). The trustee and NewMil adjusted the BAH results to reflect anticipated traffic, inflation, and rehabilitation schedules, and differing methods of equipment financing.

BAH, however, did not develop forecasts of traffic and financial performance for specific future periods but rather identified four market potential levels for each of the configurations analyzed. Thus, the "high" (market opportunities long term) and "low" (1977) NROI figures generated for a particular configuration provide only a "range of risk" associated with the implementation of that system. The high and low projections, however, do not actually represent extremes.[20] Further, the BAH study does not disclose the probability that the NROI for a particular system configuration would fall within or outside the range indicated for that system, nor the probability that the NROI would fall at one end or the other of the specified range.[21]

In revising BAH projections, the trustee and NewMil have not refined forecasts of performance but instead have sharpened previous estimates of their expective systems' potentials. Rather than honing a prediction of what the future would *probably* hold for their systems, they have simply reappraised what the future *potentially* holds.

To reach the high potentials (which the plan proponents have adopted as their forecasts), all must transpire as hoped. The BAH study indicated that achieving the high forecast would represent "a major management challenge."[22] Based on the Milwaukee's past performance, the study termed "staggering" the projected carload and revenue gains attributable to attaining the identified market opportunities.[23]

Prerequisites to achieving market opportunities long term are rehabilitation of track on key routes and concentration of the car and locomotive fleet. BAH noted, however, that rehabilitation does not guarantee that a line will be competitive.[24] In addition, the NROI estimates for each option reflect some operating

[20]See BAH Study, Vol. II, p. VI-6.
[21]See *Lines West Abandonment*, slip op. at 58.
[22]*Id.* BAH Study, Vol. II, p. VI-7.
[23]*Id.* at VI-8.
[24]*Id.* at VI-7.

improvements beyond 1977 levels. BAH pointed out that achieving those improvements would require specific management action, and that failing to implement them is an inherent risk.[25]

The traffic levels (carloads) forecast by the trustee and by NewMil are shown in appendix G, along with the traffic potentials for the corresponding configurations as estimated by BAH. The 1981 and 1986 BAH carload levels correspond to the market opportunities short term and market opportunities long-term projections, respectively. The trustee shows a 1977 carload equivalent of 571,000, exceeding by 37,000 carloads (31,000 of Sprint traffic and 6,000 of traffic on Milwaukee II lines not included in the corresponding BAH configuration) the 534,000 carloads BAH estimate for a roughly equivalent system (Miles City Sub Core plus the Kansas City Sub Core minus the Sub Core). The trustee forecasts traffic as growing by 45 percent to 825,000 carloads by 1984 (estimated from his *pro forma* revenues), whereas BAH identified only 720,000 carloads of potential traffic upon achieving market opportunities long-term. NewMil's traffic projections, on the other hand, adhere more closely to the potential identified by BAH. For the first years of the New Railroad's operation, NewMil forecasts relatively realistic traffic levels, but it predicts achieving 35 percent growth over the 1977 level by 1986.

We have great difficulty accepting the rapid and highly optimistic growth projections reflected in both reorganization plans. Certainly we expect that either system would ultimately realize some traffic level above the 1977 performance simply through economic growth. Further, as BAH surmised,[26] the Milwaukee should regain at least some traffic merely by offering service comparable to that of its competitors. We also believe that in many regions, shipper desire for competition would permit an improved Milwaukee system to expand its market share. Nonetheless, the magnitude and rapidity of the gains seem quite high, especially in light of the recent historical trend of declining rail traffic.

The Milwaukee's revenue freight carloadings for the years 1970 to 1979 are shown in appendix H. Between 1970 and bankruptcy at the end of 1977, revenue carloadings on the Milwaukee declined an average of about 2.5 percent per year. From 1977 to 1979, carloadings have declined another 14 percent. (This accelerated decline may have been concentrated on the Pacific Coast extension, however, since the trustee has been discouraging traffic on those

[25] *Id.* at VI-12-13.
[26] *Id.* at VI-8.

lines in anticipation of abandonment.) Consequently, we believe that both the trustee's and NewMil's plans are unjustifiably optimistic in forecasting a dramatic reversal of this trend. The trustee's plan in particular, by assuming an immediate turnaround and a 1984 traffic level nearly 55 percent greater than the "actual" (BAH estimated) 1977 experience, impresses us as unrealistic.

The risks attendant to full realization of potential market opportunities are many. Supply or weather problems could delay necessary rehabilitation. Unforeseen competitive responses could not only diminish access to projected traffic but also preclude realization of anticipated rate increases. Higher than expected inflation or slower than expected economic growth could also have an adverse effect.

In preparing its report, Gellman considered a range of traffic levels for both reorganization plans, providing a measure of sensitivity for each. The trustee's plan, when adjusted to reflect small traffic and cost changes, demonstrates an increase of $142.2 million in external financing requirements and a reduction in the final year's net income. Under a "no-growth" scenario (assuming Milwaukee II would realize the 1977 traffic levels, plus additions in Sprint and coal traffic specifically identified by the trustee), the system shows annual losses ranging from $91 million in 1980 to $44.7 million in 1986.

Gellman adjusted the NewMil income and cash statements, first, to reflect the trustee's inflation assumptions, second, to show the effect of lagged traffic growth and reduced revenues in the first year, and third, to demonstrate the results under the "no-growth" scenario applied to Milwaukee II. Under the trustee's inflation assumptions, adjusted net income in 1986 declines from $65.9 million to $54.3 million. With Gellman's traffic and revenue adjustments, the NewMil plan reveals a $176.4 million total increase in long-term debt in 1986. The "no-growth" scenario results in annual losses ranging from $94.8 million in 1980 to $110.4 million in 1986 (both figures excluding NewMil's projected productivity savings).

Rate of return determinations—general.—We believe that an essential prerequisite to our approval of any reorganization plan is a demonstration of potential viability, i.e., a showing that the demand for the reorganized railroad's services justifies the commitment of the required resources to the enterprise. The best single test of a railroad's viability is its ability to generate income, i.e., to market its services at a price that adequately covers its costs (including the

cost of capital). The adequacy of net income, in turn, is conventionally measured in relation to the amount of capital employed, and the traditional index is the rate of return on total investment or total capitalization.

To have a reasonable prospect of long-term viability, a newly created railroad entity should anticipate a return on its total capitalization which exceeds its current cost of capital. Without such a return, the new railroad could not long continue to fund necessary improvements, extraordinary expenditures, or unexpected cash shortfalls. It would have great difficulty attracting outside capital, and would have a strong disincentive from reinvesting its own funds in a system yielding a return below that attainable elsewhere. It would face continuous pressure to disinvest in railroad operations and reinvest the capital in more lucrative enterprises. If it resists disinvestment, it would eventually be forced to defer necessary capital improvements (*e.g.*, rehabilitation and acquisition of plant and equipment); to cannibalize parts of its plant to salvage operations on the balance; or to seek perpetual or permanent governmental assistance.

We have carefully examined the reorganization plans for evidence of viability, for reasonable forecasts that the reorganized carriers' incomes would provide rates of return that would equal or exceed the opportunity cost of the capital that would be invested. We engaged Gellman to assist us in this task: to examine the assumptions about revenues, expenses, and investment implicit in the various plans; to compute the rate of return those assumptions would produce; and to compute the rates of return that alternative assumptions and scenarios would produce. We are generally satisfied with the procedures employed by Gellman and generally accept the results in its report as valid characterizations of the reorganization plans of the trustee and NewMil.

As noted above, the Gellman report developed rates of return on total capitalization for three Milwaukee II income levels (each excluding Milwaukee Land Company income) and four New Railroad income levels (each considered both with and without NewMil's projected productivity improvements). Investments of funds and property were adjusted to reflect the time value of money at 11 and 20 percent as of the final year of the reorganization period (1984 for the trustee's income estimate for Milwaukee II, and 1986 for all other forecasts). The following tables set forth the rates found, with and without capitalizing equipment leases.

Milwaukee II return on total capitalization (equipment leases capitalized)

	At 11 percent	At 20 percent
Trustee's pro forma income forecast	3.1	2.6
Trustee's forecast, adjusted	2.7	2.0
"No-growth" scenario	0	0
Milwaukee II return on total capitalization (equipment leases not capitalized)		
Trustee's pro forma income forecast	1.8	1.5
Trustee's forecast, adjusted	1.7	1.3
"No-growth" scenario	-1.1	-0.9
New Railroad return on total capitalization (equipment leases capitalized)		
NewMil plan, without productivity	4.3	3.2
NewMil plan, with productivity	5.8	4.2
Trustee's inflation rate, without productivity	3.8	2.7
Trustee's inflation rate, with productivity	5.2	3.8
NewMil plan adjusted, without productivity	3.9	2.9
NewMil plan adjusted, with productivity	5.2	3.9
"No-growth" scenario, without productivity	0	0
"No-growth" scenario, with productivity	1.3	0.9
New Railroad return on total capitalization (equipment leases not capitalized)		
NewMil plan, without productivity	2.6	1.9
NewMil plan, with productivity	4.1	3.0
Trustee's inflation rate, without productivity	2.0	1.5
Trustee's inflation rate, with productivity	3.5	2.6
NewMil plan adjusted, without productivity	2.3	1.7
NewMil plan adjusted, with productivity	3.6	2.7
"No-growth" scenario, without productivity	-3.3	-2.4
"No-growth" scenario, with productivity	-1.9	-1.4

Recently, in *Adequacy of Railroad Revenue (1979 Determination)* 362 I.C.C. 344 (1979) (*1979 Adequacy Case*), we found that the Nation's railroads have a composite cost of capital or fair return rate, for comparisons with returns on net investment, of 11 percent. We pointed out that:

> revenue adequacy will be promoted in railroad rate proceedings by assuring that rate levels are sufficient to make new service-related investments profitable ***. So long as individual new investments obtain the cost-of-capital rate, the overall earnings level should eventually approximate that return rate. [*Id.* at 357.]

We caution that, although the methodology is important, the numerical finding in the *1979 Adequacy Case* and those in *Adequacy of Railroad Revenue (1978 Detemination)*, 362 I.C.C. 198 (1979) (*1978 Adequacy Case*), are not dispositive of the revenue needs of a newly reorganized railroad, and are not directly comparable. First, because it is an untried enterprise whose future may be viewed as uncertain, a new system would probably have a significantly higher cost of capital than that enjoyed by existing railroads simply because of the higher risk to investors. Secondly, the *Adequacy* cases developed composite figure which may not accurately reflect a particular railroad's cost of capital. Thirdly, the rates developed in the *Adequacy* cases are for return on net investment (RONI), not return on total capitalization (ROTC), as developed by Gellman; the ROTC for a particular railroad will generally be somewhat higher than its RONI. Thus, the actual difference between (a) the respective costs of capital for the new systems proposed here, and (b) the returns projected for those systems, may be significantly greater than that derived by simply comparing the rates found in the *Adequacy* cases with the tables above.

We shall not here attempt to develop a rate of return which would signify viability for a proposed Milwaukee system since the rate could vary depending upon the capital sources available to the system, the risk of the proposal, and the magnitude of public involvement. We note only that the plans presented to us, even accepting the optimistic projections of their respective proponents, would create systems which would operate just at the margin, and well below a level necessary for viability. Even minor deviation from the forecast results could prove financially disastrous. Considering the sensitivity of the traffic and revenue projections, and the risk of not fully achieving the predicted potential, we cannot foresee long-term viability for either Milwaukee II or the New Railroad as currently proposed.

We recognize that many railroads are not earning adequate rates of return, as defined in the *Adequacy* cases, but are nonetheless solvent and providing needed transportation service to the public. Comparisons between the rate of return of a newly reorganized railroad, however (especially one which implicates a wholesale restructuring, both physically and financially) and the rate of return of a solvent, ongoing railroad (which has different capital requirements and a different capitalization base) are not truly appropriate. A more informative comparison could be drawn to an

existing railroad's "hurdle" rate, that return which would make an incremental (new) investment sufficiently attractive to entice the railroad into committing funds to that investment. A railroad's "hurdle" rate should never fall below its current cost of capital since committing funds to a new investment yielding less than the current cost of acquiring those funds would produce a loss. A newly reorganized railroad constitutes a new investment, and thus the appropriate comparative index would be an enlisting railroad's "hurdle" rate or (as a threshold) its current cost of capital.

The mere existence of railroads (which may or may not themselves be marginal) having low rates of return does not justify the implementation of a new system which has only speculative prospects for continued life. Congress has recognized the seriousness of the revenue adequacy problem throughout the industry and has directed us to ensure that railroads currently earning low rates of return have the rate flexibility necessary to earn adequate revenues under honest and efficient management. As discussed below, we are gravely concerned about the continuation of the Milwaukee's services. We do not believe, however, that a plan of reorganization is compatible with the public interest unless it contemplates the creation of a railroad having a reasonable potential for long-term viability.

"Reasonable growth" scenario.—We have estimated NROI and rate of return for Milwaukee II and the New Railroad starting with a traffic projection less optimistic than those employed by the trustee and NewMil, but less pessimistic than Gellman's "no-growth" scenario. We assumed that the 1980 traffic level (in carloads) would equal the 1977 traffic levels (plus 31,000 carloads of Sprint traffic for both systems and 6,000 carloads for Milwaukee II lines not included in the BAH estimate), and that traffic would grow thereafter by 3 percent per year through 1986. Thus, the trustee was assumed to handle 571,000 carloads in 1980 and 682,000 in 1986, and NewMil was assumed to handle 603,000 carloads in 1980 and 720,000 in 1986. We believe that this "reasonable growth" scenario is neither excessively optimisitc nor excessively pessimistic.

To calculate anticipated financial results in 1986, revenues were projected using the same revenues per carload (adjusted to reflect the trustee's inflation assumptions) as projected by the respective proponents. Except for maintenance of way and property taxes, expenses were also developed on a per car basis, using the proponents' respective projections and the trustee's inflation assumptions. To provide a statement more comparable to that of

NewMil, the Milwaukee II equipment lease payments were drawn from transportation and fixed charges and reflected in rents. In computing the fixed charge coverage ratio and rate of return for both proposals, the interest component of capitalized equipment leases was returned to fixed charges.

The results for Milwaukee II and the New Railroad under the "reasonable growth" scenario are set forth in appendixes I and J, respectively. Even with this substantial growth, we project that both systems would sustain operating losses in 1986. Net income would be -$15.8 million and the fixed charge coverage ratio 0.6 for Milwaukee II. Similarly, the New Railroad would have (before productivity savings) a net income of -$9 million and a fixed charge coverage ratio of 0.9. Rates of return would be low for both, 1.1 and 0.8 percent for Milwaukee II and 2.1 and 1.5 percent for the New Railroad at discount rates of 11 and 20 percent, respectively. The forecast results do not include fixed charges on debt incurred to fund additional operating losses in the years 1980 through 1985. Beyond 1986, moreover, either system would face higher fixed charges from debt which it had incurred in reorganization but for which it had deferred payment.

Trustee's plan.—Milwaukee II, as presently constituted, is essentially the BAH Study Miles City Sub Core option with the addition of the line from Davis Junction, IL, through Savanna, IL, and Davenport, IA, to Kansas City, BAH found that:

> the Miles City Sub Core presents the lowest downside risk of the options and focuses on recovering traffic in markets where Milwaukee is already in a strong position. Since much of this traffic recovery is dependent upon reallocation of cars and locomotives to key markets, the market opportunities should be achievable quite quickly and with a considerably higher level of certainty.[27]

Although, the Sub Core option (Miles City Sub Core Renville, MN, to Miles City line and certain attendant branches) was the most attractive to BAH, the consultant concluded that, if the added investment necessary to extend the system to Miles City could be covered with outside funds, the Miles City Sub Core would be the most attractive of the options analyzed.[28]

Although noting that extending the Sub Core to Kansas City[29] would require a much larger investment for no potential gain and

[27] *Id.* at VI-23.

[28] *Id.* at VI-25.

[29] The Kansas City Sub Core configuration included the Milwaukee's line from La Crescent, MN, to Green Island, IA, a line not included in Milwaukee II.

greater downside risk, BAH stated that the long-term market potential should be reviewed.[30] In explaining his inclusion of the Kansas City to Chicago line in Milwaukee II, the trustee stated that:

> Kansas City is a primary gateway to the Southwestern and Western Markets. These Markets are important to Milwaukee shippers and receivers in Illinois, Wisconsin, and Minnesota, which are the primary traffic originating and terminating states for the smaller system. Also, the inclusion of Kansas City will permit the Milwaukee to handle overhead traffic from the Southwest and West to the East and/or from the East to the Southwest and West ***. Without a Southwestern or Western gateway via the Milwaukee shippers might choose alternative railroads.

See trustee's reorganization plan dated August 10, 1979, p. 25. He estimated that including Kansas City service would increase NROI by $4 to $5 million on an additional investment of $46 million ($34 million for equipment and $12 million for track rehabilitation). *Id.* at p. 26. The Kansas City to Chicago corridor, however, is also served by seven other railroads,[31] and the Milwaukee's present market position is at or near the bottom.

The trustee appears to have focused his attention on the lines which have the highest probability for reorganization, but analysis of Milwaukee II demonstrates that additional refinement is necessary if the system is to attain long-term viability. The Gellman report reveals that not only would Milwaukee II suffer from a very low rate of return, but in addition its fixed charge coverage (the ratio of income available for fixed charges to fixed charges incurred) is at best very low.[32] The following table shows the fixed charge coverage for Milwaukee II including and excluding Milwaukee Land Company income, with and without capitalizing equipment leases.

Milwaukee II fixed charge coverage (equipment leases capitalized)

	With MLC Inc.	Without MLC Inc.
Trustee's pro forma income forecast	1.4	1.1
Trustee's forecast, adjusted	1.0	0.9
"No-growth" scenario	NA	No coverage.

[30] BAH Study, Vol. II, p. VI-24.

[31] The other railroads are Atchison, Topeka and Santa Fe Railway Company; Burlington Northern Inc.; Chicago and North Western Transportation Company; Chicago, Rock Island and Pacific Railroad Company; Illinois Central Gulf Railroad Company; Missouri Pacific Railroad Company; and Norfolk and Western Railway Company.

[32] We have recently found that a fixed charge coverage ratio of 3.5 would afford comfortable but not excessive coverage. *1978 Adequacy Case*, 362 I.C.C. at 227.

Milwaukee II fixed charge coverage (equipment leases not capitalized)

	With MLC Inc.	Without MLC Inc.
Trustee's pro forma income forecast	1.7	1.2
Trustee's forecast, adjusted	1.1	0.8
"No-growth" scenario	No coverage	

We believe that inclusion of income from the land company, which is a severable segment of the Milwaukee estate, is inappropriate in determining the viability of the proposed system. The land company's performance is not related to that of Milwaukee II, and our analysis has not commingled the two.

Fairness and equity.—The deficiencies in the financial performance of Milwaukee II also lead to problems concerning fairness and equity. The trustee's plan provides that many classes of Milwaukee claimants would receive in partial or total settlement of their claims secured notes or stock in Milwaukee II. We shall assume, but not decided, that if the Milwaukee is capable of being reorganized on a basis that provides a fair rate of return under the flexible standard of *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), the plan may be forced on the owners and creditors even though liquidation might yield them more.[33] Under this assumption, we must be able to value the Milwaukee II securities and stock based on the capitalized earnings of the new system and (in compliance with the absolute priority rule[34]) must find that such value at a minimum fully compensates all but the most junior of the participating claimants.

We believe that the returns contemplated by Milwaukee II, even accepting the trustee's optimistic projections, do not provide a fair return. The Gellman report indicates that, under the trustee's assumptions, the net present value (NPV) of the Milwaukee II cash flows (discounted at 20 percent) is only $112 million. With the minor adjustments made by Gellman, NPV declines to $66 million.

[33]We recognize that under the new Bankruptcy Act a reorganization plan may not be confirmed unless the value of property received by creditors is not less than the value of property creditors would receive on liquidation. See 11 U.S.C. 1173(a)(2).

[34]Under the absolute priority rule, senior claimants are entitled to complete compensation for the rights they surrender before subordinate interests may properly participate. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U.S. 523 (1943); *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448 (1943).

The high risk and low yeild of Milwaukee II preclude us from finding that the trustee's plan is fair and equitable.

Tender offer.—The trustee has proposed a cash tender offer to certain classes of secured creditors, hoping to eliminate a large portion of those claims. He states that the benefits of a tender offer would include the facilitation of necessary additional borrowings under the 4R Act, and improvement of more junior claimants' status or participation. His most recent offer[35] has been conditionally accepted by the indenture trustee for Milwaukee first mortgage bonds and CTH&SE first and refunding bonds, but has been rejected by indenture trustees for Southern Indiana first mortgage bonds and general mortgage bonds.

Because of the trustee's apparent failure to garner the requisite bondholder acceptance, we do not pass upon the propriety or fairness of the tender offer as presently proposed. We believe, however, that such a tender offer, which is essentially an exchange of private for public debt and which is not funded by a sale of estate assets, may not require our separate approval. If the offer would not affect the system configuration, capital structure, or earning power of the railroad as ultimately reorganized (i.e., would not constitute an integral part of a reorganization plan), recourse to us for approval may be unnecessary.[36]

NewMil Plan

As we stated in the *MRRA* case, we are greatly concerned about rail competition in the Pacific Northwest and across the northern tier. Slip op. at p. 9. The NewMil plan, which would preserve the Milwaukee's important role in those regions while operating most of the trackage embraced by Milwaukee II, thus starts from a position of comparative strength on public interest grounds. Plans for preserving important service, however, are not equivalent to

[35]Milwaukee first mortgage bondholders would be offered $650 for each $1,000 principal amount, plus an amount equal to accrued interest (as of July 1, 1980, $120 per $1,000 principal amount) to the date of the offer.

Bondholders under the Bedford Belt first mortgage, Southern Indiana first mortgage, CTH&SE first and refunding mortgage, and CTH&SE income mortgage would be offered $455 for each $1,000 principal amount, plus an amount equal to accrued fixed interest (at 2 3/4-percent per annum, as of July 1, 1980, $82.50 per $1,000 principal amount) to the date of the offer.

General mortgage bondholders would be offered $565 for each $1,000 principal amount of series A, and $600 for each $1,000 principal amount of series B.

Each offer would be conditioned upon acceptance by holders of not less than 70 percent of the Milwaukee first mortgage bonds and 50 percent of the general mortgage bonds.

[36]See *Boston & Maine Corp., Reorganization—Tender Offer*, 354 I.C.C 621, 622-23 (1978).

prospects for attaining viability, and a finding of viability is an essential prerequisite to our approval of a reorganization plan.

The New Railroad proposed by NewMil is nearly identical to the Louisville Transcontinental configuration studied by BAH. The consultant determined that:

> If the market opportunities are realized in full, the most attractive option based on NROI potential alone is the Louisville Transcontinental ***. The risk associated with this option *** is that it involves competing head-to-head with the Burlington Northern and Union Pacific in the East-Northwest market in which they presently have (1) transit times less than half that of the Milwaukee, (2) much higher traffic density (and therefore better opportunities for run-through service) and (3) large equipment fleets tailored to meet their customers' needs. This option requires that Milwaukee make very large rehabilitation and equipment investments before a competitive penetration of the market can be expected to succeed. In the meantime, "cash" losses of nearly $20 million per year might be expected. The probability of ever penetrating this market beyond a token level is quite low, given the level of competition.[17]

BAH also found that:

> at 1977 traffic levels the potential losses are greater than the Sub Core and Miles City Sub Core options. More significantly, the Louisville option requires the second highest plant rehabilitation *** and the third highest total investment commitment ***. Additionally, the investment commitment must be largely completed before any meaningful penetration of this highly competitive market can be anticipated. The risk is all at the front end of the Louisville Transcontinental option with the Milwaukee Road coming from a position of weakness.[18]

NewMil argues that the Louisville Transcontinental configuration was identified by BAH as the "most promising" and as having "the best chance to make money." See NewMil reply statement, pp. II-1, II-17. The BAH study excerpts set forth above, however, indicate that the consultant concluded only that the Louisville Transcontinental has the *potential* for the highest NROI, and further that the risks attendant to achievement of that potential are likewise very great. As we pointed out above, the BAH study did not purport to determine the probability that a particular configuration would "make money," but rather indicated four levels of performance providing an estimated "range of risk" associated with the implementation of that system.

We believe that NewMil has been more objective than the trustee in identifying traffic potential above that projected by BAH. We also

[17] BAH Study, Vol. II, p. VI-22.
[18] *Id.* at VI-24.

believe, however, that by using maximum market potential as its ultimate forecast, as the trustee has done, it similarly anticipates overoptimistic growth. As discussed above, the New Railroad's operations would be only marginally profitable even assuming achievement of the unprecedented performance contemplated by NewMil. Further, as the Gellman report determined, the system would chafe under a low fixed charge coverage, shown in the following tables.

New Railroad fixed charge coverage (equipment lease capitalized)

	Ratio
NewMil plan, without productivity	1.4
NewMil plan, with productivity	1.8
Trustee's inflation rate, without productivity	1.2
Trustee's inflation rate, with productivity	1.6
NewMil plan adjusted, without productivity	1.1
NewMil plan adjusted, with productivity	1.4
"No-growth" scenario, without productivity	No coverage.
"No-growth" scenario, with productivity	NA

New Railroad fixed charge coverage (equipment leases not capitalized)

NewMil plan, without productivity	1.8
NewMil plan, with productivity	2.8
Trustee's inflation rate, without productivity	1.4
Trustee's inflation rate, with productivity	2.4
NewMil plan adjusted, without productivity	1.1
NewMil plan adjusted, with productivity	1.7
"No-growth" scenario, without productivity	No coverage.
"No-growth" scenario, with productivity	No coverage.

Productivity gains.—NewMil has projected productivity cost savings which would have a substantial effect on the New Railroad's financial performance. It quantifies the savings at $12 million (1977 dollars) per year, but the derivation of the figure appears rather subjective. Although the record contains many expressions of cooperation by indvidual employees and a small number from bargaining representatives, we do not see any mutual (NewMil *and* labor) expressions identifying specific areas for change.

We understand labor's reluctance to commit itself at this point, especially since NewMil is neither a carrier nor presently in control of the Milwaukee system. Nonetheless, if ever a community of interest is to exist between labor and NewMil, it is now, when both

seek preservation of more Milwaukee mileage, and more Milwaukee employees, than the trustee would retain. Were the NewMil plan to be approved, the community of interest might no longer prevail; the New Railroad's management would be concerned with productivity while labor representatives would be concerned with employment and wage levels. In this light, we find significant labor's failure to come forward indicating which work rules it might be willing to renegotiate, or even what savings goals it feels might realistically be attainable. On this record, we believe that any quantification of productivity gains is highly speculative.

The importance of achieving the savings projected by NewMil is reflected in the differing rates of return and fixed charge coverages (set forth above) which the New Railroad would enjoy with and without such gains. The NPV analysis performed by Gellman demonstrates the effect even more dramatically. As shown in the following table, absent the productivity improvement, the New Railroad would not project a positive NPV from its future cash flows (discounted at 20 percent) even under the NewMil plan as proposed.

New Railroad net present value at 20 percent

	Millions of dollars
NewMil plan, without productivity	(33)
NewMil plan, with productivity	81
Trustee's inflation rate, without productivity	(55)
Trustee's inflation rate, with productivity	60
NewMil plan adjusted, without productivity	(55)
NewMil plan adjusted, with productivity	65

Fairness and equity.—As partial compensation for the lines and equipment which the New Railroad would acquire, it would relieve the estate of (a) common carrier obligations and potential losses from operating Milwaukee II, (b) the need to incur additional debt to operate Milwaukee II, and (c) the labor protection claims of those employees hired under the NewMil plan which (because Milwaukee II employment levels would be lower) would not be employed by Milwaukee II. NewMil quantifies the consideration flowing to the estate by projecting the net present value of (a) future cash flows to the estate, (b) claims against the estate, and (c) labor protection claims against the estate, first, were the estate to operate Milwaukee II, and second, were the estate to transfer the involved

assets to the New Railroad. NewMil concludes that the difference between the results were the estate to operate Milwaukee II and were it to transfer the assets to the New Railroad (i.e., the sum of the higher cash flow, lower claims, and lower labor protection costs which would result from transfer) constitutes partial consideration for those assets. This partial consideration (termed "unallocated value"), is appraised by NewMil at $267.3 million.[39]

The NewMil plan contemplates not the reorganization of an existing railroad but the sale of a portion of the railroad's assets to a new carrier entity and liquidation of the balance. Section 77(b) of the Bankruptcy Act provides that a plan of reorganization may include the sale of all or any part of the property of the debtor "at no less than a fair upset price." The assets to be acquired by the New Railroad have a minimum value (as calculated by NewMil) of $394.8 million.[40] In addition to the proposed partial consideration described above, the New Railroad would assume obligation for about $96 million in outstanding Federal debt and about $9 million in redeemable preference shares of the Milwaukee, and would issue $22.5 million in certificates of contingent value to Milwaukee shareholders.

Setting aside all questions regarding potential overstatements or underestimates in NewMil's calculations and valuations, we cannot find that the proposed partial consideration would replace the corpus of the estate for the asset value removed. The analysis wrongly assumes that the automatic result of a failure to implement the NewMil plan is institution of the trustee's plan (otherwise the difference in cash flow is meaningless). Implicit in that assumption is the further assumption that the trustee's plan is fair and equitable to the Milwaukee estate (otherwise it could not be implemented).

The circularity of the reasoning, and the unreality of the proposed partial consideration, are then obvious. Since the proposed partial consideration is based on the differing cash flows under transfer to the New Railroad and under adoption of Milwaukee II, the valuation given to it increases as the projected performance of Milwaukee II decreases. But if Milwaukee II could not be implemented because of deficiencies, the difference in cash flows is meaningless; comparisons might as well be drawn between the NewMil proposal and a straw plan.

[39]This amount also includes the assumption by the New Railroad of the obligation to provide labor protection for all Milwaukee employees which it hires. We note that such an assumption would have a value to the estate only if all claims having a higher priority could be satisfied under the plan.

[40]The trustee avers that NewMil has undervalued those assets by $140 million.

We do not believe that the difference in projected cash flows represents compensation. Nor can we conclude that the assumption of labor protection obligations has a value to the estate of at least $267.3 million. As presented, the NewMil plan is not fair and equitable.

CMC Plan

Section 77(b) of the Bankruptcy Act provides that a mandatory feature of a reorganization plan is adequate means for its execution. The CMC plan contains no method for its implementation. It would merely require expeditious sale of assets, but provides no guidance on the manner or timing of such sales, nor the disposition of the proceeds. We do not believe that CMC's plan meets the explicit requirements of the statute.

One of the primary purposes of section 77 is the preservation of rail service. See *New Haven Inclusion Cases*, 399 U.S. 392, 431 (1970); *In Re Tennessee Central Ry. Co.*, 304 F. Supp. 789, 790 (M.D. Tenn. 1969). For a plan to comport with this intendment, we believe that, at a minimum, it should contain provisions supportive of continued rail service where such continuation is possible without resort to Procrustean measures. The CMC plan provides not even this meager assurance; as presented, the proposal is not compatible with the public interest.

FINDINGS

We find that the plans of reorganization for the Milwaukee filed by (a) the trustee and (b) NewMil, and the plan of liquidation filed by CMC, do not meet the requirements of section 77 of the Bankruptcy Act, 11 U.S.C. 205.

CHAIRMAN GASKINS, concurring:

I am concerned that this decision can be miscontrued in that it contains a wide spectrum of rate of return calculations ranging as high as 5.8 percent for the NewMil plan. In my view, this figure is based on traffic revenue and cost projections which have little creditability. Furthermore, this figure would represent the maximum rate of return such an enterprise would earn and even this level is insufficient to sustain the firm in the long run.

While I am not clairvoyant, I believe the "reasonable growth scenario" outlined in appendixes I and J is a possible, reasonably

optimistic scenario. Unfortunately, under this scenario neither plan will earn a rate of return sufficiently high to justify 5 more years of losses and a massive infusion of Federal funds at low interest rates. Consequently, it would be irresponsible for this Commission to approve either plan of reorganization.

It is ordered:

The plan of reorganization for the Chicago, Milwaukee, St. Paul and Pacific Railroad Company filed by Richard B. Ogilvie, trustee for the debtor, is disapproved.

The plan of reorganization for the Chicago, Milwaukee, St. Paul and Pacific Railroad Company filed by New Milwaukee Lines is disapproved.

The plan of liquidation for the Chicago, Milwaukee, St. Paul and Pacific Railroad Company filed by Chicago Milwaukee Corporation and Chicago, Milwaukee, St. Paul and Pacific Railroad Company is disapproved.

This decision is without prejudice to continuation of the proceeding and submission of new or revised plans.

Jurisdiction is retained in this proceeding for such further action as may be necessary and appropriate.

By the Commission, Chairman Gaskins, Vice Chairman Gresham, Commissioners Stafford, Clapp, Trantum, and Alexis. Chairman Gaskins concurring with a separate expression.

APPENDIX A

Chicago, Milwaukee, St. Paul and Pacific Railroad Company

BALANCE SHEET AS OF OCTOBER 31, 1979

Current assets:		
701	Cash	$(202,706.69)
702	Temporary cash investments	6,000,000.00
703	Special deposits	228,333.30
704	Loans and notes receivable	481,499.25
705	Accounts receivable, interline and other balances	5,380,010.65
706	Accounts receivable, customers	18,240,351.46
707	Accounts receivable, other	13,428,823.88
708	Interest and dividends receivable	131,847.97
708.5	Receivables from affiliated companies	350,569.34

Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Continued

BALANCE SHEET AS OF OCTOBER 31, 1979—Continued

Current assets—Continued:		
709	Accrued accounts receivable	$64,833,790.16
710	Working funds	9,044.00
711	Prepayments	1,517,008.54
712	Material and supplies	31,087,352.16
713	Other current assets	11,243,653.51
	Total current assets	152,730,577.53
Special funds:		
715	Sinking funds	1,437.13
716	Capital funds	2,987,224.27
	Total special funds	2,988,661.40
Investments:		
721	Investments and advances; affiliated companies	24,460,716.94
	Undistributed earnings from certain investments in account 721	89,783,393.00
722	Other investments and advances	7,413,730.27
	Total investments	121,657,840.21
Tangible property:		
731	Road and equipment property:	
	Road	622,573,337.29
	Equipment	204,780,194.74
	Road under capital leases	787,222.54
	Equipment under capital leases	127,656,464.14
	Other elements of investment	(98,723,540.42)
735	Accumulated depreciation; road and equipment property:	
	Road	(162,031,220.61)
	Equipment	(123,052,122.54)
	Capitalized leases	(39,150,185.86)
736	Accumulated amortization; road and equipment property—defense projects:	
	Road	(2,095,019.53)
	Equipment	(1,050,314.29)
	Net road and equipment property	533,694,815.46
732	Improvements on leased property:	
	Road	757,814.78
	Equipment	7,496,413.99
733	Accumulated depreciation; improvements on leased property:	
	Road	(551,155.38)
	Equipment	(2,818,156.43)
	Net improvements on leased property	4,884,916.96
	Total carrier property	538,579,732.42

Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Continued

BALANCE SHEET AS OF OCTOBER 31, 1979—Continued

Tangible property—Continued:		
737	Property used in other than carrier operations	$9,531,282.86
738	Accumulated depreciation; property used in other than carrier operations	(4,958,654.33)
	Net property used in other than carrier operations	4,572,628.53
	Total tangible property	543,152,360.95
	Other assets and deferred debits:	
741	Other assets	7,708,774.40
743	Other deferred debits	7,371,179.13
	Total other assets and deferred debits	15,079,953.53
	Total assets	835,609,393.62

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
751	Loans and notes payable	407,954.69
752	Accounts payable; interline and other balances	5,228,566.57
753	Audited accounts and wages payable	12,406,427.93
754	Accounts payable; other	7,406,852.93
755	Interest payable	1,203,558.17
759	Accrued accounts payable	94,275,107.04
761.5	Other taxes accrued:	
	Operating	5,220,770.60
	Nonoperating	64,365.32
763	Other current liabilities	28,105,153.46
764	Equipment obligations and other long-term debt due within 1 year	10,713,607.70
	Total current liabilities	165,032,364.41
Long-term debt due after 1 year:		
765	Funded debt unmatured	
766	Equipment obligations	1,406,335.96
766.5	Capitalized lease obligations	97,134,454.99
767	Receivers' and trustees' securities	85,759,892.00
768	Debt in default:	
	First mortgage 4 percent bonds, series A	48,735,300.00
	Gen. mortgage 4-1/2 percent inc. bonds, series A	25,150,700.00
	Gen. mortgage 4-1/2 percent con. inc. bonds, series B	31,127,400.00
	Bedford Belt Ry. Co. first mortgage bonds	148,000.00
	Southern Indiana Ry. Co. first mortgage bonds	5,102,000.00
	CTH&SE Ry. Co. first and refunding mtge. bonds	7,170,000.00

Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Continued

LIABILITIES AND SHAREHOLDERS' EQUITY—Continued

Long-term debt due after 1 year:		
768	Debt in default—Continued:	
	CTH&SE Ry. Co. income mortgage bonds	$4,738,800.00
	5 percent income debentures, series A	55,604,000.00
769	Accounts payable; affiliated companies	37,950,355.53
	Total long-term debt due after 1 year	400,027,238.48
Other long-term liabilities:		
774	Accrued liability; casualty and other claims	18,190,052.00
781	Interest in default	5,649,651.92
782	Other liabilities	89,662,902.69
	Total other long-term liabilities	113,502,606.61
Deferred credits:		
784	Other deferred credits	4,005,061.11
786	Accumulated deferred income tax credits	34,599,550.00
	Total deferred credits	38,604,611.11
Shareholders' equity:		
791	Capital stock (par or stated value):	
	Redeemable preference shares, series 1 initial par value $10,000 per share	9,130,000.00
	Common stock—no par value (stated value $100 per share)	217,989,200.00
	Preferred stock—par value $100 per share	51,865,200.00
	Total capital stock	278,984,400.00
797	Retained earnings; appropriated	----------
798	Retained earnings; unappropriated	(160,541,826.99)
	Total retained earnings	(160,541,826.99)
	Total shareholders' equity	118,442,573.01
	Total liabilities and shareholders' equity	835,609,393.62

APPENDIX B

Chicago, Milwaukee, St. Paul and Pacific Railroad Company

INCOME STATEMENT—1979

Operating revenues:	
Freight	$392,268,707
Passenger	11,909,290
All other	A46,821,700
Joint facility account	4,446,536
Railway operating revenues	455,446,233

See footnote at end of table.

Chicago, Milwaukee, St. Paul and Pacific Railroad Company—Continued

INCOME STATEMENT—1979—Continued

Operating expenses:	
Way and structures	$105,436,755
Equipment	172,507,289
Transportation—Train, Yard and Train, Yard Common	217,334,241
Transportation—Spec. Services, Admin. Support	30,767,733
General and administrative	48,314,573
Railway operating expenses	B574,360,591
Net revenues from railway operations	(118,914,358)
Other income	24,607,415
Income from affiliated companies:	
Equity in undistributed earnings	12,578,854
Miscellaneous deductions from income	1,727,965
Income available for fixed charges	(83,456,054)
Fixed charges:	
Interest on funded debt	20,263,754
Interest on unfunded debt	1,443,648
Amortization of discount on funded debt	14,132
Total fixed charges	21,721,534
Income after fixed charges	(105,177,588)
Unusual or infrequent items	----------
Income taxes and provisions for deferred inc. taxes	----------
Extraordinary items	----------
Net income (loss)	(105,177,588)
Ratios:	
Expenses to revenues	126.1
Total maintenance to revenues	61.0
Transportation to revenues	54.5
Reconcilation of net railway operating income:	
Net revenues from railway operations	$(118,914,358)
Income taxes on ordinary income	----------
Provision for deferred income taxes	----------
Income from lease of road and equipment	(19,615)
Rent for leased roads and equipment	119,486
Net railway operating income (loss)	(118,814,487)

A Includes the following government transfers applied to operating revenue:

Regional transportation authority contract compensation	$11,581,078
Federal Railroad Administration intermodal freight subsidy	746,052
State grants for roadway rehabilitation	2,756,300
Milwaukee Railroad Restructuring Act	10,000,000

B Includes $31,097,778 in expenditures financed by trustee's certificates issued under financial assistance provisions of the Railroad Revitalization and Regulatory Reform Act of 1976.

Source: Chicago, Milwaukee, St. Paul and Pacific Railroad Company Quarterly Report of Revenues, Expenses and Income, 4th quarter, 1979.

APPENDIX C

Chicago, Milwaukee, St. Paul and Pacific Railroad Company estimate of liquidation value of assets December 31, 1977 (dollars in thousands)

Current assets:			
Cash		$3,132	
Accounts receivable		28,513	
Material and supplies		27,898	
Other current assets		2,348	
Total current assets			$61,891
Special funds			7,127
Investments in affiliated companies:			
Milwaukee Land Company		110,203	
The Milwaukee Motor Transportation Company		1,330	
All other investments in affiliates		---------	
Total investments in affiliated companies			111,533
Other investments			435
Properties:			
Real estate		228,458	
Roadway		276,353	
Equipment	$155,390		
Less: Equipment obligations	14,040	141,350	
Total properties—liquidation value			646,161
Other assets			5,019
Total assets—liquidation value			832,166

Note: Intercompany amounts eliminated.

APPENDIX D

Chicago, Milwaukee, St. Paul and Pacific Railroad Company estimate of liquidation value of investment Milwaukee Land Company December 31, 1977 (dollars in thousands)

Current assets:		
Cash and temporary cash investments	$7,136	
Accounts receivable	903	
Other current assets	28	
Total current assets		$8,067
Long-term receivables:		
Sales contracts	803	
Notes	897	

Chicago, Milwaukee, St. Paul and Pacific Railroad Company estimate of liquidation value of investment Milwaukee Land Company December 31, 1977 (dollars in thousands)—Continued

Long-term receivables—Continued:			
Total long-term receivables			1,700
Investments in affiliated companies			1,136
Properties:			
Real estate—timber tracts 151,104 acres	$73,172		
Real estate—industrial, 3,609 acres and improvements	22,042		
Total real estate		$95,214	
Railroad equipment	14,967		
Less: equipment obligations	9,114		
Total railroad equipment		5,853	
Other equipment		15	
Total properties			101,082
Other assets			10
Total assets—liquidation value			111,995
Less: liabilities			1,792
Liquidation value of investment			110,203

Note: Intercompany amounts eliminated.

APPENDIX E

Chicago, Milwaukee, St. Paul and Pacific Railroad Company estimate of liquidation value of investment The Milwaukee Motor Transportation Company December 31, 1977 (dollars in thousands)

Current assets:			
Cash and working funds		$198	
Accounts receivable		260	
Material and supplies		113	
Other current assets		1	
Total current assets			$572
Property:			
Land and structures equipment		85	
Tractors	$1,669		
Trailers	817		
Loading equipment	864		
Service vehicles	47		
Shop, garage and office equipment	18		

Chicago, Milwaukee, St. Paul and Pacific Railroad Company estimate of liquidation value of investment The Milwaukee Motor Transportation Company December 31, 1977 (dollars in thousands)—Continued

Property—Continued:			
Total equipment	$3,415		
Less: equipment obligations	2,164		
		$1,251	
Total property			$1,336
Operating authorities			165
Investment in affiliated company			110
Other assets			3
			2,186
Total assets—liquidation value			856
Less liabilities			
Liquidation value of investment			1,330

Note: Intercompany amounts eliminated.

APPENDIX F

Chicago, Milwaukee, St. Paul and Pacific Railroad Company investments in affiliated companies (not wholly owned)

Company	Percent ownership	Investments and advances book value (000)
Chicago Union Station Company	25.0	$9,227
Davenport, Rock Island and North Western Railway Company	50.0	3,180
Des Moines Union Railway Company	50.0	1,945
Indiana Harbor Belt Railroad Company[A]	49.0	3,985
Kansas City Terminal Railway Company	8.33	2,383
Minneapolis Eastern Railway Company	50.0	24
The Minnesota Transfer Railway Company	11.11	234
The Pullman Company	1.28	123
Trailer Train Company	2.44	561
Longview Switching Company	33.33	11
Delta Alaska Terminal Ltd.	6.66	1
Total		21,674

[A] Undistributed earnings in this investment totaled $2,561,000 at the close of 1978.
Source: Railroad Company Chicago, Milwaukee, St. Paul and Pacific 1978 Annual Report.

APPENDIX G

Forecast carloadings Milwaukee II

Year	BAH[A] (000)	Index 1977=100.0	Trustee (000)	Index 1977=100.0
1977	534	100.0	571	100.0
1980	---------	---------	[D]614	107.5
1981	[B]668	125.1	[E]648	113.5
1982	---------	---------	[E]724	126.8
1983	---------	---------	[E]752	131.7
1984	---------	---------	[E]825	144.5
1985	---------	---------	---------	---------
1986	[C]720	134.8	---------	---------

NEW RAILROAD

Year	BAH[F] (000)	Index 1977=100.0	NewMil (000)	Index 1977=100.0
1977	572	100.0	572	100.0
1980	---------	---------	529	92.5
1981	[B]710	124.1	591	103.3
1982	---------	---------	663	115.9
1983	---------	---------	729	127.4
1984	---------	---------	744	130.1
1985	---------	---------	759	132.7
1986	[C]763	133.4	774	135.3

[A] Carloads for Miles City Sub Core plus Kansas City Sub Core minus Sub Core configurations.
[B] Market opportunities short term.
[C] Market opportunities long term.
[D] From trustee's initial statement. Trustee's reply to initial statement indicates that the projected 1980 forecast is for 628,051 carloads.
[E] Estimated from trustee's *pro forma* revenues. Assumes $496 (current dollars) net freight revenue per carload in 1980, inflated 7.8 percent per year.
[F] Carloads for Louisville Transcontinental configuration.

APPENDIX H

Historic carloadings Milwaukee Railroad

Year	Total carloads (000)	Index 1970=100	Market share[A] (percent)
1970	1,007	100.0	N/A
1971	919	91.3	N/A
1972	951	94.4	5.1
1973	991	98.4	5.0
1974	951	94.4	4.9

(See footnote at end of table)

Historic carloadings Milwaukee Railroad—Continued

Year	Total carloads (000)	Index 1970=100	Market share[A] (percent)
1975	846	84.0	5.0
1976	905	89.9	5.3
1977	856	85.0	5.1
1978	793	78.7	4.5
1979	736	73.1	4.1

[A]Percentage of total rail traffic in western district.

APPENDIX I

Milwaukee II 1986 results—"reasonable growth" scenario 682,000 carloads [A]*(dollars in millions)*

Operating revenues		$576.0
Operating expenses:		
Maintenance of way:		
Normalized	$103.3	
Rehabilitation	4.8	
Total		108.1
Maintenance of equipment		99.1
Transportation		257.3
General and administrative—traffic		37.3
Total operating expenses		501.8
Taxes		36.5
Rents		45.2
Total operating expenses, taxes, and rents		583.5
Net railway operating income		(7.5)
Other income[B]		6.6
Income available for fixed charges		(0.9)
Fixed charges		14.9
Net income		(15.8)
Coverage of fixed charges:		
Income available for fixed charges		(0.9)
Interest component of equipment lease payments		15.7
Rehabilitation expenses		4.8
Income available for fixed charges net of equipment lease interest and rehabilitation		19.6
Fixed charges		14.9
Interest component of equipment lease payments		15.7
Fixed charges including equipment lease interest		30.6
Coverage of fixed charge ratio		0.6

(See footnotes at end of table)

Milwaukee II 1986 results—"reasonable growth" scenario 682,000 carloads [A]*(dollars in millions)*—Continued

Coverage of fixed charges—Continued:		
Capitalization at 11 percent[C]		$1,865.6
Capitalization at 20 percent[C]		2,583.1
Rate of return at 11 percent—percent		1.1
Rate of return at 20 percent—percent		0.8

[A]571,000 carloads in 1980, increased by 3 percent per year.
[B]Excludes Milwaukee Land Company income.
[C]Gellman Research Associates, Inc., capitalization of Milwaukee II, adjusted, less additional debt.

APPENDIX J

New Railroad 1986 results—"reasonable growth" scenario 720,000 carloads [A]*(dollars in millions)*

Operating revenue		$859.6
Operating expenses:		
Maintenance of way:		
Normalized	$123.9	
Rehabilitation	5.9	
Total		129.8
Maintenance of equipment		120.2
Transportation		356.5
General and administrative—traffic		64.2
Total operating expenses		670.7
Taxes		63.9
Rents		130.1
Total operating expenses, taxes, and rents		864.7
Net railway operating income		(5.1)
Other income		7.1
Income available for fixed charges		2.0
Fixed charges		11.0
Net income		(9.0)
Productivity adjustments		28.9
Adjusted net income		19.9
Coverage of fixed charges:		
Income available for fixed charges		2.0
Interest component of equipment lease payments		34.8
Rehabilition expenses		5.9
Income available for fixed charges net of equipment lease interest and rehabilitation		42.7
Productivity adjustment		28.9
Adjusted income available for fixed charges net of equipment lease interest and rehabilitation		71.6

(See footnotes at end of table)