PROSPECTUS FOR PROVIDING CONTINUING RAIL SERVICE ON MILWAUKEE LINES LOCATED BETWEEN MILES CITY, MT AND MARENGO, WA

prepared by the

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A. Introduction

The purpose of this document is to present background information on Montana's proposal for providing continuing rail service on Milwaukee lines located between Miles City, MT and Marengo, WA. The document is divided into five sections. The first section presents background information on recent events affecting the Chicago, Milwaukee, St. Paul and Pacific Railroad (commonly known as the Milwaukee Road or simply as the Milwaukee) and an estimate of what is likely to happen in the near future. The second section summarizes the recent application submitted by the State of Montana for Federal loans/grants for the acquisition and rehabilitation of Milwaukee lines in Montana, Idaho, and eastern Washington. The purpose of this action is to (1) retain competitive rail service in Montana and Idaho and (2) preserve rail-oriented jobs and create new employment opportunities. Federal loans/grants are being sought through the Farmers Home Administration (FmHA) and the Federal Railroad Administration (FRA) under a recently implemented tri-agency agreement among FmHA, EDA and FRA for improving rural transportation. The third section reviews the economic feasibility of the lines between Miles City, MT and Marengo, WA and includes projected cash flow and proforma income statements. The forth section discusses the role that Milwaukee lines can play in the transport of coal from mines located in southeastern Montana. The final section summarizes the preceeding through a series of questions and answers designed to demonstrate that the proposed railroad is a viable solution and is in the interest of coal companies, electric utilities, and other shippers in the affected states.

B. Background[1/]

The origins of the dire financial situation faced by the Milwaukee stem from annual losses incurred on a more or less regular basis during the 1970's which finally resulted in bankruptcy being declared on December 19, 1977. Normally, when such an event occurs, the firm involved is closed down and the assets are then disposed of with the proceeds going to the creditors. Since closing down a railroad company usually causes severe economic ramifications on firms dependent upon rail service, Congress many years ago set up a special process for reorganizing railroads forced into bankruptcy while at the same time continuing essential services. Upon petitioning for bankruptcy under Section 77 of the Federal Bankruptcy Act, the U. S. District Court overseeing the case appointed a Trustee to oversee the reorganization of the Milwaukee on a self-sustaining basis or its liquidation (or some combination of the two courses of action).[2/] The process involved is inherently a confrontation between the interests of the creditors, who seek to prevent any further diminution of their assets, and the shipping public who seek the continuation of essential rail service.

How did the Milwaukee get into this situation? To understand the underlying cause, one must review the history of the Milwaukee's Pacific Coast Extension. The Milwaukee was the last of the four transcontinental

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1/ This section is intended to provide background information to those who have not closely followed the Milwaukee situation. Those familiar with recent events can skip ahead to page 13 , if so desired.

2/ Mr. Stanley E. G. Hillman was appointed Trustee on January 19, 1978 and ratified by the ICC on February 13, 1978. On July 23, 1979, due to the illness of Mr. Hillman, Mr. Richard B. Ogilvie was appointed Trustee.

carriers which developed mainline routes through Montana and Idaho to Washington and Oregon. Consequently, it was not able to select the best routes through the mountains, nor was it a land grant railroad able to obtain extensive properties through legislation to encourage settlement in proximity to the railroad. The Milwaukee never was able to develop on-line traffic comparable to the Northern Pacific or Great Northern (now part of the Burlington Northern).

Much of the Milwaukee's Montana and Idaho traffic originates on its branches -- specifically, the grain lines between Harlowton, Lewiston and Great Falls and other branches extending from Plummer Jct. to Spokane, Spokane to Coeur d'Alene (lumber), and St. Maries to Bovill (sawlogs and wood products), plus originating traffic at Deer Lodge, Bonner, Missoula, Frenchtown, St. Maries and Avery on the mainline. Other than for this traffic, the mainline through Montana and Idaho is largely a conduit for through traffic moving between the midwest and the west coast. In short, the Milwaukee has generated losses on its midwest operations and its operation on the Pacific Coast Extension has not generated sufficient income to offset these losses.

In the summer of 1978, the Trustee, concluding that the Pacific Coast Extension was inherently unprofitable, announced a plan whereby Milwaukee Lines west of Butte were to be sold to connecting railroads or to be abandoned. The disposition of the remaining lines was to be held in abeyance until completion of financial studies undertaken by Booz, Allen & Hamilton, a well-known managment consulting firm,

for the Trustee. This anouncement triggered outside efforts to maintain the Milwaukee as a transcontinental carrier and precipitated a continuing debate over the viability of the Milwaukee's western lines. Shortly after the Trustee's announcement, a coalition of employees formed an association called "Save Our Railroad Employment" (SORE) for the purpose of investigating the feasibility of reorganizing the western lines as an independent private company. The SORE study concluded that these lines could be reorganized and operated as a money-making privately-owned railroad.

The Booz-Allen strategic planning study analyzed, in detail, eight route configurations selected by the Trustee. For each network configuration, it considered (1) the availability of traffic, (2) operational requirements, (3) facilities and equipment, (4) financial impact, (5) capital investment required to rehabilitate plant and equipment, and (6) resulting employment. The results of the study were released on May 11, 1979. A midwestern alternative (since called Milwaukee II) was chosen as having the greatest prospect for success.[1/]

In late April, 1979, the Trustee concluded that the cash flow situation had become so severe that rail service had to be discontinued on a majority of the Milwaukee trackage (including all lines west of Miles City, MT). Consequently, the Trustee petitioned the U. S.

1/ Mitigating against the transcontinental alternatives was the sizable investment required to rehabilitate the Pacific Northwest extension.

District Court to approve this course of action. Normally the ICC has exclusive say over line abandonments; unilateral termination of rail service is only done in extremely dire circumstances. On June 1, 1979, the Court denied the partial embargo requested by the Trustee, since it could find no statutory or other authority for granting the requested relief. This was done reluctantly, as the Court felt that the Trustee's proposal would promote the public interest.[1/] Prior to the decision, contingency plans had been prepared by the ICC whereby connecting carriers would provide "directed service" for a minimum of 60 days, with the cost to be borne by the Federal government. The court decision was a serious blow to the Trustee's efforts to reorganize the Milwaukee and did nothing to solve the railroad's precarious cash position. Consequently, attorneys for the Trustee filed an appeal to the Court's decision.[2/]

On June 19, 1979, the Trustee received Court approval to apply to the FRA for a loan of $20 million.[3/] In approving the loan, the Court ordered the Trustee to immediately "commence proceedings to abandon the Milwaukee's entire system and, to the extent this is not

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1/ The Court also stated that allowing an embargo could "constitute a de facto abandonment," since the Trustee conceded that he would not be able to reorganize the Milwaukee "if it contains the portions sought to be embargoed."

2/ On October 2, 1979, the U. S. Court of Appeals revised the original court decision on the basis that the District Court's powers under Section 77(c)(3) of the Bankruptcy Act to impose conditions upon the issuance of Trustee's Certificates coupled with the fact that the Milwaukee had been in a condition of "imminent cashlessness" at the time of the Trustee's application to borrow $20 million of ERSA funds, and thus empowered the Court to embargo rail service on all portions of the railroad outside of the core system.

3/ The funds requested are part of the $50 million available through the Emergency Rail Services Act of 1970.

authorized by any Title VIII map not already published, to publish and file such a map as soon as feasible." He further ordered that the Trustee file a plan of reorganization on or before August 6, 1979, "such plan to include reorganization by abandonment and liquidation to the extent deemed advisable or necessary." The Court did not order the Trustee to abandon the entire railroad, but rather to develop and file a reorganization plan which would be the basis for the abandonment of existing routes.

On June 30, 1979, the Milwaukee filed a revised systems diagram map with the ICC showing all lines as subject to an abandonment application within three years, or pending before the ICC. This map did not necessarily mean that abandonment of the entire Milwaukee system was possible; but rather provided maximum flexibility to the Trustee in deciding which segments were to be eventually included in its core system.

On August 8, 1979, the Milwaukee, citing the continuing losses being experienced systemwide and the fact that the western lines were not included in the Trustee's plan for restructuring the Milwaukee, filed a petition with the ICC to abandon all of its lines west of Miles City, MT. The ICC subsequently adopted an expedited schedule allowing 155 days from the date of the Trustee's application to the final administrative decision. (The ICC has subsequently recommended to the Reorganization Court the abandonment of Milwaukee lines west of Miles City with service to be terminated on or about March 23, 1980.)

On August 10, 1979, the Trustee filed his proposed reorganization plan with the District Court. Briefly, the plan proposed that service be discontinued on all lines outside the so-called "Milwaukee II" core system (primarily a midwestern configuration of approximately 3,200 miles extending as far west as Miles City, MT). Service on all other other lines would be terminated and the lines would be sold to other carriers or abandoned.

In August, the Trustee again sought court permission to embargo service over all lines outside of the Trustee's proposed "Milwaukee II" system. Notwithstanding the Court's adverse decision in June, the Trustee contended that the Milwaukee had indeed become "cashless" during the intervening period. Hearings were held in August and the Court ruled, on September 27, 1979, that the Trustee-proposed embargo be granted, effective November 1, 1979.

In the aftermath of the Court's early June decision, which narrowly averted an embargo of rail service on the western lines, a group of shipper and employee interests, agreed to form a Washington-based non-profit corporation, known as the "New Milwaukee Lines" (New Mil), to serve as a mechanism for putting together a new railroad corporation. This organization has, and continues to, receive strong Montana support and encouragement. The objective of New Mil is to ensure continued, competitive rail service in regions currently served by the bankrupt Milwaukee. In September, SORE and New Milwaukee Lines each filed a preliminary plan of reorganization for the Milwaukee's estate with the District Court. SORE's plan proposed a reorganized system operating the Milwaukee's lines west from the Twin Cities to

the west coast. New Milwaukee Lines proposed a configuration stretching west from Louisville. Each plan was filed under substantial time pressure and recognized the need for subsequent development and amendments.

In addition to the Booz-Allen report, various other studies have been undertaken to analyze various aspects of the Milwaukee system or to critique earlier reports.

* After reviewing the Booz-Allen study, the FRA concluded, in May, 1979, that the methodology used was reasonable and consistent. However, in response to the SORE and New Milwaukee Lines proposals, and rising public interest and concern, FRA commissioned several independent studies to correct and elaborate in certain deficient areas.

* Analyzing the potential self-sustainability of the SORE-Lines West proposal, and accepting projected traffic, Consulting Center Incorporated noted that certain expense items and the acquisition plan involved were unrealistic, and that the plan was unacceptable in its current form (July, 1979).

* Later a second study conducted by Consulting Center Incorporated found New Milwaukee figures to be accurate and realistic.

* Mark Battle Associates, examining the impact upon labor and labor protection of the SORE-Lines West proposal, concluded that the "use of an ESOP should definately be considered in the overall plan for the Milwaukee Road" if the western lines were otherwise viable.[1/]

* Other studies commissioned by groups other than the Federal Government have generally been more optimistic regarding the future of the western lines.

Because of the magnitude and complexity of the problems facing the Milwaukee, and the public it serves, and because of perceived

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1/ ESOP is an abbreviation for employee stock ownership plan.

inadequacy of normal abandonment and reorganization procedures, considerable pressure was exerted on Congress to provide a more appropriate means for restructuring the Milwaukee. Many legislators felt that the option of an employee or employee-shipper-owned railroad needed to be considered and analyzed more fully. A second issue was the magnitude of the labor protection claims upon abandonment or embargo. A third issue was the taxpayer cost of directed service over embargoed lines and the fact that this action would only postpone the day of total cessation of rail service.[1/] Congress passed the Milwaukee Railroad Restructuring Act on November 2, 1979 and the President signed the Act on November 4, 1979. The legislation directs the ICC and the District Court to give prompt and expedited consideration to a plan for saving the railroad by reorganizing the Milwaukee into an employee-shipper-owned carrier operating a restructured and self-sustaining system. The statute provided funding to keep the entire railroad operating during the period required for consideration of this alternative and granted the reorganization court-sweeping powers to quickly approve abandonments on all lines not included in the employee-shipper-owned system. If the resulting plan is not approved by the ICC and the Court, the Act precludes any directed service on the Milwaukee system until April 1, 1981. The Act includes a series of tight deadlines which have to be met by the principal parties.

1/ Because of anticipated Congressional action, no directed service orders were instituted to soften the November 1st embargo authorized by the District Court. A temporary embargo did, in fact, occur.

On December 1, 1979, the New Milwaukee Lines filed its employee-shipper ownership plan for the reorganization of the Milwaukee Railroad with the ICC and Reorganization Court. The plan prepared by the New Milwaukee Lines proposed that a new employee and shipper-owned corporation be formed to operate a scaled-down system, amounting to approximately half of the Milwaukee's present total route mileage. The new railroad would extend from the northwest ports of Seattle, Tacoma and Portland across the transcontinental mainline through the Twin Cities to Milwaukee, Chicago and Louisville, KY. The plan proposed acquisition of all of the Milwaukee Road's present equipment and locomotive fleets; an immediate return to normalized track and equipment maintenance; implementation of a seven-year program to acquire more than $540 million worth of modern freight cars; and, a track rehabilitation program estimated to cost approximately $211 million. Necessary working capital was to be raised by shipper investments of $10 million, and a loan of $15 million to be raised by creation of an employee stock-ownership plan. The plan also called for the new company to take on approximately $120 million of new federal debt in order to fund portions of the rehabilitation program. The plan encompassed commitments from rail labor to participate in a task force program to negotiate changes in the new system's operating practices. These changes, when coupled with the employee stock ownership program and the physical rehabilitation of the plant, were expected by the New Milwaukee Lines to result in significant improvements in labor productivity.

On December 31, 1979, the ICC rejected the New Mil plan because it lacked adequate financing, was not financially equitable to the Milwaukee Road's estate, and could not be made self-sustaining. At

the same time, the Commission reaffirmed the need for rail competition across the northern tier of states.

Although a modified plan has subsequently been filed by New Mil supporters, the prospects for gaining ICC approval are not considered high. (An ICC ruling on a revised New Mil plan is expected shortly, however.) Montana continues to support the New Mil plan as its preferred solution; however, Montana is not particularly optimistic that this plan will be successful.

In early January, PLM (a San Francisco-based car-leasing company) presented its plan for retaining competitive rail service on Milwaukee lines in Idaho and Montana. This plan was developed as a result of encouragement provided by Montana officials. As such, it has aroused considerable interest and some controversy. It is the only other proposal (to New Mil) which has been submitted to Montana or the Federal government to date. The proposal indicates that continued operation of Milwaukee lines in Montana, Idaho and eastern Washington would be feasible if rehabilitated and operated in a lean, efficient fashion.[1/]

During 1978 and 1979, the Trustee undertook negotiations with other railroads and firms interested in purchasing portions of the Milwaukee trackage west of Miles City. In late January, the Burlington Northern placed considerable pressure on the Milwaukee Trustee to conclude the pending agreement for the transfer of selected segments to the BN. The Trustee, recognizing that the sale of these segments would foreclose the larger sale of Milwaukee properties over which competitive rail

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1/ Montana is not committed to this proposal and considers PLM to be only one of a number of possible operators who could potentially provide local rail services after March 1, 1980.

service could be conducted, inquired as to Montana's interest in acquiring the lines between Miles City, MT and Marengo, WA. As a result of negotiations conducted between Montana and the Trustee on January 25, 1980, a tentative agreement was reached whereby Montana would acquire the Milwaukee properties, provided that funding could be secured for this purpose and final negotiations concluded by March 1, 1980.

A delay in the ICC decision prevented the conclusion of negotiations with the Trustee and other parties by the March 1, 1980 deadline. Negotiations are continuing and a final agreement is expected to be reached shortly after the release of the ICC decision which is now anticipated about March 14, 1980.

On February 29, 1980 the reorganization court ruled to allow an immediate embargo on Montana lines west of Missoula, Montana. Service on lines east continue with FRA funding through March 23, 1980.

What is likely to happen in the near future? It appears quite likely that the reorganization court will reach a finding as to which reorganization plan (if any) will be implemented.[1/] Service west of Miles City will be discontinued about March 23, 1980, unless arrangements are made with the Trustee to cover the net cost of such service. However, congressional action to provide service for 30-90 days is being sought by the Montana congressional delegation and the outcome of said action is unknown at this time. Should Montana be successful (1) in raising necessary venture capital, (2) securing the requested loans and grants from the Federal government, and (3) concluding negotiations with the Trustee then it will be possible to establish a successor rail operation soon after funding runs out.

1/ It is always possible that the reorganization could direct the liquidation of the estate.

C. The FmHA/FRA Application

As a result of recent negotiations conducted between Thomas L. Judge, Governor of the State of Montana and Richard B. Ogilvie, Trustee of the property of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company whereby the Trustee offered to the State of Montana the opportunity to acquire Milwaukee properties in Montana, Idaho, and eastern Washington for $55 million, Governor Judge on February 1, 1980, forwarded to the Federal government an application to provide for the acquisition and rehabilitation of Milwaukee lines in Montana, Idaho, and eastern Washington. Montana has not in the past, nor does it now seek, long-term ownership or operation of Milwaukee lines in Montana, and is taking this step only because there no longer appears to be any practical way to ensure continued operation of these lines after March 23, 1980. Under this application, the State of Montana would acquire title to the rail lines defined in Attachment A. A Montana-based non-profit corporation (Montana Railway Corporation) has been established to oversee the acquisiton and rehabilitation financing and the general operation of rail lines acquired by the State. To do this, the corporation proposes to execute a lease-purchase agreement with a qualified operator selected on the basis of available investment capital and railroad operating experience to provide the required rail services and eventually acquire the property from the State. Thus, Montana ownership of Milwaukee lines is viewed as an expedient solution to an immediate problem and not an end in itself.

1. Financing Package Being Sought

a. Acquisition of Milwaukee Lines. A direct USDA-FmHA loan for $55,000,000 at a five percent interest rate payable on or about April, 1, 1980 with reapyment spread over a ten-year period. Interest-only payments of $234,492 would be made monthly during the first year with amortization payments principal and interest) of $633,450 would be made monthly from the second through the tenth year. The property to be acquired from the Trustee would provide the required collateral.

b. Rehabilitation of the Rail Property. Rehabilitation funds are being sought from four different sources:

(1) RRRRA Section 505 Funds. A total of $10 million in preference share-funding at a 2.03 percent interest rate payable at periodic intervals during 1980, with repayment spread out over a 30-year period, is being sought to provide a portion of the initial funds required for track rehabilitation (mainline between Miles City and Marengo).

(2) Montana State Bonds. Under Chapter 564 of the Montana Session Laws of 1979, the Department of Highways is authorized to issue revenue bonds and make loans for the rehabilitation of railroad tracks and associated facilities in Montana. Section 5 of this Act limits the interest rate to nine percent or less and the total amount of bonds outstanding at any one time to $25 million or less. The legislation did not pledge the faith and credit of Montana in support of these bonds. The $25 million in funds would be used in support of mainline track rehabilitation in Montana during the second and third years. Since the bonds are not presently marketable under the limitations of the Act, four alternatives are being investigated:

(a) Federal Guarantees. Under this alternative, Montana would sell the bonds, the proceeds of which would be used to finance a loan to the operator for rehabilitation purposes. The operator will amortize the State loan utilizing operating revenues. USDA-FmHA will guarantee the repayment of the operator's loan to the State. A second lien on the property will provide the required collateral.

(b) Revise Legislation to Remove Tax Exempt Status. Under this alternative, Montana would revise the enabling legislation (at the next legislative session) to remove the tax exempt status from the proposed revenue bonds and raise the allowable interest rate to 13 to 15 percent to ensure the marketability of the bonds. Concurrent with this, Montana will seek a USDA-FMHA guarantee of the revenue bonds; a second lien on the property will provide the required collateral.

(c) Revise Legislature to Provide Security. Under this alternative, Montana would revise the enabling legislation (at the next legislative session) to pledge the faith and credit of the State in guaranteeing repayment of the bonds and to raise the allowable interest rate to 10 to 12 percent to ensure the marketability of the bonds.

(d) Industrial Revenue Bonds. Under this alternative, Montana will request counties to float industrial revenue bonds to support track rehabilitation within counties in lieu of the $25 million bond authorization at the state level. Such tax exempt (usually) bonds can be issued by counties and cities in amounts up to $10 million per project. There is no repayment guarantee associated with these bonds.

No decision has yet been made as to which course of action is most feasible.

(3) RRRRA Section 803 Funds. A total of $14 million in local rail service assistance funding ($4 million the first year and $2.5 million per year for the next four years) is being sought to rehabilitate light density or branchlines in Montana. The local share will be provided by venture capital. Additional Section 803 funding will be sought from Idaho to rehabilitate branchlines in that state. The above amounts are subject to change as a consequence of local and national eligible mileage, the utilization of Section 803 funding by the various states, and future appropriations.

(4) Venture Capital. It is anticipated that $16 million could be raised in venture capital during the first three years ($7 million the first year and $4.5 million per year during the second and third years) through stock purchases by Montana investors and corporations dependent upon continued rail service. Initially, most of this money will be utilized as working capital to sustain operations and eventually to purchase locomotives, rolling stock and equipment. Venture capital will be utilized to provide the local match for Section 803 funds. Starting not later than the fourth year, venture capital (and retained earnings) will be used to support continuing rehabilitation. Alternatively, Section 505 funds will be sought should rehabilitation needs prove to be considerably in excess of previous estimates.

D. Economic Feasibility

1. Cash Flow and Pro-Forma Income Account Projections

Montana recognizes the necessity of demonstrating the economic feasibility of the proposed rail operation so that potential investors can conclude whether Montana acquisition and rehabilitation of Milwaukee lines is economically viable. The section of the lines from Miles City, MT to Marengo, WA was based upon the potential economic viability of this portion of the Milwaukee lines. There is sufficient originated and terminated traffic on these lines to maintain a viable short line railroad.[1/] The Milwaukee lines in this area provide the only significant rail competition to the Burlington Northern. Feasibility is dependent upon who will be the operator and the policies/philosophy adopted by that carrier; consequently, firm estimates cannot be established at this point in time.

Table 1 provides a "rough" cash flow projection for the first year of the operation. Table 2 provides a preliminary proforma income statement for the first five years. Both tables are based on information developed originally by PLM and subsequently modified by Montana officials. They are included only to indicate the viability of this or similar operations and do not imply State endorsement of PLM as the operator of these lines.

2. Managment and Control

As mentioned earlier, Montana has established a non-profit corporation, to (1) oversee the acquisiton and rehabilitation financing and general operation of the rail lines to be acquired by the state, (2) provide an acceptable conduit for raising the private and corporate venture capital needed for working capital, equipment, locomotives and rolling stock, and track rehabilitation, and (3) initially to select the most qualified and capable operator. The corporation's Board of Directors will include industry, labor, and governmental representation and will be responsibile for ensuring that USDA-FmHA and FRA monies are wisely spent and that the operator is providing adequate service and meeting the needs of shippers located along the lines. It is anticipated that the private and corporate venture capital will be raised through the sale of common stock issued by the operator and that industry representatives on the Borad of Directors will be drawn from the major investors or stockholders. The object is to keep control of the operation firmly in the hands of those dependent upon or benefiting directly from the provisions of continued rail service.

3. Track Rehabilitation Program

Acquisition of the Milwaukee lines requires a concurrent investment in rehabilitating the lines. The Booz-Allen & Hamilton study performed for the Trustee indicated that approximately $65 million will be required to rehabilitate the 1,210 miles to be acquired by Montana

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1/ Based upon estimates from the FRA commissioned Reebie Report.

The rehabilitation program shown in Table 3 is Montana's best estimate of the amount and timing of the work to be done over a five-year period. Most of the required work involves tie renewals and ballasting. Quantities involved include the installation of 600 and 750 thousand new ties, 1.6 to 2 million cubic yards of ballast, and 20 to 25 thousand tons of new rail to change out existing 100 pound mainline rail and replace curve worn and defective rail. The indicated program of $10 to $15 million per year can be accomplished either by force account employees of the operating railroad or on a contractual basis by qualified construction firms.

4. Shipper Support

There is strong statewide support for continuing service on these lines. In a state that annually ships an average of 120 million bushels of grain, Montana shippers recognize the importance of the competition and capacity of service on Milwaukee lines. During the last marketing year lack of rail service on both the BN and Milwaukee forced shippers to move 35% of all grain by truck, an increase of 21%. This truck movement has placed a heavy burden on already deteriorated highways.

5. Labor Environment

Montana has traditionally had strong union influence. The local employees are committed to continued service on Milwaukee lines in Montana.

TABLE 1

PRELIMINARY CASH FLOW FOR THE MONTANA PACIFIC RAILROAD

	WEEK ONE	WEEKS 2 THRU 6	WEEKS 7 THRU 26	MONTHS 7 THRU 12
Revenues	0	$1,152,506	$ 8,856,102	$23,131,007
Payroll	19,500	207,969	2,330,625	$ 4,017,000
Operating Expenses	49,003	535,836	3,214,306	7,109,894
Rents	9,380	187,227	1,364,235	3,188,212
BALANCE	$ (77,883)	$ 221,474	$ 1,946,936	$ 8,815,901
Taxes	31,115	155,575	622,300	808,990
HmA Debt	52,885	264,425	1,057,700	1,375,010
Contingency	80,115	400,575	1,602,300	2,082,990
BALANCE	$(241,998)	$ (599,101)	$(1,335,364)	$ 4,548,911
Cumulative Balance	$(241,998)	$(841,099)	$(2,176,463)	$ 2,372,448

Note: The cash flow shown differs from that implied in the pro-forma income statement for several reasons including: (1) The timing of services and expenses (cash versus accural), (2) Non cash items such as depreciation, (3) The contingency or overrun allowances not included in the cash flow and other inkind differences.

The maximum negative cash position would be about $2.4 million dollars and occur at about the 30th week. PLM considers this estimate to be conservative.

The above preliminary cash flow estimate is based on data and assumptions as of January 29, 1980 and will be revised as better information becomes available from potential operators.

TABLE 2

PRELIMINARY PRO-FORMA INCOME STATEMENT FOR THE MONTANA PACIFIC RAILROAD
(all costs and revenues in thousands of January 1980 dollars)

	Year 1	Year 2	Year 3	Year 4	Year 5
RAILWAY OPTG. REV.					
Freight	$32,396	$55,502	$61,668	$61,668	$61,668
All Other	744	1,274	1,416	1,416	1,416
TOTAL	$33,140	$56,776	$63,084	$63,084	$63,084
RAILWAY OPTG. EXP.					
Maint-W&S	$ 4,923	$ 7,527	$ 8,231	$ 8,231	$ 8,231
Maint-Equip	1,235	2,006	2,214	2,214	2,214
Traffic	829	897	915	915	915
Transport.	7,375	12,259	13,579	13,579	13,579
General	2,232	2,707	2,835	2,835	2,835
SUB-TOTAL	16,594	25,396	27,774	27,774	27,774
Contingency	4,166	4,166	4,166	4,166	4,166
TOTAL	$20,760	$29,562	$31,940	$31,940	$31,940
NET REV fm RWY OPTNS	$12,380	$27,214	$31,144	$31,144	$31,144
Rwy Tax Accruals	1,618	1,618	1,618	1,618	1,618
RAILWAY OPTG INCOME	$10,762	$25,596	$29,526	$29,526	$29,526
Rent Income	0	0	5	5	5
Rent Payable	4,749	7,929	8,809	8,809	8,809
NET RWY OPTG INCOME	$ 6,013	$17,667	$20,772	$20,772	$20,772
Other Income	63	63	63	63	63
TOTAL INCOME	$ 6,076	$17,730	$20,785	$20,785	$20,785
Misc. Income Deduc.	574	574	574	574	574
INC. AVAIL FOR FIXED CHGS	$ 5,502	$17,156	$20,211	$20,211	$20,211
Fixed Chgs	3,000	9,374	10,647	10,647	10,647
INC AFTER FIXED CHARGES	$ 2,752	$ 7,782	$ 9,564	$ 9,564	$ 9,564
Profit Shar.	413	0	0	0	0
TAX. INCOME	$ 2,339	$ 6,615	$ 8,129	$ 8,129	$ 8,129
Inc. Taxes	1,170	1,654	4,064	4,064	4,064
AFTER TAX INC.	$ 1,169	$ 4,961	$ 4,065	$ 4,065	$ 4,065
Preferred Dividends	216	216	216	360	360
CHANGE IN RET. EARNINGS	$ 953	$ 4,745	$ 3,849	$ 3,705	$ 3,705

NOTE: The above preliminary pro-forma income statement is based on data and assumptions as of January 29, 1980 and will be revised as better information becomes available from potential operators.

Freight Revenues. Based on the average of the Milwaukee's two highest years between 1976 and 1978. Year 1 (startup) is calculated at approximately 52.5 percent of the computed average, Year 2 at 90 percent of the computed average, and Year 3 through 5 at 100 percent of the computed average. Traffic consists primarily of grain hauled west and forest products hauled east. (See Table 27 of the PLM proposal for a more specific identification of commodity type, O&T's, carloads, and revenue). A majority of the traffic either originates or terminates on line, although some through traffic or overhead has been included as indicated below:

Traffic Component		Year 1	Year 2	Years 3-5
Received	Traffic	6,483	7,511	8,345
	Revenue (000)	$ 7,419	$ 8,215	$ 9,128
Forwarded + Local	Traffic	26,355	33,728	37,476
	Revenue (000)	$22,791	$27,293	$30,325
Overhead-Eastbound	Traffic	1,720	3,096	3,440
	Revenue (000)	$ 2,322	$ 4,180	$ 4,644
Overhead-Westbound	Traffic	7,388	10,960	12,178
	Revenue (000)	$10,624	$15,815	$17,572
TOTAL	Traffic	41,946	55,295	61,439
	Revenue (000)	$43,157	$55,502	$61,668

Revenues are based on mileage prorate divisions with connecting carriers. Westbound overhead traffic consists largely of wheat and corn produced in South Dakota and is dependent upon assigning covered hoppers to Dakota stations and preservation of Milwaukee routes between Aberdeen and Mitchell, S.D. Carloads and revenues shown are dependent upon the operator leasing some Milwaukee equipment. (See Table 28 of the PLM proposal for assumptions utilized). Eastbound overhead traffic consists of traffic destined to points on the Milwaukee II system.

Other Revenues. Revenues attributable from switching, demurrage, storage, and short-term rentals of operating property and equipment.

Maintenance of Way and Structures. ICC Accounts 201-282. Based on the employment of 175 to 200 persons for track and structure maintenance and the installation of 86,000 ties, 142,000 cu. yd. of ballest, and 20 to 25 miles of new rail per year.

Maintenance of Equipment. ICC Accounts 301-339. Based on the employment of 30-40 persons for freight car running repairs and cleaning and locomotive light repairs.

Traffic. ICC Accounts 351-360. Based on the employment of 15-20 persons for sales; rates, tariffs and divisions; and marketing and development.

Transportation. ICC Accounts 371-422. Based on the employment of 150-200 persons for train and station operation (enginemen, conductors, freight agents).

General Operating Expenses. ICC Accounts 451-460. Covers expenses of executive, law, finance and accounting departments.

Contingency. Allowance for unanticipated operating expenses. Safety factor.

Railway Tax Accruals. Allowance for the payment of property taxes; if required, and other taxes (e.g. personal property taxes).

Rent Income and Rent Payable. Lease payments for locomotives and rolling stock required to operate the line. Also covers the lease of roadway machines.

Other Income. Primarily leases.

Miscellaneous Income Deductions.

Fixed Charges. Includes payments to (1) amortize the $55 million USDA-FmHA loan, (2) the $10 million in preference share funding, and (3) the $25 million in state revenue bond funding.

Profit Sharing. Computed at 15 percent of the income after fixed charges to be paid to employees.

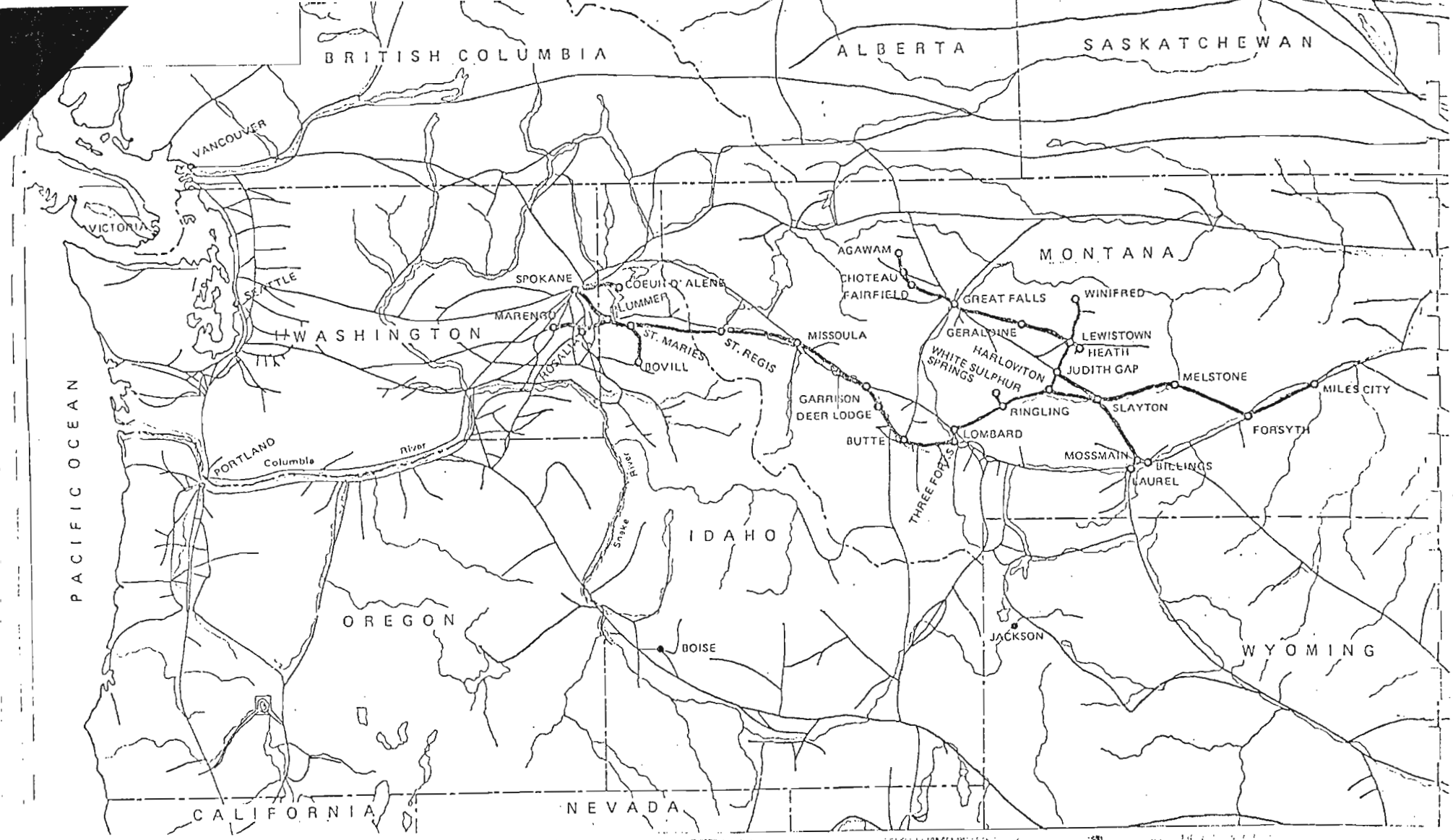
Income Taxes. Computed at 50 percent of taxable income.

Preferred Dividends. Computed at 12 percent on $1.8 million in preferred stock issued in the first three years and on an additional $1.2 million issued in the fourth year.

TABLE 3

TRACK REHABILITATION PROGRAM

Funding Source	Terms	Expenditure in Year ($ millions) 1	2	3	4	5
FRA 505	30 yr, 2%	10.0				
MT State Bonds	20 yr, 9%		12.5	12.5		
FRA 803	Grant	4.0	2.5	2.5	2.5	2.5
Venture Capital	803 Match	1.0	0.6	0.6	0.6	0.6
Venture Capital or FRA 505					6.3	6.3
Total		15.0	15.6	15.6	9.4	9.4


BRITISH COLUMBIA
ALBERTA
SASKATCHEWAN
VANCOUVER
VICTORIA
SEATTLE
WASHINGTON
PACIFIC OCEAN
PORTLAND
Columbia
River
SPOKANE
COEUR D' ALENE
LUMMER
MARENGO
ROSALIA
ST. MARIES
DOVILL
ST. REGIS
MISSOULA
GARRISON
DEER LODGE
BUTTE
AGAWAM
CHOTEAU
FAIRFIELD
GREAT FALLS
WINIFRED
GERALDINE
LEWISTOWN
HEATH
HARLOVITON
JUDITH GAP
WHITE SULPHUR SPRINGS
RINGLING
SLAYTON
MELSTONE
MILES CITY
FORSYTH
LOMBARD
THREE FORKS
MOSSMAIN
BILLINGS
LAUREL
MONTANA
Snake
River
IDAHO
OREGON
BOISE
JACKSON
WYOMING
CALIFORNIA
NEVADA

E. Can the Milwaukee Lines Play a Major Role in the Future Transport of Coal?

Whether the Milwaukee (includes lines both east and west of Miles City) will ever play a significant role in the transport of coal depends upon the attitudes of the coal companies and the utilities. If used simply as a bargaining ploy in rate negotiations with the BN (the dominant carrier serving the Montana coal fields), then the role of the Milwaukee may be a fleeting one. If the Milwaukee is to assume the role of a legitimate alternative to the BN, then its long-term existence must first be partially assured by those who will directly benefit from rail system competition and necessary rehabilitation undertaken to re-establish the coal-hauling capabilities of Milwaukee lines. Otherwise, the coal-producing sections of Montana will remain captive to the BN with all the economic limitations that course of action implies.

The ability to negotiate reasonably favorable rates and other terms is directly dependent upon maintaining routing choices. If the ultimate destination for westbound coal shipments is at a location served exclusively by the BN, then maintenance of competing rail lines matters little, as the BN would seek single carrier control of the movement. If the ultimate destination is on the UP or another railroad, then a run-through operation utilizing the Milwaukee trackage is an obvious alternative to a BN-dominated movement. Since there are no serious BN rail system capacity limitations on traffic moving west from Miles City, it is not clear the degree to which the BN will seek to attract unit coal train traffic. However, a strong bargaining position is not possible if, through a lack of competing facilities, BN considers the resulting coal traffic as being captive to their system. Hence the long-term value of the Milwaukee in helping assure the orderly development and marketing of Montana's coal reserves.

ATTACHMENT A

Properties and Rights to be Conveyed

Milwaukee Main Line

Miles City, Montana (MP 1120.0) to Marengo, Washington (MP 1927.0), 807 miles.

Montana Division, 3rd, 4th, 5th, 6th, and 7th Subdivision; Washington Division, 1st Subdivision.

Milwaukee Branch Lines

Montana Division	10th Subdivision	Harlowton-Lewistown Yard	61 mi.	
Montana Division	11th Subdivision	Lewistown Yard-Heath	9 mi.	
Montana Division	12th Subdivision	Winifred Jct-Winifred	43 mi.	
Montana Division	13th Subdivision	Lewistown Yard-Falls Yard	135 mi.	1/
Montana Division	14th Subdivision	Falls Yard-Agawam	56 mi.	2/
Montana Division		Ringling-Dorsey	3 mi.	
Montana Division	8th Subdivision	Bonner Jct-Bonner	2 mi.	
Washington Division	5th Subdivision	Plummer Jct-Manito	20 mi.	3/
Washington Division	23rd Subdivision	Dishman-Spokane Bridge	11 mi.	
Washington Division	23rd Subdivision	Spokane Bridge-Coeur d'Alene	14 mi.	4/
Washington Division	24th Subdivision	St. Maries-Purdue	50 mi.	

Milwaukee Trackage Rights (to the extent legally possible)

at Miles City (MP 1120.0 - MP 1116.5) (trackage rights on Milwaukee II)
Purdue-Bovill (trackage rights on the WI & M)
Manito-Dishman (trackage rights on the UP)
Dishman-Spokane (trackage rights on the UP)
Judith Gap-Laurel/Billings (trackage rights on the BN)
Running track through Spokane Yard together with whatever rights are necessary for (1) interchange with the BN and UP at Spokane, (2) access the Ford Motor Company automobile ramp, and (3) access reciprocal switching.

1/ Segment between Spring Creek Jct and Lewistown, jointly owned with BN (BN maintained)
2/ Segment between Dracut Jct jointly owned with the BN (BN maintained)
3/ UP has trackage rights over this segment
4/ Alternate segments are owned by the BN and the Milwaukee with the other railroad having trackage rights

F. Questions and Answers

Q - Why is competitive rail service so important?

A - Although very few shippers in Montana have a direct choice, the benefits of competition extend much farther. Competitive service (1) helps keep rates commensurate with costs, (2) encourages carriers to provide the cars and local service if they want to maintain a share of the market, and (3) prevents a "taken for granted" or "captive market" attitude which so often accompanies transport service when one company is dominant.

Q - Why is shipper financial support necessary at this time?

A - Montana has made application to the Federal government for loans/grants with which to acquire and rehabilitate Milwaukee trackage in Montana, Idaho and eastern Washington. Federal approval of this package is being withheld pending the demonstration of local financial support. There are some who feel that Montana is not serious and even if it were, it could not organize and carry out their responsibilities within the time available. Consequently, the ability to raise venture capital appears to be an important ingredient in determining whether the requested loans/grants will be approved.

Q - Would the new railroad serve the coal-producing areas of the State?

A - Yes, through an access line extending between Ashland and Miles City. The coal-producing areas are dominated by the BN. The BN prefers to exploit its own reserves and thus is not particularly interested in serving competing mining operations except on its own terms. Traffic is already reaching capacity on lines extending east, thus, the BN is not particularly interested in additional traffic. The situation is somewhat different on westbound traffic where the BN's interest would be somewhat greater. Retention of competitive rail service in this portion of the state provides better long-term assurance that the coal reserves will be developed as demand increases and that development will not be constrained or otherwise adversely affected by the corporate goals of the transportation company.

Q - Do shippers have a stake in the new railroad?

A - Very definitely yes. All-too-often in the past, shippers have sought competitive service as a means of keeping rates down and, at the same time, have not felt a lasting responsibility to utilize the service provided. All-too-often, companies have opted for least-cost transport and have not considered the long-term economic ramifications of eventually becoming captive shippers. Shippers must recognize that not all the risk can or should be borne by the transportation company -- that they indeed have a stake in the financial success of the transportation company. Part ownership through common stock is an excellent way to help assure that the service measures up to expectations.

Q - Isn't the New Mil proposal a better solution?

A - In theory, yes. However, there appears to be little likelihood that the New Mil proposal will be accepted by the Reorganization Court. While the Miles City-Marengo proposal was originally conceived as a "backup" to the New Mil proposal, it now appears to have a far better chance of being implemented. It complements, rather than competes, with the Trustee's Milwaukee II plan. It costs the Federal government far less in rehabilitation costs. It has a greater chance of being profitable. It may well be the only practical solution left.

Q - Why doesn't Montana state government become more directly involved?

A - First, Governor Judge is committed to a private sector rather than a governmental solution. There is always a question of whether politics could be kept out of rail operations and economic decisionmaking, if done under government auspices. In addition, government involvement requires legislative action which is not practical within the available time frame. Montana does not want to be in the rail business.

Q - Will interim rail service be available?

A - The first need is to obtain sufficient commitments for venture capital to facilitate Federal approval of the requested loan. Unless this is achieved, interim rail service is moot. Assuming for the moment that potential investors do come through with sufficient commitments to result in Federal approval, then Montana will proceed ahead to purchase the property from the Milwaukee Trustee, select an operator, and make arrangements for interim service.

Q - How will an operator be selected? We understand that a proposal has been received by a San Francisco-based firm. Does this firm have the inside track?

A - Assuming that the necessary venture capital is indeed raised and the Federal government approves the requested loans/grants, an operator would then be selected on a competitive basis. In choosing an operator, Montana will be looking for (1) a willingness to reach an appropriate accommodation with labor on compensation, benefits and conditions, (2) ability to supply cash and non-cash start-up capital and to develop standby lines of credit necessary to ensure the financial success of the rail operation, (3) management expertise and experience in operating rail properties of a similar character, (4) an ability to supply through lease or purchase necessary locomotives, rolling stock, and mechanized maintenance equipment, and (5) proven ability to manage or supervise a major trade rehabilitation program.

Q - How can the new operation make money when the Milwaukee went bankrupt?

A - Contrary to popular opinion, the abandonment proceedings showed that the Milwaukee's Pacific Coast Extension was inherently marginal rather than unprofitable. The losses that indeed occurred were the result of years of deferred maintenance and the additional costs resulting from slow-speed operators. The Montana proposal (1) retains the traffic (and revenue) producing branches, (2) eliminates unproductive mainline trackage in Washington, and (3) includes expenditures for restoration of track conditions necessary for efficient operation. It is important to recognize that this trackage can only be profitable if operated in a lean, efficient manner. There are many examples of similar lines written off by the owning railroad as hopeless which have become financially successful local service lines.

Q - What will happen if this effort should fail?

A - Most of the 1,200 miles would be abandoned, limited portions would be sold to competing carriers. In Montana, the BN would achieve virtually a monopoly position -- with little incentive to improve car supply or service or inaugurate innovative services and rates. Montana shippers would have even less leverage than they enjoy today. In Idaho, continuing rail service to St. Maries and Bovill would be dependent upon corporate interests; long-term rail service to users in this area could not be assured. The full ramifications of what this means could only be determined by allowing it to happen -- by then, it is too late. Shippers and potential investors should carefully consider whether this course of action is in their long-term interest. An opportunity forsaken could be one forever lost.

Q - What is the prime ingredient necessary to make the Montana proposal succeed?

A - A willingness to invest in the railroad by those benefiting from continued rail service.

Q - What does Montana need?

A - A commitment (in letter form) to invest a stated amount in the new railroad along with an associated schedule for payment of the obligation.