

A STATEMENT BY
STANLEY E. G. HILLMAN
CONCERNING
THE MILWAUKEE ROAD



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Stanley E. G. Hillman
concerning
the Milwaukee Road

In mid-March, 1978, about five weeks after officially assuming his duties as the court-appointed Trustee of the properties of the Milwaukee Road, Stanley E. G. Hillman filed with the court in Chicago a statement in support of his request of the court to issue \$5.1 million in Trustee's Certificates secured by a federal guarantee under the Emergency Rail Services Act of 1970. Mr. Hillman's statement constituted his first public discussion of his inquiries into the present and future condition of the Milwaukee. Here is what he said.

Since my appointment, I have approached my responsibilities as Trustee with full recognition of the diversity of interest groups which must receive consideration and protection and equal recognition of the difficulty in satisfying any of those groups entirely. These interests include creditors, secured and unsecured, shareholders who may have equity, employees, shippers and others who may be generally classified as the public.

The few weeks since my appointment have not been sufficient for me to analyze in full the position of the Milwaukee Road, develop an outline of a reorganization plan or to reach a final conclusion that the Milwaukee Road can be reorganized as an operating entity. I have, however, identified several overriding considerations.

First, the Milwaukee Road has a great many valuable assets. While some of these assets may have greater value in other uses, much of the property and equipment has greatest value in railroad operations.

Second, while some of the railroad property may best be operated by other railroads, it remains possible that most of the system can profitably be operated by a reorganized Milwaukee Road and that such a reorganization will provide the greatest benefits to all of the interests in this proceeding.

Third, the Milwaukee Road provides important and in some instances unique services to the shipping public.

Fourth, legal and commercial considerations make prompt liquidation impractical as an alternative.

In the remainder of this statement, I will deal with the actions I am taking to improve the performance of the Milwaukee Road and, more specifically, with the grounds for the request which is before the court. However, I must emphasize at the outset that the considerations I have cited mandate maintaining the operations of the Milwaukee Road for the foreseeable future so that

all possibilities may be evaluated and unnecessary harm to any of the affected interests may be avoided.

Internal management

As Trustee, my first efforts have been to utilize the resources presently available to maintain operations.

Accordingly, I immediately announced that there would be no policy of wholesale employment terminations so that necessary personnel would stay with the organization. At the same time, I am conducting performance reviews throughout the railroad's management so that the effectiveness of the organization can be increased. I have found that the Milwaukee Road has a substantial number of talented officers, and I am confident that I can direct the talents of these people to improve the performance of the railroad. In addition, I have continued an effort to obtain early retirements which has resulted in about 100 non-union people leaving the organization.

I have begun the process of separating all operations of the holding company, Chicago Milwaukee Corporation, from the operations of the railroad. Completion of this separation will yield further efficiencies for the railroad's operations.

Similarly, I have been analyzing the railroad's equipment fleet in order to assure that it is utilized to the fullest extent possible. For example, after analyzing the railroad's locomotive availability problem, which I will discuss more extensively later, I determined that unnecessary delays in repairs were occurring because of the low level of maintenance activity. Accordingly, I have directed the employment of additional men at our repair shops to expedite crucial repairs to our fleet. This action adds approximately \$350,000 to my monthly mechanical budget.

These steps are only a beginning. In the next few months I plan to conduct an over-all review of our total freight locomotive and car requirements to determine the numbers and types required and the necessary levels of maintenance. I also intend to analyze and revise the capital program for fixed plant and the maintenance-of-way budget so that adequate service can be maintained on the railroad's productive lines. Each of these actions will be guided by my evolving information and judgment with respect to the future of the Milwaukee Road so that expenditures are not made for assets which are likely to become unproductive.

Structural changes

While I believe that significant improvements in the Milwaukee Road's income can be made as a result of measures such as those set forth above, the size of the losses experienced in recent years indicates to me that additional structural changes

may be necessary to restore economic viability.

Upon assuming my position, I was pleased to learn that the Milwaukee Road had conducted an extensive program to identify lines which should be abandoned. Pursuant to this program, abandonment was recommended for approximately 1,700 miles out of the Milwaukee Road's more than 10,000 miles of line. For all of the lines to be abandoned the revenue attributable is considerably less than the direct and opportunity costs.

For example, by March 31, applications are expected to be on file with the Interstate Commerce Commission to abandon 1,188 miles of line out of the approximately 1,700 initially identified. The savings to the Milwaukee Road from abandoning these 1,188 miles of line have been estimated to be \$1.4 million annually. Additional expenditures of \$10.5 million for deferred maintenance will be unnecessary as a result of these abandonments. These lines represent approximately \$10.6 million in current investment in land, track and materials. In addition, when the full 1,700 miles identified in the initial project are abandoned our studies indicate that the equivalent of about 1,000 cars and about 11 locomotives will be freed for profitable operations, which increases the benefits listed above.

After reviewing this abandonment program, I decided to adopt and expedite it. Accordingly, motions to adopt certain applications and to submit others to the ICC have been submitted to the court and I am pleased that the requested authority was granted. I expect that additional requests will be presented in the near future. The ICC has now authorized the abandonment of certain lines totaling 107 miles which were the subject of applications submitted by the Milwaukee Road prior to my appointment. Requests for authority to complete these abandonments are being presented to the court. I hope that they will receive prompt affirmative action.

I have directed my officers to continue the process of identifying lines which should be abandoned. We will be filing a new System Diagram Map with the ICC at the end of this month. It will indicate that about 540 miles of lines, in addition to the approximately 1,700 previously referred to, may be beneficially abandoned, making a total of about 2,200 miles so identified. The map also indicates that an additional 1,500 miles is yet under study for possible abandonment in the future. The Milwaukee Road must be freed of unnecessary burdens at the earliest possible date in order for it to meet needs for service and to stem its operating losses.

In addition to abandonments, I am investigating arrangements with other railroads which might improve profitability for all concerned. I have continued ongoing discussions with other railroads,

77 of the Bankruptcy Act), For a Guaranty in Respect of Proposed Loans of \$5.3 Million."

The exhibits filed with the application illustrate the Milwaukee Road's critical cash shortage and describe the planned locomotive repair program as of the preparation of these documents in early February. The cash forecast suggested that I might run out of cash during March. As a result, action was required immediately to bolster the railroad's cash position.

Although I had received assurance that the FRA would act quickly on our application, I expected that the ERSA funds might not be available until April. FRA personnel strongly urged that income of the Milwaukee Land Company be used along with any ERSA funds to provide essential service in accordance with Section 662(3) of ERSA, which conditions rely upon the unavailability of other practical means of obtaining funds.

These conditions prompted me to request an opinion from my counsel as to my authority to direct that the Milwaukee Land Company pay a dividend to the Milwaukee Road. Based upon Order No. 1 and this advice, I directed that a dividend be paid by Milwaukee Land Company on February 28, 1978. A dividend in the amount of \$5.8 million was paid on such date based upon a determination by our outside accountants as to the availability of earnings as a source from which to pay the dividend.

As a result of the dividend from the Milwaukee Land Company, somewhat lower operating expenditures and better agents' collections than originally anticipated, at the end of February the railroad had a book cash balance of approximately \$14 million. Our current estimate for March suggests that cash will decline to approximately \$7 million by the end of the month. Although the improvement in cash as compared to the levels originally forecasted pleases me, I am keenly aware that additional funds such as those requested in this proceeding will be necessary to prevent a cash crisis in the next several months.

I am facing serious demands for cash in a number of areas. For example, as soon as the weather permits, I must spend a significant amount for track maintenance. Our locomotive fleet requires substantial expenditures for both light and heavy repairs. For this proceeding I wish to concentrate upon the light repair program for locomotives since the need to perform such running repairs and preventative maintenance at a higher level is most crucial at this time.

The past winter, with its unusually severe snowfalls and low temperatures, has had a devastating effect upon locomotive availability. The weather problem and deferrals in maintenance due to inadequate cash have caused nearly 45% of our road locomotive fleet to be unavailable. While essential track work and other unavoidable cash

demands may not allow all of the proceeds of the Trustee's Certificates to be earmarked solely for locomotive repairs, and the repair program has evolved since the exhibits were prepared, my present intention is to use most of these funds to accelerate my light repair program for locomotives.

In order to begin to attack the serious problem caused by having nearly 45% of our road fleet out of service, I have not only authorized the increase in maintenance-of-equipment expenditures referred to previously, but also have entered into the short-term emergency leasing of locomotives from other parties (which was approved by the court in Order No. 26). As a result of this action and earlier actions by the Debtor, I anticipate retaining under these short-term leases 43 locomotives until such time as the availability of our power improves sufficiently. The present expanded level of locomotive maintenance will not, even with the leased power, enable us to have an adequate number of units in service by the end of the year. However, if we are able to add the ERSA funds to the present locomotive repair program over the last three quarters of 1978, we may be able to reduce our short-term locomotive leases and reduce our bad-order ratio from 45% to around 20 or 25%.

Conclusion

I am requesting the authority from the court to issue \$5.1 million in Trustee's Certificates and to obtain a guarantee by the United States Department of Transportation, even though such action involves the creation of a lien having priority over existing claims, because I believe that additional cash is essential to maintain the operations of the Milwaukee Road. In my judgment obtaining these funds is even more crucial than is suggested by the exhibits filed with the ERSA application because I do not believe the railroad can function on many of its lines without the additional cash and locomotive maintenance. Many of our operations are essential to substantial shippers and to the public interest. Our important operations cannot legally be abandoned quickly. I am taking steps to abandon all operations which I find cannot be justified.

At this time maintaining the operations of the Milwaukee Road is desirable for the estate as well as legally necessary. While operating the railroad, I can and will evaluate a complete range of alternatives and ultimately develop recommendations which provide the maximum degree of protection to all of the interests in this proceeding. A premature liquidation would result in substantial losses which may ultimately prove unnecessary.

While I cannot, at this time, confidently assure the court that there will always be a Milwaukee Road, I can state that many of the assets of the estate will be vital parts of this nation's rail transportation system for years to come. Moreover, the

Information concerning the assets and operations of the Milwaukee Road which I have been able to assimilate in the past few weeks convinces me that there is every possibility that the Milwaukee Road will emerge from reorganization.

If I can curtail the railroad's least-productive operations through abandonments and increase the performance of its productive operations through arrangements with other railroads and improvements in our best lines, a profitable Milwaukee Road may develop. I believe this solution would be the best for all of the interests involved in this proceeding.

I am confident that issuing the Trustee's Certificates to make possible the continued operation of the Milwaukee Road is in the best interests of the public, the shippers, the employees, and the shareholders.

I am aware that the creation of a new priority claim raises the question of whether there is injury to the creditors. I will not discount the creditors' interests at any time. However, I believe that making our operations as effective as possible is also in the best interests of the creditors. This is true even for secured creditors since a quick abandonment of our operations is not legally possible.

Moreover, the balance sheet on an ICC accounting basis for December 31 shows total assets of about \$721 million and liabilities of \$438 million for an equity of \$283 million. Under liquidation conditions, the value of the Milwaukee Road's railroad transportation property has been estimated to be about \$527 million compared to the book value of \$487 million. As a result, the creditors are well protected and their interests cannot be harmed by the creation of a new \$5.1 million lien. The secured creditors, First and General Mortgage Bondholders, have a very high level of protection for their bonds totaling \$122 million.

Given the magnitude of the railroad's assets and the importance of the service it provides, I believe that all possible measures should be taken to maintain and improve the railroad's operations for the foreseeable future. The issuance of the proposed Trustee's Certificates and the provision of additional cash is essential in this respect.

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