

# 1st MONDAY 3rd MONDAY SPECIAL

Prepared for employees by the  
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March 13, 1979

Managers and Supervisors:

On March 12, Trustee Stanley E. G. Hillman filed a progress report with the reorganization court. He discussed among many subjects the Milwaukee's current and future financial condition, the impact of this winter, our cash situation, the Booz, Allen & Hamilton study, and the next six months of the reorganization process.

Here, briefly, are the highlights of the report:

THE FIRST YEAR: Emphasis has been on maintaining principal operations and sources with available resources and obtaining working capital from the limited outside sources; improving operations where possible and justified; abandoning hopelessly unprofitable branch lines, seeking trackage rights where economically justified, and improving the productivity of the work force; analyzing the value of the Milwaukee's properties and searching for a viable core of routes; and converting assets not needed in railroad operations to cash.

"Through these actions, I have maintained significant services to which the public is entitled while providing the creditors with protection, to which they have the right, against an unconstitutional erosion of their property," Mr. Hillman said. "However, over both of these objectives hangs the plain and inescapable economic fact that I cannot indefinitely maintain operations at a loss without a substantial infusion of external funds. Similarly, I cannot reorganize the Milwaukee Road as an operating entity if I cannot make it profitable."

After taking into account the earnings of its subsidiaries, the Milwaukee had a consolidated net loss in 1978 of \$65.2 million on the basis on which railroads are required to report to the ICC, and \$48.5 million on the "Generally Accepted Accounting Principles" basis which recognizes that track structure is subject to wear and tear just as are other types of assets used in railroading. On the ICC basis, the railroad and its subsidiaries lost an estimated \$34 million in the first two months of 1979, some \$13 million more than the loss in the first two months of 1978.

CASH: The disruption of the winter cut deeply into available cash by late February. Prior to bankruptcy, cash problems often had been alleviated through dividends from Milwaukee Land Company, but the Trustee is restricted from using this source by court action prompted by the company's mortgageholders. "By the weekend of March 3, I was faced with the very real prospect of terminating rail service unless I could promptly obtain \$10 million," Mr. Hillman told the court.

Mr. Hillman consulted with the Federal Railroad Administration. He was told that no funds could be made available immediately, that funds should be sought from Milwaukee Land Company or from property-sale funds held in escrow under the mortgages before he requested additional funds under the Emergency Rail Services Act of 1970. He did arrange to borrow \$10 million from the Land Company with the consent of the mortgage trustees and to issue a Trustee's Certificate. The cash emergency was so severe that he borrowed the funds and applied them to paying bills subject to the approval of the court and the ICC.

I am confident that the best interests of the estate, the creditors and the public are served by maintaining operations at this critical time," Mr. Hillman declared. "I believe that about \$10 million in additional funds will be needed in April to sustain operations. I believe these funds would be sufficient to maintain operations until the early summer when I will be better able to judge the situation and the outlook for the second half of the year." He applied to the court for the additional \$10 million.

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MAINTENANCE: "The Milwaukee Road has been literally starved for funds with which to acquire revenue-producing equipment and maintain properly its locomotives, cars and track. The revenue derived from its overly large and in part unprofitable system of routes has not permitted it to achieve adequate maintenance levels for many years. Yet, during 1978 it was necessary to keep the railroad alive, regardless of the effect of the higher levels of spending on the profit-and-loss statement."

Mr. Hillman indicated that expenses would have been reduced and the losses would have been smaller had the Milwaukee not utilized 4R Act, state and shipper rehabilitation assistance. But: "Had the track and equipment programs not been undertaken in 1978, the physical condition of the railroad would be such that it would be unable to meet the service requirements which are imposed upon it by law. The railroad would not have been able to survive long enough to allow the development of a reorganization plan."

THE BOOZ, ALLEN STUDY: Booz, Allen & Hamilton, independent consultant to the Trustee, has completed its basic analytical work and computer programming, its detailed examination of the Milwaukee's track condition, and its detailed market study.

"On March 4, I received a preliminary oral report from Booz, Allen," Mr. Hillman said. "My current understanding of its analyses reinforces my earlier judgment that the system as a whole cannot become self-sustaining. The necessary rehabilitation funds are simply unavailable. The losses would remain very large for many years. I do not believe that adequate traffic would be available to sustain the railroad as a whole and service its debt even after complete rehabilitation.

"With respect to the identification of a reduced system or core railroad and determination of its potential long-term viability, Booz, Allen is still analyzing alternative configurations, I must, in addition, conduct investigations of my own to reach a firm judgment with respect to market opportunities,

the availability of funds and materials for rehabilitation, and the extent of losses during the rehabilitation period. I expect to be able to present firm judgments in the form of a preliminary reorganization plan in about six months."

SALES OF LINE WEST OF BUTTE: "The Union Pacific has identified the segments of line which it may wish to purchase and the Burlington Northern is interested in some small segments. We are also discussing possible sales to several shippers. I am working with those most closely involved to find a solution to the difficult problem of providing rail service between Miles City and the Twin Cities. While I am pursuing these matters, I am also maintaining operations in these areas to the extent of my financial capability. No proposed agreements to sell any major line segments will be signed and presented to the court for its approval until Booz, Allen's core configuration analyses are complete and until my own reviews have yielded clear assurance that the sales are in the best interest of the estate."

THE NEXT SIX MONTHS: Mr. Hillman's target is to develop by September 30 a preliminary plan of reorganization which will address

- the identification and potential viability of the most promising core railroad configuration;
- the kind, amount and availability of the funds and materials needed to achieve such a core;
- initial plans for disposing of assets which cannot be operated by a reorganized Milwaukee Road. "Where these properties provide important rail services, my plans will include possible measures to assure the continuation of such operations."
- Initial plans concerning the interests of the creditors; and
- the treatment of the economic interest of the Milwaukee Road's employees.

"While I am not at this time able to provide positive assurance that the Milwaukee Road can be reorganized around a viable core, I can state that continued operation in the immediate future is clearly in the best interests of the estate, the creditors and the public," Mr. Hillman told the court.

"The interests of the estate and its creditors are served because an immediate liquidation of all of the properties is not economically or politically feasible. Cessation of operations would result in claims against the assets of the Milwaukee Road by employees. The government would respond immediately by directing other carriers to operate all or large portions of the Milwaukee Road under Section 1(16)(b) of the Interstate Commerce Act. Such action would prevent the development of a core railroad or the disposition of railroad operations on an orderly basis. Obtaining going-concern values for portions of the Milwaukee Road's properties would also become more difficult. Finally, the full extent of government action is not yet foreseeable.

"I strongly believe that operation of the Milwaukee Road must be maintained until I can develop a preliminary reorganization plan in order to meet the objectives of Section 77 (of the federal Bankruptcy Act) in this difficult situation. On the other hand, because of the rapidly deteriorating condition of track in many areas and the magnitude of the Milwaukee's losses, I cannot maintain the operation of the entire system very much longer without substantial external funding.

"I personally do not believe that the public interest requires long-term operation of the entire system, but if Congress disagrees with this judgment, the necessary funds must be provided on a basis which does not impair the constitutional rights of the Milwaukee Road's existing creditors."

We face a difficult period with an uncertain outcome. Your help in conserving cash, in assuring that our handling of every customer's shipment is as rapid and efficient as possible, and in seeing that all concerned understand where we are and what we must do is most urgently required and most sincerely appreciated.

Thank you.

W. L. Smith