1st MONDAY 3rd MONDAY

Prepared for employees by the
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January 7, 1980

Managers and Supervisors:

As the New Year begins, I'd like to outline for you what the ICC determined about New Milwaukee Lines' employee-shipper ownership plan and, to the extent that we know at this time, where the Trustee and his staff will now be headed in reorganizing the railroad.

On December 31, the Commission ruled that the New Milwaukee Lines plan was not feasible. The seven Commissioners who participated in the decision agreed, although one would have had the written decision actually be stronger than it was. The Commission's decision effectively eliminates the NewMil Plan from further consideration. There is no need for Judge McMillen to hold hearings on it.

The Commissioners found that the NewMil plan "lacks adequate financing, is not fair and equitable to the Milwaukee estate, and does not propose a railroad that can be operated on a self-sustaining basis."

The Commissioners were clearly impressed with the intent of Congress that employees should participate in the ownership of the Milwaukee. "In passing the Milwaukee Railroad Restructuring Act, Congress itself determined that the public interest would best be served by a Milwaukee restructured in the ESOP form," their decision said. "Thus, Congress has charged us not with determining whether an ESOP submitted under section 6 (of the Restructuring Act) would comport with the public interest, or whether it would better serve the public interest than the Trustee's or any other plan, but only with determining whether the ESOP submitted is feasible."

Many months ago, in testimony before Senator Long, Trustee Hillman indicated his support for the idea that an ESOP might be possible for the reorganizable segment of the Milwaukee.

The Commission expressed its concern about rail competition in the Pacific Northwest and across the northern tier of states. "The Milwaukee plays an important role in providing transportation in those regions, and we recognize the potential economic and social costs associated with the loss of that service," the ICC said. "We understand the adverse implications that our determination here will hold for the western lines, given the Trustee's current reorganization proposal to cease operations west of Miles City, Montana."

While the Trustee does indeed believe that the Milwaukee Road itself must cease operations west of Miles City, as well as in a number of other markets, we've said all along that our doing so doesn't necessarily mean that rail service will disappear from areas which the Milwaukee now serves. There are some interesting possibilities in this connection.

Here is the Commission's summary of its findings on the New Milwaukee Lines plan:

"The railroad contemplated by the plan cannot reasonably be expected to operate on a self-sustaining basis. For the foreseeable future, the proposed system would be entirely dependent upon massive amounts of external funding, almost certainly derived from the public sector.

"The proponents of the plan appear to have available, and could possibly obtain, the financing that their plan contemplates. We foresee operating losses in considerable excess of those projected by NewMil, however, and the sources of additional funds necessary to cover such losses are uncertain. Therefore, we cannot conclude that adequate public and private financing is available.

"In return for assets estimated by NewMil to be worth $387.8 million, the New Railroad would assume the Milwaukee's obligations to run a railroad and the need to incur debt to maintain service, and would relieve the estate of potential labor-protection claims. We do not believe that such consideration provides adequate compensation for the assets proposed to be acquired. Therefore, we find that the plan is not fair and equitable to the estate.

"With some reservation, we find that had we approved the plan, 'implementation' could have occurred by April 1, 1980. The legislative history seems to indicate that Congress did not intend a literal reading of the statutory term, but rather means a less-restrictive interpretation. Our reservation stems from the announcement by NewMil that it does not intend to become operational by April 1, 1980.

"Finally, we conclude that 'the plan contains an assessment of all operating practices, and includes agreements by labor and management to make implementing changes designed to achieve labor-productivity increases.' NewMil's proposal does not include labor-management agreements, but again the legislative history would seem to admit something else."

In response to the desire of some members of Congress for a projection of the amount of capital necessary to make the NewMil plan feasible, the Commissioners determined that at least a half billion dollars more would be required to finance anticipated operating losses and make necessary payments to the estate. "Much of this additional financing would have to be in the form of grants or equity capital to avoid crushing debt-service payments in subsequent years," the Commissioners said. "Even with such a commitment of funds, the success of the venture would involve significant risks."

So, what happens next?

Trustee Ogilvie has announced that we would resume the process of restructuring the Milwaukee to its economically viable size -- but that, assuming we receive the federal funding for lines outside "Milwaukee II" which the Restructuring Act contemplates, he wouldn't immediately seek an embargo or do anything to thwart the intent of states and shippers who have been helping us with rehabilitation. You'll remember that we're precluded by court order from using "our own" funds outside "Milwaukee II."

We are today executing an agreement with the FRA for $30 million of the $75 million in loan-guarantee entitlement for which the Act provides. That $30 million should cover our shortfall in February. After that, the funding provisions of the Restructuring Act expire. Hearings on the $45 million will be held January 25.

A consideration in the Trustee's planning is the fact that the Restructuring Act prohibits directed service over the Milwaukee by other railroads until after April 1, 1981. We don't want to leave shippers stranded without service if we can help it. Yet it's imperative that we shut off the losses which the non-"Milwaukee II" lines produce, particularly since the end may be in sight for outside financial assistance for these lines.

Our program for the future has three elements in it. We'll intensify our efforts to sell to others line segments which we cannot keep. We'll proceed as quickly as possible with our abandonment program, which should move rather rapidly since the authority for abandonments now rests with the reorganization court rather than with the ICC. And, we'll try to have the prohibition against directed service appealed by Congress.

It's fair to expect that some potential buyers or lessors of parts of the Milwaukee have been awaiting the outcome of the NewMil ESOP proceeding. They may now step forward with their proposals. Indeed, last week PLM, Inc., a San Francisco-based railway equipment repair and leasing concern, announced that it is considering the formation of a "Montana Pacific Railroad" out of the 1,396 miles of the Milwaukee which lie between Miles City and the connection with the Union Pacific at Marengo, Washington. The concept has considerable support within Montana state government, we understand. While PLM's studies haven't resolved themselves into a formal proposal which Trustee Ogilvie can consider, we expect a proposal to be made and we'll be very interested in it.

As you know, we have a number of other sales negotiations under way. It's our hope that shortly we can reach the point in all such negotiations that the court will authorize prospective buyers to operate the segments they intend to buy on an interim basis, using Milwaukee Road employees. The Restructuring Act provides this opportunity. The court has approved the sale of the Port Townsend line to the Seattle & North Coast, and steps are being taken to arrange for an interim operation pending the ICC's approval of the application of this new railroad company.

The Commission has given its report to the court on 18 separate abandonment cases involving 880 miles of uneconomic branch lines in "Milwaukee II" states -- recommending the abandonment in each case. Court hearings on these cases will begin before Master Gray January 16. Last week, the ICC asked for and received the court's permission to postpone its report on the proposed abandonment of the 2,500 miles west of Miles City until no later than January 31. We expect the court's ruling on the 18 cases in early February and on the Lines West case soon after the ICC files its report with the court.

Down the road are further steps in the abandonment process. The ICC has reported favorably on the abandonment of the 29-mile Fond du Lac branch except for the seven miles from Iron Ridge to Mayville. No date has been set for a court hearing on this case. This week, we'll file our abandonment application for 143 miles of the Souteastern between South Chicago Heights and Fayette; concurrently, we'll file our application for permanent trackage rights over Conrail's parallel route. The ICC has before it four more cases covering 328 miles of branch lines in Wisconsin, Michigan, South Dakota and North Dakota including the Ontonagon line, on which it is directed by the court to report no later than March 1. We expect to file with the ICC, by the end of January, an application covering 1,573 miles of line in Iowa and South Dakota. Then, during the first quarter of 1980, we shall file the final

set of abandonment applications covering some 448 miles mostly in Wisconsin and Minnesota. In total, nearly 5,900 miles of the Milwaukee are covered in the steps I've described.

Given the possibility of appeals of favorable court rulings, it's too early to predict just when we might actually be able to abandon these lines. But it's important to note that the court may order service to be terminated on any line it orders to be abandoned even while the appeal process runs, and this order of the court may not be stayed. It's also important to remember that our moving ahead with the abandonment process on a line doesn't preclude a shift of direction to an ultimate sale of the line to someone who would continue its operation. Indeed, the state of Wisconsin is interested in acquiring some 16 light-density lines.

On January 10, Judge McMillen will hold hearings on the labor-protection agreement we recently worked out with the Railway Labor Executives Association. This agreement was described in a "To All Concerned" message and news release on December 18.

Finally, the disposal of the NewMil proposal restored the vitality before the ICC of the Trustee's preliminary plan of financial reorganization. That plan will be the subject of ICC hearings beginning January 17.

Meantime, we're expecting a court decision soon on our application to obtain some $65 million in 4R Act funds with which to continue our rehabilitation of the main and principal secondary "Milwaukee II" lines as well as more locomotives and cars. Also, I'll have something to say to you very soon about the kind of organizational structure which "Milwaukee II" needs and will have.

We're moving! And the ICC's decision on the last day of 1979 has given us a much better sense of direction!

W. L. Smith
President

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SUPVR. CAR UTILIZATION
THE MILWAUKEE ROAD
MILWAUKEE

OFFICE OF DIVISION MANAGER
WISCONSIN DIVISION

Milwaukee, Wisconsin
January 9, 1980
file 121

NOTICE AC-2 BC-2 CIRCULAR LETTER NO. 10

To All Concerned - All Districts:

Have the following from Wally Abbey, Director of Corporate Communications, Chicago dated today.

In the First Monday/Third Monday of January 7, a statement was made that the $30 million which we are now receiving would cover our shortall in February. The correct information is as follows:

"We are today executing an agreement with the FRA for $30 million of the $75 million in loan guarantee entitlement for which the act provides. That $30 million should cover our shortfall from last November 1 thru January 31. We've also applied to the Reorganization Court for authority to obtain a portion of the remaining $45 million in guaranteed loans to cover our shortfall in February. After that, the funding provisions of the Restructuring Act expire. Hearings on the $45 million will be held January 25." My apologies.

N. H. McKegney
Division Manager

RJT HMH CNM GYN EEH RHS DAR FAD CFW SEL RLS RGK HFB WJD WRB JEE DLM RCB RGK RRD JLF HWW LCH RDB CRA JLM AGB JEP DRD DKH RMC JM JDL TRAFFIC HHH BDM EEG RLQ JWG TJL MAB GAS