1st MONDAY
3rd MONDAY

Prepared for employees by the
Milwaukee Road's Corporate Relations Department
516 West Jackson Boulevard Chicago, Illinois 60606
Telephone 312 648-3324

May 3, 1982

To All Milwaukee Road Employees:

In a progress report to the Reorganization Court last Friday, Trustee Ogilvie said that despite the unexpectedly long and severe recession which has had a devastating impact on the railroad industry, aggressive and creative marketing efforts - along with a stringent cost reduction program - have allowed the Milwaukee to proceed toward its financial goals for the year.

In March, Milwaukee II was in the black for the first time in its existence. It generated $4.2 million of net income after fixed charges.

The report described the status of the reorganization and mentioned certain significant events that occurred during the first quarter of 1982.

Here are some of the highlights:

The Trustee continues to make progress in carrying out the specific measures contemplated in the Revised Plan of Reorganization. These include the implementation of crew reductions; a 7% reduction in total compensation for all of the Milwaukee's employees and reduction in overhead costs; the abandonment and negotiation of a sale of the lines west of Ortonville, Minnesota; progress toward the elimination of losses on Chicago area commuter service; and a tender offer to certain of the Milwaukee's bondholders. Also, the Trustee continues to pursue the possibility of a sale of the railroad operations. Discussions with Grand Trunk Corporation are proceeding.

With respect to the wage and crew reductions, the report indicated the 7% reduction in total compensation produced savings of $3,020,000 during the first quarter of 1982. Additional savings of about $9 million are expected over the remaining nine months of 1982.

On February 4, 1982, the Court approved an agreement between the Trustee and the United Transportation Union which permits the operation of road freight and yard trains with reduced crews and provides for the voluntary separation and involuntary furlough of unneeded employees. In March, 7,432 road freight and yard trains operated with reduced crews, as compared to 1,930 reduced crew trains in January. The crew consist agreement produced savings of $468,000 in wages and fringe benefits in March. Savings will continue to accrue as long as this agreement remains in effect.

On April 16, 1982, the Reorganization Court approved an agreement between the Trustee and the South Dakota Railroad Authority for the sale and interim lease, effective April 19, 1982, of the "Miles City Line." The Rail Authority will continue rail service along the line through its operator, Burlington Northern.

The Trustee will receive $30.4 million in cash for the property on closing. In addition to the purchase price, the Trustee will receive rental payments of $304,000 per month until the agreement is closed. The sale is expected to close some time after July 1, 1982.

Upon completion of the planned rehabilitation of the line in late 1983, the Milwaukee will receive coal traffic interchanged at Ortonville, MN, which is expected to yield an incremental contribution of $4 million per year. Also, the continued operation of the Miles City Line will make it possible to conclude a sale of the Sisseton branch line for continued rail service. Interchanged grain shipments from the Sisseton line should produce approximately $1 million in contribution annually. These revenues are in addition to those assumed in the Revised Plan.

On April 28, Trustee Ogilvie filed an application with the Reorganization Court for authority to proceed with tender offers to holders of the railroad's General Mortgage bonds and certain categories of the so-called "Terre Haute" bonds. The Trustee proposed that tender offer prices be set at an amount equal to the Trustee's estimated value of the bondholders' claim as of December 31, 1984, discounted back to the time of tender, and further discounted to recognize the risks inherent in the reorganization process.

Trustee Ogilvie believes that the tender offers would benefit both the bondholders receiving the offers and the estate. The affected bondholders would be given a choice of receiving immediate cash payment or waiting for satisfaction of their claims in the normal course of the reorganization proceedings. The tender offer would benefit the estate by reducing the aggregate book liabilities of the estate by the difference between the principal plus accrued interest on the tendered bonds and the tender offer payment for tendered bonds.

The report said that on March 2, 1982, the United States Supreme Court, in its decision in Railway Labor Executives' Association v. Gibbons, held that the employee protection provisions of the Rock Island Transition and Employee Assistance Act were unconstitutional because they violated the uniformity requirement of the bankruptcy clause of the U.S. Constitution. Following the decision, the Federal Railway Administration suspended disbursements under Section 15 of the Milwaukee Railroad Restructuring Act to fund payment of labor protection claims arising under the Section 9 Labor Protection Agreement, pending review of the constitutionality of those provisions.

In the Trustee's opinion, the MRRA, including the labor protection provisions, is a constitutional exercise of the Commerce Power because it is comprehensive legislation designed to continue the Milwaukee's operations in interstate commerce.

The Trustee is proceeding on both legislative and judicial fronts to seek a solution which will permit the FRA to resume funding MRRA labor protection benefits.

In addressing the floundering economy, the report said economic conditions continued to have an adverse impact on our revenues through the first quarter of 1982. Specifically, they have prevented attainment of Revised Plan revenue and traffic projections. These conditions are now expected to persist through 1982. However, based on graphs prepared from information furnished by the Association of American Railroads comparing Milwaukee Road loading performance to that of the Western Region railroad group and to all U.S. railroads, we were at or slightly below the group trends until the fourth quarter of 1981 when the Milwaukee trend straightened. An even stronger comparative Milwaukee trend developed in the first quarter of 1982. As a result, while we are suffering along with the rest of the industry, the Milwaukee is improving its market share. This is largely due to contract placements in markets such as grain, coal, metal products, waste and scrap. A much stronger market share improvement for the Milwaukee is evident when analyzing cars received from connections, particularly in the first quarter of 1982. This performance is largely due to contracts negotiated and made operative in the latter half of 1981 and the first quarter of 1982.

For the full year of 1981, Milwaukee II reported a loss of $89.9 million after taking into account the impact of fixed charges and other income. Of this amount, $24 million was expended for plant and equipment rehabilitation which increased the value of the estate. The railroad also capitalized $14 million of improvements during 1981. Except for the fourth quarter, the loss experienced for the year was in line with the $61.8 million deficit originally forecast. The fourth quarter loss was the result of unexpectedly bad economic conditions influencing the level of traffic in certain commodities, particularly grain, farm products and coal. The railroad was, however, able to operate through the end of 1981 using only the originally authorized borrowing for 1981 and without having to use any of the $60 million authority for 1982-1983.

Total operating results in 1981 for the railroad, on an ICC accounting basis, including earnings from subsidiaries and the net effect of extraordinary items and income taxes, were a gain of $173.2 million.

The report concludes that while much remains to be done before reorganization is accomplished, substantial progress continues to be made.

W L Smith

W. L. Smith
President