

Milwaukee Road's freight-carrying capacity

*Hearing before the Subcommittee on Civil and
Constitutional Rights of the Committee on the
Judiciary, House of Representatives, Ninety-sixth
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MILWAUKEE ROAD'S FREIGHT-CARRYING CAPACITY

MONDAY, JULY 23, 1979

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CIVIL AND CONSTITUTIONAL RIGHTS
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2237, Rayburn House Office Building, Hon. Don Edwards (chairman of the subcommittee) presiding.

Present: Representatives Edwards, Hyde, and Drinan.

Also present: Charles F. Vihon, bankruptcy consultant, and Thomas M. Boyd, associate counsel.

Mr. EDWARDS. The subcommittee will be in order.

Mr. Reuss, you are going to be our first witness.

We will recognize Mr. Hyde just for a minute.

Mr. HYDE. Mr. Chairman, I move that the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary permit coverage of this hearing in whole or in part by television broadcast, radio broadcast, or still photography, or any of such methods pursuant to committee rule V.

Mr. EDWARDS. Without objection, the motion is agreed to.

Today we will consider H.R. 4686, a bill which its sponsors believe will aid in the reorganization of the Chicago, Milwaukee, St. Paul & Pacific Railroad, commonly known as the Milwaukee Road.

The judge in the pending *Milwaukee Road* case appears to agree that the most reasonable solution to the current dilemma in this proceeding is to allow an embargo of sections of the Milwaukee Road.

The court held, however, that it did not have such authority under current law until other Federal regulatory agencies had acted on such a request.

We hope to be able to shed further light on this issue today.

Our first witness is our distinguished colleague, the chairman of the House Banking Committee, the Honorable Henry Reuss of Wisconsin, the principal sponsor of this legislation.

Before proceeding, however, Mr. Reuss, I would like to recognize my colleague, the ranking minority member of this subcommittee and a cosponsor of the bill, the Honorable Henry Hyde.

Mr. Hyde?

Mr. HYDE. Thank you, Mr. Chairman.

I am very pleased that we are holding those hearings this morning on this important legislation.

I commend the chief sponsor, Congressman Reuss, for his initiative in this area, because the Chicago, Milwaukee, St. Paul & Pacific

Railroad is a very important part of public transportation in my district as well as other areas of Wisconsin and Illinois.

Its continued viability is very important not only to constituents in my district but to the resolution of all of the energy problems we have.

I am delighted that we are undertaking these hearings this morning, and I thank you.

Mr. EDWARDS. Thank you, Mr. Hyde.

Mr. Drinan?

Mr. DRINAN. Thank you, Mr. Chairman.

I just want to welcome Congressman Reuss. I know that he does so many things so well that he can run a railroad well, too, so we welcome him.

Mr. EDWARDS. Mr. Reuss, you may proceed.

**TESTIMONY OF HON. HENRY S. REUSS, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF WISCONSIN**

Mr. REUSS. Thank you very much, and thanks to your subcommittee members for their responsible and most helpful attitude about H.R. 4686, on the Milwaukee Road's problems.

The road has been in bankruptcy since December of 1977. Its troubles go back for more than half a century, and stem from its improvident expansion to the Pacific coast in the 1906-09 period.

The expansion ran into heavy competition. The railroad has suffered more than most carriers from competition by other means of transportation, and more recently the burden it has had to bear is the old cash flow problem, compounded by the interminable delays that the ICC has visited on the road whenever it sought to abandon unprofitable branch lines.

Forced by governmental inaction to continue operating many losing lines, the Milwaukee naturally enough deferred maintenance on its tracks, locomotives, and rolling stock, and this produced a downward spiral. Any shipper who could make a change did so, and revenues and operating funds went down. So here we are bankrupt and bleeding to death.

Meanwhile, it was business as usual at the ICC.

Just to give you some examples of the attitudes of that extraordinary agency, there is a short segment of track in southeastern Wisconsin between Waukesha and Whitewater, some 29 miles, and back in 1976 and 1977 the Milwaukee Road applied for abandonment.

There was an investigation lasting 2 years, and oral hearings and much testimony, but the railroad application was denied.

Then in March of 1978, a year later, in formal bankruptcy, the railroad came in again saying: "we have to abandon this segment, it costs at least \$9 million to make it operate; we are losing \$30,000 a year just on operating costs.

Traffic averages 7.4 cars per mile. It's about a fifth of what it must have in order to break even, so they applied again for abandonment, including an additional segment to Milton Junction, a segment which hadn't been in use for 2 years because the weeds and brush had overgrown the tracks.

So the ICC undertook another exhaustive examination. Seven months went by before the Commission could even decide which procedure to use to process the case.

Fifteen months after the application was filed, an initial decision was issued granting the application, only days before the legal maximum time for the handling of the case would have expired.

We are still not through. The Commission just extended the time for filing of appeals until August 25. They will then have 180 days to file the appeal.

The Milwaukee Journal, just a few weeks ago, sent a reporter out on that Whitewater-Waukesha line. The story is instructive:

The handful of freight cars destined for the handful of customers on the Milwaukee Road's branch tie to Waukesha and Whitewater arrives at the Brookfield depot late Monday night.

The next morning, the three-man crew assembles the train for the leisurely and remarkable inefficient run to Whitewater, 36 miles away. The day's labor will consume 12 hours of expensive labor and equipment . . . The crew of the train usually works 12 hours a day, four on overtime.

Non-stop from just west of Waukesha to Whitewater, about 28 miles in one hour and 20 minutes. The speed limit never exceeds 25 miles per hour. The conductor, referring to somebody along the route, makes himself a bet: If this train goes by with more than 10 cars, he buys the house a drink.

A young man in Wisconsin who is currently hiking our Wisconsin version of the Appalachian Trail, the Ice Age Trail, recently hiked part of this within the last few weeks, and he reported that it looks something like the German Reichsbahn at the end of World War II, endless cars lying where they fell in the ditch. Meanwhile grain rots on the ground out West because they don't have rolling stock.

You can never see the ties. They are all overgrown. Upon occasion, you can't see the tracks because the brush and the willows and the choke cherries have come around it.

The ICC's irresponsible delay in ruling on this effort is just one of scores. It is neither an isolated example nor even the worst example of the tortoise-like pace of the Commission.

The Commission averages 5.4 months to process unopposed Milwaukee Road cases, and averages 6.2 months merely to assign cases for oral hearing or modified procedure. It averages 7 months after assignment to issue initial decisions, so the net time elapsed is in years.

The Commission, additionally, has resorted to artifice to extend time limits even further. In one case, for example, the Commission vacated an initial assignment order and claimed that its later assignment started the clock running on the time periods the 4-R Act imposes for taking evidence and issuing a decision.

Frustrated by ICC in his attempts to reduce money-losing lines, the just resigned trustee, Mr. Stanley Hillman, announced last April his intention to embargo about three-fourths of the Milwaukee Road's 9,800 line, cutting service down to a 2,400-mile core which could be profitable.

This looked like the solution but, unfortunately, Judge McMillen, of the U.S. District Court for the Northern District of Illinois, on June 1 found—correctly, in my opinion, although unfortunately—that the Milwaukee Road was not, technically speaking, "cashless," and thus couldn't qualify for the embargo provisions.

The judge was stymied by the fact that the Milwaukee Road's petition for bankruptcy was filed under the old bankruptcy law in which the abandonment provision requires ICC approval. All railroad bankruptcies initiated after October 1, 1979, will be covered by the provision of section 1107 of last fall's Bankruptcy Reform Act, which will allow in the future the judge to do what, of course, he wanted to do, and should have done, in the Milwaukee Road case—permit a large-scale, immediate abandonment.

The ICC, gazing upon this June 1 decision, reacted predictably. On the day the decision was issued, the chairman pronounced himself gratified—that is his word—that every money losing mile of the Milwaukee Road's track would be kept in operation.

The exultant release promised no quick ICC action to help the Milwaukee Road, only a vague reference to "explore long-term solutions," which they should have done years before.

So here we are. The Milwaukee Road then applied, in order to keep going, for \$20 million from the emergency railroad fund of the Federal Railroad Administration, and on July 12, just a week ago, they got those funds.

The cupboard is rapidly becoming bare, because in the whole national reservoir of the emergency railroad fund, there is only \$50 million, and this takes \$20 of it. The FRA, I thought, was a little blithe in its findings that, "The railroad can reasonably be expected to become self-sustaining." In fact, the railroad can reasonably expect to go broke and cease all its operations just as soon as that \$20 million is used up, and since they have been losing money at the rate of \$10 million a month, that gives them August and September.

To pour Federal money into the Milwaukee Road, if it cannot get out from under its light density lines which are choking it, simply throws good money after bad. After the June 1 decision of the Federal Court for the Northern District of Illinois denying embargo, another blow fell on the Milwaukee Road.

The excellent trustee, Stanley Hillman, announced he was resigning for reasons of health.

The judge promised to name a new trustee by July 2. He didn't. Then he promised to name a new one by July 16. He didn't. Then he promised to name a new one today, and I hope during the course of this hearing we will be able to hear from Chicago that he has done so.

I would personally hope that he would appoint Mr. Ogilvie, the former Governor of Illinois, because Ogilvie was the lawyer for Hillman and knows the inchoate reorganization plan thoroughly, and I am sure he believes in it and so do I.

The plan would look to the maintenance of the core of the road in Illinois, Wisconsin, Indiana, Iowa, Minnesota, the Dakotas, and west to Miles City, Mont., and that would be about 2,400 of the 9,800-mile total lines.

The plan's intention is to sell large sections of the road to the Burlington Northern and the Union Pacific, which are interested in purchase and are now commencing negotiations for it.

If all of this is done, and if the unviable branch lines are discontinued as they should be, this would provide continued services for 98 percent of the shippers, and for all but 1,000 or 2,000 at most of the railroad's 10,000 employees.

Unfortunately, the new trustee, whoever he is, will not be able to propose on August 6, as he is supposed to do under the court order, a sensible plan for reorganization of the road, because the only alternative he has is to rest his future on the tender mercy of the ICC, which on past performance takes years to effect an abandonment.

Judge McMillen in his June 1 decision clearly pointed the way for those who want to save the Milwaukee Road.

"Every avenue which has been explored leads, in our opinion, to a roadblock, erected primarily by the Federal Government. Congressional action is the only foreseeable alternative."

Truer words were seldom spoken.

Accepting the judge's suggestion, we all went to work immediately after the bad news on June 1, and I wrote a letter to the President on June 13, which is attached hereto as exhibit C.

Incidentally, this whole thing is not only an interesting case study on how the Milwaukee Road may be saved, but it also throws some light on how Government works or does not work, in Washington, and suggests possibly some reasons why the public is increasingly turned off at Government.

At any rate, in my letter to the President, I set forth what I thought need to be done and said:

"Prompt action to avoid the catastrophe of a complete Milwaukee Road closing is needed. I stand ready to assist your administration in any way."

The President did appoint Stuart Eizenstat to head up the Administration's rescue efforts, and on June 20 I wrote Mr. Eizenstat a detailed memorandum, which is included here in as exhibit E, setting forth exactly what needed to be done, the kind of statute that would be needed, but unfortunately nothing much happened.

And so, believing that God helps those who help themselves, on June 20 some 20 of us, later joined by five or six more Members introduced H.R. 4686.

The nub of the bill is section 1, which simply says—in language for which I am most grateful to the excellent staff of this subcommittee, Mr. Vihon and Mr. Boyd—that as regards the Milwaukee Road, the bankruptcy court judge may issue an abandonment order.

Then there is a section 2 which I added, which section 2 was intended to save the taxpayers a buck or two. Under the regular ICC procedure, it may in the case of an abandoned line, where it feels its services are essential, direct another railroad to carry the freight. That seemed to me wasteful, because in many of the Milwaukee Road branch lines another railroad is just going to waste millions of Federal dollars, so the idea occurred to me why shouldn't one serve the shippers by an occasional truck, which could be subsidized.

That is the gist of section 2. Unfortunately, it may be that I bit off more than I could chew on that, because section 2, since it involved trucks, caused the sequential reference of this bill to a third committee, the Public Works Committee, and in discussing it with those excellent people, it was brought home to me that this suggestion of mine, of using alternative means of transportation, involves a whole new outlook on directed service.

Nobody has ever suggested this before and, therefore, lengthy hearings for the trucking industry, the rail industry, the shippers

and everybody else, because it would affect not just the Milwaukee Road but directed service from here through eternity would be involved.

So I would recommend that this committee strike section 2 entirely in the event that it thinks favorably of H.R. 4686, because it's a perfectionist section 2, and would so slow things down that I am afraid it would cause the bill to lose its purpose.

Section 3, which if this committee strikes section 2, would then become a new section 2, contains the labor protection clause.

We all felt it was necessary, and this clause follows the Amtrak abandonment procedure labor protection clause. Labor has found the Amtrak procedure satisfactory, and rather than break new ground, we adopted that existing Amtrak law. This section is peculiarly the province of the Interstate Commerce Committee, which has sequential reference and is even now working on this aspect of things.

So what I would very much hope and pray is that this committee and its parent, the Judiciary Committee, could promptly report H.R. 4686, section 1, and present section 3, if it strikes section 2, and then send it on its way to the Interstate Commerce Committee.

Thus my testimony pursuant to the rule, I prepared it Friday afternoon, and I no sooner had gotten it done and mimeographed when I was made aware of an astounding thing, the ICC at 3:30 o'clock last Friday afternoon—it could be with knowledge of the prudent action of this committee this Monday morning—announced that it was adopting a streamlined procedure for the reorganization of the Milwaukee Road, I include the ICC's as an additional exhibit.

In a nutshell, they said they will move with expedition toward abandonment, and they give a schedule to finish the whole procedure no later than next January 10.

This puts me in somewhat the position of the fellow who ordered some years ago from Sears Roebuck by mail a phonograph, and when he got the thing and unpacked it, there was no turn crank. He sat down and wrote an indignant letter to Sears Roebuck, saying he was going to report them to the Better Business Bureau, for their sending out this defective merchandise, and he went on for about 3 pages of a vituperation, signed it—and said, "P.S. Please disregard this letter. I have just found the damn crank."

Well, I have just found the ICC. I want here and now to credit this committee, Mr. Edwards and Mr. Hyde, Father Drinan and Mr. Sensenbrenner of my State, who has taken a great interest in this, and every member of it, because I think you did with the ICC what nobody has been able to do before.

Having been made aware of the ICC's conversion, I still believe this bill is very necessary for two reasons. First, converts sometimes backslide.

Second, January 10 really isn't quite fast enough, and I think a Sword of Damocles—a bill going through the legislative process would be the best focus of the attention on the ICC on its duty to keep a railroad system running. So while this is good news, and a very important victory for the subcommittee and its responsible attitude, I think the bill should still go forward.

We have here a not too lovely tale of less than perfect action by the executive and judicial branches of our Government.

Let the Legislature now do its part, and perhaps people will think more kindly of us.

Mr. EDWARDS. Thank you very much, Mr. Reuss.

The gentleman from Illinois, Mr. Hyde.

Mr. HYDE. Thank you, Mr. Chairman. I appreciate the accolades that the gentleman, the chief sponsor, Mr. Reuss, has bestowed on this committee, but I think his initiative and his persistence has been the real motivating force.

We have been pleased to be of what help we can.

I have no particular questions to ask at this time.

Mr. EDWARDS. Mr. Drinan.

Mr. DRINAN. Thank you, Mr. Chairman.

I just ask this of Mr. Reuss:

If the ICC follows through on what it promised on July 19, why precisely do we still need the passage of the bill involving the bankruptcy law?

Mr. REUSS. The Milwaukee Road is substantially cashless and has been losing money at the rate of \$10 million a month.

Its president, Worthington Smith, is here and will testify shortly, but in my conversations with him and a look at their situation, I believe it isn't going to get any better.

That means that the \$20 million from the \$50 million nationwide kitty which the railroad got 10 days ago is going to be used up by early September.

I would, therefore, be very fearful that if nothing is done by Congress, they would be broke. The ICC, even with its accelerated schedule, would still be 3 or 4 months behind that early September 16 date, and there is a considerable chance then that the railroad's creditors, represented by the First National Bank of Chicago and the Continental Illinois Bank of Chicago, which have been in the U.S. District Court demanding that the whole railroad be sold off by the U.S. Marshal tomorrow, would succeed.

If the railroad goes kerplunk, then it wouldn't be able to reconstitute the 2,200 mile core, or even an orderly transition to some of these lines out West that stand ready to buy portions of it.

I believe this legislation is necessary, one, as a sword of Damocles over the ICC; two, even if the ICC sticks to its schedule, I doubt whether it is expeditious enough. I think we will need that law.

Mr. DRINAN. I take it that this decision of Judge McMillen is not appealable. He is right on the law. I take it that he doesn't have that authority?

Mr. REUSS. The decision is appealable. It has in fact been appealed.

Mr. DRINAN. It really couldn't be reversed.

Mr. REUSS. That in my opinion cannot be won, because I think Judge McMillen was unfortunately right and had to do that which he did.

Mr. DRINAN. I thank you, Congressman Reuss, for your testimony, and for my part we will move forward as expeditiously as we can on this matter.

Thank you very much.

Mr. EDWARDS. Mr. Reuss, I know that you are always concerned about people losing their jobs. You have been one of the leaders in Congress for full employment and taking care of people who are necessarily out of work because of other considerations.

Now, on page 7 of your excellent testimony, you point out that 1,000 or 2,000 employees wouldn't be able to work for the Milwaukee Road any more. What would happen to those folks?

Mr. REUSS. I would hope that the candle that would be lit by this subcommittee would introduce enough light of reason into our whole railroad structure so that we can have a rationalized rail system throughout the country, including particularly the West.

It's a cause for tears that wheat is now rotting on the ground of Kansas because there aren't rail cars to haul it.

There is a great need for every one of the 10,000 employees of the Milwaukee Road in railroading, not all of them with the Milwaukee Road, but with retaining allowances, and bridge allowances, there should be good, well-paid steady jobs in railroading, because nobody has invented anything as energy efficient as the flanged wheel, which you don't have on trucks. I predict a great future for the American railroad if we will but have the wit to stop driving them into the ground as we have been doing for the last 30 years.

The energy crisis requires that we seek an energy-saving means of transportation, and railway freight is an extraordinarily efficient way of doing it. If we can electrify more miles of rail, it will be even more independent of OPEC, and with our western coal, we may be able to do that.

So I would say that if this is done right, no Milwaukee Road employee is going to lose his opportunity to do that which is his life work—namely, railroading.

In case we are wrong, however, we put in a labor protection clause, using the Amtrak clause, which says that if worst comes to worst, you get your choice between a separation allowance or 6 years' salary. It's the kind of thing which your colleague, Mr. Burton of California, put into the Redwoods bill. It's the kind of clause which was a necessary price to pay for Amtrak. It's like that which we have in Conrail.

Mr. EDWARDS. That is very helpful. Thank you.

Well, what do you think? We are going to ask Mr. Smith some of these questions, of course, but what is your surmise as to what the testimony of these creditors would be, if they were called in here?

Why aren't they writing us letters asking us to move ahead to save the line, so that they will get 100 cents on the dollar and also provide a service to their bank clients and to encourage the saving of a very important transportation system in the area where these banks make their living?

Mr. REUSS. I would like to add at this point an additional appendix, my telegram of late May to the First National, to my friends Bob Abboud of the First National Bank of Chicago, and John Perkins of the Continental Illinois National Bank, who were then in Federal court urging on behalf of the creditors that the Milwaukee Road be sold—locomotive, boxcar, and track—at once.

I pointed out that they were a bank, and that the Government gave them the right to conduct a banking business in the public interest, and that I considered it unedifying, at a time when they were lending money to Chile and Nicaragua "hand over fist," that they were taking the lead in seeking to put out a business, the oldest, and once one of the strongest, railroads in the West, the Chicago Milwaukee,

St. Paul & Pacific Road, their lifeblood, the lifeblood of their bank's depositors and borrowers.

Mr. EDWARDS. All of this will be received into the record.

[The information follows:]

[Telegram]

MAY 7, 1979.

FIRST NATIONAL BANK OF CHICAGO,
Chicago, Ill.

CONTINENTAL ILLINOIS NATIONAL BANK,
Chicago, Ill.

1. As Chicago's two largest banks, with total deposits of \$39 billion, you appeared in the U.S. district court—northern district of Illinois Friday and moved, as major creditors of the Milwaukee Road, to kill all Milwaukee Road operations immediately and liquidate the company. One of your attorneys is reported as telling the court that continued operation of the railroad is "a violation of creditors' rights * * * the critical fact is you're taking our cash, and once it's taken we won't get it back."

2. The Milwaukee Road is a vital hauler of freight throughout the Midwest. I fully support the plan of trustee Stanley E. G. Hillman to forthwith eliminate the railroad's unprofitable lines and concentrate on essential traffic arteries.

3. I wish you would reflect on whether your effort to block trustee Hillman's proposal is consistent with the purpose of your bank charter—to serve the convenience and needs of the public. I am disturbed that your institutions are so ready to cooperate with loans to foreign dictatorships, but show no sensitivity toward the Milwaukee Road, a mainstay of the Midwestern economy, and the businesses and employees who depend on it. Ironically, you will have a much better chance of "getting your money back" if you cooperate with trustee Hillman than if you pursue the dog-in-the-manger tactic of having the sheriff sell the railroad tomorrow as junk.

4. In short, shame on you. I call upon you to cooperate with trustee Hillman and to inform Federal Judge McMillen at the May 15 hearing of such cooperation.

Congressman HENRY S. REUSS.

WINSTON & STRAWN,
Chicago, Ill., May 11, 1979.

Re Milwaukee Road Reorganization.

Hon. HENRY S. REUSS,
Rayburn Office Building,
Washington, D.C.

DEAR CONGRESSMAN REUSS: The First National Bank of Chicago serves as Trustee of the Income Debentures issued by the Milwaukee Road and is participating in the Milwaukee Road reorganization under a fiduciary duty to the Debenture holders. I am one of the attorneys representing the Bank in this fiduciary capacity and this letter is a reply to your recent Telex which seems to misapprehend certain facts.

First National, as Trustee, has respect and high regard for the ability and integrity of Mr. Hillman. Last year it supported his request for \$47 million in Federal funds to rehabilitate the property; in March and April of this year it supported his requests for loans totalling \$20 million to offset the ravages of the 1978-79 winter; and in May it supported his request for a partial embargo and his request for a further loan of \$15 million provided that the partial embargo was applied immediately. A copy of the Bank's Statement of Position filed on May 2, 1979 is enclosed.

At the hearing on May 4, 1979, various parties opposed the partial embargo and sought to keep the entire Milwaukee Road system operating even though the record showed that the railroad's physical properties and ability to provide service were deteriorating and that cash disbursements were exceeding each receipts by \$500,000 per day. When others opposed the immediate partial embargo and tried to have the Milwaukee Road continue operating its entire system, First National, as Trustee, was obliged to oppose the continued depletion of funds in the estate since there is no reasonable hope that the Milwaukee Road will ever be viable unless its mileage is reduced. The situation is unpleasant and the immediate problems cannot be substantially alleviated except by massive infusions of cash which neither the public nor private sectors seem likely to provide. Continued deficit

operations are on a "run-to-failure" basis and, if allowed to continue, will injure the public and all interests which rely upon the Milwaukee Road as well as the creditors for whom the Bank is fiduciary.

I hope that this letter will put the Bank's position as Trustee in perspective. I am sure you will agree that the Bank, as a Trustee, cannot willingly agree to a course of action in the Milwaukee reorganization that is destructive of its beneficiaries already precarious interest; the Bank, we believe, must adhere to its fiduciary duties in this unpleasant situation. If further information is needed, I will be pleased to furnish it.

Very truly yours,

EDMUND J. KENNY.

Enclosure.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN
DISTRICT OF ILLINOIS, EASTERN DIVISION

IN PROCEEDINGS FOR THE REORGANIZATION OF A RAILROAD

No. 77 B 8999

In the Matter of
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD CO., DEBTOR.

STATEMENT OF POSITION BY THE FIRST NATIONAL BANK OF CHICAGO (FIRST NATIONAL) AS TRUSTEE UNDER THE INCOME DEBENTURE INDENTURE OF MILWAUKEE ROAD ON THE APPLICATION BY THE TRUSTEE IN BANKRUPTCY TO ISSUE \$15 MILLION IN TRUSTEE'S CERTIFICATES AND FOR DIRECTION WITH RESPECT TO A PARTIAL EMBARGO OF FREIGHT OPERATIONS

First National states its position as follows:

1. First National objects to the Trustee's motion filed on April 16, 1979 seeking authority for the issuance of up to \$15 million in additional Trustee Certificates.
2. First National supports the Trustee's petition filed on April 23, 1979 seeking authority for a partial embargo of freight operations.
3. If the Court should enter an order authorizing a partial embargo which covers all lines requested by the Trustee in his amended filing of April 30, 1979, and such order is effective and operative immediately, First National will withdraw its opposition to issuance of the \$15 million in Trustee Certificates. If the effective date of the embargo is delayed or suspended First National will oppose issuance of the Trustee Certificates.

Supporting Reasons

The facts and legal principles set forth below demonstrate that realistically there are only two alternatives—a temporary embargo or liquidation. Authorizing additional borrowing to preserve the existing railroad system under the present circumstances would be serious abuse of discretion and confiscatory action. An attempt to continue operation of the existing system without new funds may be impractical and probably would cause serious economic damage to the public, to employees and to creditors.

Fact 1.—The Milwaukee Road's situation has gone from serious to critical to desperate. The Milwaukee Road lost approximately \$100 million in the years 1975, 1976, 1977; lost \$82 million in 1978, and lost \$45 million in the first quarter of 1979 (Hillman Statement of April 30, 1979, p. 3). Losses for the full year of 1979 are estimated at \$157 million. (Nugent Statement of April 30, 1979, p. 2).

Fact 2.—Despite receipt of \$88 million in external funds and deferral of an additional \$20 million in current obligations in the last 15 months, the losses have not been reversed and, in the Trustee's opinion, the railroad cannot continue to operate without substantial changes in its structure and configuration (Hillman Statement of April 30, 1979, pp. 4-6, 12).

Fact 3.—The Indenture Trustees advanced \$20 million in the last two months of March and April in order to support the court appointed Trustee through the ravages of winter. The Trustee admits that the Milwaukee Road cannot continue to operate its present railroad system. Why? It has no money; its roadway properties are in deplorable condition; its operating schedules and transit times are not competitive; its service is deteriorating; its markets are being lost (Hillman's Statement of April 30, 1979, p. 4-5 and Cruikshank Statement, generally).

Fact 4.—The Trustee's financial statements on file with this Court show that declines in Railway Operating Revenues and deficits in Net Revenue from Railway Operating, Net Railway Operating Income, Income After Fixed Charges, and Net Income have been increasing since January 1978 compared with the comparable period in the prior year.

Fact 5.—The analysis prepared by Booz, Allen & Hamilton gives no assurance that any configuration of the Milwaukee Road can be profitable. The Booz, Allen study shows that Segment 1, a subcore of 1700 miles, requires the least amount of additional investment (\$125 million), probably would lose the least amount of money at the level of Net Railway Operating Income ("NROI") (\$16 million), and might under optimum conditions show a positive \$4 million in NROI. (Power's April 30, 1979 statement pp. 12-13, 18 and Table 34). Trustee Hillman points out on page 10 of his April 30 Statement that NROI does not include debt service and that the numbers on Table 34 cannot be equated to net income and profits. Anticipated rehabilitation expenses of \$125 million on top of existing debt without any assurance that profits can be made is a discouraging prospect for an existing creditor to accept.

Fact 6.—First National has confidence in the Trustee's ability and integrity and commends his efforts. The severe winter of 1978-1979 undoubtedly accentuated the Trustee's difficulties, but the underlying cause of the Milwaukee's weakness is of long-standing duration. A predecessor of Milwaukee Road went bankrupt in 1925 (see 131 ICC 673), and again in 1935 (see 239 ICC 485). Interest on Income Debentures has not been earned since 1969; and losses in net income have been reported in 9 of the last 11 years.

Law 1.—There is no valid basis on which the security holders can be required to furnish additional funds to a system that has lost such staggering sums of money and has no reasonable prospects of altering its continuing losses. *Brooks-Scanlon v. Railroad Commission*, 251 U.S. 396 (1920); *In re Penn Central Transportation Co.*, 474 F. 2d 832, 837 (3rd Cir. 1973); *In re Third Avenue Transit Corp.*, 198 F. 2d 703, 707 (2nd Cir. 1952); *In re Chicago, Rock Island & Pacific Railroad*, 545 F. 2d 1089 (7th Cir. 1976).

Law 2.—The courts have recognized erosion in two senses. Financial erosion when additional new monetary burdens are placed on the bankrupt estate which take priority over claims of pre-bankruptcy creditors, and physical erosion when the physical plant is depleted by sales of assets and also deteriorates from lack of maintenance. Both types of erosion are present here. The reorganization court has a responsibility to bring a case to an end if all hope of success has faded.

On this issue see generally the line of cases on the *New Haven Inclusion* matter reported at 289 F. Supp. 418, 440-41 (S.D.N.Y. 1968); 304 F. Supp. 793, 802-4 (D. Conn. 1969) modified affirmed in 399 U.S. 392 (1970); the *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 122 (1974); and *In the matter of Valuation Proceedings Under the Regional Rail Reorganization Act*, 439 F. Supp. 1351, 1364 (1977).

The First National anticipates that some parties may request more time in this matter. It respectfully suggests that these petitions be denied. However well intentioned the requests may be no reasonable man can expect existing service to continue when a railroad is constantly running out of cash and its officers have fully explained the increasingly bleak picture that the railroad faces.

Conclusion

Massive rehabilitation is needed to revitalize the Milwaukee Road and such moneys are not available. Continued operation based on emergency month to month financing will unconstitutionally erode the estate without solving any problem. The unpleasant choice is between gradual collapse of service followed by complete liquidation and a partial embargo designed to reduce losses and gain time.

With a partial embargo, federal regulatory agencies, state regulatory agencies, shippers and other interested parties will have time to formulate plans under Section 11125 of the Interstate Commerce Act to preserve essential rail service to most of the Milwaukee Road's shippers at low cost to the public. If liquidation becomes necessary the shutdown once started is probably irreversible and no one knows how long the process may last, which competing groups may get which part of the assets, or the extent to which any group may receive compensation.

The choice is difficult but the reality must be faced. On balance, First National supports the Trustee's program for a partial embargo of all lines outside Segment I but only on condition it be made immediately effective.

Respectfully submitted,

THE FIRST NATIONAL BANK OF CHICAGO, AS TRUSTEE,
By EDMUND J. KENNY,
One of its Attorneys.

May 2, 1979.

Edmund J. Kenny,
Frank O. Wetmore II,
James A. Vroman,
WINSTON & STRAWN,
Chicago, Ill.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the above Statement of Position was served upon the persons listed in the attached Service List by mailing a copy thereof this 2nd day of May, 1979.

EDMUND J. KENNY.

CONTINENTAL BANK,
Chicago, Ill., May 11, 1979.

HON. HENRY S. REUSS,
Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, Rayburn House Office Building, Washington, D.C.

DEAR HENRY: Your telex to the bank concerning the bankruptcy hearing on the Milwaukee Railroad came in while I was traveling on bank business. It was immediately given to me upon my return, and I wanted to drop you a note to make sure you saw the bank's reply so that you could have a chance to understand our position.

I have been told that Mr. Hillman had arrived at an earlier decision than the one he proposed in open court, and we had agreed to support that position. Literally, on a one-day notice, we were informed that Mr. Hillman had changed his position and in view of our responsibilities as trustee, we had to oppose his new plan. We have been trying to work toward an acceptable plan for everyone, but our fiduciary obligations are fixed and they dictate all of the four trustees' actions accordingly.

Sincerely,

JOHN H. PERKINS, *President.*

DEAR SIR: In reply to your telex on the position taken by the Trustees, I want to emphasize that the bank in its legal capacity as a fiduciary for bondholders must act in strict compliance with the immediate best interests of the bondholders. As a trustee, we did not have the option nor the discretion to base their decision on such broad and general concepts applicable to commercial banking affairs "as convenience and needs of the public." We regret this lack of choice, but as a trustee of one of the four major publicly-held debt issues of the Milwaukee Road, Continental Bank, under its fiduciary responsibilities, must undertake any steps necessary to protect the interest of the many bondholders of the railroad. In this fiduciary capacity, we had no choice but to take a position which would fulfill our trustee obligations under the law.

In our capacity as a trustee, not as a creditor of the railroad, we were obliged to oppose the Hillman plan to place an embargo on approximately 70 per cent of the financially troubled railroad's 7,400 miles of track in portions of the Midwest and Northern Plains. From our viewpoint and that of the other three trustees for the bondholders, it was seen that any continuance of the railroad's operation would jeopardize the bondholders' investment and therefore, in meeting our responsibilities by law as trustee, it was felt that the Hillman proposal would not protect the beneficiaries to whom we owe our primary responsibility.

Continental Bank understands the economic ramifications of the problem as it might affect points served by the railroad, and we share the concern for the interests of the railroad's employees and customers. However, the law and banking regulations hold us to a firm duty, and our position was arrived at accordingly.

We too have high opinion of the reorganization trustee, Mr. Stanley Hillman, who is acting both for the Railroad and for all the various interests affected by the reorganization. Within the confines of our legal obligations we are working as closely as possible with him. As you know, everyone in the proceeding is subject

to certain legal rules which govern railroad reorganizations and these take precedence over whatever private preferences may be held. Judge McMillen has the final responsibility for weighing the fairness of any reorganization plan.

It is most unfortunate that the interests of the bondholders, and those which we must uphold in accordance with strict legal requirements, not our personal preferences, of the railroad's employees and customers are in such sharp conflict, but we look to the U.S. District Court in Chicago as the proper place for a resolution of the differences.

Mr. REUSS. I think we can fend off the banks with a reorganization plan. I hope Mr. Ogilvie will be appointed today, and I hope he will be filing his plan which has been gestating for months and I hope the judge will approve it the day after, and I hope that the Department of Transportation and the White House will come to life and get behind a rescue plan.

If so, we can have the Milwaukee Road on the way by Labor Day.

It has got to be within that timeframe.

Mr. EDWARDS. Why is it going to take until January 10? Is it?

Mr. REUSS. They set forth their plan. By contrast with what they have done earlier, it is a miracle of expedition.

Mr. EDWARDS. Well, does the law require a certain time period?

Mr. REUSS. No; they can pretty much set their own time. Application filed, comments due, hearings commenced, draft environmental impact statement issued, hearings concluded, briefs due, reply briefs due, final environmental impact statement issued—they could expedite that.

The railroad has asked them to.

I could pare a week here and 10 days there, and yet see that everybody got due process.

The ICC is simply an incredibly fuddy-duddy agency that has been doing things in the 1880 fashion for so long they are incapable of addressing themselves to the catastrophe which lies ahead.

Mr. EDWARDS. Well, the subcommittee is not, I am happy to say, and maybe we can move ahead much, much faster than that.

Counsel?

Mr. VEHON. No questions.

Mr. BOYD. No questions, Mr. Chairman.

Mr. EDWARDS. I want to compliment you for moving ahead so quickly on this in such a responsible way, and also your cosponsors, especially Mr. Hyde and Mr. Sensenbrenner and the Representatives who are responsible for the way of life in this key part of our country.

We certainly will move expeditiously but with all deliberation, and we are very anxious to hear from Mr. Smith.

Thank you very much.

Your full statement will be included in the record at this point.

[Mr. Reuss' complete statement follows:]

STATEMENT OF HON. HENRY S. REUSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. Chairman, the Milwaukee Road has been in bankruptcy since December, 1977. Its troubles go back many years, and stem largely from its improvident expansion to the Pacific Coast in 1906-08, an expansion which ran into thin traffic and heavy competition. It has suffered more than most carriers from the competition of trucks and other means of nonrail transportation.

More recently it has been plagued by cash flow problems, compounded by the interminable delays visited upon it by the Interstate Commerce Commission whenever it sought the abandonment of unprofitable lines. Forced by ICC inaction to continue operation of scores of money-losing lines, the Milwaukee

deferred track and locomotive maintenance. With inadequate maintenance derailment and delay in service were inevitable, and the delays drove away shippers who needed reliable rail service. Revenues and operating funds went down, the Milwaukee Road was caught in a brutal downward spiral.

While the Milwaukee Road was bankrupt and bleeding to death, it was business as usual at the Interstate Commerce Commission. Its treatment of a short segment of track outside my city of Milwaukee speaks volumes about the agency's attitude. In 1977, the Commission denied a Milwaukee Road application to abandon 29 miles of track between Waukesha and Whitewater in Southeastern Wisconsin. Its investigation, which had lasted two years, was by any measure full and fair. Several days of oral hearings had been held, and shippers, state, and local governments, unions, and interested citizens testified at length.

But by March, 1978, the Milwaukee Road was bankrupt. Rehabilitation of just that short segment would cost almost \$9 million, money the Road simply didn't have. The annual operating deficit alone was more than \$30,000. Traffic on the line averages 7.4 cars per mile, about a fifth of the break-even number.

On March 31, 1978, new Milwaukee Road bankruptcy trustee Stanley Hillman applied to abandon the line, this time adding an additional 12-mile segment, to a town called Milton Junction. (It is worth noting that the additional 12 miles requested in the second abandonment application, from Whitewater to Milton Junction, has not been used since before 1976; an inspection train could not even cross the tracks today because of the overgrowth by weeds.) Fully aware of the Milwaukee's dire straits, the ICC undertook yet another exhaustive examination of the line. Seven months went by before the Commission could even decide which procedure to use to process the case. Finally, more than fifteen months after the application was filed, an initial decision was issued granting the application, only days before the legal maximum time for the ICC's handling of the case would have expired. We are still not through: the Commission has just extended the time for filing of appeals and replies until August 25. It will then have 180 days to decide the appeal.

Does the ICC's deliberate pace simply reflect its care in deciding an important industrial or agricultural rail route, with thousands of jobs and millions of dollars riding on its continuation? Ken Kinney, a Milwaukee Journal reporter, rode the train a few weeks ago on one of its two-a-week trips. His story contradicts any such supposition.

"The handful of freight cars destined for the handful of customers on the Milwaukee Road's branch line to Waukesha and Whitewater arrives at the Brookfield depot late Monday night," Kinney wrote. "The next morning, the three-man crew assembles the train for the leisurely and remarkably inefficient run to Whitewater, 36 miles away. The day's labor will consume 12 hours of expensive labor and equipment * * * The crew of the train usually works 12 hours a day—four on overtime."

"Non-stop from just west of Waukesha to Whitewater—about 28 miles in one hour and 20 minutes. The speed limit never exceeds 25 m.p.h. (Conductor Bud Morris alludes to the light traffic on the line. 'A guy in Palmyra (a small town along the route) makes himself a bet. If this train goes by with more than 10 cars, he buys the house a drink.' No drinks for the house on this run.

"The further the train gets away from Waukesha, the worse the track becomes. The only place the ties are visible is where the track has recently been repaired after a derailment."

I am sorry to say that the ICC's irresponsible delays in ruling on this effort to trim uneconomic lines through established procedures is neither an isolated example nor even the worst example of the Commission's tortoise-like pace:

Item.—the Commission has averaged 5.4 months to process unopposed Milwaukee Road cases, and has taken as long as thirteen months;

Item.—the Commission averages 6.2 months merely to "assign" Milwaukee Road cases for oral hearing or "modified procedure" with only written submissions. The Commission has before it unassigned Milwaukee Road cases averaging 7.5 months since filing. One case has gone without assignment more than a year-and-a-half. (The law does not impose a time limit on this phase.)

Item.—the Commission averages seven months after assignment to issue initial decisions.

Not content with allowing upwards of thirteen months to elapse before issuing a decision in the average Milwaukee Road case, the Commission has resorted to artifice to extend time limits even further. In one case, for example, the Commission vacated an initial assignment order and claimed that its later assignment

started the clock running on the time periods the 4-R Act imposes for taking evidence and issuing a decision.

Frustrated by the ICC in his attempts to reduce money-losing lines, Trustee Hillman announced on April 23, 1979, his intention to "embargo" approximately three-fourths of the Milwaukee Road's track, cutting service down to a 2,400-mile "core" which he thought might be made profitable. After lengthy hearings, however, Judge Thomas R. McMillen of the U.S. District Court for the Northern District of Illinois, found—correctly in my opinion—that the Milwaukee Road was not, technically speaking, "cashless" and thus could not qualify for the "embargo" procedures specified in 49 U.S.C. 11125. Judge McMillen made his finding "reluctantly," acknowledging that "the Trustee's proposal is one which we believe would promote the public interest." (The decision is attached as Exhibit A.)

The Judge was stymied, of course, by the fact that the Milwaukee Road's petition for bankruptcy was filed under the old bankruptcy law, in which the abandonment provisions required ICC approval. All railroad bankruptcies initiated after October 1, 1979, will be covered by Section 1170 of the Bankruptcy Reform Act which, of course, will allow Trustees to do precisely what Trustee Hillman proposed and Judge McMillen found himself powerless to grant.

The ICC's reaction to this setback for the Milwaukee Road, its employees, and its shippers was quick and predictable. On the day the decision was issued, ICC Chairman Daniel O'Neal pronounced himself "gratified" that every money-losing mile of ICC track would be kept in operation. O'Neal's exultant release (attached as Exhibit B) promised no quick ICC action to help the Milwaukee, only a vague reference to "explore" "long-term solutions."

Unable because of the June 1 decision to reduce its losses from uneconomic lines, it became necessary, as the Judge predicted, for the Milwaukee Road to look again to the Federal Railroad Administration to guarantee an additional \$20 million worth of trustee's certificates. In a June 19 decision (attached as Appendix D), Judge McMillen authorized the trustee to apply for this guarantee, conditioning his authorization on the immediate (though pro forma) application to the ICC to abandon the entire system, the submission by the trustee of a reorganization plan by August 6, and the use, before the \$20 million is drawn down, of all other funds available to the railroad.

On July 12, the Federal Railroad Administration approved the guarantee. (Its findings are attached as Exhibit F). I supported the additional guarantee, the only way for the Milwaukee Road to keep operating while a legislative solution is sought. I was not happy, however, with the FRA's blithe finding that "the railroad can reasonably be expected to become self-sustaining." While specifically praising the trustee's desire to pare the railroad down to the core as the only potentially profitable configuration, the FRA's findings make no mention of the legislative action without which an expeditious paring-down will be only a chimera. To pour more federal money into the Milwaukee Road if it cannot get out from under the light-density lines which are choking it is simply to throw good money after bad. Only if the trustee can implement a core system will the federal money be an investment in an operationally and financially sound freight carrier.

Also just after Judge McMillen's June 1 decision Trustee Stanley Hillman announced his intention to resign when a replacement could be found. Former Governor Ogilvie of Illinois, who had been serving as the trustee's counsel, was designated to head the reorganization effort pending selection of a trustee, and is rumored to be the leading candidate for the position. Judge McMillen promised the name of the new trustee by July 2, then by July 16. Unless a new trustee is named today, we still do not have the official who must meet the court's August 6 deadline for a reorganization plan.

The outlines of the trustee's proposed reorganization plan are matters of public knowledge, and they make a good deal of sense. They look to the maintenance of the essential core of the Milwaukee Road—in Illinois, Indiana, Iowa, Minnesota, Wisconsin, South Dakota, North Dakota, and west to Miles-City Montana. This reorganized and viable core would contain roughly one-third of the Milwaukee Road's present 9,800-mile lines. Service on other of its major lines would, pursuant to current negotiations, be assumed in Iowa by the Northwestern, in Iowa and Missouri by the Rock Island, and in Montana-Idaho-Washington by the Burlington Northern and the Union Pacific. Uneconomic branch lines would be abandoned, subject to the usual directed service procedures of the Interstate Commerce Commission. The plan would insure good rail freight service to substantially the entire system, and require the continued services of all but 1,000 to 2,000 of the railroad's 10,000 employees.

Unfortunately, in light of Judge McMillen's June 1 decision the trustee will not be able on August 6 to propose any such sensible plan of reorganization, because

he will have only the impossible alternative of petitioning the Interstate Commerce Commission for abandonment, a process that on past performance takes years. Long before that time, the Milwaukee Road will grind to a halt, its 10,000 employees jobless, its assets seized by creditors, and industry and agriculture throughout the northwestern United State devastated.

Judge McMillen's decision, while blocking the Trustee's plan, clearly pointed the way for those who wanted to save the Milwaukee Road. " * * * (Every) avenue which has been explored leads, in our opinion, to a road block, erected primarily by the Federal government * * *. Congressional action is the only foreseeable alternative."

I accepted Judge McMillen's challenge, and on June 13 I wrote to President Carter (in a letter attached as Exhibit C) outlining the Milwaukee's difficulties and asking for his help. The President promptly appointed his top adviser for domestic affairs Stuart Eizenstat to head up the Administration's efforts to save the Milwaukee Road. On June 20, I wrote Eizenstat a detailed memorandum (a copy of which is attached as Exhibit E) suggesting a solution to the situation, a solution which corresponds closely to the bill before you. Unfortunately White House leadership was not forthcoming, and on June 28 I introduced H.R. 4686, cosponsored by my colleagues, Mr. Hyde, Mr. Zablocki, Mr. Aspin, Mr. Kastenmeier, Mr. Obey, Mr. Sensenbrenner, Mr. Roth, Mr. Petri, Mr. Sabo, Mr. Yates, Mr. McClory, Mr. Annunzio, Mr. Stewart, Mr. Derwinski, Mr. Nolan, Mr. Oberstar, Mr. Bonker, and Mr. Mikva. Since then Mr. Erdahl, Mr. Vento, Mr. Andrews, and Mr. Lowry have joined us as cosponsors.

Under Section 1 of the bill, Section 77(o) of the Bankruptcy Act would be amended to permit the judge, after a hearing but without ICC permission, to order Milwaukee Road abandonments.

Section 2 would allow the ICC to direct willing nonrail carriers to assume traffic previously carried by a rail carrier which has discontinued service under 49 U.S.C. 1125, if it finds that nonrail shipment would be less costly or more energy-efficient. This provision caused the referral of the bill to the House Committee on Public Works, which has jurisdiction over nonrail transportation, as well as to this Committee and to the Committee on Interstate and Foreign Commerce. The Public Works Committee feels, understandably, that the provision represents a major policy innovation, one that they feel requires full hearing and deliberation, over the course of many months. Therefore, because of the emergency of the Milwaukee Road's situation, I recommend that this Committee strike the clause entirely. The Public Works Committee has graciously agreed, if the provision is struck, to waive its jurisdiction over the bill, and to so inform the Rules Committee.

Section 3 of the bill—which, with the striking of the present Section 2 will now become Section 2—makes available to Milwaukee Road employees the labor protection available with other officially approved abandonments. It provides that these provisions would be administered by the Railroad Retirement Board; that necessary sums for this are authorized to be appropriated; and that the abandoning railroad, at such time after it is reorganized and its financial condition permits, shall repay to the Railroad Retirement Board such sums as it can, so as to eliminate or lessen the burden on the taxpayers.

For those who have sought time to piece together financing for an employee-shipper stock ownership plan (ESSOP) to purchase all or part of the railroad, the time between the announcement of the putative embargo on April 23, 1979, and the August 3 target date for enactment of this bill will have provided more than the ninety days extension that was sought. Passage of time after enactment while the Court hears the Milwaukee's applications for abandonment will provide yet more time. Should an ESSOP materialize, I'm sure Judge McMillen and the Trustee will be glad to sell the group that part of the to-be-abandoned lines it is able to purchase and operate.

I am grateful to you, Mr. Chairman, for moving so quickly on this emergency legislation. My gratitude, too, to Subcommittee members and H.R. 4686 cosponsors Rep. Hyde and Rep. Sensenbrenner, whose advice and support have been invaluable. And both Mr. Vihon and Minority staff member Mr. Boyd have been instrumental in steering us past the unfamiliar rocks and shoals of federal bankruptcy law.

Your work here today will be the first step in putting a bill on the President's desk by August 3 that will save the Milwaukee Road and its thousands of workers and shippers. I am grateful for all you have done and are about to do.

P.S. At 3:30, Friday afternoon, July 20 after preparing this testimony I received word of the imminence of an astounding order from the ICC which may markedly affect the reorganization and on which I shall comment on in my presentation to the Subcommittee on July 23.

Mr. EDWARDS. Our next witness is Mr. Worthington Smith, who is president of the Milwaukee Road.

Mr. Smith, we welcome you.

Are you accompanied by anyone?

TESTIMONY OF WORTHINGTON L. SMITH, PRESIDENT, CHICAGO MILWAUKEE, ST. PAUL & PACIFIC RAILROAD CO., ACCOMPANIED BY JOHN ROWE, COUNSEL TO THE TRUSTEE

Mr. SMITH. Thank you, sir.

I am accompanied by John Rowe, who is counsel to the trustee.

Mr. EDWARDS. Mr. Rowe, you are welcome also.

Without objection, your full testimony will be made a part of the record, and you may proceed, Mr. Smith, at your own pace.

[Mr. Smith's statement follows:]

STATEMENT OF WORTHINGTON L. SMITH, PRESIDENT OF THE MILWAUKEE ROAD

My name is Worthington L. Smith. I am President and Chief Executive Officer of the Milwaukee Road. In that capacity I am responsible to the Trustee for the day to day operation of the Railroad. I would like to thank the Chairman and Subcommittee for this opportunity to discuss the grave crisis which faces the Milwaukee and to emphasize the need for prompt and decisive action in solving its problems. I will begin my discussion with a brief description of the Milwaukee and the events which have led to the current crisis and close with some general suggestions about the types of actions which are needed.

The Milwaukee Road is a large common carrier. It serves the Midwest and the northern tier of states to the Pacific Northwest extending both east and west from Chicago while serving that city. Among the other major points the Milwaukee serves are Tacoma, Seattle, Portland, Kansas City, Minneapolis-St. Paul, Milwaukee and Louisville. The Milwaukee Road is a contractor to Amtrak for intercity passenger service between Chicago, Milwaukee and Minneapolis and to Chicago's Regional Transportation Authority for suburban service providing for the daily movement of some 41,000 commuters. Presently the Milwaukee operates approximately 9,800 miles of route, and has some 10,000 employees.

Many of the services which the Milwaukee provides, and many of the lines of railroad it operates, are essential to the economic life of the railroad's territory and to the entire nation. But it is also a fact of the company's economics that many of its services are neither essential nor unique. Much of the territory which the Milwaukee serves is also served quite well by several other railroads and by several other modes of transportation. As a result, the Milwaukee's average traffic density is rather low. In 1977, the Milwaukee ranked seventh among the nation's 51 Class I railroads in mileage operated, but only 15th in total operating revenues. In that year, the latest for which statistics are available, the Milwaukee constituted about 5 percent of U.S. railroading measured in mileage but only just over 2 percent measured in revenues.

Having tried to support too many miles of railroad in relation to what it could earn by operating all those miles, the Milwaukee not surprisingly has long been financially marginal. The Milwaukee Road is now bankrupt, unable to pay all of its bills, for the third time in its history. In 1975, 1976, and 1977 combined, the railroad lost approximately \$100 million. It lost \$82 million in 1978. It will likely lose about \$150 million this year if its entire system remains in operation.

In the 19 months since our bankruptcy filing, the Trustee has put \$120 million into the Milwaukee Road, all the outside cash he could get and all the postponement of obligations he could arrange. Yet the Milwaukee's overextended, under-maintained physical plant continues to deteriorate. Our services generally continue to become less responsive to the needs of our customers.

We are, however, making progress in certain areas. The help of the Federal Railroad Administration through loan guarantees and preference share financing is beginning to show some results. We are near completion of rebuilding 111 locomotives and 950 freight cars. Presently, locomotive availability is the best it has been in some years. The equipment rehabilitation programs have stabilized our bad-order car ratios. As a result of the track work, our train running times in the essential corridor between Milwaukee and St. Paul are improving. The Chicago-Milwaukee-Twin Cities line is, in fact, the backbone of the Milwaukee Road. The ongoing federally funded work will help guarantee that this line remains strong.

Nonetheless, sufficient funds are not available to rehabilitate the entire 9,800-mile Milwaukee so that it can increase its earning power adequately and become self-supporting. The funds which the Trustee has been able to obtain have been used to sustain our operations at little more than a subsistence level. In fact, it is highly improbable that the Milwaukee, in its present form, could make it through another winter such as the last one. Even with all available federal assistance, our losses averaged about \$10 million per month in the first half of this year. While the last several months have shown some improvements, these losses will rise substantially in winter weather. The \$20 million which we have recently been authorized to borrow under the Emergency Rail Services Act will be exhausted early in the fall, and only \$30 million remains available for all insolvent railroads under the ERSA appropriation.

The critical question with which the Trustee and officers of the Milwaukee are faced is, where do we go from here? What will the future of the Milwaukee Road be?

I believe the future prospects of the Milwaukee must be viewed in relation to a single critical absolute: The Milwaukee Road simply cannot accumulate sufficient financial strength to compete effectively against other railroads and other modes of transportation over its present 9,800-mile system. The Milwaukee must become smaller, concentrating those resources which are available to it on the route structure which best offers the prospect for future viability.

If the Milwaukee is allowed to concentrate its resources on a smaller segment of its present system, on a key segment on which it can perform best and on which the cost of rehabilitation can be minimized, there is a reasonable possibility that a reorganization of the Milwaukee as an operating railroad can be achieved. The result would be the preservation of many jobs, the continuation of much existing service in the Milwaukee's name, and, quite possibly, a substantial saving to the nation's taxpayers. There is, I should warn, no guarantee that a successful reorganization might emerge; but, the possibility justifies the try.

I want to impress upon you how vital to the future size and shape of the Milwaukee is the necessary investment in physical rehabilitation of the railroad's property and equipment. We have seen from the Booz, Allen & Hamilton report that the rehabilitation cost for the railroad's existing route structure would be in excess of one billion dollars. Plainly, obtaining and investing funds of that magnitude are neither possible nor prudent. Only on a small segment of the present Milwaukee can the investment risk be reasonably equated with potential return.

It was with these conditions squarely before him that, on April 23, Trustee Hillman asked the reorganization court to direct him to embargo all but some 2,700 miles of the Milwaukee's routes; to reduce employment essentially to what would be required to operate that smaller railroad; and to indicate to the Interstate Commerce Commission the possible need for directed service over the embargoed lines, by other railroads, under Section 11125 of the Interstate Commerce Act.

In his proposal to the court the Trustee indicated that a Milwaukee Road of some 1,700 route miles, operating essentially between Louisville and Duluth through Chicago, Milwaukee and Minneapolis-St. Paul with extensions to Green Bay and the Upper Wisconsin River Valley, best equated potential return with the risk of necessary rehabilitation investment. Additional lines to Miles City, Montana, and in southern Minnesota, bringing the route-mileage to some 2,700 were added to this core structure on the strength of financial commitments by Minnesota, North and South Dakota. It is around this basic route system that we believe the Milwaukee can be reorganized to emerge as a well-equipped, service-oriented railroad operating in the territory in which it has the best chance for viability.

This system, with some possible additions, encompasses the region which has historically generated the largest share of the Milwaukee's freight revenues. It is the only area in which we have qualified for and received federal funds for track rehabilitation. It is an area in which we serve major metropolitan markets as well

as some important agricultural areas. It is a region in which we are on a better competitive footing with other railroads and other transportation modes.

After a lengthy hearing, the reorganization court denied the Trustee's request to embargo service in areas outside the region I have just described. In essence, the court's denial compels us to continue to operate the entire system to the best of our ability by borrowing whatever funds may be authorized.

It is important to note that the court denied the embargo on legal grounds. It did not dispute the facts which the Trustee and his officers had presented during the hearing. If anything, the denial served to underscore the critical nature of the facts, and especially the economic facts. We still have our cash problems. We still have our potentially self-supportable core. We also have strong support among several states and many customers. We lack only a legal vehicle to shorten the time and reduce the expense in attaining its goal of restructuring the railroad on a viable basis and the funds to finance the restructuring and rehabilitation.

But we are not standing still. We are well into an alternative plan to arrive at the core. The Trustee will present to the reorganization court, on or before August 6, a preliminary plan of reorganization for the railroad. That plan will be based, in part, on the elimination of many miles of route which, in the Trustee's opinion, cannot successfully be incorporated into a viable railroad. To a large extent the preliminary plan will reflect the core route structure which we presented to the court during the embargo hearing. Our line from Chicago to the Twin Cities will remain, as before, at the heart of the core system. We are also in the process of reevaluating the economic potential of some lines, including our route to Kansas City, which were excluded from the original core.

As part of this process, and as quickly as we can do so, we shall file with the Interstate Commerce Commission formal applications to abandon all lines which are not in the core. We have already notified the Commission and the public that by August 8 we will file to abandon all of our lines west of Miles City, Montana—some 2,225 route miles. Also, in compliance with the court's order, we have published a map which indicates that the balance of our routes may be subject to the filing of abandonment applications in the event we cannot find a way to successfully reorganize the operation in this region.

Concurrently with these efforts, we are expediting our negotiations with other railroads which have expressed interest in purchasing some of the lines which lie outside the core. We are confident that most of the Milwaukee's current shippers would continue to have rail service even if the Milwaukee system is reduced in size.

I would like to address the need for decisive and farsighted action by Congress. First I urge Congress to create a vehicle for timely restructuring of the Milwaukee. Under the current law, applications to abandon or sell lines of railroad generally require very time consuming consideration. I am pleased to report that the Interstate Commerce Commission has been responsive to this problem and has proposed for comment an expedited review schedule for our lines west of Miles City which would yield a decision by January 10, 1980. However, even if the Interstate Commerce Commission were to expedite its normal procedures to this degree, nearly a year would pass before abandonment could finally take place. The Milwaukee cannot borrow sufficient funds to operate so long; and, if the funds were borrowed, the resulting debt service obligations could not be met by the restructured railroad. As a result, Congress must establish an expedited review mechanism for the restructuring of the Milwaukee or all hopes for the survival of our railroad may be lost in the avalanche of our current losses.

We have seen proposals for expedited reviews by the Interstate Commerce Commission, the Department of Transportation or the reorganization court. While any of these forms could be utilized with a stringent Congressional mandate and the Commission has shown willingness to be responsive, we believe the reorganization court is best equipped to consider all relevant factors in a relatively short time period. In this context we would point out that the court is able to consider alternative proposals, such as the ESOP which has been suggested by some, in addition to the Trustee's plan. In this respect we believe that H.R. 4686 is a sound approach.

Second, Congress must take into account the fact that the restructuring of the Milwaukee would have a more substantial impact upon labor than on shippers. We firmly believe that the great majority of the shippers who are actually dependent upon the Milwaukee would continue to get rail service from carriers who acquire portions of our line. The most significant problem which would arise from our reduction in plant would be the effect upon our labor force. We would hope to place a substantial number of our employees with acquiring carriers but there remains the possibility that several thousand employees would lose work in the

areas in which they are now assigned and would be forced to look to other locations or other carriers for jobs. Fortunately, there are substantial demands in the industry at this time.

This labor protection question is extremely difficult to handle since the extent to which the estate of a liquidating railroad can be subjected to labor protection claims is in some question, as is the priority which those claims would receive in a bankruptcy situation. My immediate concern is, however, the practical fact that a reorganized, scaled down Milwaukee Road would not be able to support a substantial protection burden. Therefore, it seems to me that it is possible that leaving such claims for the estate to bear would undermine the assurance of protection for the employees and potentially destroy the railroad we all wish to save. Accordingly, I urge the Congress to provide an appropriate level of funds to protect the railroad workers who may be affected by the retrenchment of the Milwaukee.

Finally, I would like to urge the Congress to act rapidly and to provide for a far reaching solution rather than simply using federal funds to postpone the problem. Given the magnitude of the Milwaukee's losses, funds which are used to delay a restructuring can cost the taxpayers a great deal without achieving any real solution. As I have said earlier, our losses will increase to even higher levels this winter and even if the remaining \$30 million ERSA funds were devoted to our needs, it is unlikely the railroad could survive the winter. In my opinion, public monies are for better spent in rebuilding essential rail lines and meeting, to the extent possible, the desires of the employees for protection than in simply spinning out our present situation.

Mr. SMITH. I believe you have been provided copies.

I have a few additional copies that will be made available to the hearing room.

My name is Worthington L. Smith.

I am president and chief executive officer of the Milwaukee Road.

In that capacity, I am responsible to the trustee for the day-to-day operation of the railroad.

I would like to thank the chairman and subcommittee for this opportunity to discuss the grave crisis which faces the Milwaukee and to emphasize the need for prompt and decisive action in solving its problems.

I will begin my discussion with a brief description of the Milwaukee and the events which have led to the current crisis and close with some general suggestions about the types of actions which are needed.

The Milwaukee Road is a large common carrier. It serves the Midwest and the northern tier of States to the Pacific Northwest extending both east and west from Chicago while serving that city.

Among the other major points the Milwaukee serves are Tacoma, Seattle, Portland, Kansas City, Minneapolis-St. Paul, Milwaukee, and Louisville.

The Milwaukee Road is a contractor to Amtrak for intercity passenger service between Chicago, Milwaukee, and Minneapolis and to Chicago's Regional Transportation Authority for suburban service providing for the daily movement of some 41,000 commuters. Presently, the Milwaukee operates approximately 9,800 miles of route and has some 10,000 employees.

Many of the services which the Milwaukee provides and many of the lines of railroad it operates are essential to the economic life of the railroad's territory and to the entire Nation. But it is also a fact of the company's economics that many of its services are neither essential nor unique.

Much of the territory which the Milwaukee serves is also served quite well by several other railroads and by several other modes of

transportation. As a result, the Milwaukee's average traffic density is rather low.

In 1977, the Milwaukee ranked 7th among the Nation's 51 class I railroads in mileage operated, but only 15th in total operating revenues. In that year, the latest for which statistics are available, the Milwaukee constituted about 5 percent of U.S. railroading measured in mileage but just over 2 percent measured in revenues.

Having tried to support too many miles of railroad in relation to what it could earn by operating all those miles, the Milwaukee not surprisingly has long been financially marginal.

The Milwaukee Road is now bankrupt, unable to pay all of its bills, for the third time in its history. In 1975, 1976, and 1977 combined, the railroad lost approximately \$100 million. It lost \$82 million in 1978. It will likely lose about \$150 million this year if its entire system remains in operation.

Mr. EDWARDS. Is that a calendar year you are talking about?

Mr. SMITH. Yes, sir, calendar; and that is an ICC accounting figure that I am using there.

In the 19 months since our bankruptcy filing, the trustee has put \$120 million into the Milwaukee Road, all the outside cash he could get and all the postponement of obligations he could arrange. Yet the Milwaukee's overextended, undermaintained, physical plant continues to deteriorate. Our services generally continue to become less responsive to the needs of our customers.

We are, however, making progress in certain areas. The help of the Federal Railroad Administration through loan guarantees and preference share financing is beginning to show some results. We are near completion of rebuilding 111 locomotives and 950 freight cars. Presently, locomotive availability is the best it has been in some years.

The equipment rehabilitation programs have stabilized our bad-order car ratios. As a result of the track work, our train running times in the essential corridor between Milwaukee and St. Paul are improving. The Chicago-Milwaukee-Twin Cities line is, in fact, the backbone of the Milwaukee Road. The ongoing federally funded work will help guarantee that this line remains strong.

Nonetheless, sufficient funds are not available to rehabilitate the entire 9,800 mile Milwaukee so that it can increase its earning power adequately and become self-supporting.

The funds which the trustee has been able to obtain have been used to sustain our operations at little more than a subsistence level. In fact, it is highly improbable that the Milwaukee, in its present form, could make it through another winter such as the last one.

Even with all available Federal assistance, our losses averaged about \$10 million per month in the first half of this year. While the last several months have shown some improvements, these losses will rise substantially in winter weather. The \$20 million which we have recently been authorized to borrow under the Emergency Rail Services Act will be exhausted early in the fall, and only \$30 million remains available for all insolvent railroads under the ERSA appropriation.

The critical question with which the trustee and officers of the Milwaukee are faced is, where do we go from here?

What will the future of the Milwaukee Road be?

I believe the future prospects of the Milwaukee must be viewed in relation to a single critical absolute: The Milwaukee Road simply cannot accumulate sufficient financial strength to compete effectively against other railroads and other modes of transportation over its present 9,800 mile system.

If the Milwaukee is allowed to concentrate its resources on a smaller segment of its present system, on a key segment on which it can perform best and on which the cost of rehabilitation can be minimized, there is a reasonable possibility that a reorganization of the Milwaukee as an operating railroad can be achieved.

The result would be the preservation of many jobs, the continuation of much existing service in the Milwaukee's name and, quite possibly, a substantial saving to the Nation's taxpayers. There is, I should warn, no guarantee that a successful reorganization might emerge, but the possibility justifies the try.

I want to impress upon you how vital to the future size and shape of the Milwaukee is the necessary investment in physical rehabilitation of the railroad's property and equipment.

We have seen from the Booz, Allen & Hamilton report that the rehabilitation cost for the railroad's existing route structure would be in excess of \$1 billion. Plainly, obtaining and investing funds of that magnitude are neither possible nor prudent. Only on a small segment of the present Milwaukee can the investment risk be reasonably equated with potential return.

It was with these conditions squarely before him that, on April 23, Trustee Hillman asked the reorganization court to direct him to embargo all but some 2,700 miles of the Milwaukee's routes; to reduce employment essentially to what would be required to operate that smaller railroad; and to indicate to the Interstate Commerce Commission the possible need for directed service over the embargoed lines, by other railroads, under section 11125 of the Interstate Commerce Act.

In his proposal to the court the trustee indicated that a Milwaukee Road of some 1,700 route miles, operating essentially between Louisville and Duluth through Chicago, Milwaukee and Minneapolis-St. Paul with extensions to Green Bay and the upper Wisconsin River Valley, best equated potential return with the risk of necessary rehabilitation investment.

Additional lines to Miles City, Mont., and in southern Minnesota, bringing the route mileage to some 2,700, were added to this core structure on the strength of financial commitments by Minnesota, North & South Dakota. It is around this basic route system that we believe the Milwaukee can be reorganized to emerge as a well-equipped, service-oriented railroad operating in the territory in which it has the best chance of viability.

This system, with some possible additions, encompasses the region which has historically generated the largest share of the Milwaukee's freight revenues. It is the only area in which we have qualified for and received Federal funds for track rehabilitation. It is an area in which we serve major metropolitan markets as well as some important agricultural areas. It is a region in which we are on a better competitive footing with other railroads and other transportation modes.

After a lengthy hearing, the reorganization court denied the trustee's request to embargo service in areas outside the region I have just

described. In essence, the court's denial compels us to continue to operate the entire system to the best of our ability by borrowing whatever funds may be authorized.

It is important to note that the court denied the embargo on legal grounds. It did not dispute the facts which the trustee and his offices had presented during the hearing. If anything, the denial served to underscore the critical nature of the facts, and especially the economic facts.

We still have our cash problems. We still have our potentially self-supportable core. We also have strong support among several States and many customers. We lack only a legal vehicle to shorten the time and reduce the expense in attaining its goal of restructuring the railroad on a viable basis and the funds to finance the restructuring and rehabilitation.

But we are not standing still. We are well into an alternative plan to arrive at the core. The trustee will present to the reorganization court, on or before August 6, a preliminary plan of reorganization for the railroad. That plan will be based, in part, on the elimination of many miles of route which, in the trustee's opinion, cannot successfully be incorporated into a viable railroad.

To a large extent the preliminary plan will reflect the core route structure which we presented to the court during the embargo hearing. Our lines from Chicago to the Twin Cities will remain, as before, at the heart of the core system. We are also in the process of reevaluating the economic potential of some lines, including our route to Kansas City, which were excluded from the original core.

As part of this process, and as quickly as we can do so, we shall file with the Interstate Commerce Commission formal applications to abandon all lines which are not in the core.

We have already notified the Commission and the public that by August 8 we will file to abandon all of our lines west of Miles City, Mont., some 2,225 route-miles. Also, in compliance with the court's order, we have published a map which indicates that the balance of our routes may be subject to the filing of abandonment applications in the event we cannot find a way to successfully reorganize the operation in this region.

Concurrently with these efforts, we are expediting our negotiations with other railroads, which have expressed interest in purchasing some of the lines which lie outside the core. We are confident that most of the Milwaukee's current shippers would continue to have rail service even if the Milwaukee system is reduced in size.

I would like to address the need for decisive and farsighted action by Congress. First, I would urge Congress to create a vehicle for timely restructuring of the Milwaukee.

Under the current law, applications to abandon or sell lines of railroad generally require every time-consuming consideration.

I am pleased to report that the Interstate Commerce Commission has been responsive to this problem and has proposed for comment an expedited review schedule for our lines west of Miles City which would yield a decision by January 10, 1980. However, even if the Interstate Commerce Commission were to expedite its normal procedures to this degree, nearly a year would pass before abandonment could finally take place.

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The most significant problem which would arise from our reduction in plant would be the effect upon our labor force. We would hope to place a substantial number of our employees with acquiring carriers but there remains the possibility that several thousand employees would lose work in the areas in which they are now assigned and would be forced to look to other locations or other carriers for jobs.

Fortunately, there are substantial demands in the industry at this time. This labor protection question is extremely difficult to handle since the extent to which the estate of a liquidating railroad can be subjected to labor protection claims is in some question, as is the priority which those claims would receive in a bankruptcy situation.

My immediate concern is, however, the practical fact that a reorganized, scaled-down Milwaukee road would not be able to support a substantial protection burden. Therefore, it seems to me that it is possible that leaving such claims for the estate to bear would undermine the assurance of protection for the employees and potentially destroy the railroad we all wish to save.

Accordingly, I urge the Congress to provide an appropriate level of funds to protect the railroad workers who may be affected by the retrenchment of the Milwaukee.

Finally, I would like to urge the Congress to act rapidly and to provide for a far-reaching solution rather than simply using Federal funds to postpone the problem.

Given the magnitude of the Milwaukee losses, funds which are used to delay a restructuring can cost the taxpayers a great deal without achieving any real solution. As I have said earlier, our losses will increase to even higher levels this winter and even if the remaining \$30 million ERSA funds were devoted to our needs, it is unlikely the railroad could survive the winter.

In my opinion, public moneys are far better spent in rebuilding essential rail lines and meeting, to the extent possible, the desires

of the employees for protection than in simply spinning out our present situation.

Mr. EDWARDS. Thank you, Mr. Smith.

The gentleman from Illinois, Mr. Hyde.

Mr. HYDE. Thank you, Mr. Chairman.

I wonder why the railroad didn't formally seek approval from the ICC for the proposed abandonment? Why hasn't the railroad done that?

Mr. SMITH. The events that led to our embargo proposal and the hearings that came about as a result of that were to a large extent forced by the cash problem as we came out of the winter.

We believed, and were found to be incorrect, that an embargo could be granted and that directed service for a period of 240 days could be put in place under formerly 116(b) section or the 11125 and during that 240-day period we would be able to work out the sale and advance of essential lines to other areas.

It was a time/cash problem we were attempting to meet. Clearly, the judge did not agree with that but, as Congressman Reuss said, he agreed with the facts. In fact, he stated in his order of June 1 that the plan proposed by the trustee was in the public interest, but he did not have the legal support to grant the embargo and put directed service in place.

I think that had we been successful it clearly would have been a much more expeditious way to get the plant reduced than the process of the filing for abandonment.

Mr. HYDE. I don't wish to pursue any more questions along this line but I noticed in the ICC's press release that they have to consider environmental impact statements concerning your petition for reorganization. I know environmental considerations are important but can you tell me what an environmental impact statement has to do with abandoning profitless lines?

Mr. SMITH. I think I would share the implication in your question. The environmental impact statement is a substantial amount of paper which requires specialists, which we have on our staff, to compile, and generally goes to the matter of the impact the discontinuance of rail service will have upon the movement of goods by some other form of transportation and what will that do to the environment. This is one of the thrusts.

It goes to the matter of will this create more truck activity, will it create more barge activity? What will be the result, and what will be the adverse affect, if any, or the positive effect of going from one mode of transportation to another?

There is also the requirement that when the rails are removed and the right of way reverts, to what purpose does the right of way revert, agricultural, State hiking trails, as has been done on a number of occasions, or will it become a commercial use, and what might this lead to?

This is an extremely complex and I think burdensome requirement.

Mr. HYDE. I agree. I think it is pretty farfetched to have you speculate on what the impact on the environment will be which will result from your abandonment. Really, your abandonment will help the environment. There will be less noise, the trains won't be rattling through the town, et cetera, but what will follow is really a matter of

speculation, I suppose, which you are required to do and that takes about 45 days for hearings.

It is a classic example of the bureaucratic morass that people get into. I am surprised that you have to go through all that.

Mr. SMITH. I agree with you, Mr. Hyde. The biggest single document filed in the abandonment of anything is the environmental impact study. The smallest is the economic analysis which seems a bit backward to me but that is the world we live in.

Mr. HYDE. Thank you very much.

Mr. EDWARDS. The time frame concerns me. I am sure it concerns you too. Even with the \$20 million that is going to be made available, are you still going to be operating by January 1980? How can you? How can you pay your bills?

Mr. SMITH. I think we have a bit of a dilemma on this, Mr. Edwards. It was our thought that we would need a transition amount to get from the full system to the core. There is testimony in our May hearings, the unsuccessful hearings getting toward the embargo, that if we could move to the smaller core this would be the minimal expense and, therefore, the minimal amount of borrowings and consequently a burden to pay back that the core railroad could undertake.

What occurred as a result of the judge's decision is we are literally ordered to run the whole railroad at a level of activity on the first of May, or words to that effect. Here we have an economic statement that says we shouldn't be doing this and it is our intent to restructure and actually to respond to the very explicit section 101 of the 4-R Act encouraging physical restructuring of the rail system of the United States and yet, we are prevented from doing so because of a legal impediment.

I suggest a method has to be found in either getting us quickly to the core we believe represents the future of Milwaukee or the only other alternative is to fund the redundancy until such time as the process can be completed.

Mr. EDWARDS. Even without this legislation you are proceeding as though you are going to be successful in reducing the size of the railroad. You are going to pick up \$20 million from the Government but you are losing \$10 million a month and you won't be able to go into the core assistance until perhaps spring of 1980.

Where is the additional money going to come from?

Mr. SMITH. We will try two other sources. We will continue to petition for the release of funds on deposit with the mortgage trustees. We have done this, and we will continue to do this.

I believe within the next week or two we will have a petition for a specific drawdown from what have been internally generated funds which are impounded by the banks. This we will do and this we are ordered to do.

We also will at a point, and probably this will be filed in August or early September—we will apply, I am sure, for the additional \$30 million because of the requirement that we keep the whole plant going.

Mr. HYDE. Mr. Chairman, may I? I am just pursuing this environmental impact issue. I have asked counsel and I have been informed that the environmental impact statement is reviewed by the EPA office within the ICC and if they don't like it, if it decides that there

are going to be too many trucks rolling to take up the freight that you are not any longer going to take, they could deny the thing.

Mr. SMITH. Yes, sir.

Mr. HYDE. So despite the fact that you are not only dead broke but overwhelmingly in debt, the environmental considerations could stop you from abandoning these lines. Then you would have to go back into court, right?

Mr. SMITH. Right.

Mr. HYDE. Also go through the Administrative Procedure Act and play around with that for a couple more years. That is all the more reason it would seem to me for prompt legislative action here.

I am getting educated to the pervasiveness of the environmental considerations on almost every aspect of our economy. This comes as a revelation to me.

Mr. SMITH. The critical path, if you will, of filing for preference share or 511 loan proceeds under the 4-R Act and the critical path on the abandonment process is the environmental impact statement. That is where the time goes and that is one that has to be done as meticulously as possible because it is quite possible if a sentence is incomplete or a comma is out of place the whole thing can come back.

Mr. HYDE. One of the basic problems with this whole procedure, it seems to me, is the predictable narrowness of concern of these various agencies. The environmentalists are interest in the environment.

Mr. SMITH. Yes, sir.

Mr. HYDE. They are less concerned—I don't mean they are unconcerned—about the economics of the situation than they are about the environment. That is why they are there. Anything negative on the environment is something that displeases them.

We need a balance between our needs for the environment, or legitimate concerns, and the economic commonsense that perhaps the Interstate Commerce Commission has yet to consider but we hope this legislation will help the court to consider.

These competing interests, which can slow the whole process down, are really at the heart of the morass which we find ourselves in throughout all of the regulatory reviews in administrative agencies.

Mr. SMITH. I would agree with you. Coming from a multiregulated business it is impressive each day to be reminded of this. I think that each legitimate functional discipline is attempting to do the right thing, nevertheless it is a tedious process.

I think the incongruity of this is that I believe as a professional transportation person that there is indeed redundant excess rail plant in the United States. I believe that my company has a great deal of that redundant plant.

So the economic answer and the ultimate well-being total user of transportation is to get rid of the waste to this economy and the redundancy, and yet the thrust appears to be to perpetuate it while there is a continual review as to whether the analysis was correct or not.

I think somehow the intent to restructure which is well stated in the 4-R Act really ought to mean more than it does. I guess sometimes I feel that restructuring a railroad is a great idea as long as no one steps forward and tries to do it. That seems to be the box we are in at the moment.

The judge doesn't feel he has the right to assist the process expeditiously, and those who oppose it for their legitimate vested interests I presume, I think do get things a bit out of perspective as you indicated.

We are going to run out of cash if this is kept up too long.

Mr. HYDE. The chairman has been very generous with me. I will make one more comment.

I have been disturbed that the declines in productivity in our country—which is the only real wealth we have—this redundancy seems to be a major obstacle in that between increasing our productivity, which is something we had best be about trying to increase; and this has been very illuminating.

Thank you very much, Mr. Chairman.

Mr. EDWARDS. I don't want to cut this short at all. As a matter of fact, I think it is very important that you be asked all the questions that we feel are important.

This subject is not one with which this subcommittee is familiar.

In your testimony on page 10, Mr. Smith, you added a consideration that I don't think we expected and one which would be outside the jurisdiction of this committee unless, of course, the trustee could handle it in the event this legislation comes about. That is, you are urging Congress to provide an appropriate level of funds to protect the railroad workers who may be affected by the entrenchment of the Milwaukee.

All members of the subcommittee, and I know Mr. Reuss and all the sponsors of the bill, are very interested in the protection matter but this legislation would not provide any additional money to protect the workers so that labor protection would not be too much of a burden on the reform of the railroad.

Mr. SMITH. Yes, sir, I understand that. I had the occasion in mid-May to appear before Mr. Florio's committee in a discussion something like this. We had not had the completion of the embargo hearing at that time. The point that was made that day was in sorting out what is the issue in this proceeding, and perhaps in another railroad like ours, it is fundamentally a labor displacement problem and my concern would be that dealing with that is the clear issue. Solving that problem so that restructuring can go forward I think is the better way for everyone, in particular the taxpayer, rather than perpetuating the whole in order to not deal with the displacement problem.

Somehow this is really the key issue. I acknowledge that it is terribly important. I don't have the precise answer on this but I am firmly convinced that is the whole problem and that is the real sticker in what it is we are trying to do.

It comes about because we began with the economic analysis that there can be a reorganization around the small core, and in getting to that core we think we can take care of the commercial problem very easily with the sale to other railroads. There has been virtually no adverse commercial comment throughout this entire proceeding, but there is the displacement problem that has to be met head on.

Mr. EDWARDS. Is the road in real danger of liquidation unless something takes place?

Mr. SMITH. I might defer to John Rowe on that, if I may. I think he has the feel of the opposing counsel better than I.

Mr. EDWARDS. Mr. Rowe.

Mr. ROWE. Thank you, Mr. Edwards. Yes. The answer to your question is clearly yes. The size of the railroad's losses in proportion to the magnitude of its assets creates a very strong case under prevailing constitutional principles for liquidation.

There have already been motions before the court seeking an order of liquidation. The judge has denied them to date but did go so far as to direct that we identify our entire system as a potential candidate for abandonment.

I believe that in conjunction with the next round of borrowings we will have to seek, and certainly no later than October 1 when the new Bankruptcy Act becomes effective with its language more directly permitting a railroad in reorganization to liquidate, we will see another barrage of motions for a complete liquidation and we will see those motions heavily supported by testimony.

One of my most fundamental concerns here is that the size of the potential labor protection obligation plus the size of our interim operating losses create a potential burden of debt so large that there may be no hope of reorganizing a railroad in a way that the debt can be serviced.

In that instance the viable portions of the railroad go down the drain with the unviable.

Mr. EDWARDS. Is that why the banks are recommending liquidation so that the assets are preserved and made available for sale by the court and so that the debt doesn't keep increasing month by month?

Mr. ROWE. Exactly.

Mr. EDWARDS. Mr. Volkmer.

Mr. VOLKMER. I have no questions.

Mr. EDWARDS. Mr. Hyde.

Mr. HYDE. I have no further questions.

Mr. EDWARDS. Mr. Vitton.

Mr. VITTON. Mr. Smith, in your testimony you indicated there was in fact no absolute certainty that a reorganization would be effective with the passage of this proposed legislation.

Can you identify any more than you and counsel already have what would be the sine qua non of a successful reorganization?

Mr. SMITH. There are two factors involved here that are hard to project in a precise answer. The one is what is going to be the availability of funds to maintain the whole and the other is what can be done to shorten the timespan of the process and it is in the balance of these two that lies a much more satisfactory answer.

It relates to the question Mr. Edwards raised. I am sure the reason we are getting the increased pressure on the liquidation is the direct result of having been ordered to maintain the whole and everybody knowing and we being the prime testifiers that there has to be an infusion of funds to maintain the whole.

This has caused a lot of difficulty for the creditors. If we could move by the first of October to the core, we have taken on a lot less future obligation than if we are talking a year from October.

I would like to think that with an identified core and the objective of reorganization we aren't smothered by a time process so that we never can get to a starting point. This is the dilemma.

Mr. EDWARDS. Did all of the banks make these loans directly or did the banks buy some paper on the market and issue bonds or otherwise?

Mr. SMITH. The money we have drawn down?

Mr. EDWARDS. No; the money that the railroad owes to the various banks, are the banks creditors who made loans to the railroads or did they go in the market and buy some of the paper that was floating around at a discount.

Mr. SMITH. No.

Mr. ROWE. Mr. Edwards, the banks are what is called indenture trustees in this case which means that they are acting as fiduciaries for the holders of the bonds. In that capacity the banks are legally required to take what is perhaps a more narrow approach than they would take if they were acting in their commercial capacity.

This is partly the reason for their response to Mr. Reuss' letter but beyond that the bondholders whom the banks are representing include individuals who acquired their bonds as a result of the prior bankruptcies and individuals who have acquired their bonds on the market since that date.

There is no way of distinguishing between the two, and I am highly doubtful that there is any legal basis for distinguishing between the two.

Mr. EDWARDS. Did some of these individuals buy these bonds at a discount?

Mr. ROWE. Surely.

Mr. EDWARDS. How much of a discount?

Mr. ROWE. It could have been as much as 60 percent in some cases.

Mr. EDWARDS. Thank you. Mr. Vitton.

Mr. VITTON. Mr. Smith, are there any of the States through which the railroad runs regulating the activities of the Milwaukee Road?

Mr. SMITH. There is a body of State regulation. The primary regulatory agency is the Interstate Commerce Commission.

Mr. VITTON. I realize that. The reason I ask my question is that there is a decision that was rendered by the Third Circuit Court of Appeals that indicated notwithstanding the ICC jurisdiction being lifted in abandonment situations, nevertheless, the railroad might have to go back to the States who have an interest in the operation of the railroad and seek permission that it can be abandoned within each of the States where it may be regulated.

I am leading up to asking you whether there is any such regulatory scheme present in any of the States wherein the Milwaukee does operate and where it seeks to abandon lines, and if so, whether any inquiry has been made of those agencies whether they would be positively responsive to an abandonment?

Mr. SMITH. I think broadly there is no machinery such as that at the moment. A variation of that would be if the Interstate Commerce Commission were removed and now the Federal court is in its place so sometimes the question comes up a little differently, who is going to look after the well-being of the public and so forth, it is not as though there is no process. There is a process.

I should assume from what we have observed in the previous embargo discussions that the States would appear in Federal court and argue their case at that level rather than we have to go to each of the States.

Do you have a thought on that one?

Mr. ROWE. Yes. I think the only significant State involvement of the type you described would be the involvement with the regional