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MILWAUKEE
ROAD

How the Milwaukee Road Was Saved

NOW, THIS IS THE WAY TO RUN A RAILROAD

The route traveled by the Milwaukee Road—formally, the Chicago, Milwaukee, St. Paul & Pacific Railroad—is not unlike that of other major railroad lines in recent years. After the postwar boom, the Road experienced a steady loss of passenger and freight revenues to federally subsidized airways, waterways, and highways during the 1950s. In the mid-1960s, the federal government moved all mail transportation to the airlines and motor carriers, ending a steady source of revenue the railroads had enjoyed almost since their inception. In the early 1970s, the Milwaukee Road phased out its obsolete electrified operations in favor of diesel power, just in time to be caught by the skyrocketing fuel prices fostered by the OPEC oil embargo of 1973–74. Each slight of fate's hand widened the gap between revenues and costs, and the Milwaukee Road filed a voluntary petition for reorganization late in 1977.

At the time, the board of directors of the Chicago Milwaukee Corporation, the diversified holding company that owned 96 percent of the railroad's stock, believed the shareholders would best be served by liquidating the company. The railroad was cash-poor and regularly posting operating deficits, but it was asset-rich mainly because of its extensive land and timber holdings.

On the other side was a strong contingent supporting a move to turn the railroad around in order to arrange a merger. Among the most visible members of this group were Richard B. Ogilvie, former governor of Illinois and, since 1979, the trustee; Worthington L. Smith, the railroad's president; and Thomas F. Power, Jr., the chief financial officer. They realized changes would have to come quickly to show that the feat was possible.

History seems to have vindicated the yea-sayers, as the Road has returned to

profitability. The common stock of its holding company has soared to well over $100 per share this year, from an all-time low of $3 per share, and three major carriers are pursuing the Road as a merger candidate: the Grand Trunk Corp., owned by the Canadian National Railway; Chicago & North Western Transportation Co.; and, most recently, the Soo Line Railroad, controlled by Canadian Pacific Limited.

Such popularity is new to the Milwaukee Road. Reminiscing about how far it has come in the past seven years, Power likened the railroad's newfound allure to that of an attractive young girl pursued by several suitors. "Or perhaps an older one with a face-lift," Ogilvie interjected.

If it did have the benefit of some cosmetic tucks, the railroad's face is still etched with character lines suggestive of a rich past. Chartered in 1847 as the Milwaukee and Waukesha Railroad Company, the line opened operations with five miles of track. An aggressive expansion record sprinkled with new construction, acquisitions, and various combinations yielded 9,800 miles of track linking Chicago with points as far west as Seattle and Tacoma by the time the line filed for reorganization.

This growth was not without stumbles. At prosperous times, the Road undertook expansions that exceeded its financial means and caused a quick fall from the summit. These slips brought the line or its predecessors to bankruptcy court three times in its 137 years.

At the same time, the Road racked up an impressive list of railroading advances. The western expansion begun in 1905 resulted in 2,300 miles of track through five major mountain ranges—a remarkable engineering feat at the time. An early move to electrification yielded the largest electrified operation of its kind in the United States. In the 1930s, when automobiles barely made 60 miles per hour and propeller-driven airplanes were still under development, the line introduced the Hiawatha trains, capable of traveling faster than 100 mph. When you add a number of power struggles between railroad barons, wars, depressions, and sundry other pieces of Americana that affected the railroad's development, it's clear that the Milwaukee Road has an undeniable place in our history.

Ogilvie had his first involvement with the railroad as counsel to Stanley E. G. Hillman, former chairman of the Illinois Central Gulf Railroad, who was initially appointed trustee of the Milwaukee Road's property in reorganization by the U.S. District Court in Chicago. During Hillman's trusteeship, several important steps were taken to get the railroad back on a firm footing.

The trustee had quickly determined that the railroad couldn't be reorganized unless it closed the Pacific Coast extension between Minneapolis/St. Paul and Seattle/Tacoma. He reported to the court that he had already entered into negotiations with the Union Pacific and the Burlington Northern to sell portions of the line west of Butte, Montana.

A study completed in March 1979 confirmed the railroad's belief that the entire 9,800-mile system could not be sustained, and the trustee asked the court to permit an embargo of service over all but 2,400 miles of track and the furlough of employees not required for the continuing service. He also sought approval to borrow $15 million to keep the remaining operations afloat.

U.S. District Court judge Thomas McMillen, presiding over the reorganization, denied the trustee's proposal to shut down portions of the line, but approved the request to borrow $15 million. Undaunted, Hillman filed another application in August to abandon almost 2,500 miles of track west of Miles City, Montana, projecting that future traffic would not justify the $100 million investment it would take to rehabilitate that portion of the line. The Interstate Commerce Commission was unconvinced, believing it was possible to save the line, and employees formed their own organization to fight the move.

Soon afterward, Hillman decided to retire for health reasons, and the court appointed Ogilvie trustee of the railroad. One of his first acts was once again to present the railroad's case for the embargo, this time successfully. The embargo—unprecedented in the history of railroading—became effective on October 31, 1979, but was short-lived. On November 2, Congress passed the Milwaukee Road Restructuring Act, which required the railroad to operate the entire line while the ICC considered a proposal for an employee stock ownership plan to be presented by December 1.

The ICC rejected the proposal and, by its action, transferred approval of abandonments and sales of the Road's lines to the reorganization court and the trustee. This critical action set the stage for the railroad to resume its embargo in March 1980, a move that proved to be the key to the success of the reorganization. Though his position ultimately prevailed, Ogilvie remarked about the jockeying among the various regulatory agencies: "Serving as trustee of a bankrupt railroad is much like playing poker with all your cards face up on the table —while the other players are holding theirs close to the vest."

Much of the game was played in the courtroom, "in the context of arcane legalisms in which few become expert," according to Isham Lincoln & Beale partner Robert H. Wheeler, legal counsel to the trustee. Wheeler and John Rowe, his predecessor as counsel who went on to become senior vice president of law at Conrail and is now president of Central Maine Power Company, thrived in the courtroom setting. When there was no precedent for restructuring moves, they worked to establish one.

"If what the trustee was proposing made sense and furthered the reorganization, we believed the law should follow," Wheeler said. "We've been right so far, and in the nine appellate decisions reviewing the reorganization, we have been consistently upheld."

In the midst of the courtroom battles and power struggles, Power, now CFO and vice president of reorganization, emerged as a leader in developing creative solutions to the railroad's financial problems. A fourteen-year veteran of the Milwaukee Road, he understood the issues and earned the respect of management, the court, the creditors, and the auditors. Continuing to focus on the core activities, he worked to improve the profitability of the reorganized, regionalized railroad.

Former Illinois governor Richard B. Ogilvie (left) and Milwaukee Road vice president—reorganization Thomas F. Power, Jr., led the movement to turn the Milwaukee Road around.

Thomas J. Stahlschmidt, Peat Marwick engagement partner for the Milwaukee Road audit, discussed the railroad's situation with Chicago office managing partner Lee W. Jennings, a longtime business adviser to Ogilvie. Both agreed that the Firm could offer valuable consulting assistance in addressing the critical issues the Road was facing. A series of meetings and proposals followed, and Peat Marwick was engaged to evaluate the Road's systems and controls under the overall direction of principal William J. Ainsworth. Jennings was named client partner.

Ainsworth sent senior consultant Milan Saric to Milwaukee to direct the on-site consulting work, a tour of duty that lasted almost two years. The consultants' report to the trustee, issued in November 1980, focused on five critical areas: purchasing, joint facilities, disbursements accounting, payroll, and revenue accounting. Initial findings led to nearly three years of consulting work in strategic planning, organization, and systems policies and procedures.

The consulting team estimated that the railroad could achieve significant savings by increasing inventory turnover, reducing inventory carrying costs, and reducing purchasing expenditures. More savings could be realized by increasing billings to and reducing accounts payable from other railroads. Revenue accounting focused on savings through identification of unreported waybills, identification of prior years' unreported waybills, and an improved tracing system to provide up-to-the-minute information on freight-car systems. In all, the report concluded that the cash-starved railroad could achieve almost $34 million in total savings.

The primary focus was on cost containment and cost reduction. Peat Marwick's mission was to assist management in the identification of areas that could generate desperately needed cash to help fund the reorganization. Results were impressive. Within three years, inventories were reduced by over $21 million while service improved, and another $68 million were saved through procurement reductions.

By an odd twist of fate, Mount St. Helens in Washington erupted four times in the spring and summer of 1980, destroying thousands of acres of valuable timberland in the Pacific Northwest and driving up the value of the property owned by the Milwaukee Land Company, a wholly owned subsidiary. Ogilvie seized the opportunity in early 1981—at the top of the market—to sell several thousand acres of timberland and certain mineral rights for $180 million.

Cost-containment and cash-generating activities were proceeding on other fronts. The sale of 764 miles of rail lines to the state of South Dakota was closed in escrow. Peat Marwick principal Vincent J. DeSostoa headed up a team of transportation industry professionals based in Washington, D. C., that assisted the state in the acquisition. Another 383 miles of track in Montana and Washington State were sold to the Burlington Northern. The combined sale price reached almost $40 million.

A joint labor/management action group composed of the principal labor organizations and the new Milwaukee reorganization company voluntarily elected to accept wage deferrals of 10 percent in 1980 and 7 percent in 1981, a demonstration of the employees' commitment to share the risk of continuing deficit operations while working toward reorganization. The group agreed to wage reductions into 1982, 1983, and 1984, if necessary. In exchange, a class of preferred stock would be created when reorganization was completed to reflect the value of deferred wages as the employees' investment in the railroad.

The wage-concession agreement was not hammered out easily, nor did all the unions agree to participate. John Mogan, general chairman of the United Transportation Union and a thirty-six-year railroad veteran who represents the train crews, gives much of the credit to Ogilvie. He characterizes the former governor as a "straight shooter" who is "tough and demanding, but fair. The governor knows I'm not a yes man; we've had our adversarial peaks and valleys, but I'm sure he also knows I've never lost respect for him. I always knew he had the interest of the railroad at heart.

"I supported the wage concessions in spite of their unpopularity at times because the alternative—liquidation—doesn't consider the employees," Mogan explained. "We expected that it would be our 'trail of tears' but we're survivors. We've gone through a lot of difficulties, including bankruptcies and the things that have led to our problems today. We now have a greater investment in our jobs because of the wage and crew-size concessions we made, and we appreciate them more."

Gradually, the cost-cutting and cash-generating activities began to have an effect on the reorganization efforts and the continuing operations of the railroad. In the spring of 1981, the Milwaukee Road received court approval to obtain a dividend from the Milwaukee Land Company to prepay $50.1 million of trustee's certificates issued to cover borrowings during the period from February 1979 to November 1980. The prepayment saved approximately $7 million in interest payments. In addition, the railroad was able to retire $37 million of its first mortgage bonds by the summer.

By the fall of 1981, Ogilvie and the management team could see the light at the end of the tunnel. On September 15, 1981, a revised plan of reorganization was filed in anticipation of successful completion of the reorganization by January 2, 1985.

By October 1981, the Road had reached an agreement with Grand Trunk Corp. to discuss the integration of the Milwaukee into the Grand Trunk's system of railroads. In a statement, Grand Trunk cited the Milwaukee Road's progress in eliminating unproductive lines, improving service, and reducing operating costs as the major reasons for its interest.

In a gesture symbolizing the emergence of a revitalized Milwaukee Road, the railroad revived and modernized its Hiawatha logo. The logo now adorns the freshly painted freight locomotives, a visible link between a proud heritage and a promising future.

The railroad entered 1983 with both its finances and its management strong. On April 25, the Milwaukee Road announced its first quarterly profit in almost a decade, piquing the interest of other suitors. A Chicago and North Western proposal to acquire the assets of the operating core of the Milwaukee was filed with the reorganization court, and on July 28 the ICC delayed Grand Trunk's planned acquisition. In January, the Soo Line entered the fray with a last-minute proposal.

Top: Chicago office managing partner Lee W. Jennings (right) and Milwaukee Road vice president—non-operating properties James T. McGuire pose among the pews in the renovated waiting room of Chicago's historic Union Station.

Bottom: Key members of the Milwaukee Road's engagement team are (from left) MC manager Milan M. Saric, audit partner Thomas J. Stahlschmidt, and MC principal William J. Ainsworth.

Another round of bidding followed, and as this issue goes to press, the latecomer seems to have the advantage. In a statement filed with the ICC, Ogilvie said that a review of the amended offers indicated that the Soo Line proposal was about $700,000 better than the North Western bid, but "both offers are in the interests of the shareholders, Milwaukee employees, and the public."

Acquisition by the Grand Trunk seems unlikely, since its proposal is $160 million less than the others and GTC management did not sweeten the offer in its amended bid.

While the two leading proposals are structured slightly differently, the Milwaukee Road estimates that the Soo Line's combination of cash and debt assumption is worth $570.6 million, while the North Western's bid of cash, stock, and debt assumption is valued at $569.9 million. On a comparable basis, the Grand Trunk offer is worth about $410 million.

Both top offers include $29 to $30 million that will go to employees in return for the 7 percent wage reductions they have taken since 1982. Along with termination of the wage reduction, the employees will gain increased health and pension benefits, and job security.

The ICC has until September 10 to review the offers, including public interest considerations, and decide which to refer back to the bankruptcy court with commission approval.

Whether it's because of the railroad's inherent beauty or its timely face-lift, the prospective grooms are lining up at the church doors.

—*Samuel A. Cypert*

Railroading has always held a special place in America's heart. It was all so romantic, the early railroad builders being only a step behind the pioneers to make yesterday's frontier today's civilization. Travelers could pass through threatening elements and near-impossible terrain in the comfort of their railroad cars, watching the trees, mountains, fields, and miles of track fall behind to a soothing clickety-clack rhythm. Railroaders have always been a special breed. When the railroad had to get through, nothing could stand in their way.

"You can look at the numbers and read the reports to get an idea of what's happened with the reorganization," legal counsel Bob Wheeler told us. "But you will never really understand what railroading is all about until you get on a train and talk to the people."

So, on one clear and cold morning, several of us caught a Sprint train piggybacking semitrailers to St. Paul, Minnesota. When we arrived at the main yard in Bensenville (near Chicago), the thermometer registered around minus 10 degrees Fahrenheit. Frozen switches and other weather-related problems had delayed "making up" trains. Our 8:30 departure was rescheduled; we left about a half hour late.

The Milwaukee Road's vice president of operations, Paul F. Cruikshank, was our host in a spartan but comfortable 30-year-old caboose. Also along were assistant vice president and chief engineer Nate Smith and assistant vice president and general manager Bill Plattenberger. Among them, they have 112 years of railroading experience. Cruikshank was the rookie, with only 32 years. Smith had logged 37 years, all with the Road. Except for the time he spent railroading with the government and the army during the Second World War, Plattenberger has spent all of his 43 years in the business with the Road.

The caboose's upper deck offered an expanse of windows for a panoramic view, while rear windows provided an uninterrupted view of track. As we surveyed the route, we had available the railroad's "condensed profile," which consists of detailed charts and maps with such information as age, depth, and composition of the ballast or stone in the roadbed; the weight, age, and manufacturer of rail sections; and the type of ties used and when they were last replaced. Our hosts seldom referred to the profile, however; they could cite most of the information from memory. Statistics and engineering data are the staples of their business.

The operations men breathed life into the numbers. We soon realized that inventory management and control involved not only the locomotives and rolling stock that make up the mile-long freight trains, but also the 3,200 ties and 25,000 or so spikes in every mile of track. It costs close to half a million dollars to build a mile of track today, Cruikshank said, so everything is done with economics firmly in mind.

The loudspeaker in the caboose poured forth a steady stream of radio conversations between our crew, stations along the route, and other trains on the line. The weather was still causing problems. One Chicago-bound train was stalled because moisture in the air caused a valve to freeze somewhere along a mile and a half of interconnecting pneumatic line, activating the emergency air brake system. The train couldn't move until the problem was isolated and repaired.

We changed crews in Milwaukee without stopping; we slowed enough for one crew to hop off and replacements to jump on.

The 415 miles of our trip passed quickly, the hours filled with fascinating details about the history, construction, operation, and maintenance of the railroad, or with just plain spinning yarns about this mode of transportation that captured the fancy of Americans like no other before or since.

The next morning, we took a tour of the St. Paul yard and diesel house. Despite the minus-32-degree-Fahrenheit weather, things were running surprisingly smoothly. Workers, their faces wrapped in ice-caked scarves, went about the business of making up trains and performing the routine of daily maintenance checks and repairs necessary for efficient operation. The freight must be kept moving.

Nine-pound hammers and steam locomotives have long since given way to power tools and modern diesel engines, but the spirit of the railroad pioneers who forged their way across America's heartland still lives on in the sons and daughters of the Milwaukee Road. As they will proudly tell you, they are survivors. Adversity only makes them more determined to succeed.

Such conviction is contagious. The briefest visit leaves one with the lasting impression that they will indeed prevail. Whoever acquires the Chicago, Milwaukee, St. Paul & Pacific Railroad Co. will have bought one helluva railroad.

—S.A.C.

Ahead of its time in 1937—the *Hiawatha*.

Photos courtesy of the Milwaukee Railroad