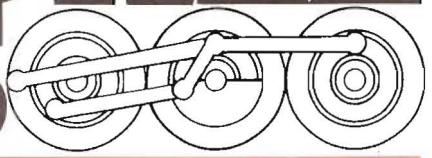
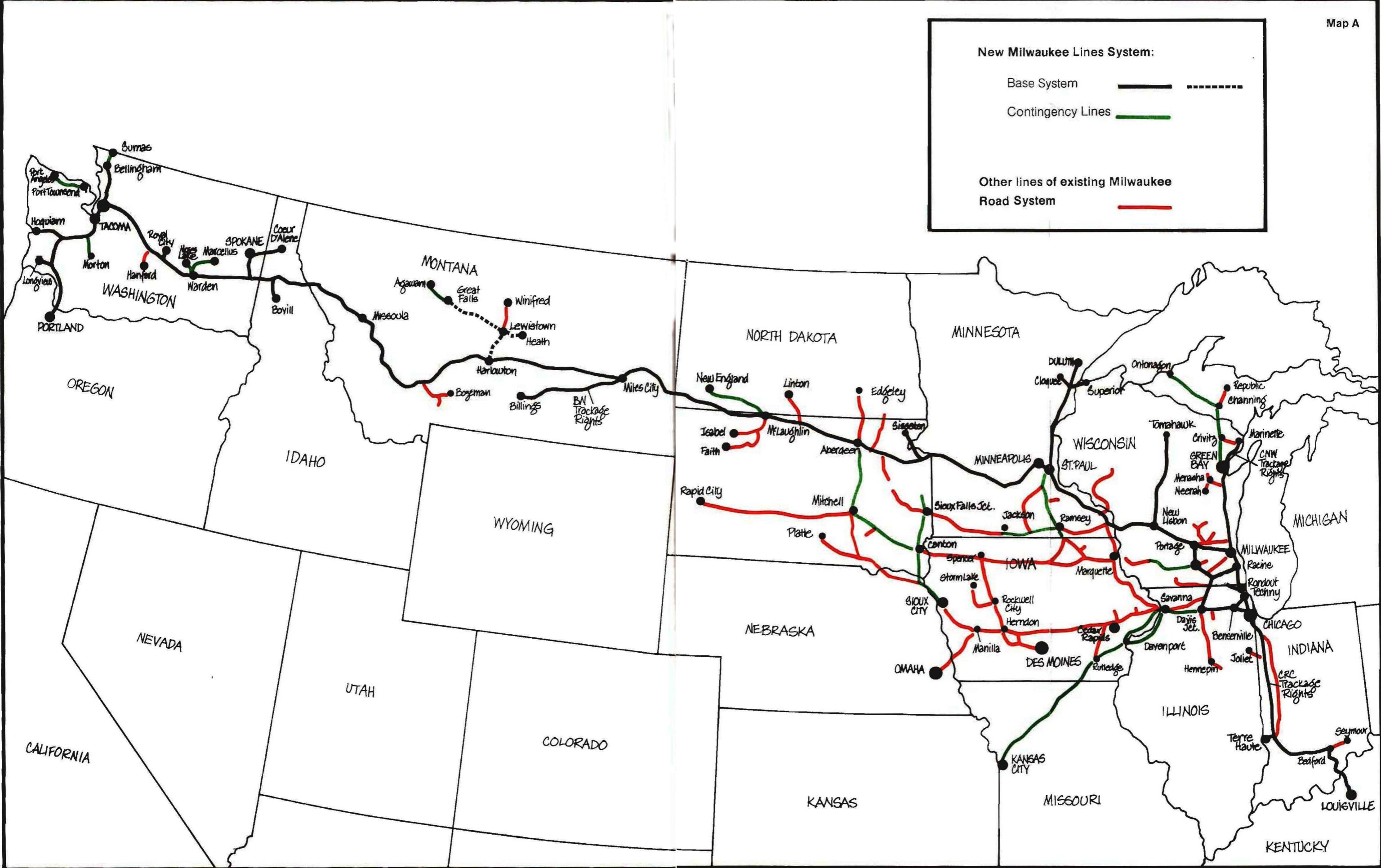


NEW MILWAUKEE LINES



Employee-Shipper Ownership Plan

Map A



Map B

Lines of Milwaukee Road System to be considered for inclusion
in NewMil System under Section 401 Process.



BEFORE THE
INTERSTATE COMMERCE COMMISSION

RICHARD B. OGILVIE, TRUSTEE OF THE)
PROPERTY OF CHICAGO, MILWAUKEE,)
ST. PAUL AND PACIFIC RAILROAD)
COMPANY -- SUBMISSIONS UNDER)
SECTION 6 OF THE MILWAUKEE ROAD)
RESTRUCTURING ACT)

Finance Docket
No. 29171

NEW MILWAUKEE LINES

Proposed

EMPLOYEE-SHIPPER OWNERSHIP PLAN

December 1, 1979

NEW MILWAUKEE LINES

Employee-Shipper Ownership Plan

ERRATA

The following are the typographical errors in the printed text of the Plan submitted to the Interstate Commerce Commission:

<u>Page and Line</u>	<u>Errata</u>
Table of Contents	Chapter VI - "Assets" should be "Asset"
Chapter I	
I-2, line 12	"Owned" should be "Ownership".
I-7, line 14	"operatons" should be "operations".
I-9, line 2	"API" should be "401".
I-9, line 4	"expert" should be "excess".
2-9, line 21	"VII-J" should be "VII-G".
I-10, line 18	"conservation" should be "conservatism".
I-13, line 7	"reedemable" should be "redeemable".
I-15, line 3	"standard" should be "standards".
I-15, line 21	"for" should be "forth".
I-17, line 1	"drives" should be "drive".
MAP A	"Raymond" branch is not shown. It should be a red line. "Metaline Falls" branch is not shown. It should be a red line. "Limestone Junction" branch is not shown. It should be a red line. "Fargo" branch is not shown. It should be a red line. The CRC trackage rights from Chicago to Terre Haute are the red line and should be black, and the black line, which is the Milwaukee's line, should be red.
MAP B	Above mentioned lines, which are part of existing system, are also not shown on this map.
Chapter II	
II-4, line 28	"Milwaukee" should be "Milwaukee".
II-15, line 7	"toes" should be "ties".
II-15, line 20	"thatn" should be "that".
II-17, line 23	"Stekton" should be "Steelton".

II-22, Line 20 "TR" should be "TR 1500-03".
II-41, line 6 "carrid" should be "carried".
II-44, line 17 "contin-gent" should be "contingent".
II-55, line 19 "Comission" should be "Commission".
II-66, line 19 "equiptable" should be "equitable".
II-79, line 11 "notel" should be "note".
II-87, line 18 Omit "rather".
II-90, line 1 The period after "Road" should be a colon.
II-93, line 36 "n. 7" should be "n. 41". Also "Power" should be omitted at the end.
II-93, line 37 "n. 13" should be "n. 47". Also at the end of the line "ll." should be added.
II-94, line 1 "n. 22" should be "n. 55".
II-94, line 3 "n. 22" should be "n. 55".
II-94, line 6 "n. 13" should be "n. 47".
II-94, line 36 "n. 38" should be "n. 69".
II-96, line 23 "n. 42" should be "n. 73".
II-96, line 24 "n. 34" should be "n. 65".
II-96, line 25 "n. 35" should be "n. 66".
II-96, line 34 "n. 51" should be "n. 83".
II-96, line 35 "n. 54" should be "n. 86".
II-96, line 41 "n. 34" should be "n. 65".

Chapter III

III-2, line 6 "Company" should be "Railroad".
III-3, line 6 "necessary requirements" should be omitted.

Chapter IV

IV-1, line 7 "line" should be "lines".
IV-1, line 10 "as" should follow the word "such".
IV-2, line 7 "leassing" should be "leasing".
IV-3, line 14 "grains" should be "gains".

Chapter V

V-2, line 6 "," after "Washington" should be a ". ".
V-3, line 9 ":" is needed after "contingencies".
V-4, line 24 "ot" should be "it".
V-8, line 3 Insert "," after "line".
V-9, line 20 "Junstion" should be "Junction".
V-10, line 2 ":" should be a ", ".
V-10, line 12 "part 112b" should be "part 1121".
V-10, line 15 "rehabilitaion" should be "rehabilitation".
V-11, line 10 Insert "," after "operations".
V-12, line 17 "through" should be "thorough" and "evaluations" should be "evaluation".
V-14, line 15 "NeMil" should be "NewMil".
V-14, line 21 "Milwaukees" should be "Milwaukee's".
V-17, line 4 Omit "[".
V-17, line 18 "9.2%" should be "7.2%".
V-18, line 11 Omit last "the".

V-18, line 12 Omit "NewMil".
V-20, line 7 "Exhibits" should be "Exhibit V-A".

Chapter VII
VII-2, line 14 Insert "the" after "from".
VII-3, line 14 Omit "that".
VII-3, line 16 Omit "a".
VII-3, line 17 Omit "()".
VII-6, line 16 Insert "is" after "operations"; omit "()".
VII-8, line 24 Insert "seen in" after "is".
VII-16, line 9 Omit "that".
VII-16, line 25 "of" should be "for".
VII-21, line 4 "povide" should be "provide".
VII-21, line 22 "ca" should be "can".
VII-23, line 15 "O" should be "24,604"
VII-23, line 16 "1980" should be "1985".
VII-26, line 10 "adjusmeents" should be "adjustments".
VII-30, line 5 Insert "," after "traffic".
Exhibit VII-C
note 1/ "1" should be "10".

Chapter VIII
VIII-22, line 17 Omit "for".

Chapter IX
IX-13, line 19 Omit "the".

Chapter X
X-12, line 13 "2.3%" should be "2.03%".
X-13, line 17 After "rather" insert "than".
X-14, line 8 "3/6%" should be "3/8%".
X-22, line 11 "elimantes" should be "eliminates".

Appendix A
Summary, line 10 "November" should be "December".
Summary, line 17 The first "of" should be "or".
Summary, line 20 "Pil." should be "P.L.".
Page 1, line 27 "impremented" should be "implemented".
Page 2, line 2 "shipper" should be "Shipper".
Page 2, line 11 "as" should be inserted after "such".
Page 2, line 30 "leassing" should be "leasing".
Page 3, line 9 "grouth" should be "growth".

Appendix B
Page 1, line 4 "Chairman of Board" should be deleted.
Page 1, line 5 "and Chief Executive Officer" should be inserted after "President".
Page 1, line 28 insert "Clerks" after "Airline".
Page 1, line 34 insert "Terminal Association" after "Grain".
Page 3, line 10 "Ilasca" should be "Itasca".

NEW MILWAUKEE LINES
EMPLOYEE - SHIPPER OWNERSHIP PLAN

TABLE OF CONTENTS

Chapter

- I. Executive Summary and Maps
- II. Background
- III. New Milwaukee Lines - The Proponent of the Plan
- IV. Brief Summary of Financial and Operating Plan
- V. Physical Description of the New Railroad
- VI. Assets Values to be Acquired
- VII. Financial Projections and Determination of Self-Sustainability
- VIII. Development of Pro-Forma Projections
- IX. Assessment of Operating Practices and Role of the ESOP
- X. Method of Implementation
- XI. Public Interest in and Fairness and Equity of Plan

Appendices

- A. Federal Register Notice
- B. Board of Directors and Officers of New Milwaukee Lines
- C. Consultant Team
- D. Legal Counsel
- E. New Milwaukee Lines Articles of Incorporation and Bylaws

Glossary

- (1) "Abandonment proceeding" refers to the proceeding before the Interstate Commerce Commission by the Trustee in August 1979 seeking permission to abandon the Milwaukee Road's lines west of Miles City, Montana. The proceeding was given Docket Number AB-7, Sub.No.86F and is entitled Richard Ogilvie, Trustee of the Property of Chicago, Milwaukee, St. Paul and Pacific Railroad Company -- Abandonment -- Portions of Pacific Coast Extension in Montana, Idaho, Washington and Oregon.
- (2) "Booz-Allen" and "Booz, Allen studies" respectively refer to Booz, Allen - Hamilton, the consulting firm employed by the Trustee, and its "Strategic Planning Studies" which were performed for the Trustee.
- (3) "Consulting Center" or "CCI" refers to the Consulting Center, Inc., a Virginia-based consulting firm that established and managed the project team which produced the operating and financial data and analyses contained in this Plan.
- (4) "ESOP" refers generally to an employee stock ownership plan that is capable of obtaining certain favorable federal income tax treatment, and, where the context so indicates, to the particular ESOP that this Plan proposes be established as part of the capital structure for the New Railroad.
- (5) "Milwaukee" or "Milwaukee Road" means the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.
- (6) "MRRA" means the Milwaukee Road Restructuring Act, P.L. 96-101.
- (7) "NewMil" means New Milwaukee Lines, a nonprofit corporation composed of representatives of employee coalitions and shippers.
- (8) "New Railroad" is the term used in this Plan to refer to the company that will own and operate the rail system to be established under this Plan.
- (9) "Northern tier" refers to the states of Minnesota, North Dakota, South Dakota, Montana, Idaho, Oregon and Washington.

- (10) "Pacific Coast Extension" or "PCE" means that portion of the existing Milwaukee Road west of Miles City, Montana. Historically, the expression "Pacific Coast Extension" may have referred to the Milwaukee lines west of Mobridge, South Dakota. Since, however, the former definition was freely used in the abandonment proceeding, we adopt that usage here.
- (11) "Pacific Rim countries" refers to the developed nations located on or near the Pacific Coast of Asia, particularly Korea, Japan, China and Taiwan.
- (12) "Plan" means the employee-shipper ownership plan filed by NewMil under section 6 of the MRRA.
- (13) "Reebie" and "Reebie Study" respectively refer to Reebie Associates and its "Traffic Effects Study of the Viability of the Western Lines" performed for the Federal Railroad Administration.
- (14) "Reorganization Court" and "reorganization proceeding" respectively refer to the United States District Court, Northern District of Illinois, Eastern Division, and the proceeding in that Court for the reorganization of the Milwaukee Road, captioned In the Matter of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor, Docket Number 77 B 8999.
- (15) "Reorganization Plan" and "Milwaukee II" refer respectively to the plan of reorganization filed by the Trustee on August 10 in the reorganization proceeding, and subsequently with the Interstate Commerce Commission, and to the railroad configuration proposed in that plan.
- (16) "SORE" refers to the Association to Save Our Railroad Employment, a coalition of past and present Milwaukee Road employees.
- (17) "Trustee" means the Trustee of the property of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

I. EXECUTIVE SUMMARY

Introduction

The Milwaukee Road filed its petition for reorganization on December 19, 1977. The reorganization proceeding has been complicated and costly litigation in which a wide range of parties -- the Trustee, the railroad's creditors and shareholders, rail labor, shippers, various agencies of the Federal government, a number of states, and many others -- have all been competing to protect their particular interests. The railroad has lost nearly \$200 million since its petition was filed.

This past autumn was a particularly bleak period in the proceedings. In late September of 1979 the reorganization court found that the railroad was literally "cashless." The railroad's creditors introduced an analysis demonstrating persuasively that the scaled-down "Milwaukee II" system previously proposed by the Trustee was unlikely to survive. The parties to the reorganization proceedings seemed to be hopelessly at odds with each other with little, if any chance, that the main parties to the litigation would ever agree voluntarily to a compromise resolution. No early end to the crisis appeared possible.

On November 4, 1979, the President signed the Milwaukee Railroad Restructuring Act ("MRRA"). This statute ordered the Interstate Commerce Commission and the reorganization court to give prompt and expedited consideration to a plan for saving the railroad by reorganizing the Milwaukee into an employee and shipper-owned carrier operating a restructured and self-sustaining system. The statute provided funding to keep the entire railroad operating during the period required for consideration of this alternative and granted the reorganization court sweeping powers to quickly approve abandonments on all lines not included in the employee and shipper owned system. If an Employee-Shipper Owned Plan, as contemplated in the statute is not approved by the commission and court and implemented by NewMil on or before April 1, 1980, MRRA precludes any directed service on the Milwaukee system until April 1, 1981.

New Milwaukee Lines ("New Mil"), a not for profit corporation created under the laws of the State of Washington, has been organized by concerned employees and shippers, joined by representatives of government, for the purpose of forming, obtaining funding for, and preparing and processing various applications for approvals for a new company that will purchase and operate a substantial portion of the bankrupt Milwaukee Railroad's present system.

The present document represents NewMil's specific Employee-Shipper Ownership Plan for the reorganization of the Milwaukee Road. Adoption of the proposals contained in this Plan will enable the most essential lines of the present Milwaukee Road to be operated as a money-making private railroad. The railroad proposed here will provide valuable, and rapidly improved, service to shippers and states that badly need rail transportation. Moreover, the proposals contained in this Plan, when coupled with the funding provisions and summary abandonment powers contained in the new statute, make it possible for the proposed reorganization to be accomplished on terms that are scrupulously fair to the railroad's creditors, shareholders, and employees. All of these interests receive substantially more generous treatment under the present Plan than they were accorded under any other plan that has been filed to date with the Commission. Indeed, based upon preliminary discussions with representatives of most of the major interests represented in the reorganization proceedings, NewMil is cautiously optimistic that the proposals contained in this Plan may form the basis for a reorganization of the carrier that will be supported by many, and possibly all, of the former antagonists.

This Executive Summary briefly describes the central elements of NewMil's Plan. Detailed discussions of each of the subjects treated here follow in the body of the Plan.

A. The New Railroad's System

NewMil's Plan proposes that a new corporation ("New Railroad") be formed to operate a substantial portion, but not all, of the Milwaukee Road's present system. The routes to be included in the new system are shown on Map A. The proposed system extends from the North Coast Ports of Seattle, Tacoma and Portland through the Twin Cities to Milwaukee, Chicago, and Louisville, and also includes a number of important feeder lines. The system's base route mileage will be approximately 3,550 miles. Certain of the system's lines -- those shown in green on Map A -- are still being subjected to blocking and other analyses by New Milwaukee Lines' traffic consultants.

The new system proposed is for a single system comprised of (i) a base system for which the financial analysis is, with one exception, complete and (ii) contingent lines that will be included in the final system if (a) it can be determined that the line will make a positive cash contribution to the system (whether from operating revenues, surcharges or subsidies), (b) any required rehabilitation will be borne by a third party such as a state agency or shippers, (c) all contingent lines taken on a whole do not adversely affect the overall revenue and expense structure of the resulting system, and (d) arrangements for compensation to the Estate, for the included contingent lines do not adversely affect the cash flow or financial positions of the New Railroad during its first six

years of operation. As discussed more fully in the body of the Plan, compensation to the Estate is required since the conclusion that the Plan is fair and equitable to the Estate assumes a system of base lines only. If contingent lines are added to this base system, the system's total route mileage will be increased accordingly.

B. The New Railroad's Level of Service

New Railroad will concentrate all of the Milwaukee Road's present fleet of equipment and locomotives, and more than \$540 million worth of modern new cars and rebuilt boxcars, on a system with approximately half as many route miles as the present Milwaukee system. New Railroad will immediately return to fully normalized maintenance on all of its equipment and track. In addition, an ambitious seven-year program of rehabilitation will be undertaken to return the track structure and equipment fleet to truly competitive levels.

These programs are designed to permit safe operations at 25 mile-per-hour speeds on all of New Railroad's major line segments by the end of its first year of operations and a minimum mainline speed of 40 miles per hour by the end of the third year of operations. By the end of 1984, the fifth year of operations, 85% of the system will have been rehabilitated to competitive track standards.

New Railroad's service will not only be faster than that provided by the Milwaukee today: Service will also be more frequent and more dependable. More and better equipment will be moving over a rationalized and rehabilitated system. The result will be improved turn-around times, significantly expanded ability to meet shipper demand, and predictable delivery dates.

New Railroad will employ approximately 7,900 employees in 1980. Approximately 9,200 employees will be needed by 1982. The present Plan encompasses commitments from rail labor to participate in an innovative labor management task force that will be created to fashion changes in operating practices, and an employee stock ownership plan ("ESOP") designed to give New Railroad's employees a substantial ownership stake in their company. Both will result in significant improvements in labor productivity for the new company.

Even more importantly, the Milwaukee's employees will be given a chance to operate a modernized and rehabilitated system. The Milwaukee's employees have managed to retain their reputation for high quality, loyal service despite the disintegration of the present system that has been going on around them. For the first time in years, these employees will be given an opportunity to show what they can do with a physical system that is as good as they are.

New Railroad will provide a level, and quality, of service that bears no resemblance to the performance of the present Milwaukee Road.

C. Financial Performance

Based upon the detailed projections prepared by NewMil's expert consultants, and taking into account all projected rehabilitation expenditures, New Railroad is expected to lose money in its first two years of operation, then turn around during the third and fourth years, and make rapidly increasing profits thereafter. New Railroad's annual adjusted net income for the seventh year of the projected turn-around period is expected to be approximately \$60 million. New Railroad is expected to attain a positive cash flow for the first time in its fourth year of operations and to have a cash flow of nearly \$60 million by 1986. New Railroad's pro forma income and cash flow statements are attached as Exhibits VII-A and VII-B.

These projections reflect the fact that the revised system proposed in this Plan has an earning potential that the present Milwaukee system does not. By concentrating existing and new equipment, maintenance efforts, rehabilitation work and the labor force on the system's main money-making lines, the New Railroad can pursue a realistic turn-around strategy that would not be possible if the available resources had to be spread over a much larger, and costlier, system.

Moreover, the new system's traffic configuration will differ sharply from that of the present system. Much of the Milwaukee's present system operates in areas plagued by substantial overcapacity in their general transportation systems. A number of the Milwaukee's lines, for example, cover routes that the Department of Transportation classifies as "corridors of excess capacity." All carriers that operate in these areas suffer from intense competition with each other, and from other modes of transportation, that has resulted in depressed rate structures. Moreover, the traffic moved in these areas is costly to carry by rail. Substantial per-car costs are incurred because of the frequent switching and extensive yard times endemic in congested systems carrying large amounts of short-haul traffic. The Rock Island and the ICG are but the latest examples of marginal midwestern carriers that have found it difficult or impossible to survive under such conditions.

NewMil provides a realistic opportunity to deal with some of these problems. The Labor Management Task Force concept will be employed to help improve efficiency in moving cars through terminals. The Task Force will also be effective in helping to introduce operating efficiencies that can turn marginal traffic into profitable traffic and simultaneously strengthen the New Railroad positions in highly competitive markets.

The fact that other railroads are in financial trouble can lead to opportunities under the "AP1" process. New Railroad can work with other carriers directly and with the Federal Railroad Administration to address the problems of expert capacity. At the same time the New Railroad can strengthen the traffic flows in those markets to which it is committed and help other carriers improve traffic in areas that cannot be served by the New Railroad.

The new railroad proposed here is designed to seek a different kind of traffic. The long-haul, high revenue, relatively low cost per car, traffic available to the new company over the transcontinental mainline and other long-haul arteries in the present Milwaukee system offers the new system its best chance to survive and prosper. It is no accident that the five major railroads that provide transcontinental service to the west are today among the nation's healthiest rail carriers. These railroads have concentrated their efforts on developing traffic configurations that permit revenues to be maximized with minimal operation expense.

NewMil and its consultants regard the detailed financial projections contained in Exhibits VII-A through VII-J as conservative. Indeed, there is good reason to believe that these projections substantially underestimate New Railroad's true potential for successful financial performance. The projections have intentionally excluded a number of important

opportunities that NewMil believes are likely to be available to New Railroad to significantly expand its tonnages of transcontinental and other long-haul traffic. Long-haul bulk commodity traffic -- particularly in coal, grain, containerized export-import shipments and lumber -- recently have become available to the Milwaukee in unprecedented volumes. Substantial growth in all such traffic is projected in the future. The consultants that prepared this Plan's financial projections, however, deliberately excluded the revenue opportunities created by these developments from their projections.

In order to ensure a conservative and cautious analysis, the projections were based instead on the traffic levels projected by Booz-Allen and Hamilton, the Trustee's expert consultants, coupled with a small number of specific movements discounted by an appropriate probability analysis described to the consultants in personal interviews they conducted with specific shippers. This methodology reflects the proper concern of NewMil's consultants that only conservation and generally agreed-upon revenues be included in the financial forecasts upon which the various plans are based.

If this plan is approved and implemented, however, the new company will be running a railroad, not defending a methodology. NewMil believes that the forecasts used here show only a fraction of the actual revenue opportunities that will

be available to a properly-managed, rehabilitated transcontinental carrier serving the Northern Tier in the coming decades.

NewMil believes that one additional factor will heavily influence the ability of New Railroad to make money. The employees of the present Milwaukee Road, many of whom are third and fourth generation members of "Milwaukee families," have a loyalty and concern for the success of this railroad not often encountered in any industrial enterprise. The major restructuring and rehabilitation of the system proposed in this Plan, the productivity commitments that rail labor has made, and the fact that these employees will become part owners of the new company through their ESOP, when combined with the traditional commitment that Milwaukee employees have always made to the success of their company, will ensure an employee contribution of profound importance to the financial performance of New Railroad.

D. Implementation of the Plan

1. Assets to be Acquired and Acquisition Procedures

The plan would be implemented by the acquisition by New Railroad of all the assets necessary to operate the New System and the assumption of certain specified liabilities of the Milwaukee. After necessary proceedings under MRRA, implementation will proceed in two phases. In the first, assets to be transferred will be identified in greater detail and transition mechanics will be refined and expanded. These details

described in the plan will be included in a comprehensive plan which will be submitted to the Reorganization Court with requests for the necessary orders authorizing and directing the transfer of assets and assumption of liabilities. Also, in this period, a preferred alternative transfer mechanism having certain advantages of economy, simplicity, and speed, but intended to accomplish the same result, will be explored to determine whether certain limitations apparently precluding its utilization for the ultimate transfers can be overcome. In the second phase the Reorganization Court will consider the mechanical transfer procedures contained in the acquisition plan and after proceedings limited to the consideration of those issues, will enter the necessary orders authorizing and directing the Trustee to take the necessary action to conclude the transaction.

Assets now committed to railroad service but not included in the New System would be ordered abandoned pursuant to the procedures established in MRRA; the Estate would therefore retain those assets free of the obligation for service, permitting prompt disposition thereof in the bankruptcy proceeding.

2. Capital Requirements and Financing for New Railroad

During the initial phase of the implementation process, arrangements would be completed for the financing of New

Railroad. The financing would be accomplished by the issuance of redeemable preference shares of New Railroad under Section 505 of the 4R Act, the issuance of guaranteed debt obligations under Section 511 of the 4R Act, and borrowings guaranteed by the EDA or FMHA, or both, which would finance the acquisition of common stock by an ESOP trust, and by investment by shippers. The redeemable preference share financing will provide approximately \$101 million in 1980 and 1981 for the purposes of rehabilitation and improvement of properties transferred to the New Railroad that carried high average daily tonnage during the previous three-year period. The guaranteed borrowings would provide approximately \$22.8 million for equipment rehabilitation and a new yard at Fife, Washington. Federal financing programs, in general, offer to the New Railroad both the advantages of low average annual costs of capital and deferrals of debt service obligations to years of significantly improved performance.

3. Equity Ownership and Management of New Railroad

The ESOP trust would acquire, with funds provided under federal loan guarantee programs just described, \$15 million of the common stock of the New Railroad. The preliminary investigation described in the plan indicates a willingness of shippers to invest at least \$10 million in New Railroad. NewMil management anticipates that when the details of the plan are

available for consideration by the shippers it will be possible to obtain shipper investment of \$15 million in the form of common equity. This is consistent with NewMil's desire that the common stock of New Railroad be owned by the ESOP trust and the shippers in equal parts. The projections and the pro forma statements included in the plan reflect these financing assumptions, except that in the case of shipper investment they conservatively assume investment of \$10 million in the form of a noncumulative 12 percent preferred stock.

The Board of NewMil has begun an ambitious program for the selection of a management team having the experience, background, commitment, and ability to insure the success of New Railroad, including a search for persons outside the Milwaukee Road and the NewMil organization to become New Railroad's chief executive officer and chief operating officer. In structuring new management strategy, NewMil recognizes the importance of continuity. NewMil's Board, reflecting the viewpoints of executives of shippers experienced in the operation of their own businesses and in the importance of transportation to the development of that business, representatives of local government having somewhat different perspectives and representatives of labor bringing yet a third viewpoint, is uniquely qualified for this task of management selection.

E. The Value of New Milwaukee Lines' Proposal to the Present Creditors and Shareholders of the Milwaukee Road

The NewMil Plan offers to the estate, under legal standard, an arrangement which is fair and equitable. Two alternative analyses of the impact on the estate are presented in the body of the Plan -- an analysis based on present values to it of earnings power and of net liquidation values. Under either analysis, the estate is more valuable to creditors and stockholders without a railroad than with it. In addition, without the railroad the liabilities of the estate are significantly reduced, dramatically emphasizing that the NewMil Plan offers to the estate the most favorable opportunity for satisfying the interests of creditors and stockholders.

F. Importance of the New Milwaukee Lines Proposal to the Public Interest

Section 77 of the Bankruptcy Act requires that any plan of reorganization provide for the convenience and necessity of the shipping public, the wellbeing of employees, and fair treatment of the estate. Section 2(b) of the Milwaukee Railroad Restructuring Act recited a Congressional declaration that the "emergency measures set forth in this Act must be taken to restructure the Milwaukee Railroad and to avoid the potential unemployment and damage to the economy of the region and the Nation which a cessation of essential services by the Milwaukee Road would otherwise cause."

NewMil believes that the employee-shipper ownership Plan proposed here would make an important contribution to the public interest.

The New Railroad proposed in this Plan will provide desperately needed service -- and, as the new company's equipment acquisition, normalized maintenance, and plant rehabilitation programs take effect, significantly improved service levels -- to the communities and shippers that the system will serve. The need for this rail service is particularly pressing in the northern tier states, where available transportation service is presently substantially inadequate and where demand for such service is rising at a rapid rate.

The communities and companies that genuinely need the services that the present system provides will continue to receive service, and will receive more and better service, than they do now.

Moreover, the rehabilitated railroad proposed in this Plan will help preserve meaningful and genuine competition for the provision of rail services in large portions of the country that otherwise will become the sole province of one monopoly carrier. The preservation, and eventual strengthening, of this rail competition will yield favorable impacts on car supplies and rate levels throughout these areas. The importance of these competitive benefits will become even more significant as proposals for deregulation of railroads and as the steady

escalation of diesel fuel prices inexorably drives the prices of intermodal alternatives to unacceptable levels.

The proposals contained in this Plan would contribute to a rationalization of the present excess capacity in the midwestern rail network by reducing the Milwaukee's present concentration on local, short-haul, traffic in congested midwestern corridors of excess capacity and would tie the Milwaukee's remaining, essential midwestern traffic to the inherent strengths involved in a transcontinental system traversing areas that have a genuine, and growing, need for rail transportation.

New Railroad will not hire all of the existing system's employees, but it will provide employment for approximately 8,000 employees in its first year of operations, and it is anticipated that many more employees will be needed in the years immediately following as service levels expand to the projected levels. Moreover, these employees will no longer be confronted on a daily basis with the uncertainties and insecurities that have attended their employment in recent years by a sick and troubled carrier providing steadily deteriorating service and possessing no certain prospect of survival. New Railroad's employees will work for a genuinely viable, competitive, and growing railroad that will be providing profitable and aggressive service in expanding market areas.

The employee and shipper ownership features of the present Plan will place ownership of New Railroad in those interests

most vitally concerned with the venture, and thereby create a built-in incentive for management, labor, and shippers to flexibly fashion a railroad that responds directly to the concerns of each of those interests. Important advances in the efficiency and productivity of operations will almost certainly result.

The agricultural communities of the northern tier, presently unable to move large volumes of grain to western ports for export, will receive improved and expanded service. The rapidly growing Puget Sound ports of Seattle and Tacoma, as well as the Columbia River ports, will be afforded the rail capacity to move import-export traffic in the volumes presently projected. Important concepts such as Milwaukee's successful Sprint train operation will be significantly expanded.

Moreover, the preservation of the essential portions of this railroad will contribute in two very important ways to resolution of this nation's current energy problems. On a consumption side, preserving the railroad's ability to continue to provide long-haul transcontinental freight service would represent one small but significant contribution to the formulation of a national freight transportation system designed to maximize fuel conservation. In a period of rising fuel prices and frequent shortages, this nation should be striving for a freight transportation network that moves long-haul traffic on trains and short-haul traffic on trucks.

On the supply side, the proposals contained in the present Plan would help protect the national interest in assuring that adequate transportation capacity will be available to move low sulfur western coal to market in the coming years. The service that will be provided by New Railroad will make available important rail capacity to move western coal into markets in the midwest, southeast, and -- in a few years -- the west, where it will be needed for domestic consumption and for export.

The Employee Shipper Ownership Plan proposed by New Milwaukee Lines offers a blueprint for preservation, not destruction, of a precious and irreplaceable national asset.

II. BACKGROUND

A. The Milwaukee Road as a Transcontinental Carrier

1. The Early Years^{1/}

Founded around 1850 and fortified through the consolidation of approximately 200 small midwestern railroads, the Milwaukee Road, by the turn of the century, had become one of the strongest and best financed railroads in the country. It was, however, solely a midwestern railroad, serving a territory quite similar to that which the Trustee now proposes to serve under his proposed Milwaukee II reorganization plan.

By the turn of the century, three other railroads -- the Union Pacific (UP), Northern Pacific (NP) and Great Northern (GN) -- also were already established, but as transcontinental carriers operating in the northern tier of states. The UP extended west from Omaha, to Ogden, Utah, and north to Oregon. It was the first railroad to reach Montana, having constructed a line north from Ogden to Butte in 1881 to serve the mining trade.

The NP had also built west, from North Dakota, joining an extension east from Washington in 1883. The NP did not extend into southern Montana, however, as a result of an agreement it reached at the time to leave Butte for the UP, in exchange for the UP staying out of the northern-most states (or portions of them) the NP had reserved for itself.

Without extensive land grants to the UP and the NP, among others, this transcontinental expansion would have been much more difficult. The value of those grants today, of course, is astronomical.

The third northern tier transcontinental carrier of the day, the GN, financed by Morgan banking interests, had followed a northern route across North Dakota, Montana, Idaho and Washington to reach Puget Sound at Everett, Washington. Interestingly, and a precursor of events to follow, in 1889, the year the GN reached Butte and Helena on its westward expansion, the NP, reacting to its new competition, actually reduced its rates from Helena to St. Paul by one-third.

In 1893, one of these three northern tier transcontinental carriers, the Northern Pacific, went bankrupt. With the backing of J.P. Morgan, James J. Hill, the leader of the competitor GN, managed to gain control of the bankrupt NP's reorganization, and eventually to acquire half of its capital stock for the GN.^{2/} Despite a successful Supreme Court challenge by a GN stockholder voiding that acquisition of NP stock on state railroad antitrust grounds,^{3/} the link forged by Hill between the NP and GN (the "Northern Lines") persisted, through the artifice of having individual GN stockholders, rather than the GN itself, acquire the NP stock.^{4/}

Hill also went on to acquire control for his "Northern Lines" of the Chicago, Burlington & Quincy (CB&Q), and thus

gain direct access to Chicago. Then, with the approval of the Harriman forces controlling the UP, Hill placed the interests of the NP, GN and CB&Q in a holding company, the Northern Securities Company. That arrangement did not have the approval of the Attorney General under trust-buster President Roosevelt, however, who, after protracted court battles, convinced a divided U.S. Supreme Court effectively to order the dissolution of Northern Securities on antitrust grounds.^{5/} In fact, however, the ordered dissolution once again did not change the actual control of the companies, as Hill and his group still controlled the stock in the individual companies. Indeed, Hill is reported to have said of the new post-decision arrangement, "Two certificates of stock are now issued instead of one. They are printed in different colors. That is the main difference."^{6/}

Thus, by the turn of the century, the Northern Pacific and the Great Northern and the Chicago, Burlington and Quincy were already linked in fact, although it was not until seven decades later that the Commission was to give formal recognition and legal sanction to their union in the reformed Burlington Northern.^{7/}

2. Construction of the Pacific Coast Extension (PCE)

It was as a result of these activities by Hill and Morgan of the Northern Lines, and Harriman of the UP, and their

respective trusts, that the Milwaukee rightly saw a very substantial threat to its ability effectively to compete for a share of lucrative transcontinental freight traffic routings, and to stave off further attempts by them to acquire additional midwestern carriers. As the ICC staff has phrased it:

Faced with this dilemma, the Milwaukee had three options: (1) do nothing, (2) align itself with the trusts, or (3) build its own transcontinental route. The do-nothing option required reliance on other railroads for transcontinental traffic, alliance with trusts required the relinquishment of corporate decision-making authority to the trusts, and in-house construction of a trans- continental railroad required bountiful financial resources. For a railroad which owned and operated its own pullman cars, which built its own locomotives, and which generally prided itself on its independence, reliance upon other railroads, much less outright collusion or attachment, was considered intolerable. Aided by the railroad's strong financial position, the Milwaukee board of directors decided in 1905 to proceed with construction of the PCE [the Pacific Coast Extension, beginning at the railroad's then-western terminus in Mobridge, South Dakota, and ending in Puget Sound].^{8/}

That turn-of-the-century decision, to build the Pacific Coast Extension or PCE and thereby to compete aggressively and effectively for its share of transcontinental freight, was as correct for the Milwaukee then as such continued transcontinental carriage is for it today. The plain fact then, as now, is that a Milwaukee confined to the midwest could not survive.

By 1906, when construction of the PCE began, the west was already fairly well-surveyed and the Milwaukee was able to select a route for its extension, through the five mountain ranges it traversed in Washington, Idaho and Montana, providing

the shortest mileage to the west coast, the least grade and the best curvature of all of the northern railroads.^{9/} Although construction was expensive, with an original cost estimate of \$60 million dollars turning into an actual expenditure in excess of \$230 million dollars, the Milwaukee of the time was prosperous and wealthy, and construction, financed by substantial loans, was to high standards of engineering excellence.^{10/}

The traffic then available to the newly expanded trans-continental Milwaukee included lumber, foreign trade, grain and passengers. To assure lumber traffic for its new line, the Milwaukee Land Company, a wholly-owned subsidiary, purchased substantial timber acreage in western Washington concentrated on the Olympic Peninsula, in southwestern Washington, and in north central Idaho. The land company still owns land and timber worth millions of dollars.

In 1914, the Milwaukee began electrifying its operation over the five mountain ranges it crossed. Largely completed in 1919, the electrification program cost \$23 million by 1925 and produced the longest electrified rail line in the world. With such an electrified system, although train engines going up a mountain drew energy from the system, train engines going downhill provided braking forces of their own during their transit and acted as generators feeding electricity back into the system.^{11/} Electrified trains, unlike those of the

Milwaukee's competitors which were powered by steam, did not lose efficiency in the winter, had better traction, and lasted almost indefinitely. Indeed, some of the original electric engines were still in service when the system was scrapped in the mid-1970s. In sum, "the electrification project ... provided a significant cost and service improvement over steam engine operations."^{12/}

3. The Bankruptcies

Despite the obvious desirability of the PCE, six years later, in 1925, the Milwaukee found itself in the first of the three bankruptcies it was to confront in the next 55 years.

The reasons for this 1925 bankruptcy were many. Among them were the ever-growing importance of the Panama Canal, opened just 11 years earlier, which increasingly began to draw a significant share of the available transcontinental traffic away from the competing transcontinental carriers in the northern tier. Lumber companies, in increasing numbers, bought their own ships to move their own lumber through the canal to the East Coast or to Chicago through the Gulf ports. In addition, the federal takeover of the railroads during World War I adversely affected the Milwaukee, as did a severe drought through 1918.^{13/} Another cause for this 1925 Milwaukee collapse was the questionable practices of its bankers. As the press has summarized the ICC's investigative findings of the

time:

Although business was poor in the early years of the Pacific Extension, especially after the opening of the Panama Canal in 1914, and the great drought of 1917-19, the ICC concluded that bankruptcy would not have occurred if the company's bankers had not consistently given purposely poor advice; advice designed only to provide the bankers with unusual profits in financing of bonds and designed to cause the collapse of the railroad.

Forcing the Milwaukee into receivership was important to the bankers; it was one of the largest railways, with an untarnished financial reputation. Its 1925 receivership was the largest in business history.

The company's failure meant that the bankers could control as reorganization managers, which meant that they would have the dominant hand in the creation of the new company that would end receivership. Control of the new company, according to Lowenthal, 'would determine who should have the profitable posts as its bankers, its lawyers, and its suppliers of materials.'^{14/}

In 1926, a reorganized Milwaukee emerged from the 1925 bankruptcy with the sale of its assets to its bankers, the only bidders. It never truly recovered from that bankruptcy, though, and in the wake of the Depression, again went into receivership in 1935, from which it did not emerge until 1945.^{15/}

The post-1945 period for the Milwaukee was also an unhappy one, largely as a result of the interplay of two critical factors. The first was the substantial deterioration of the Milwaukee's physical plant through a program of deferred maintenance, deferred tie and rail installation, and ultimately

the cannibalization of its locomotive and car fleet. The second was the damaging impact on the Milwaukee of the Northern Lines merger, consummated in 1970, through the creation of the Burlington Northern.

To be sure, neither of these two factors was unrelated to the general inability of the pre-1970 flow of transcontinental traffic to help sustain these four competitive northern tier carriers. It is equally clear, however, that for a wide variety of reasons discussed more fully below -- among them the rise of west coast port containerization traffic and a consequential downgrading of the importance of the Panama Canal, and the growth of import-export and commodity/coal traffic throughout the northern tier states -- the post-1970 revenue contribution of the PCE lines to the Milwaukee is, and will continue to be, among its most valuable assets.

4. Deferred Maintenance

In part to make it appear to be an attractive (though ultimately unsuccessful) merger partner for the Chicago and Northwestern railroad, the Milwaukee, as noted above, attempted to hold down its cost expenditures in the fifties and sixties through a massive cut-back in its ongoing maintenance and rail and tie replacement programs.^{16/} Exhibit IV of the Executive Summary of the Booz, Allen and Hamilton report prepared for the

Milwaukee Trustee^{17/} graphically illustrates the drastic decline in tie and new rail installations over the 1934-1977 period, and follows as Exhibit II-A. In the early 1970's, this deferred maintenance program was combined with a decision by the Milwaukee to park rather than repair system cars sustaining more than a relatively nominal amount of damage, thereby avoiding rehabilitation costs for such cars but, of course, also taking them out of revenue service and increasing foreign car hire costs; and to "run-to-failure" its locomotive fleet, allowing locomotive units to run without maintenance until a major failure rendered them inoperable.^{18/}

The unfortunate, adverse long-run consequences of these short-term measures to minimize operating and rehabilitation expenditures are vividly reflected in the discussion of current rehabilitation estimates presented infra.

5. The BN Inclusion Case

The other factor of major consequence in the more recent history of the Milwaukee was the Commission's decision to approve the Northern Lines merger, and its aftermath.

Having formally concluded their merger "negotiations" in 1960, the Northern Lines (NP and GN) and the CB&Q and their subsidiaries sought the Commission's approval for their merger into the Burlington Northern. Aligned against that application were the U.S. Departments of Justice and Agriculture, nine

states, the railroad employees, the Milwaukee, and the Chicago and Northwestern. At least initially, also aligned against it was the Commission, which formally rejected the merger application on the ground that it would impair competition and unduly injure the lines' employees. Stated the Commission:

Approval of the merger would combine the two strongest transcontinental railroads ... and the strongest midwestern carrier. The chief competitor of this giant combine would be the Milwaukee, whose financial condition, even today, is anemic. ... It is far from certain that the Milwaukee could survive absent special conditions to ameliorate the impact of the merger. It is inconceivable that the merger could be approved without reasonable assurance that the essential transportation services of the Milwaukee would be continued. ... We conclude ... that the disadvantages of an appropriately conditioned merger -- a drastic lessening of competition and adverse impacts on carrier employees -- outweigh the benefits that might be derived by applicants and the shipping public (emphasis added).^{19/}

Undeterred, however, the merger applicants went back to the Milwaukee and the Chicago and Northwestern, and having negotiated with them certain traffic diversion agreements and with affected employees job protection for incumbents, again approached the ICC for approval. This time they were successful.^{20/}

In exchange for withdrawing its opposition to the merger application, the Milwaukee had negotiated the following protections for itself: (a) the opening of 11 new gateways; (b) entry into Portland; (c) Renton-Snohomish and Everett-Bellingham (Washington) trackage rights; (d) the extension of

Milwaukee service to Billings; (e) the elimination of dual switching charges; and (f) the reestablishment of rate relationships affected by the merger.^{21/}

In approving this merger the second time around, the critical determination by the Commission was its unshakable conclusion that the Milwaukee, strengthened through these conditions, must and would survive and prosper as a competitor to the Burlington Northern. Indeed, at the core of the ICC approval was its finding that "a properly conditioned merger -- with a substantially strengthened Milwaukee -- will actually enhance competition in the area and will be consistent with the public interest" (emphasis added).^{22/}

In relying directly on the survival of the Milwaukee as a transcontinental competitor as the linchpin for its approval of the merger, the Commission brushed aside the vigorous complaints that such reliance was sorely misplaced and premature. Stated the majority, "We reject the allegation of Justice that reliance upon the strengthening of the NW and Milwaukee as competition to a merged Northern Lines would be a baseless ground on which to approve the merger."^{23/}

Instead, the majority emphasized its belief that:

The effect of the Milwaukee and North Western conditions would be to strengthen the Milwaukee -- both as to revenue potential and competitive posture. Milwaukee would receive all of the benefits it has requested, including access to Billings, and North Western would also receive all the major benefits requested. Applicants have also accepted a condition which would require NuCo to 'improve and expedite interchange of freight with the Milwaukee at the Twin Cities.'

As modified by the conditions which we impose hereinafter, most of which were the subject of agreements between applicants and the railroad interveners, the proposed unification presents an entirely new perspective for intramodal competition in the efficient and economic movement of transcontinental, western and Pacific Coast traffic. That perspective portends for a stronger capability in those railroads individually and collectively to prosper and to effect numerous economies and efficiencies from which the public will benefit

We believe that the overall effect of the conditions imposed here will portend for a strong degree of intramodal rail competition in the affected territory, promote the effective development of improved transportation services to the shipping and receiving public, and comport generally with the purposes and objectives of the national transportation policy as declared in the act.^{24/}

Commissioner Brown, in a trenchant analysis, remained unconvinced. As she phrased it in dissent:

I do not agree with the majority that the proposed transactions are shown to be consistent with the public interest. Reconsidering the matter at this time, after a rather limited further hearing, I am still not convinced that this merger should be approved

The . . . salient factor to be reconsidered is the fact that applicants have now agreed to open up a number of gateways to the Milwaukee and North Western and it is apparent that this was done to get these carriers to withdraw their objections to this merger. Similar situations occurred in other merger cases and, needless to say, it was necessary for this Commission to go beyond such agreements in order to properly decide those cases, as we are clearly required to do under the statutory criteria enunciated by Congress. On the basis of the record herein, I do not believe that these agreements will make the present Milwaukee an effective competitor of the merged Northern Lines. Therefore, if these transactions are approved, we will have a single railroad composed of the Great Northern, Northern Pacific, and Burlington, which are large, strong, and prosperous railroads, on the one hand, competing against the much weaker Milwaukee on the

other. The opening of the gateways, and other conditions agreed to by these applicants, will not change the fact that there will still be a drastic lessening of competition, due primarily to the fact that the Northern Lines constitute either the majority or the only lines serving many of the points. I, therefore, do not believe that applicants have met their burden of showing that this merger will be in the public interest (emphasis added).25/

The Justice Department also remained unconvinced, but when its objections were similarly overridden by a unanimous Supreme Court, the merger was consummated.26/

In upholding the merger, the Court reasoned that:

Under the new conditions the posture of the Milwaukee, lying largely between the two Northerns and handicapped by limitations at both eastern and western terminals, will be greatly improved. Absent the protective conditions it would continue to be virtually strangled by the unified system; with them the Milwaukee gives prospect of affording substantial competition to the merged lines and will be placed in the position that at its inception it hoped to achieve. Its past failure to become a meaningful competitor came in large part because its lines did not reach into Portland, Oregon, or into the southwest terminal of the Northern Lines in California

The contention that the Commission failed to project an analysis of the relative position of the Milwaukee vis-a-vis the merged Northerns discounts the difficulty of precise forecasts and tends to overstate the need for such projections. The Commission can deal only in the probabilities that will arise from the Milwaukee's improved posture as a genuine competitor for traffic over a wide area, something it had never been able to achieve. After the merger it will afford shippers a choice of routes and service negating the idea that all rail competition will disappear in the Pacific Northwest.27/

The reality of the merger consequences, however, was far different. The competitive environment in the northern tier area has seriously deteriorated since 1970. This deterioration

is attributable in large part to the relative ineffectiveness and inadequacy of the Commission's conditions.

Although the merger conditions in some part cushioned the impact of the competitive dominance of the Burlington Northern, they were wholly inadequate to assure a "strong degree of intra-modal rail competition in the affected territory" as the Commission had intended. Glenn Reynolds, Milwaukee Vice President of Market Development and Pricing, has testified:

Much of the decline in carloading since 1970 is directly attributable to competition from the Burlington Northern. Although the Commission imposed protective conditions upon the BN merger, we quickly began to feel what I call "synergistic fact" of the merger, particularly on our transcontinental traffic, despite our management's strenuous attempt to exploit the opportunities made available by the protective conditions.^{28/}

Among the conditions thought most significant were the opening of 11 gateways to the Milwaukee in the western states. The gateways were Fargo and Linton, North Dakota; Bozeman, Butte, Great Falls, Judith Gap, Miles City and Missoula, Montana; and Seattle, Spokane and Tacoma, Washington. However, as to the effectiveness of the eleven western gateways, Mr. Reynolds has stated:

Unfortunately the eleven gateways did not offer our company an effective competitive tool to compete with the much stronger Burlington Northern ... BN was also entrenched in the market, having served the territory by their single line haul for many years. Moreover, minor juctions such as Fargo, Linton, Judith Gap and Bozeman apparently meant little if anything to most shippers. These obstacles proved insurmountable, and as a result we have been disappointed with the ultimate results of the eleven western gateways.^{29/}

The other conditions were similarly insufficient to blunt growing BN dominance.

Other factors have exacerbated the inadequacy of the conditions themselves. Milwaukee's own deteriorating service made it impossible to take full advantage of the conditions. As noted above,, the Milwaukee installed large numbers of new rails and toes, and otherwise rehabilitated the western lines immediately after World War II. The post-BN merger period coincided with the end of the useful life of these improvements. The result has been a gradual and then massive deterioration in service, particularly transit time. Milwaukee Vice President Reynolds has documented instances where market opportunities born of the merger conditions have been forgone or undercut due to deteriorating operations on the Milwaukee.

A more important factor that has impacted the potential ability of the Milwaukee to provide a strong competitive force in the Northern Tier is the growing dominance of the BN. Bolstered by massive increases in coal traffic, attributable in large part to the land grant holdings of its predecessor roads, BN has been less than cooperative with the Milwaukee in various areas, including, for example, traffic interchange. As noted by Milwaukee Vice President Reynolds:

... the Milwaukee road began to feel the "synergistic effect" of the Burlington Northern merger as early as 1973. Most of the protective conditions had little effect. Moreover, in years following the merger we observed that our total interchange traffic with the new BN began to decline sharply both in cars received and in cars delivered at all junction points.

The combined effect of inadequate merger conditions, collapse of the Milwaukee physical plant, and the predatory behavior of the BN has served to totally frustrate the Commission's intent to maintain vital intramodal competition in the Northern Tier. As is more fully discussed below, the growing non-competitive atmosphere in the Northern Tier is having disastrous effects upon shippers and the public generally.

Fortunately, the merger approval decision by the Commission did include a "re-opener," under which the Commission retained jurisdiction to enable it to make further adjustments should further circumstances so warrant. The re-opener, known as "Condition 33," provided as follows:

The Commission shall retain jurisdiction over these proceedings for a period of 5 years following consummation of the transactions herein authorized, or such other period as the Commission, for good cause shown, may hereafter prescribe, for the purpose, among others, of considering petitions, under section 5(2)(d) of the act, by any railroad in the territory involved requesting inclusion in the merger so authorized. The Commission shall also retain jurisdiction over these proceedings for a period of 5 years following consummation of the transaction herein authorized, or such other period as the Commission, for good cause shown, may hereafter prescribe, to impose such just and reasonable conditions upon petition by any party in interest, or on its own motion, after hearing, as may be necessitated by any cumulative or crossover problems stemming from approval of this merger and any other transaction authorized under section 5 with respect to the territory involved. Consummation of the transactions herein authorized shall constitute irrevocable assent by applicants to the power of this Commission to impose, after hearing, such just and reasonable conditions as may be necessary or appropriate.^{30/}

Eventually recognizing the unfortunate bargain the Milwaukee had made in withdrawing its opposition to the merger on the false hope that the conditions it had negotiated would enable it effectively to compete,^{31/} in 1973 and 1976 the Milwaukee petitioned under the authority of "Condition 33" for inclusion in the Burlington Northern, over the merged railroad's vigorous objection and without its cooperation. And when the Commission dismissed that inclusion petition, in FD-21748 (Sub. No. 4), the Milwaukee sought judicial review and, in October, 1978, won a decision from the Seventh Circuit Court of Appeals ordering the Commission to entertain it.^{32/}

This judicial reversal of the Commission's effective refusal to consider the Milwaukee's petition for inclusion, and its remand to the Commission, did not occur, however, until after the Milwaukee had already petitioned the Bankruptcy Court, in December, 1977, for reorganization. Under the direction of its new Trustee, on remand to the Commission, the Milwaukee substantially amended its original BN inclusion application, asking on February 6, 1979, not for inclusion at all, but instead for the imposition of a series of protective conditions, as follows: (a) eight markets swaps with BN; (b) no BN opposition to a Milwaukee trackage rights application between Steekton and Saunders, Minnesota; (c) BN divestiture of the Davenport, Rock Island, and Northwestern Railway in

Clinton, Iowa; (d) renegotiation of two BN-Milwaukee trackage rights agreements (St. Croix, Wisconsin - St. Paul, and St. Paul - Duluth); and (e) good faith negotiations by BN for the purchase of nine Milwaukee lines, each of which was located west of the Miles City, Montana point marking the western-most extension of the Trustee's proposed Plan of reorganization.^{33/} It is that amended application seeking further conditions, but not inclusion, that the Milwaukee is presently pursuing in the BN Inclusion case.

In its latest decision in the case served July 25, 1979 in FD-21478, the Commission upheld the prehearing conference orders of its Administrative Law Judge which established a two-stage proceeding to evaluate Milwaukee's application, with a first stage to decide whether the Milwaukee could prove it had suffered substantial harm from the merger, and a second stage to consider the appropriate form of relief.

Whatever merit the Milwaukee's current posture in the BN Inclusion case may have from the Trustee's vantage point of attempting to establish a drastically reduced midwestern Milwaukee Road,^{34/} that position ill-serves the public interest to which the Commission has already pledged its unswerving allegiance: that of creating in the Milwaukee a viable, vigorous transcontinental competitor to the Burlington Northern. None of these new conditions suggested by the Milwaukee would accomplish that goal. Upon approval of this

Plan, however, it is the present intention of NewMil to press for conditions in that proceeding that will.

In sum, then, the history of the Milwaukee as a transcontinental carrier is replete with examples of a transcontinental carrier at times ahead of its times (as with the construction of the PCE), at other times a victim of them (as with the Depression, and the intermodal shift in transcontinental carriage to waterway passage), and at still others prey to its own managerial ineptitude (as with its program of deferred maintenance and poor financial planning) and to adverse governmental decisionmaking (as in the aftermath of the Northern Lines merger decision).

Our time, however, is more than ripe for the Milwaukee to assume its critically important role as a competitive transcontinental carrier, and thereby to secure at last its rightful share of the lucrative transcontinental trade across the Northern Tier states that the Pacific Coast Extension was originally designed to, and will successfully, capture for it.

B. Importance of the Western Lines to the Milwaukee System and to the Northern Tier.

The Plan proposed by NewMil includes the Pacific Coast Extension. As will be fully developed in this Plan, such a transcontinental system is superior by every relevant criterion to a midwest-only system such as Milwaukee II. However, since the PCE in particular has been perceived by some as economically inferior to the balance of the system and as regionally insignificant, and since its abandonment is before the Commission, the relative performance and importance of the PCE is addressed specifically here.

Throughout the abandonment and reorganization court proceedings the Trustee and related parties have represented the financial plight of the Milwaukee Railroad as largely attributable to a financial drain caused by the railroad's Pacific Coast Extension.^{35/} In addition, the PCE has been portrayed as a line segment having only marginal market opportunities^{36/} and only an insignificant impact upon the rates, car supply, shipper needs and competitive environment of the states of the northern tier.^{37/} In short, in this view, the PCE was seen as harmful to the railroad of which it is a part and as having little or no value to the public it serves.

A consideration of the full record developed in the abandonment proceeding completely dispels any notions of the relative economic inferiority or regional insignificance of the western

lines. Of the dominant themes which arose from that proceeding, four are crucial to the understanding of the requisites for a viable railroad system. They can be summarized as follows:

- (1) In direct contrast to the Milwaukee system as a whole, the PCE made relative and absolute improvements in carload and revenue performance during the period from 1970 to 1977. This occurred despite the fundamental negative impacts of the Burlington Northern merger and steadily deteriorating facilities and service.
- (2) Of even greater significance, the PCE is, or until very recently has been, a financial net contributor to the Milwaukee system. The Milwaukee's own figures, developed pursuant to Interstate Commerce Commission methodology, show that the economic performance of the PCE is superior to that of the entire railroad.
- (3) The PCE possesses significant market opportunities when operated as part of an efficient transcontinental system. The Booz-Allen Studies and scores of shipper witnesses confirm that given reasonable service and car supply, fundamental opportunities for greatly increased traffic and revenues exist on the PCE.
- (4) The abandonment proceedings have forcefully demonstrated that the existence of the Milwaukee

or a successor in the northern tier region is crucial to the continued economic growth of and competitive balance in transportation service for that region.

Individually and collectively these points strongly argue for the need to include the PCE in any viable reorganized system to be formed from the Milwaukee.

1. Recent Carload and Revenue Trends

An analysis of the PCE must begin with an examination of the recent relative carload and revenue performance. An analysis of PCE carload trends yields information about actual traffic growth or decline independent of the effects of inflation.^{38/} A comparison with carload trends of the entire Milwaukee system will indicate the PCE's relative traffic performance. The revenues generated by such traffic can be compared similarly, especially when revenues are adjusted to a base year rate level. It is significant that neither the Reebie Study nor the Trustee has publicly made this analysis. Indeed, Milwaukee Vice President of Marketing Reynolds stated that such figures were not available [TR], although in fact internal Milwaukee data to this effect has existed since at least January 18, 1978.^{39/} Instead of making a specific comparative analysis, both the Trustee and Reebie have apparently assumed that the PCE has experienced downward carload and

revenue trends consistent with, or greater than, the entire system.^{40/}

This assumption is incorrect. Exhibit II-B, developed from Milwaukee and public records, portrays a strikingly different picture. From 1970 to 1977, carloads and adjusted revenues increased by 26% and 3% respectively on the lines west of Miles City. This is in stark contrast to the performance of the entire Milwaukee system, which decreased by 17% and 16% respectively. Moreover, this comparison understates the superiority of the performance on the PCE because the comparable figures for the entire Milwaukee system include the PCE traffic gains. Comparison of the PCE to the rest of the system without the PCE would yield an even starker comparison. These increases on the PCE occurred despite massive service problems caused by deteriorated track conditions, a reduction of sales staff, car supply problems, and the competitive impact of the Burlington Northern merger. Significantly, these increases were not attributable to coal traffic, since such traffic was confined during this period to the segment east of Miles City.

2. Financial Analysis

Perhaps the single most significant revelation to come out of the abandonment proceeding was the relative financial performance of the PCE in comparison to the balance of the system and the system as a whole. The various independent

analyses of the performance of the PCE and the Trustee's own information confirm the financial performance of the PCE as superior to the balance of the present system and Milwaukee II. Moreover, the PCE has been a net contributor to the system as recently as 1978, a year in which the entire system (again including the PCE's contribution) lost \$74,400,000.

The Commission's Cost/Revenue Methodology

The starting point for the financial analysis of the PCE is the results that are yielded by application of the Interstate Commerce Commission's cost/revenue methodology used in abandonment cases. (49 CFR Part 1121 Subpart D.) In essence, this methodology includes all revenues from traffic originating or terminating on the line of railroad to be abandoned, regardless of whether the revenue is attributable to on-branch or off-branch transportation. Actual verifiable costs are used to determine on-branch expenses. Off-branch expenses, the corollary of off-branch revenues, are estimated through the Rail Form A costing approach.

The abandonment proponents allege that the Subpart D methodology described in the preceding paragraph, and the results it yields, do not portray accurately the financial performance of the PCE.^{41/} Specifically, the proponents of abandonment argue that the methodology fails to measure the true performance of the line because it is done on an

avoidable cost basis and does not include all associated fixed costs. They also allege that Subpart D overstates attributable revenue by assuming that all revenue on the lines in question would in fact be lost upon abandonment and understates avoidable off-branch costs because of its reliance on the Rail Form A costing method. Finally, the methodology is claimed to be particularly inappropriate for estimating the off-line costs for a large line segment such as the PCE.

Contrary to the abandonment proponents' characterization, the methodology employed by the Commission to assess the revenues and costs attributable to the operation of lines involved in abandonment proceedings is entirely appropriate for a financial analysis of the contribution that the PCE makes to the system as a whole. The Interstate Commerce Commission fully considered, after solicitation of, and review of responses to comments from interested parties, various approaches to allocation of costs and revenues for line abandonments in Ex Parte No. 274 (Sub-No. 2), Abandonment of Railroad Lines and Discontinuance of Service, decided November 5, 1976. The methodology in Subpart D is the final result of that extensive rulemaking process.

The issue of avoidable vs. fully allocated costs in abandonment and subsidy cases was directly addressed by the Commission and Congress:

Congress was afforded an opportunity to choose between fully distributed and avoidable cost methodology (see Senate Report 94-31, 94th Congress, 1st

Session, pp. 660, 796, 804-05, 844-45). It rejected the former and enacted the latter; therefore, it would be contrary to statute to compensate the railroad for its fixed nonvariable costs.^{42/}

Also considered and rejected were methodologies using mileage-based revenue allocation, replacement cost equipment accounting, and non-Rail Form A based variable cost approaches.^{43/}

The specific criticisms raised by the abandonment proponents are unfounded. As to the alleged statement of attributable revenues, the proponents essentially claim that some PCE revenues will be retained by routing some of the present PCE traffic via the Union Pacific to Kansas City and thence via the Milwaukee to Chicago (or vice versa). However, the omission of this revenue, assuming it exists, corresponds to the methodology's omission of the costs associated with such movements. As noted by George B. Dutton, Jr., Vice President, R.L. Banks and Associates, an expert witness in the abandonment proceeding:

If the Milwaukee gains the revenue of movements from Kansas City to Chicago, it also incurs the costs of such movements. It follows that the overstatement of abandonment loss through failure to allow for revenue retained is in large degree offset by the omission of corresponding costs.^{44/}

The Milwaukee's criticism of Rail Form A is similarly unwarranted. The Rail Form A methodology, which develops estimates of the off-branch long-run variable costs associated with all branch-originated or terminated movements, includes overhead and administrative costs as well as return on investment. As witness Dutton testified:

Witness Power states that the variable cost approach understates avoidable costs. He provides no

support for this startling assertion. Variable cost is, as the term implies, the cost which varies with traffic . . . As applied to the off-branch movement of traffic originating or terminating on a branch long-run variable cost is true avoidable cost.^{45/} [Emphasis in original.]

Dutton then discusses the usefulness of Rail Form A in estimating variable costs and notes the efforts pursuant to the Commission's new system of accounts to revise Rail Form A. He concludes, however, that at present ". . . Rail Form A is the best tool we have."^{46/}

Abandonment proponents have also contended that the Commission's cost/revenue methodology is inappropriate for analysis of large line segments such as the PCE. In fact just the opposite is true. As the proportion of the railroad to be abandoned increases, the role played by actual costs as a proportion of total avoidable costs increases, thus lending greater objectivity to the methodology.^{47/} While this methodology is subject to somewhat greater potential inaccuracy when used in small line segment abandonments, its use of broad averages becomes more appropriate and accurate when used in large scale abandonments.^{48/} For these reasons the results of the Subpart D approach should be particularly probative in any analysis of the PCE.^{49/}

Results

Appendix K to the Trustee's Application for Abandonment reflects the result of applying the Subpart D methodology to

the PCE abandonment.^{50/}

In a railroad experiencing substantial losses such as the Milwaukee, it might be expected that any substantial portion of the railroad, if examined pursuant to Subpart D, would show avoidable losses significantly in excess of attributable revenues. The fourth and most recent version of Appendix K that the Trustee submitted,^{51/} however, indicates that the Miles City west portion of the railroad actually produced a substantial contribution to the system as a whole in 1976 and 1977 and only a statistically insignificant -- and dubiously calculated -- loss in 1978. This version of Appendix K developed by the Trustee shows a net gain of approximately \$9.9 million in 1976 and \$8.0 million in 1977, and a loss of only \$0.4 million in 1978.^{52/} These results are doubly significant in light of the deteriorating service experienced on the western lines during this period, particularly in 1978 which was the first full year of bankruptcy and a year of particularly poor system-wide performance.

Analysis of the fourth version of Appendix K by consultants retained by the Office of Rail Public Counsel^{53/} indicates that even these results understate the contribution of the PCE. From examination of Milwaukee work papers and discussion with and cross-examination of Milwaukee personnel, these expert consultants confirmed that certain transportation costs were counted twice in the preparation of this version of Appendix K. The revised results show a net contribution from the western

lines of \$13,386,721; \$11,759,730; and \$3,262,415 for 1976, 1977, and 1978, respectively.

A comparison of the revenue-cost relationship -- one of the prime measures of financial performance -- on the PCE and the entire system provides equally striking results.^{54/} This comparison, shown in Exhibit II-D, shows that the revenue-cost ratio for the Miles City west segment of the railroad is superior to that of the entire railroad (including the Miles City west segment) during the 1976-1978 period. Furthermore, the balance of the system, which consists of the system without Miles City west, is decidedly inferior in economic performance to the segment west of Miles City. More importantly, although each segment shows a decline in the revenue-cost ratio for the years 1976 through 1978, the rate of decline for Miles City west is approximately half the rate of decline for the entire system and is correspondingly less for the balance of the system without Miles City west.

The Booz-Allen study also supports the conclusion that a transcontinental configuration, which includes the PCE, is incrementally superior to a midwest-only operation such as Milwaukee II.^{55/} It should be noted that the Booz-Allen study did not make an analysis of either Milwaukee II or the lines west of Miles City. It is, however, possible to use the Booz-Allen data to approximate Milwaukee II and the Miles City west segment. According to Mr. Thomas Power, Assistant to the

Milwaukee Trustee, it is possible to approximate the economic performance of Milwaukee II by adding Booz-Allen's "Miles City subcore" configuration to their "Kansas City subcore" configuration and subtracting out one of the two "subcores."^{56/} Similarly, it is possible to approximate the PCE by subtracting the "Miles City subcore" from the "Louisville-Transcon."^{57/} This introduces a streamlined version of the PCE, much like what is part of the base system under this Plan.

The results of this analysis, based on Booz-Allen data, are portrayed in Exhibit II-E. It should be noted that this approach is useful only for a comparative analysis; as the Booz-Allen Study emphasized, their figures are intended to show internally consistent comparisons but do not purport to have absolute accuracy. Further, this kind of analysis is more appropriate for an examination of the PCE than for Milwaukee II since the PCE data show the incremental effect of the PCE on the balance of the system while the Milwaukee II data project the actual performance of that configuration as part of a separate system. This approach in the latter instance has a significantly greater potential for inaccuracy because of the high likelihood of double counting of traffic by the overlay of the separate configurations studied by Booz-Allen.

The results of this analysis indicate that the Louisville-Transcon represents the most promising configuration from an income perspective. It is the only alternative which produces

a positive NROI of \$2.9 million in the long term, without improvements. By comparison, Milwaukee II produces a long-term NROI of a negative \$5.7 million. It should be noted that the PCE segment produces a 1977 level of negative \$7.8 million, but shows a long-term income level of positive \$9.4 million, the best of all results shown. Remarkably, the PCE is superior to Milwaukee II in all respects except for long-term NROI adjusted for depreciation.

The relative superiority of the PCE when compared with other lines east of Miles City is corroborated by the Booz-Allen Study of Proposed Acquisitions.^{58/} Exhibit 1 of Appendix B(3) of that study compares the additional income available for fixed charges when various system segments are deleted from a base configuration. The results of the analysis show that deletion of the PCE results in an additional \$1 million income available for fixed charges. With the deletion of other route segments there is, in each case, income in excess of \$1 million available for fixed charges. The Exhibit expressly notes that the income figures are meaningful "only to rank the various systems or this exhibit relative to each other." The PCE is thus clearly superior under this analysis to the other route segments examined.

Several conclusions follow from the above analyses. First, whether in terms of long-term variable costs and revenues, fully allocated costs and revenues, or revenue/cost ratios, the

economic performance of the PCE is superior to that of the entire Milwaukee system. This in turn confirms that, instead of the PCE, some major segments of the present Milwaukee system east of Miles City are the most likely candidates for being the major financial drains on the railroad. Significantly, abandonment proponents have never provided for the record any analysis to show the immediate cash impact upon the balance of the system of stopping service on various alternative parts of the Milwaukee system. Finally, and most significantly, the analysis clearly demonstrates the positive incremental financial contribution of the PCE to a restructured rail system.

3. Market Opportunities

The primary and regional hearings held in the abandonment proceeding and the Booz-Allen study confirm the existence of significant market opportunities on the PCE. Despite significant shortcomings in its methodology which resulted in undervaluing or over discounting the available traffic, the Booz-Allen methodology, which involved a shipper survey and an independent market opportunity analysis of Milwaukee studies, concluded that the Louisville-Transcon option had significant long-term market opportunities.^{59/} From the Booz-Allen data base, the relative market opportunities of Milwaukee II as a system and the PCE as a segment of Louisville-Transcon can be approximated.^{60/} These potentials are compared in Exhibit II-F.

This comparison is particularly important to the successful restructuring of the Milwaukee rail system. In both the short and long term, projected potential increases in carloads for Milwaukee II exceeds that of both the Louisville-Transcon and the PCE. Of crucial significance to the restructuring process, however, is the fact that in terms of projected revenue Milwaukee II is substantially inferior to both the Louisville-Transcon and the PCE. The apparent asymmetry of this result is explained primarily by the transcontinental nature of the Louisville-Transcon and the PCE (which is analysed incrementally). In a transcontinental rail system, revenue performance per car-load is maximized because of the long hauls involved. Correspondingly, a short haul, midwest-only carrier is penalized. The relative financial health of western transcontinental carriers when compared with midwestern regional carriers is based in part on this phenomenon.

The testimony of shippers and market experts in the abandonment proceeding confirms that even the Booz-Allen market opportunity analysis substantially understates the market potential of the PCE and therefore a Louisville-Transcon configuration. Significant traffic and marketing developments are currently underway in basic industries of the northern tier. Although a full compilation of the abandonment record cannot be attempted here, the following discussion is included to provide examples of the scope of market opportunities in selected industries.

Coal

Projections of demand for coal from northern tier production areas show massive increases in the coming years.61/ The modal division of these prospective flows have been shown to heavily favor the rail mode.62/ Although the Milwaukee participation in this projected traffic is limited in the short term (1980-1985), it would be a major mistake to ignore coal traffic potential for the Milwaukee western lines in the middle and long term. As noted in the June 1979 report of the National Transportation Policy Study Commission (NTPSC) :

One significant conclusion which can be drawn from the NTPSC regional forecasts is that to judge energy transport needs on the basis of 1985 flows could result in shortsighted policies. The crucial shift in coal movement after 1985 from eastern to western coal sources is expected to change the relative balance of flows over different segments of the coal rail network.

From the NTPSC's investigations, it is believed that by 1985 many segments of the nation's rail system may experience some degree of deficiency. The key corridors requiring investment will be those which connect the Great Plains coal region to the West North Central and West South Central Census Regions and the corridor which connects the Appalachian coal region, especially Kentucky and Tennessee, to the South Atlantic Census region.63/

The NTPSC has specifically projected additional coal carriage by the Milwaukee Road of 18.1 million tons by 1985 and 70.8 million tons in the year 2000.64/ These figures exclude local movements.

The testimony of coal industry representatives in the abandonment proceeding document the trends indicated above.

For example, Martin White, Vice President and General Manager of Western Energy, stated:

My purpose in offering testimony before the Commission is to add the voice of Western Energy Company to those arguing against the abandonment of any Milwaukee Railroad operations west of Miles City, Montana, a situation of critical long-term importance to the State of Montana, the Northwest, and the nation.

Although the Milwaukee's Pacific Coast Extension serves the public interest in a variety of ways, I will limit my remarks to the role of that line in the field of energy, specifically coal production and consumption. The continued operation of that rail line is a vital necessity to the intermediate and long-term coal transportation needs of the nation. It will be my further intention to demonstrate that the coal market represents a significant revenue opportunity to assist in financing the rehabilitation and continued operation of that portion of the Milwaukee system.

. . .

Most important to this proceeding, the Pacific Coast Extension of the Milwaukee Road traverses billions of tons of coal and lignite in other areas of central and southeastern Montana. The Montana Bureau of Mines and Geology has identified to date 23.35 billion tons of strippable sub-bituminous and lignite coal in eastern Montana contained in 51 deposits. Milwaukee would be the logical carrier of choice for approximately 20 percent of that tonnage . . . 65/

While current coal traffic flows are almost all eastbound, White and other industry witnesses stressed the potential for considerable west-bound coal traffic, particularly for export to Pacific Rim countries, and the likelihood of Milwaukee participation in the hauling of that traffic.66/

Of particular significance is the fact that the Milwaukee is the only rail carrier serving the Bull Mountain coal

formation near Roundup, Montana. The coal reserves in the Bull Mountain area are estimated at approximately 440 million tons.^{67/} Louisiana Land and Exploration Company currently is planning development of the Manati-Rehder Seam in the Bull Mountain formation. Louisiana Land projects that annual production of approximately 2 million tons is achievable by 1986-1988.^{68/}

In sum, although there is little immediate new coal traffic available for the Milwaukee, the intermediate and long-term prospects are exceptionally bright.

Agricultural Commodities

The testimony of grain and produce industry representatives in the abandonment proceeding indicate significant present and future market opportunities for the PCE. The representative of the Grain Terminal Association, an agricultural cooperative owned by approximately 200,000 farmers and marketing grain for over 600 county elevators in Montana, North Dakota, South Dakota, and Minnesota, testified that the Milwaukee is not currently carrying substantial amounts of the grain traffic tendered to it:

. . . we know that there is presently a substantial amount of west-bound grain traffic from our farmer-owners tendered to the Milwaukee on lines west of Miles City which it has declined to handle, and which the Burlington Northern cannot handle. This failure to adequately serve the grain rail transportation needs of our members has forced them to turn to

other, far more costly, forms of transportation, and has resulted in the loss of millions of dollars of revenue to the Milwaukee.

. . .

The total amount of all these revenues available to the Milwaukee, today, from these States, for grain traffic, is, accordingly, in the range of \$30 million. That business is here, now, if only the Milwaukee would or could take it, and will, as I will explain in a moment, grow substantially in the future.69/

The inadequacy of present service similarly results in understated present rail transportation demand for perishables:

Our service now is very poor compared to 2 or 3 years ago, and, as a result, almost all of the fresh potatoes and onions are now shipped by truck. Prior to 1975 rail service was used but was by no means satisfactory, consequently rail shipments have never been used to the extent Sunfresh would like to use them.70/

This testimony supports the view that current PCE revenues grossly underestimate the total amount of revenue from traffic currently available to the Milwaukee.

The record in the abandonment proceeding also indicates that agricultural traffic will increase significantly in the future. For example, projections for the total output for the State of Montana after correction for local consumption show aggregate growth of 34% over the next 15-year period.71/ Sixty to 70 percent of this increase is projected to be shipped to the west coast by rail40/ and, as the Grain Terminal Association testified, the availability of service on the Milwaukee's PCE will be critical to meeting that demand:

We know that the export market for grain shipped by rail from our farmer-owners through North Coast ports to markets around the Pacific Rim is developing, and is destined to continue to develop, at an explosive pace. That market cannot be fully served without the continuation of a transcontinental line by the Milwaukee.^{72/}

In a statement opposing abandonment of the PCE, the U.S. Department of Agriculture reached a similar conclusion:

The long range outlook for exports is also quite good. In one study released last year by the U.S.D.A., it was projected that grain exports will increase from the 1978 level of 112 million metric tons to 148 million metric ton in 1990 and 190 million metric tons by the year 2000. More recent internal estimates of exports indicate the projection of 148 million metric tons will be reached much sooner than 1990. As these figures illustrate, we are faced with ever increasing export demands and the Pacific Northwest will continue to share in this increased volume.^{73/}

Elsewhere in its testimony the U.S.D.A. notes that approximately 75% of export grain moves by rail. Testimony of scores of smaller grain producers and marketers corroborates such region-wide projections of grain output growth.

Equally important is convincing evidence that the rail mode's market share in the transportation of agricultural products in this region, which has been declining in recent years, is stabilizing:

Many shippers have joined in shipper associations to divert fresh fruit and vegetables from the truck to the rail. One cooperative has already implemented plans to divert 3,000 trailer loads shipped from the Imperial Valley from truck to rail. The Pacific Northwest Perishable Shippers Association, a Seattle group, has already diverted 60 loads a week from trucks. In the past, most all of the export business from the San Joaquin Valley was shipped by truck because of the

short haul nature of the movements. Several major shippers have implemented plans this year to ship nearly all of this short haul business by rail because the freight rate for trucks is increasing about 1% every time the price of fuel moves 4 cents a gallon.

These dramatic changes have all occurred within the past 18 months:

At industry meetings, no one has predicted that trucks will be diverting any freight from the railroads. In fact, the opposite is being predicted. The railroads that serve the California and Arizona areas have seized the initiative. The current switching of freight from trucks to railroads in the produce industry reverses a historical trend. The trend was based on a time of "cheap energy." That time has passed and conclusions based on an assumption that those trends would continue have become invalid.^{74/}

The impact of increased fuel costs upon the modal share of agricultural products can be expected to have a similar effect on other traffic. The Booz-Allen market opportunities analysis did not give any effect to changes in modal share.^{75/}

Forest Products

A situation similar to that experienced in agricultural commodities is occurring in the forest products industry. Current wood products rail traffic on the Milwaukee is likewise significantly depressed by poor service, car shortages and other factors. As Potlatch Corporation, a major shipper of primary forest products, has pointed out, current traffic levels are a poor indicator of actual demand:

1978 traffic volume would have been even greater if Milwaukee Road had been able to fulfil all of the demand for rail service on the subject Idaho lines

. . . While I can only speak for Potlatch on [this] subject, I strongly suspect that other shippers on the subject Idaho lines were denied the opportunity to ship additional traffic over the Milwaukee Road because of poor rail service or car supply.76/

As in the agricultural commodity area, the forest products industry predicts substantial growth in future rail shipments. For example, Bennett Lumber Products, an Idaho lumber operation, foresees future additional traffic and a trend back to rail:

Over the next five to six years, we expect a ten to fifteen percent growth in our production levels. These projections take into account the recession we are now beginning to experience. Given the likely increase in fuel costs, we feel that, other things being equal, most of this production will move by rail. I have conferred with other lumber producers in our area and they also see a trend back to rail, particularly for shipments east. We further project that if the Milwaukee's service were to continue, it would participate in at least its 1977 proportion of our rail traffic which was slightly less than fifty percent. With improvements in its track and upgrading of its motive power, we believe that the Milwaukee could increase its share significantly.77/

Bennett also stressed the cost penalty that accompanies a shift from rail to truck.

Import/Export Traffic

The testimony and statements of the representatives of West Coast ports strongly indicate that significant market opportunities exist or will develop for import/export traffic. The Port of Seattle, for example, projects that by 1983 its overland common point (OCP) traffic, carried almost exclusively by rail, will increase from 67,300 TEUs (twenty ton equivalent unit)

in 1978 to approximately 100,000 TEUs in 1983. The Port concludes that if the Milwaukee can handle roughly the same percentage of OCP traffic in the next five years as it has in the past five years, it will be tendered an estimated average of 20,800 TEUs per year for each of the next five years. This compares with 16,819 TEUs carried in 1978.^{78/}

The above discussion is simply exemplary of evidence of market opportunities available on the PCE submitted in the abandonment proceeding. A complete review of the abandonment proceeding record reveals that scores of shippers predict similar increases for the years ahead. From this record it is clear that significant opportunities exist for substantial improvement in traffic levels on the PCE over the 1977 base level, that those opportunities are both immediate and long term, and that they have been insufficiently addressed by previous studies.

4. Regional Impacts

Impacts of Abandonment

The record developed in the abandonment proceeding firmly documents the economic significance of the Milwaukee's trans-continental service in the northern tier. A consultant with substantial experience in analyzing social and economic impacts reached the following conclusion after carefully considering relevant testimony in the abandonment proceeding and state rail plans in the affected areas:

Under the Trustee's Reorganization Plan, Milwaukee rail service west of Miles City, Montana will be abandoned. This proposal will have social and economic repercussions throughout the 500 small communities and/or stations scattered along the line. Montana, Idaho and Washington will lose over 1,400 rail jobs and nearly 2,000 primary and secondary jobs. The gross impact of these layoffs will be even more sizable in context of the communities affected. Most of them are small, 476 of the 500 having a population of less than 10,000 persons. Thus, the impacts of job loss and closures or reductions of operations by rail-dependent firms are expected to reverberate through these communities which are dependent on the firms for tax revenues, income, employment, and general community stability.

. . . in the three states of Montana, Idaho and Washington alone, over \$40 million in income will be lost over the four-year period following rail abandonment. The business community in those three states will suffer an additional \$42 million loss as rail-dependent firms absorb increased transport costs and employers throughout the three states assume responsibility for unemployment payments. . . . Government revenues, collected from income, sales, and property taxes, will decrease by \$11 million. These costs represent a loss of 3,300 jobs and \$223 million over a four-year period in the three states alone.79/

The staff of the Interstate Commerce Commission reached a similar conclusion in its Draft Environmental Impact Statement:

Assuming rail service is discontinued on any or all Milwaukee Lines west of Miles City, abandonment will cause numerous adverse socio-economic and environmental impacts. Communities in Washington, Idaho, and Montana will lose rail service or competitive rail service, suffer increases in unemployment rates for both railroad workers and workers of firms dependent on rail service, lose property tax receipts, and incur difficulties in expanding agricultural, silvicultural, mineral, commercial, and industrial development. The reduction in property taxes will force numerous local governments to cut back on essential services. Traffic will be diverted to motor carriage, causing millions of dollars in roadway damage and increasing energy consumption by up to 200%. . . . abandonment will cause additional truck-related safety hazards, and increase intrusive noise incidence.^{80/}

The Draft Statement did not attempt to quantify economic impact.

Impact of Retained and Improved Service

The above statements summarize the negative impacts resulting from the abandonment of a railroad with poor service, deteriorated track, and a reduced employee force; however, the potential benefits flowing from retention and improvement of service are not considered. Corresponding positive impacts upon the socio-economic environment, energy use, shippers, and state and local governments would result if the Milwaukee or a successor became, in time, a vital transportation force in the northern tier.

Although not generally quantifiable on the basis of the abandonment record, the potential positive impacts resulting

from retention and improvement of service are significant. Rail employment, for example, would increase as a result of the rehabilitation requirements of the present Plan. These employment increases will be augmented as increased service demands additional workers.^{81/} Similarly, secondary employment would be favorably affected as rail-dependent or potentially rail-dependent individuals and firms expand and prosper with improved rail service.^{82/} Of particular importance, for example, is the impact of continued and improved service upon farm income. Diversion to truck because of rail abandonment or inadequate car supply directly reduces the farmer's already inadequate profit margins.^{83/} On the other hand, a vital and improving rail transportation system can aid in the maximization of farm income and facilitate the participation of farmers in the world market.^{84/} Similar salutary effects can be expected for other shippers. For each shipper predicting increasing traffic contingent on rail service, scores of related individuals and firms, though not direct rail users, potentially will benefit if service is retained and improved.

Other benefits can be expected. Retaining current flows and the prospective diversion of other traffic from trucks will result in tangible environmental and energy benefits.^{85/} The retention and diversion of traffic by rail will take some pressure off public roads and thus obviate the need for significant repair and maintenance expenditures. Local governments will retain property tax revenue.

In each of the areas discussed above it is important that potential positive impacts be judged, not on the basis of the traffic left after 20 years of deferred maintenance or the many constraints both within and without the rail industry which have impeded past performance, but rather on potentials which are reasonably attainable at present.

Competition

An additional and fundamental benefit of retaining the Milwaukee PCE is the significance of a transcontinental railroad as a competitive force in the northern tier. This significance was a recurring theme throughout the abandonment hearings (as it has been in other proceedings before the Commission -- e.g. the BN inclusion case). Even though most shippers conceded the extremely poor level of recent service on the Milwaukee, many shippers still cited the fundamental competitive importance of a transcontinental Milwaukee. Without the Milwaukee or a transcontinental successor, large sections of Washington, Idaho and virtually all of Montana will be without competitive rail service.

Rail competition to these shippers is not an abstract notion but a very tangible determinant of service, rates, car supply and market area. Many shippers have noted that service, even with two or more rail carriers, is currently inadequate. For example, the Anaconda Copper Company is currently

experiencing inadequate car cycle times even though it is served by both Burlington Northern and Milwaukee. Although Milwaukee transit time is slower than that on BN because of recent Milwaukee service reductions, Anaconda is obliged to use both railroads because the combined car supply of both railroads "barely meets" their current requirements. Even assuming adequate car supply, however, Anaconda fears significant service problems without the competition that Milwaukee affords:

Historically, the cycle times for both carriers were lower, and the current time of BN leaves much to be desired. But if the Milwaukee line were abandoned, all of our traffic would go to the BN, and we expect car cycle time would increase significantly. This will have the effect of reducing our production capability and lowering our ability to compete. While I cannot offer firm estimates of what those charges will cost our company, our customers, and the economy of Montana, we fear it could be substantial, which is why we are participating in this [abandonment] proceeding.86/

The U.S. Department of Agriculture has expressed similar fears concerning the shippers of agricultural commodities:

[I]f these producers have only one means of getting their grain to market [Burlington Northern], freight cost will tend to reflect the market power which that (sic) one transportation system can exercise. These shippers would become "captive shippers" in the most literal sense of that term. The captive shipper problem and how to resolve it in an equitable manner is the major factor blocking current legislation to deregulate the railroads. But even if we were to assume the only railroad remaining would treat these stranded shippers equitably, there is little evidence to support a contention that they would receive adequate service. The Burlington Northern is not able to fully serve the demands from its on line customers today.87/

Perhaps the most significant impact of maintained intramodal competition is the effect of such competition upon freight rates. The significance of this issue flows in part from the effective lack of non-rail transportation for certain major traffic segments. As noted by Western Energy, a major Montana coal producer, one of these non-divertable commodities is coal:

Because there is no presently available alternative for the shipment of coal from the Northern Great Plains to the Pacific Northwest or the Upper Midwest other than the railroad, and because of the major impact of the cost of transportation on the marketability of Montana coal, Western Energy feels it is absolutely essential to rehabilitate the Milwaukee Road to present long-term competition. Effective intramodal competition is necessary not only to produce better service and lower prices, but also to assure that existing carriers will be able to handle all the coal traffic.^{88/}

Given the captive nature of coal traffic, the industry is particularly attuned to the competitive impact on rail rates. NERCO, Inc., another major shipper of Montana coal, has testified:

. . . it is important to remember that from two-thirds to three-fourths of the delivered cost of coal is the transportation component and that the railroads represent the only practical means for getting the coal to market.

Given these circumstances, it makes no sense to further encourage abusive rail tariffs anywhere in the nation by eliminating existing or prospective competitive lines. This would be the case in the northwestern United States in the event that abandonment of 2,500 miles of the Milwaukee Road from Miles City westward is approved. At that point, the Burlington Northern Railroad . . . which the record indicates will levy high tariffs where it is able to monopolize coal traffic . . . that same Burlington Northern

Railroad would have complete control of rail shipments from all Montana coal fields and many Wyoming coal fields to the northwestern states and to key ports from which overseas shipments would be likely to originate. It is our belief that such competition should be both encouraged and stimulated . . . certainly not eliminated.89/

Coal is not the only commodity for which rail is the only realistic transportation alternative. For example, the U.S.D.A. stated that "trucking does not appear to be a viable alternative to rail for transportation of export grain."

Loss of rate competition is not merely a prospective concern. Many shippers noted that BN had followed Milwaukee rate reductions with corresponding action. All shippers, whether Milwaukee or BN, benefit from such a competitive atmosphere. The rate benefits of competition have occurred, for example, in the area of grain transportation:

The important point is that the Burlington Northern followed that rate reduction [7 to 8 cents per Cwt on grain] initiated by the Milwaukee as a result, I believe, of the marketplace requirement that it remain price competitive with it. Absent the Milwaukee's initiative in proposing this reduction, I do not believe Burlington Northern would have pursued it. For every 100 million bushels of grain shipped from Montana by rail a year, that rate reduction on both the Milwaukee and Burlington Northern amounted to a net savings to Montana grain shippers of some five million dollars -- a result I attribute directly to the competitive pressure of the Milwaukee in this area.90/

In other areas BN has not matched lower Milwaukee rates. Accordingly, the disappearance of the Milwaukee will automatically result in higher rates even if BN maintains the status quo:

Another aspect of this traffic [sulfuric acid] is that in the absence of the Milwaukee, our costs to ship the acid will increase substantially. This is because the BN has refused to offer the same point-to-point through rates for this traffic that the Milwaukee has. Certainly the absence of the Milwaukee will only reinforce the BN's position in this regard. Then as a captive shipper will have to pay the [higher] combination rates required by the BN. . . 91/

Finally, the prospect of increased rates may actually effect the market areas of some shippers:

In our business, where margins are frequently low, the disappearance of meaningful rail competition is a matter of the greatest significance. Such a development would threaten our continued ability to sell in markets that we have taken years to develop. Loss of those markets to ConAgra would trigger harmful consequences that would reverberate throughout Montana's economy.92/

These and similar potential rate impacts are correspondingly more severe for smaller shippers with no market power.

The competitive balance in the northern tier simply bears no resemblance to that in the overbuilt midwest. The Federal Railroad Administration (FRA) has identified a variety of "corridors of excess rail capacity" in which the stated policy goal of FRA is to consolidate service and reduce redundant truckage.93/ In these corridors, such as Chicago - Kansas City, as many as 8 railroads compete for a static or declining traffic base. The addition or deletion of one rail carrier from such a rail corridor has limited competitive significance. In contrast, in Montana and much of the northern tier, there were ten years ago three competing railroads, "Today there are

two, and depending on the Commission's actions, tomorrow there may be only one."⁹⁴/ As the Milwaukee itself noted in a statement on the Burlington Northern Merger, ". . . essential to the public interest, is the need to preserve a realistic and effective competitive balance between the merged lines and other existing railroad services. It is principally in this regard that the Milwaukee Road occupies a central and critical position."⁹⁵/ At a time when Congress is considering legislative proposals to deregulate the railroad industry, the preservation of competitive service across the northern tier is not only desirable, but absolutely essential if the public interest is to be protected.

II. Background

C. BRIEF HISTORY OF THE BANKRUPTCY PROCEEDING AND OTHER EVENTS LEADING TO THIS PLAN

1. Filing for Bankruptcy

The Milwaukee Road filed its petition for reorganization under Section 77 of the Federal Bankruptcy Act, 11 U.S.C. §205, on December 19, 1977. The Honorable Thomas R. McMillen, District Judge, was assigned to oversee the reorganization.

Mr. Stanley E.G. Hillman was appointed Trustee of the property on January 19, 1978. Mr. Hillman's appointment was ratified by the Commission on February 13, 1978. On July 23, 1979, due to the illness of Mr. Hillman, Mr. Richard B. Ogilvie was appointed Trustee.

A brief discussion of the factors that contributed to the railroad's slide into bankruptcy is set forth above in Part II-A.

The stated goal since bankruptcy of both Mr. Hillman and Mr. Ogilvie has been to "preserve the Milwaukee estate in the short run and to enhance the possibility of a successful reorganization in the long run."

On August 3, 1978, about eight months after he took office, Trustee Hillman announced publicly that "the Milwaukee Road can no longer be operated as a transcontinental carrier." This

announcement significantly shaped the events and perceptions of interested parties that followed. Specifically, the announcement both triggered efforts to maintain the Milwaukee as a transcontinental carrier and precipitated a continuing debate as to the viability, and importance, of the system's western lines.

2. Formation of SORE

Shortly after the Trustee's announcement in August 1978 that he intended to exclude the Milwaukee's western lines from any reorganized system, a coalition of employees who worked in a variety of positions on the Railroad's western lines, and who were members of a variety of different labor organizations, formed an association known as the Association to Save Our Railroad Employment ("SORE"). This employee group announced its intention to investigate the feasibility of reorganizing the western lines as an independent private company. Approximately 600 employees participated in SORE and contributed financial support to its efforts. On April 28, 1979, SORE published the results of a detailed viability study of the Milwaukee's lines west of the Twin Cities. The SORE study concluded that the Lines West could be reorganized and operated as a money-making, privately-owned railroad.

3. Booz, Allen and Hamilton's Strategic Planning Studies

In order to analyze in depth the prospects for a successful reorganization of some or all of the Milwaukee system, the Trustee engaged Booz, Allen and Hamilton ("Booz-Allen"), a transportation consulting firm, to make an extensive analysis of the Milwaukee system. Specifically, Booz-Allen was requested to analyze:

- availability of traffic for various network configurations;
- operational requirements for the configurations;
- facilities and equipment required for operations
- financial impact of each system configuration
- the capital investment required to rehabilitate the plant and equipment
- employment impact of each system.

It was not the assignment of Booz-Allen to analyze the interests of creditors, employees, or the public.

The Booz-Allen methodology was essentially based on an analysis of various Milwaukee system configurations. Eight route configurations were subjected to detailed analysis. Included were configurations approximating the Milwaukee lines west of Minneapolis, Minnesota [the "Twin Cities-Transcon"], the Louisville-Tacoma main line [the "Louisville-Transcon"], and various midwestern systems. Booz-Allen made no specific analysis of the lines west of Miles City, Montana.

The Booz-Allen Strategic Planning Study was released on May 11, 1979. Specific parts of this study are discussed and analyzed at length throughout this document.

4. Embargo Proceeding - May

On April 23, 1979, Trustee Hillman petitioned the reorganization court for permission to institute an "embargo," effective "12:01 a.m., CDT on May 8, 1979," on all freight service over approximately 8,000 miles of the Milwaukee's 10,000-mile system. An emergency hearing on the matter was set for May 4, 1979. Prior to that hearing, the Trustee twice significantly revised the configuration of "core" lines to be exempted from the proposed embargo and also revised the proposed onset of the embargo to May 31, 1979.

Concurrently, the Trustee requested permission to borrow \$15 million from the property sale account of the railroad. The Trustee represented that these funds were necessary to permit the railroad to continue to operate beyond May 8, 1979. At the May 4 hearing, the Trustee filed an additional petition for permission to borrow \$20 million of available federal funds under the Emergency Rail Services Act of 1970 ("ERSA"), 45 USC §661 et seq. At the conclusion of the May 4 hearing, the District Court granted the Trustee's petition for permission to borrow the \$15 million.

On May 10, 1979, the District Court appointed Mr. Milton H. Gray as Special Master to consider evidence on the Trustee's embargo request and to submit recommended findings of fact and conclusions of law to the District Court. Four days of evidentiary hearings on the Trustee's embargo petition were held before the Special Master commencing on May 15, 1979. Based on the record developed at the May 4 hearing and at the May 15-18 hearings, the Special Master recommended that the District Court grant the Trustee's petition for a partial embargo.

On June 1, 1979, the District Court entered its Order sustaining the objections of the State of Montana and other parties to the Special Master's conclusions of law and denying the Trustee's permission to institute the proposed embargo.

Appeals from the District Court decision were filed by the Trustee and other parties.

5. The Abandonment Proceeding

On August 8, 1979 the Trustee filed a petition before the Interstate Commerce Commission seeking abandonment of all lines west of Miles City, Montana. The reasons cited for the abandonment were the continuing losses that the Milwaukee was experiencing system-wide and the fact that the PCE was not included in the Trustee's plan for restructuring the Milwaukee.

The Commission subsequently adopted an expedited schedule allowing 155 days from the date of the Trustee's application to the final administrative decision. As of December 1, 1979, comments on the petition have been filed, and primary and secondary hearings have been held. In addition, the Commission has submitted a Draft Environmental Impact Statement and hearings have been held thereon. The Commission has ordered post-hearing briefs to be filed by December 14, 1979.

6. Formation of New Milwaukee Lines

In June, 1979, in the aftermath of the District Court's ruling on the Trustee's first embargo petition, a broad range of shipper and employee interests, joined by representatives appointed by the governors of many of the northern tier states, agreed to form a Washington non-profit corporation that was named New Milwaukee Lines. New Milwaukee Lines is the proponent of the present employee-shipper ownership plan. The formation, membership, management, and objectives of New Milwaukee Lines are discussed in greater detail in Chapter III, infra.

7. Trustee's Reorganization Plan -- "Milwaukee II"

On August 10, 1979, the Trustee filed with the Reorganization Court his proposed Plan of reorganization for the Milwaukee Railroad's estate. In brief, the Plan proposed that

service on all Milwaukee lines outside the so-called "Milwaukee II" core system, a primarily midwestern configuration of approximately 3,200 route miles, be discontinued. Although the Booz-Allen study had not addressed the potential viability of the Milwaukee II configuration, the Trustee's Reorganization Plan reported that analysis of the system by Milwaukee management, when coupled with the results of the Booz-Allen analysis, yielded the conclusion that this particular configuration was the portion of the railroad that should be retained in active service. The plan projects net operating deficits of approximately \$212 million for the 1980-1983 period. The plan projects a NROI of \$18.6 million in 1984. External government financing of approximately \$220 million is expected to be required.

The Milwaukee considered the following events "benchmarks of success:"

- achievement of 90% of the forecasted 1980 revenue level within one year of commencing separate operation of Milwaukee II
- approaching the Booz-Allen market opportunity level in revenue by the end of the third year of such operation
- generating a positive cash flow from operation in the fourth year; rehabilitation costs are not included in this calculation.

Milwaukee has noted that the failure to attain these goals would call for "reconsideration of the viability of Milwaukee II." Many of the specific proposals, figures, and projections contained in the Trustee's Reorganization Plan are referred to for purposes of comparison in the present Plan.

8. Reorganization Plans Filed by SORE and New Milwaukee Lines

In September, 1979, SORE and New Milwaukee Lines each filed a plan of reorganization for the Milwaukee Railroad's estate. SORE's plan proposed a reorganized system operating the Milwaukee's lines west from the Twin Cities to the Puget Sound area. New Milwaukee Lines proposed a configuration stretching from Louisville to the Puget Sound area. Each plan was filed under substantial time pressure and recognized the need for subsequent development and amendments. No interested party other than the Trustee, SORE, and New Milwaukee Lines has filed a proposed plan of reorganization to date.

9. Embargo Proceeding - August

In August, 1979, Trustee Ogilvie filed a second petition in the Reorganization Court seeking a wide-ranging "embargo." This second petition sought permission to embargo all service over all of the lines outside the Trustee's proposed "Milwaukee

II" configuration proposed in the Reorganization Plan. The Trustee contended that this second embargo petition properly could be granted by the Court notwithstanding the District Court's adverse decision in the first embargo petition because the railroad had become "cashless" during the intervening months. Hearings on the Trustee's second embargo petition were held in Chicago during August, again before Special Master Grey. The Special Master recommended, and the District Court on September 27, 1979, held, that the Trustee's second embargo petition should be granted, effective November 1, 1979, because the railroad was "cashless."

10. Court of Appeals Decision

On October 2, 1979, the United States Court of Appeals for the Seventh Circuit reversed the Reorganization Court's June 1 decision denying Trustee Hillman's first petition for a partial embargo. The Court of Appeals held that the railroad had been in a condition of "imminent cashlessness" at the time of the Trustee's application for permission to borrow the \$20 million of ERSA funds sought at the time of the Trustee's first embargo petition. The court held that but for the availability of those funds the railroad would have been actually "cashless," and that the Reorganization Court's powers under section 77(c) (3) to impose conditions upon the issuance of Trustee's Certificates, coupled with the "cashlessness" exception to the

Interstate Commerce Act's general requirement that railroads must continue to perform their common carrier obligations unless and until the Interstate Commerce Commission grants them permission to do otherwise, empowered the Reorganization Court to condition the requested \$20 million ERSA borrowing upon a requirement that service cease on all portions of the railroad outside the core area found by the Judge to be potentially viable.

11. Studies and Analyses of the Milwaukee

In addition to the Booz-Allen report, various independent studies and reports have been undertaken to analyze various aspects of the Milwaukee system or to critique other such reports. The first such report was a review of the Booz-Allen effort by the Federal Railroad Administration (FRA). After summarizing the Booz-Allen report, the FRA review concluded that the Booz-Allen methodology was reasonable and consistent. The FRA analysis was released in May, 1979.

In response to the SORE Lines West Proposal and rising public concern over proposed western lines abandonment, several studies were commissioned by the U.S. Department of Transportation. The Reebie Report, released in July 1979, was financed by the Federal Railroad Administration to examine the financial viability of the Milwaukee's lines west of Minneapolis. Using a highly controversial methodology which

predicted that over half of the western lines' present traffic would be diverted to other modes by 1985, the report concluded that the western lines would not be viable in the future.

On July 2, 1979, the Consulting Center, Incorporated (CCI) released a report which analyzed the potential self-sustainability of the SORE - Lines West Proposal. The report was commissioned by the Office of the Secretary of the U.S. Department of Transportation. While essentially accepting the traffic and revenue projections of the SORE proposal, CCI noted that certain expense items and the acquisition plan involved were unrealistic and that therefore the plan was unacceptable in its then current form.

On July 19, 1979, a study entitled "Financial Analysis of the Impact on Labor and Labor Protection of the SORE Lines West Proposal" was released by Mark Battle Associates. The Mark Battle study was commissioned by the Office of the Secretary of the U.S. Department of Transportation to analyze the labor issues accompanying various approaches to the Milwaukee's western lines. The report concluded, inter alia, in regard to an ESOP-type plan, that if Lines West were otherwise viable, the "use of an ESOP should be definitely considered in the overall plan for the Milwaukee Road."

In September 1979, Policy and Management Associates, Inc. ("PMA") made an independent analysis of previous studies and of the prospects for the Milwaukee. The study, commissioned by

the Railroad Labor Executives Association and New Milwaukee Lines, reached several conclusions. First, the study noted that all existing studies and factors point to the long-term viability and desirability of a transcontinental rail system, but that inadequate research as to this option had been performed at the time. In regard to previous studies, the PMA report noted in particular that the Reebie report's prediction of diversion of traffic to other modes was illogical, unrealistic and conceptually in error. The report also concluded that an ESOP could be expected to have a significant impact on productivity which would be reflected in operating costs and profits lower and higher respectively than historic levels.

12. Milwaukee Railroad Restructuring Act - Why Congress Acted

Because of the magnitude and complexity of the problems facing the Milwaukee and the public it serves, and because of the inadequacy of normal abandonment and reorganization procedures, there has been considerable pressure on Congress to act to provide a means for restructuring the Milwaukee which fully addresses the public interest. Of pivotal importance was the concern of many legislators that the option of an employee or an employee-shipper owned railroad be fully considered and analyzed. Another major issue was the magnitude of labor

protection claims if abandonment or embargo occurred. The embargo itself had potentially disastrous consequences. A service embargo over thousands of miles of Milwaukee line was scheduled to and did go into effect on November 1, 1979. Directed service by the ICC over such embargoed lines was estimated to cost the taxpayers approximately \$150 million and yet would only postpone total cessation of service for eight months. Yet because of anticipated Congressional action, no directed service orders accompanied the November 1 embargo. The result was cessation of service over thousands of miles of railroad with no provision for alternative arrangements.

On November 2, 1979, the Congress passed and on November 4, 1979 the President signed legislation to address these important and complex issues. The Milwaukee Railroad Restructuring Act ("MRRA"), P.L. 96-101, responds to most of the pressing issues. The centerpiece of the legislation is its provision for the consideration and implementation of an employee or employee-shipper ownership plan. This section of the statute is considered in detail below. Also included is government assistance in the form of a \$75 million loan to the Milwaukee Railroad for labor protection payments.

In a November 23, 1979, opinion, the District Court found MRRA constitutional.

D. The Decision to be Made by the ICC and the Reorganization Court

1. Elements of a Qualified Plan

MRRA provides the opportunity for the consideration and implementation of an employee or employee-shipper ownership plan for the acquisition and operation of all or a substantial part of the Milwaukee Railroad. The statute creates a series of steps and requirements which must be met by the proponents of a plan in order to adequately demonstrate the financial self-sustainability, fairness, and feasibility of such a plan to the Interstate Commerce Commission and the Reorganization Court. It is important to fully understand the requirements of the statute and their interrelationship.

The statute provides for an employee or employee-shipper plan in Section 6. According to legislative history of MRRA an employee or employee-shipper plan submitted pursuant to Section 6 is the preferred option for reorganization of the rail operations of the Milwaukee. As noted in the recent District Court opinion on the constitutionality of Section 6 of MRRA:

Section 6 gives priority to an employee-shipper ownership plan as an alternative to any plan of reorganization. The priority plan (hereinafter referred to as E.S.O.P.) is subject to scrutiny by the Interstate Commerce Commission and the court but is not the equivalent of a bankruptcy reorganization plan. Only if an E.S.O.P. fails do the reorganization plans now on file regain any vitality."96/

The preferred position of a Section 6 plan should underlie consideration of the following statutory analysis.

Section 6 distinguishes between the group submitting the plan and the prospective owners of the system proposed in the plan. The plan must be submitted no later than December 1, 1979, by an association of representatives of national railway labor organizations, employee coalitions, and shippers, or any combination thereof. Paragraph 6(a)(1). The language is permissive and thus does not require, for example, representatives of employee coalitions but clearly allows their participation in the sponsoring group. The statute prescribes employees or employees and shippers as the owners of the acquiring company. Section 6 does not employ the technical phrase "employee stock ownership," "employee stock ownership plan," or the acronym "ESOP." The Act does refer specifically to an "employee stock ownership plan" in Section 23 in regard to the Delaware and Hudson Railroad Company. It therefore is reasonable to conclude that the plan proposed under Section 6, while requiring employee or employee-shipper ownership, need not meet the purely technical requirements of an employee stock ownership plan, although it clearly may.

The word "ownership" is not defined in MRRA nor is it a term of art which is technically defined under the Interstate Commerce Act. It is clear, however, that rail company ownership and control need not be and usually are not conjoined

in the same group.^{97/} The Interstate Commerce Act focuses on rail company control in its regulation of the industry.^{98/} Ownership per se is generally not addressed.

Rather than any technical definition, it is clear that the congressional intent is only that ownership be defined in a manner consistent with the broad requisites of an employee stock ownership plan. Accordingly, under a typical scenario, a corporation is formed to take legal title to railroad operating assets. This corporation would establish an employee stock ownership plan trust for the benefit of employees. The ESOP trust would purchase the authorized common shares of the rail corporation with funds borrowed from third parties. The borrowed funds would be secured by either the employer rail corporation or by a security interest in the rail corporation assets. The ESOP trust holds and manages trust assets for the benefit of the employees. Thus although the legal title of the assets is directly held by the rail corporation, the employees are in fact the beneficial owners of the trust assets and therefore the rail corporation assets. Since such equitable ownership is an essential characteristic of a typical employee stock ownership plan it clearly satisfies the requisites of "ownership" as used in MRRA.

The statute requires a "single plan" (Paragraph 6(a)(1)) which is explained by the Joint Explanatory Statement of the Committee of Conference as precluding a plan "containing one

or more alternative system configurations" H.R. Rep. No.96-583 at 18, Cong., 1st Sess. (1979). The essential purpose underlying the "single plan" directive is presumably that a basic route configuration and corporate structure be readily subject to Commission and court analysis within the short time frames involved.

Given the extremely short time frame within which the fairness and feasibility determinations must be made, the exclusion of multiple "alternative system configurations" was intended to avoid a situation that would require the Commission and the Reorganization court to both evaluate and choose between competing system configurations. For example, if the Plan submitted to the ICC included the Twin Cities-Seattle configuration and a competing Louisville-Chicago Twin Cities-Seattle configuration, it would not comply with the requirements of MRRA. On the other hand a system containing a base system with contingent lines that would complement the basic configuration if they satisfied objective financial and economic standards would comply with the statutory standard.

NewMil believes it consistent with the public interest and with the Congressional intent of MRRA that service over the present Milwaukee system be maximized to the extent justified by strict financial analysis. NewMil recognizes an obligation to work with shippers, states and local governments where such entities are willing to finance continued service and such

continued service will not affect the financial performance of New Railroad. Thus, if, for example, certain lines are economically justified for inclusion only if rehabilitation cost is borne by a third party, it is reasonable to assume that their expressly conditioned inclusion would not violate the single plan requirement.

The plan must propose a method for "converting all or a substantial part" of the existing Milwaukee Railroad into an employee or employee-shipper owned company. Paragraph 6(a)(1). Since prior drafts of the legislation used the language "all or substantially all" (see, e.g., H.J. Res. 341, 125 Cong. Rec. H9922 (daily ed. October 30, 1979) in lieu of the present wording, the intent of Congress is to allow, if necessary, a plan which proposes ownership of less, and perhaps significantly less, than the present system. As noted above, it is the intent of NewMil to include only as much of the present system as can be justified by strict and prudent economic analysis.

The plan must include a description of a method for implementation. Paragraph 6(a)(1). A method of implementation is essentially a blueprint for an ongoing process which looks toward actual operation, or operation on behalf of, an employee or employee-shipper owned railroad by April 1, 1980. As discussed below, the House and Senate conferees intended "implementation" to be a flexible concept.

The plan must include a "comprehensive evaluation of the prospects for financial self-sustainability of the Milwaukee Railroad." Paragraph 6(a)(1). The literal language of this section of MRRA is somewhat ambiguous. Subsection 3(s) defines "Milwaukee Railroad" as the Chicago, Milwaukee, St. Paul and Pacific Railroad Company" -- the present operating system. Thus one literal interpretation of this section would require the plan submitted herein to make an analysis of the prospects of self-sustainability of the "remainder" of the Milwaukee Railroad, that is, those parts of the Milwaukee Railroad not included in the NewMil Plan.

While literally possible, this is a highly improbable construction of Paragraph 6(a)(1). Moreover, such a construction is inconsistent with the feasibility determination that the Commission must make under subparagraph 6(a)(3)(D) that "the railroad proposed to be operated under the plan can be operated on a self-sustaining basis." (emphasis added). Presumably, Congress did not intend for the proponents of the plan to make a showing of the financial self-sustainability of two different systems, i.e. the existing Milwaukee and the New Railroad. Thus, fundamentally at issue both in the Plan itself and in the Commission's analysis is the self-sustainability of the proposed system. The Milwaukee Railroad will not continue to operate any rail segments not conveyed to the new company and thus any self-sustainability analysis based thereon would

be meaningless. Moreover, full consideration of the fairness and equity of the Plan to the Milwaukee estate is required by a separate section of the statute. Subsection (6)(a)(3)(B). Accordingly, NewMil believes that New Railroad, the operating system proposed herein and the primary successor to those portions of the Milwaukee estate which will continue in rail service, is the subject of this comprehensive evaluation of prospects of self-sustainability.

To meet the requirement of a "comprehensive evaluation," the plan proposed herein undertakes to fully address those issues which bear on self-sustainability such as an analysis of available public and private financing, rehabilitation requirements, equipment requirements, expenses, revenues, projected inflation effects, the projected state of the economy, productivity improvements, short and long term obligations, and contingencies. "Self-sustainability" comprehends a cash flow which, given internally generated funds and private and public financing, is sufficient to provide a return on equity, sufficient to service debt, and sufficient to attract investment capital if needed.

2. Interstate Commerce Commission Determination of Feasibility

Under MRRA, the plan proposed must be determined to be feasible by the ICC. The feasibility determination requires an

submitted to the Commission pursuant to Section 6."

(Congressional Record S15755 (November 2, 1979) (Remarks of Senators Baucus and Magnuson)).

Under Section 77(e) of the Bankruptcy Act the Reorganization Court must find a plan to be "fair and equitable" to the estate before a plan can be confirmed.

Although the 'fair and equitable' language in Section 77 has generally been understood as a term of art embodying the "absolute priority rule," which governs the order of creditors' claims, See, e.g., Ecker v. Western Pac. R.R., 318 U.S. 448, 513 (1942) (Roberts, J., concurring); Matter of Penn Central Transp. Co., 458 F. Supp. 1234, 1247 (E.D. Pa. 1978), reorganization courts have also compared the proposed treatment of the estate under plans of reorganization with assessments of the likely value of the estate in order to ascertain whether particular plans were "fair and equitable."

"At the heart of that determination ... is the valuation of the debtor's property." New Haven Inclusion Cases, 399 U.S. 392, 434 (1970).

The statute provides that a plan may be confirmed over the opposition of any voting class under the statutory "cram-down" procedure if the Court is satisfied that the plan is "fair and equitable" to the estate. Based on the estimates of value of particular estates, reorganization courts have frequently approved plans, for example, that effectively eliminated

shareholder interests. See, e.g., Ecker v. Western Pac. R.R., 318 U.S. 448, 475-77 (1942) ("the elimination of the claims of stockholders and creditors which are valueless from participation in the reorganization is in accordance with valid provisions of §77(e). Actual bankruptcy means a loss to some investors. Subsection (e) recognizes this inevitable result and provides a method for their elimination from the reorganization proceedings."); Wisconsin Central Ry. Co. v. Zelle, 210 F. 2d. 113 (8th Cir. 1954); Matter of Penn Central Transp. Co., supra, 458 F. Supp. 1234, at 1247 ("If the total amount of the claims against the estate exceed the total value of the estate, the estate is insolvent, albeit still reorganizable, and equity interests cannot be permitted to participate under the plan.") Similarly, the first proviso of the second paragraph of Section 77(e) expressly provides that an approved plan need not even be submitted to a vote by any class of stockholders if the corporation "is insolvent" that "the equity of such ... stockholder has no value" or that "the interests of such ... stockholders will not be adversely and materially affected by the plan."

"Earning power" is mandated by Section 77 as the primary criterion for assessing the value of the assets of railroads undergoing reorganization. Section 77(e) provides as follows:

The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property,

past, present and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.

Historically, asset valuation based on capitalization of the projected earnings of the reorganized entity has been the primary method of valuation in cases applying the requirements of Section 77(e). See e.g., Group of Institutional Investors v. Chicago, M. St.P. & Pac. R.R., 318 U.S. 523, 538-42 (1943):

The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn. Earning power was the primary test in former railroad reorganizations under equity receivership proceedings. [citations omitted.] The reasons why it is the appropriate test are apparent. A basic requirement of any reorganization is the determination of a capitalization which makes it possible not only to respect the priorities of the various classes of claimants but also to give the new company a reasonable prospect of survival ...

The finding of the Commission, affirmed by the District Court under §77(e), that the stock had "no value" is supported by evidence. The issue involved in such a determination is whether there is a reasonable probability that the earning power of the road will be sufficient to pay prior claims of interest and principal and leave some surplus for the service of the stock. If it is established that there is no reasonable probability of such earning power, then the inclusion of the stock would violate the full priority rule [citation omitted] -- a rule of priority incorporated in §77(e)(1)... through the phrase "fair and equitable."

A valuation for reorganization purposes based on earning power requires of course an appraisal of many factors which cannot be reduced to a fixed formula. It entails a prediction of future events. Hence, an

estimate, as distinguished from mathematical certitude, is all that can be made. [citation omitted.]

Application of these standards to the present Plan will require the Commission and the Reorganization Court to focus on the anticipated future earning power of the reorganized railroad -- on "how much the enterprise in all probability can earn."

Reorganization is achieved through the mechanism of a Plan which translates the value represented by the earning power of the enterprise into a new set of securities and distributes these new securities appropriately among creditors and other claimants in discharge of the debtor's obligations.

Valuation of the enterprise involves at least two exercises of judgment: determining what the earning power of the enterprise realistically is (based upon past performance, present circumstances and supportable predictions of future events), and establishing the appropriate capitalization rate for converting the predicted future earnings into present value ...

Matter of Penn Central Transp. Co., supra, 458 F. Supp. 1234, at 1246; In re Missouri Pacific R.R., 93 F. Supp. 832, (E.D. Mo. 1950), aff'd sub nom. Texas v. Group of Institutional Investors, 191 F. 2d 265 (8th Cir. 1951), cert. denied, 343 U.S. 929 (1952).

In this regard, the District Court's November 23, 1979 decision upholding the constitutionality of the MRRA suggests that the present plan "cannot be evaluated in the abstract under this new statute. It must be found "fair and equitable" to the estate. This means to us that it must be at least as

favorable to the creditors as any other plan which is brought to the attention of the ICC or the Court." (Slip 5 op. at 13). Part XI, infra, of the present Plan contains a discussion of the appropriate valuation of the assets of the Milwaukee Railroad's estate derived from application of these principles. That discussion includes a detailed comparison of the substantially more favorable valuation of the debtor's estate that will result if the present Plan is approved and implemented than would be the case if the Trustee's alternative "Milwaukee II" plan were put into effect.

Formulation of an appropriate theoretical framework for analysis of the "fairness and equity" of the present Plan's proposed manner of dealing with the Milwaukee Railroad's estate also requires consideration of the extent, if any, to which the "earning power" principle of asset valuation mandated by Section 77(e) and its progeny has been modified by the holding of the United States Supreme Court in the New Haven Inclusion Cases, 399 U.S. 392 (1970). In that case, the ICC had determined that the railroad had "long been dry of earning power" and that it had "neither earning power nor the prospect of earning power." 399 U.S. 392, at 436. In those circumstances, the Commission's plan of reorganization for the New Haven provided that the New Haven's assets, valued on a net liquidation basis, would be transferred to the Penn Central as a condition of the Penn Central's then-pending merger with the New York Central.

The Supreme Court approved the plan's reliance on "asset value rather than earning power" as the "primary determinant" of the value of the New Haven's estate, observing that "[i]n light of the 'chronic deficit character' of the New Haven operation, ... the Reorganization Court understandably accepted the liquidation approach to valuation." Id. Implicit in the Supreme Court's holding is the conclusion that, in the circumstances of the New Haven case, the "fair and equitable" test of Section 77 was satisfied by a plan that valued the estate on a net liquidation basis.

It has been suggested that the New Haven holding -- permitting utilization of the net liquidation value approach to asset valuation -- must be strictly limited to the particular facts present in the New Haven reorganization. The holding in the New Haven case was dominated by the finding that the New Haven had no earning power left in its system. Indeed, it was never suggested that continued operation of the portion of the New Haven system to be operated as part of the Penn Central System, following the merger, would either independently generate any earning capacity for the Penn Central or enhance the Penn Central's total system's earning capacity. Penn Central was required to acquire the New Haven rail properties and continue their operations as a condition of its merger with the New York Central in the belief that the total merger benefits would exceed such acquisition and operating costs. 399 U.S. 392, at 494-95.

Given the total absence of earning power in the New Haven, and the ultimate consequential right of the estate's creditors to force an ultimate abandonment and liquidation, the Supreme Court held that "it would be unfair and inequitable to allow Penn Central to take the properties for any lesser sum." 399 U.S. 392, at 489.

The applicability of this holding has been doubted, however, as to any case where the estate of the railroad in reorganization retains the capacity to achieve positive earnings as a result of an income-based reorganization. See generally, Notel Conrail and Liquidation value: Creditor's and Stockholders' Entitlement in the Regional Rail-Reorganization, 85 Yale L.J. 371 (1976) (contending that asset valuations derived from a capitalized earnings analysis yielding values well below net liquidation value have frequently been approved as "fair and equitable" by reorganization courts.)

The primary objective of Section 77 proceedings is not the liquidation of a debtor railroad's estate but rather rehabilitation of the financial structure of the debtor in a manner calculated "to bring about a reorganization."

Continental Illinois National Bank and Trust, Co. v. Chicago, R.I. Pac. Ry., 294 U.S. 648, 676 (1935).

Although the New Haven case held that a plan allowing that bankrupt railroad's estate the liquidation value of its assets was appropriate in a case where the railroad had no earning

power, the "earning power" approach to asset valuation mandated by Section 77(e) as the preferred method of valuation should remain the primary approach to valuation in any case where -- unlike the New Haven's situation -- the railroad retains the possibility an income-based reorganization. As the Supreme Court expressly recognized in the New Haven case, See 399 U.S. 393, at 489-93, service obligations imposed on common carrier railroads by the Interstate Commerce Act are "not simply a condition which must be fulfilled by a railroad that wishes to continue operations on some part of its lines: rather they enforce a dedication of indefinite duration on any capital committed to a railroad system." Note, Conrail and Liquidation Value: Creditor's and Stockholders' Entitlement in the Regional Rail Reorganization, 85 Yale L.J. 371, 392 (1976) citing Schwabacher v. United States, 334 U.S. 182, 201 (1948). The many cases approving refusals by the Commission to permit abandonments unless and until the applicant carrier can demonstrate unavoidable future losses, and the many rate-making cases making clear that "there is no longer any ground for a regulated company to contend that it has a constitutional right to an earning stream whose present value equals liquidation value as such," both lend considerable support to this analysis of the limited reach of the New Haven decision. Note, supra, at 393-395, citing cases.

If a net liquidation value approach to asset valuation, if applied to analysis of the present Plan, would require careful consideration of the component steps necessary to a proper use of that method of valuation analysis.

The Supreme Court's application of the net liquidation value approach in the circumstances of the New Haven case makes it very clear that this approach, properly applied, must take into account the economic realities which surround the putative liquidation alternative.

Liquidation value was defined by the Commission in the New Haven case as "the estimated market value that would be realized in a total liquidation, less the cost of dismantling properties and other liquidation costs and after discounting proceeds to present worth." 399 U.S. 392, at 436. The Plan approved by the Supreme Court hypothesized a six year period of liquidation during which "the bulk" of the liquidation was expected to be accomplished, deducted the anticipated expenses of carrying out the liquidation, and discounted the projected proceeds to an estimated present value. Id. at 437-438.

Moreover, although the New Haven's reorganization petition had been filed on July 7, 1961, the price to be paid by the Penn Central to the New Haven bondholders was the discounted liquidation value of the New Haven's properties as of December 31, 1966. Id. at 489. The year-end 1966 valuation date approved by the Supreme Court reflected an attempt in the

analysis by which the net liquidation value was derived to allow for the delay that would have accompanied actual to abandon the railroad and begin the six liquidation process. See New Haven Inclusion Cases, 399 U.S. 392, at 461 ("The parties agree that ... a delay occasioned by abandonment proceedings inheres in the liquidation process ... and Penn Central need not pay for the consequent diminution in the value of the assets of the debtor."); Note, Takings and the Public Interest in Railroad Reorganization, 82 Yale L.J. 1004, 1005-1007 (1973).

The December 31, 1966, valuation date employed in the New Haven plan was the hypothetical date by which the ICC believed that the New Haven could have obtained permission to abandon its service, and then could have begun its six year liquidation program. New Haven Inclusion Cases, 399 U.S. 392, at 463. The Supreme Court also approved provisions of the plan that placed on the estate of the New Haven losses from continued deficit operations between 1967 and the effective date of the Penn Central merger, January 15, 1968, as well as one-third of the operating losses from the date of the merger until actual inclusion of the New Haven in the merged system eleven months later. Id. at 493 and 479.

In effect, the net liquidation valuation of the New Haven's assets approved by the Supreme Court resulted in the "imposition on New Haven bondholders of more than six years of erosion loss

as part of the railroad's reorganization ... Between 60 and 70 million dollars was lost from the pre-bankruptcy liquidation value of the New Haven's assets." Note, Conrail and Liquidation Value: Creditors' and Stockholders' Entitlement in the Regional Rail Reorganization, 85 Yale L.J. 371, 384-385 (1976). The erosion apparently "may have been as much as 28% of the pre-bankruptcy value of the New Haven's estate." Most of this erosion "was incurred when it was already apparent that an independent income-based reorganization of the New Haven was impossible." Id. at 385, n. 47. See, New Haven Inclusion Cases, 399 U.S. 392, at 489-492.

It is thus apparent from the facts of the Supreme Court's New Haven decision that proper application of a net liquidation value approach to valuing the assets of the Milwaukee Railroad would require the Commission and the Bankruptcy Court to employ a number of assumptions as to the events that would in fact occur if the creditors of this estate were actually to attempt a liquidation. In this regard, the Final System Plan prepared by the United States Railway Administration ("USRA") in the Penn Central proceedings is instructive. In the Final System Plan USRA was required to consider in considerable detail "the process that would be followed by a trustee weighing the decision to liquidate." (I Final System Plan, 141 (July 26, 1975). USRA concluded that such a liquidation process would require "the development of a plan of liquidation which reasonably answers seven fundamental questions:

- What is the public policy framework within which liquidation would occur?
- When would the estate receive the judicial and regulatory approvals necessary to permit sale of its rail properties?
- In what order and over what time periods should the assets be sold?
- What is the inventory and condition of the properties to be sold?
- What are the estimated growth proceeds from sales?
- What are the estimated liquidation expenses?
- What are the proceeds after deducting liquidation expenses, and what is the present value to the estate of those proceeds as of January 1, 1976?"

I Final System Plan, 141-44.

As a practical matter, the ultimate valuation placed upon the assets of the Milwaukee Railroad's estate may vary substantially depending upon whether the Commission and the Reorganization Court employ the preferred "earnings power" (capitalized earnings) theory of valuation or instead employ a net liquidation method of valuation. In theory, the estate of a railroad in reorganization might have a "going concern" value, based upon a capitalized earnings analysis, either higher or lower than the estate's net liquidation value. Moreover, even in the case where a higher overall value would be placed upon the estate if a net liquidation analysis were employed, it is possible that certain assets of the estate might possess a "going concern" value that exceeds their liquidation value. The New Haven's bondholders, for example, urged the Court to

require that they be allowed "going concern value" in excess of liquidation value for certain assets of the New Haven. These requests were rejected by the Supreme Court as "antithetical to the liquidation hypothesis." 399 U.S. 392, at 482. Viewing the bondholder argument on this point as an attempt to pick and choose between the valuation principles most favorable with respect to any particular item, the Supreme Court observed that "nothing could be more unfair or inequitable to the Penn Central than to permit the New Haven bondholders, at its expense, to have the best of both worlds." Id.

For the reasons explained in Chapter XI of the present Plan, NewMil believes that the treatment accorded the Milwaukee Railroad's estate under this plan satisfies the statutory test for fairness and equity regardless of whether the preferred "earning power" approach to asset valuation or the doubtfully applicable net liquidation value approach is employed. Although a rigid application of the "earning power" valuation principle would dictate treating the estate considerably less generously than is done under the present Plan, New Milwaukee Lines believes that a reorganization of the Milwaukee Railroad is -- fortunately -- possible that will permit all parties, including the estate as well as shippers, employees, and the public, to be treated in a manner that is plainly fair and equitable.

Implementation

A third requirement of feasibility requires a determination that implementation of the plan will occur by April 1, 1980. "Implementation" is not defined in the legislation, but the intent of the Conferees is to allow a relatively flexible construction. The following colloquy on the Senate floor reflects this understanding:

MR. BAUCUS: ... I do not want to see an employee-shipper acquisition plan survive the Interstate Commerce Commission and Bankruptcy Court review process, obtain adequate public and private financing, but then fail due to the fact that the last "i" has not been dotted and the last "t" has not been crossed on, for example, rehabilitation loan financing documents which the Federal Railroad Administration has not completely processed by the deadline. In other words, the fact that necessary financial commitments have been made but not all of the funds have been disbursed by April 1, 1980, should not render the plan's implementation a nullity.

MR. MAGNUSON: The Senator's interpretation of the meaning of "implementation of the plan" is correct. 125 Cong. Rec. S15755 (daily ed. November 2, 1979).

Given the short timeframe involved, such a flexible understanding is crucial.

Self-Sustainability

The Commission must also determine that the proposed railroad can be operated on a self-sustaining basis. Subparagraph (6) (a) (3) (D). As noted above, "self-sustainability" comprehends a cash flow sufficient to provide a return on equity, meet operating requirements, plus the ability to attract investment

capital, if needed, given public and private financing likely to obtained under existing (as of January 1, 1980) programs.

Operating Assessment

Finally, the plan must contain an assessment of all operating practices and labor-management agreements, and make implementing changes designed to achieve labor productivity increases consistent with safe operations and adequate service. Subparagraph 6(a)(3)(E). As noted in the Joint Explanatory Statement of the Committee on Conference, "the term 'agreements' in the bill is not to be construed as requiring formal finalized labor agreements. Rather, the intent is that binding written commitments will be made in the form of letters of intent or in any other appropriate matter." H. R. Rep. No. 96-583 at 18, 96th cong.) 1st. Sess. (1979).

The role of an employee stock ownership plan (ESOP) or similar device should be specifically noted here. The legislative history of the Act indicates that an ESOP or ESOP-like plan was favored not rather as a tax or financing tool but primarily as a means by which labor productivity could be improved. Accordingly, it should be emphasized that simply the implementation of an ESOP or ESOP-like plan facilitates significant potential productivity increases and thus goes far toward the satisfaction of Subparagraph 6(a) (3)(E).

The Commission will accept statements in support of or in opposition to the Acquisition Plan submitted if the statements are filed by December 14, 1979. Replies to those initial statements must be filed by December 20, 1979. Interstate Commerce Commission Order, Service Date November 8, 1979, Finance Docket No. 29173. The Commission shall make its feasibility determination no later than December 31, 1979.

3. Reorganization Court Determination of Fairness and Equity

If the Commission finds the plan feasible, it shall submit its finding to the Reorganization Court. The Reorganization Court then has ten days in which to determine, after a hearing, whether the plan submitted is fair and equitable to the estate of the Milwaukee Road. Subsection 6(b). The standard of fairness and equity used by the Commission, discussed above, is the same standard used by the court. As noted below however, the Commission's determination that the plan is fair and equitable carries a strong presumption of accuracy. Unlike the Commission, the court does not address any aspect of feasibility.

The Commission's determination with respect to whether the plan is fair and equitable is to be rebutted only by clear and convincing evidence. "Clear and convincing" is a legally defined standard used in civil cases which requires proof beyond

the typical standard of "preponderance of evidence" to a point where the proof of a fact or its opposite is essentially "highly probable."^{99/} In other words, a finding by the Commission that the plan is fair and equitable can not be rebutted by the court unless the court finds it "highly probable" that the Commission's determination is in error.

If the Commission finds that the plan is feasible and the Reorganization Court determines that the plan is fair and equitable, the proponents must implement the plan no later than April 1, 1980. Subsection 6(c). The Congressional understanding of "implementation" is discussed above.

FOOTNOTES

- 1/ See generally Derleth, August, The Milwaukee Road. Its First Hundred Years, (Creative Age Press, N.Y., 1948) (hereinafter "Derleth").
- 2/ See Joseph G. Pyle, The Life of James J. Hill (N.Y., Peter Smith, 1936) Vol. II, p.15 (hereinafter "Pyle"). See generally, Information Alert III: The Milwaukee Road and the Burlington Northern Mergers--A Status Report, by Rick Applegate, Director, Center for Balanced Transportation, Inc., at p.14, attached as an Exhibit to the Supplemental Affidavit of Fred J. Simpson of March 5, 1979 (hereinafter "Simpson"), of record in the Milwaukee Road reorganization court proceedings, No. 77 B 8999, U.S.D.C. (N.D. Ill.).
- 3/ Pearsall v Great Northern Ry Co., 161 U.S. 646 (1896) ("The consolidation of these two great corporations [the NP and GN] will unavoidably result in giving to the defendant a monopoly of ... all transcontinental traffic north of the line of the Union Pacific, against which public regulations will be but a feeble protection. The acts of the Minnesota legislature ... undoubtedly reflected the general sentiment of the public that their best security is in competition.")
- 4/ Pyle, supra, at pp.23-25.
- 5/ Northern Securities Co. v United States, 193 U.S. 197.
- 6/ Malone & Roeder, Montana: A History of Two Centuries, Univ. of Washington Press, 1976.
- 7/ See 331 ICC 228. The Burlington Northern merger, and the subsequent efforts of the Milwaukee seeking inclusion or the imposition of conditions, are discussed infra.
- 8/ Draft Environmental Impact Statement (hereinafter "Draft EIS"), Milwaukee Abandonment Docket No. AB-7 (Sub. No. 86), at pp.1-5, 1-6.
- 9/ See generally, Simpson, supra, at p.13; Draft EIS, supra, at p.1-6.
- 10/ Id.
- 11/ See F.H. Johnson, Brief Record of the Development of The Milwaukee Road From the Chartering of its First Predecessor Company in 1847 to Date - July 1935, Chicago, 1936, at p.55.

- 12/ Draft EIS, *supra*, at p.1-6.
- 13/ *Id.*
- 14/ SOL, "The Missoulian" p.4, December 15, 1978. See also Derleth, *supra*, at pp.211-13; 131 ICC 615 (Investigation Report of the Commission).
- 15/ See generally, Woods, *The Milwaukee Road West*, Superior Publishing Co., 1972; Draft EIS, *supra*, at p.1-6.
- 16/ See generally, Simpson, *supra*, at p.21.
- 17/ Abandonment Proceeding, Exhibit 35, Booz-Allen.
- 18/ See Simpson, *supra*, at pp.26-27.
- 19/ 328 ICC 460, 488, 528.
- 20/ 331 ICC 228.
- 21/ See 331 ICC, at 280, n.19.
- 22/ 331 ICC, at 271.
- 23/ 331 ICC, at 275.
- 24/ 331 ICC, at 281, 283.
- 25/ 331 ICC, at 297-98.
- 26/ See United States v Interstate Commerce Commission, 396 U.S. 491 (1970).
- 27/ 396 U.S. at 515, 516.
- 28/ Abandonment Proceeding, Exhibits 6, Statement of Glenn F. Reynolds, pp.4,5,18.
- 29/ Ibid, at p. 18.
- 30/ 331 ICC, at 359.
- 31/ op. cit., n. 28, Reynolds, p. 18.
- 32/ See Chicago, Milwaukee, St. Paul and Pacific R.R. Co. v United States, 585 F.2d 254 (1978).
- 33/ See Draft EIS, *supra*, at pp.1-4.

34/ The Milwaukee is also participating in another case pending before the Commission, the Burlington Northern - Frisco Merger, FD-28583 (Sub. No.22). In it, the Milwaukee has filed trackage rights applications as a protective condition in the proposed merger to permit operation over BN lines from Miles City to coal mines at Kuehn, Montana and Big Sky, Montana, and thereby partially to offset what the Milwaukee has estimated will be millions of dollars of losses of revenues resulting from the proposed merger. If the ICC approves the merger, in its decision expected in Spring, 1980, with conditions BN - Frisco considers to be unfavorable, it has the option of withdrawing the merger application. Significantly, the coal traffic which would come to the Milwaukee as a result of the conditions, should the merger be approved with the Milwaukee's conditions, would not utilize lines proposed for abandonment in AB-7 (Sub. No. 86), but would, instead, apparently improve traffic levels and profitability of the Milwaukee mainline east of Miles City. See Draft EIS, supra, at pp.1-3.

Oral argument in this case, at which the Milwaukee discussed its proposed conditions, was recently held before the full Commission.

35/ Petition of the Trustee, Abandonment, AB-7, Sub. 86F, p.3; (AB-7, Sub. 86F), Exhibit 1, Statement of Richard Ogilvie, Milwaukee Trustee, p.14

36/ Abandonment Proceeding Exhibit 6, Statement of Glenn Reynolds, Milwaukee Marketing Vice President

37/ Ibid

38/ Carload trends actually understate the growth of tonnage due to a historical increase in car size. For a system-wide indication of the magnitude of this factor, see (AB-7, Sub. 86F); Exhibit 39, Reebie Report, p.19

39/ Reorganization Court Exhibit 54, Milwaukee Road Internal Memo, January 18, 1978, p.18

40/ Abandonment Proceeding, Exhibit 39, Reebie Report, pp.19-30

41/ Abandonment Proceeding, Exhibit 3, Statement of Thomas Power, Milwaukee Planning Vice President

42/ Interstate Commerce Commission, "Abandonment of Railroad Lines and Discontinuance of Service", Ex Parte No. 274 (Sub-No. 2), November 5, 1976, p.157; Note that at this time Subpart D used the same standard for both cost-revenue determination and subsidy calculation.

- 43/ Ibid
- 44/ Abandonment Proceeding, Exhibit 112, Statement of George Dutton, R.L. Banks and Associates, p.3
- 45/ Ibid, p.5
- 46/ Ibid, p.7
- 47/ (AB-7, Sub 86F), Exhibit 106, Statement of Lee A. Bertman, Bertman, Clark and Associates.
- 48/ op.cit., n.10, Dutton, pp.5-6
- 49/ op.cit., n.10, Dutton, p.8
- 50/ (AB-7 Sub. 86F), Milwaukee Abandonment Application, Appendix K
- 51/ Abandonment Proceeding, Exhibit 69, Appendix K (version 4, October 15, 1979)
- 52/ Ibid
- 53/ An analysis by the R.L. Banks and Associates consulting firm of the work papers used to develop the 4th version of Appendix K was requested by the Office of Rail Public Counsel (RPC). This analysis revealed that certain transportation expenses, primarily train and engine crew costs, were double counted. Cross examination by RPC of both Mr. Bigott, who was responsible for preparing the Trustee's on-branch cost estimates, and Mr. Krienitz, who prepared the corresponding off-branch cost estimates, confirm the existence of double counting. Abandonment Proceeding, Exhibit 113, Statement of David F. Miller, R.L. Banks and Associates, is a discussion of this issue. Also included is an "Appendix K" modified to eliminate the double count.
- 54/ A revenue cost ratio is derived by dividing attributable revenue by attributable expenses. The higher the number the better the performance of the segment involved.
- 55/ Abandonment Proceeding, Exhibit 36, Booz, Allen and Hamilton, Strategic Planning Studies
- 56/ See ibid, pp. III-3,4 for a description of system configurations. For the additive process used to approximate Milwaukee II, see op. cit n.7, Power
- 57/ op.cit., n.13, Bertman, p.

- 58/ op.cit., n.22, Volume III, "Results of Study of Proposed Union Pacific Acquisitions"
- 59/ op.cit., n.22, Booz-Allen, Volume II, pp.
- 60/ As above, the Booz-Allen configuration data can be added and subtracted to approximate the relative performance of other configurations. See op.cit., n.13, Bertman, Exhibits E and F
- 61/ See e.g.; Energy Information Administration, Report to Congress, July 1979; National Transportation Policy Study Commission, National Transportation Policies Through the Year 2000, June 1979; (AB-7 Sub. 86F) Exhibit 85, Statement of Martin White, Western Energy Co.
- 62/ Federal Coal Management Program, Final Environmental Impact Statement
- 63/ National Transportation Policy Study Commission, National Transportation Policies, June 1979, p.145
- 64/ Ibid, p.146
- 65/ (AB-7, Sub. 86F) Exhibit 85, Statement of Martin White, Western Energy Co., pp.2,6
- 66/ Ibid; see also Abandonment Proceeding, Exhibit 82, Statement of W.W. Lyons, NERCO, Inc.
- 67/ Abandonment Proceeding, Exhibit 86, Statement of Frederick Knabe, Louisiana Land and Exploration Co., p.2
- 68/ Ibid, pp.2-4
- 69/ Abandonment Proceeding, Exhibit 105, Statement of Andrew Nelson, Manager of Transportation Research, Grain Terminal Association, pp.3,8
- 70/ Abandonment Proceeding, Moses Lake Exhibit 11, Statement of M.E. Stark, Sunfresh Grain, p.2
- 71/ See: Agricultural Economics Department, College of Agriculture and College of Letters and Science, Economic Effects of a Milwaukee Rail Line Abandonment of the Montana Grain Industry, by Won Koo, Sarahellen Thompson, and James C. Cornelius, Staff Paper in Economic 79-7, Montana State University, 1979
- 72/ op.cit., n.38, Nelson, p.3

- 73/ Abandonment Proceeding, Exhibit 97, Statement of behalf of Robert Berglund, Secretary, U.S. Department of Agriculture, pp.3-4
- 74/ Abandonment Proceeding, Exhibit 81, Statement of A.L. Goolsbee, Big Sky Farmers and Ranchers Marketing Cooperative, p.3
- 75/ See e.g. (AB-7, Sub. 86F), Testimony of Neal Owen, TR 1908
- 76/ Abandonment Proceeding, St. Maries Exhibit 3, Statement of James Benson, Potlatch Corporation, p.7
- 77/ Abandonment Proceeding, Exhibit 89, Statement of R.G. Bennett, Bennett Lumber Products, pp.5-5
- 78/ Abandonment Proceeding, Exhibit 96, Statement of R.C. McQuigg, Port of Seattle, pp.6-7
- 79/ Abandonment Proceeding, Exhibit 102, Statement of Robert Brandwein, Policy and Management Associates, Inc., pp.2-3
- 80/ Interstate Commerce Commission, Draft Environmental Impact Statement, October 23, 1979, p.5-1
- 81/ See Section V.F., infra
- 82/ A full review of testimony submitted in the regional hearings in the Abandonment proceeding provides some indication of the potential economic benefits of retention of service. Many shippers have planned expansion and capital investment contingent specifically on continued rail service. Similarly, various representatives of state and local governments, municipalities, chambers of commerce and other bodies have expressed the belief that a vital Milwaukee is essential to or will greatly facilitate future growth.
- 83/ Abandonment Proceeding, Testimony of Andrew Nelson, Grain Terminal Association.
- 84/ It was noted, for example, in Exhibit 97, the Statement on behalf of Robert Berglund, Secretary, U.S. Department of Agriculture:
- As a nation we are committed to a policy of agricultural exports. This policy has been found to be in the best interest of the agricultural producer as well as the general public.
- . . .
- But as our Nation continues to expand its grain production and increase its exports, the absence of clear and concise agricultural transportation policy is beginning to chip away at our chances of successfully meeting our national export goals.

I do not know whether the Milwaukee lines west of Miles City, Monatana can or will be profitable. While there are certainly indications of potential growth in traffic volume, much would depend on the marketing and service objectives of the railroad's management.

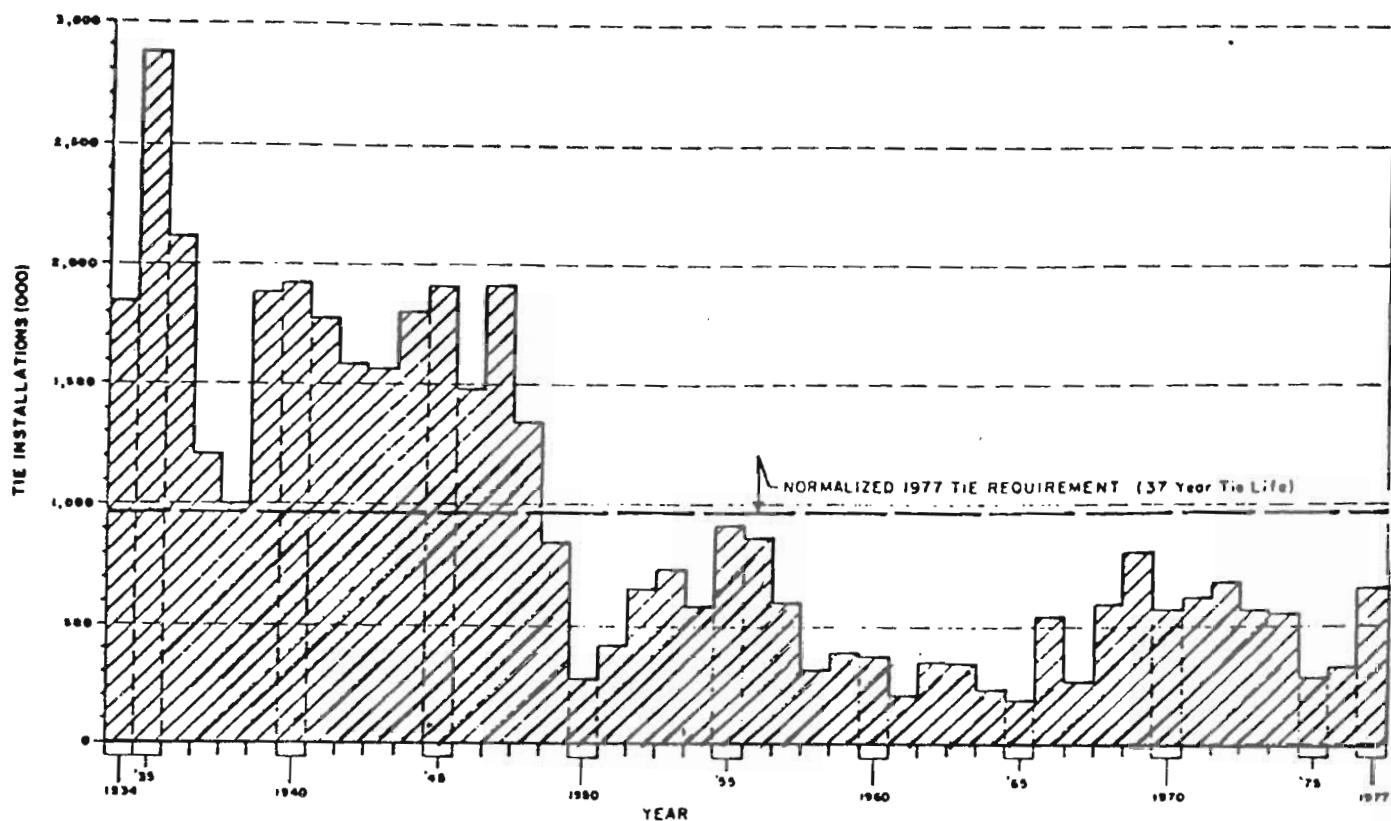
But I can state that it is my firm belief that continuous operation of those lines is beneficial to grain producers in the states affected and is helpful in achieving national policy goals for agricultural exports. At pp.4-5.

- 85/ A discussion of the energy and environmental impacts of abandonment was undertaken by the Commission in the Draft Environmental Impact Statement, October 23, 1979. The adverse energy and environmental impacts due to abandonment were primarily the result of anticipated diversion of present traffic to trucks. If rail service is maintained and improved and some present traffic is diverted from trucks, corresponding energy and environmental benefits can be expected.
- 86/ Abandonment Proceeding, Exhibit III, Statement of N.C. Whitehouse, Anaconda Copper Corporation, pp.13-14
- 87/ op.cit., n.42, Bergland, p.2
- 88/ op.cit., n.34, White, p.15
- 89/ op.cit., n.35, Lyon, pp.3-4; see also, Interstate Commerce Commission, No. 37105, Increased Rates on Coal, Colstrip and Kuehn Montana, to Minnesota embracing No. 37105, Sub 1, July, 1979; where the Commission Found BN Coal rates unreasonable and required the BN to refund that part of the increase fund unjustified, with interest. The Commission stressed that BN should not attempt to make up revenue shortfalls by extracting monopoly profits from captive shippers.
- 90/ op.cit., n.51, pp.8-9
- 91/ op.cit., n.54, p.10
- 92/ Abandonment Proceeding, Great Falls Exhibit, Statement of Duane Olson, Con Agra, p.7
- 93/ U.S. Department of Transportation, Final Standards, Classification, and Designation of Lines of Class I Railroads in the United States, Vol. 1, January 19, 1977
- 94/ op.cit., n.34, White, p.15

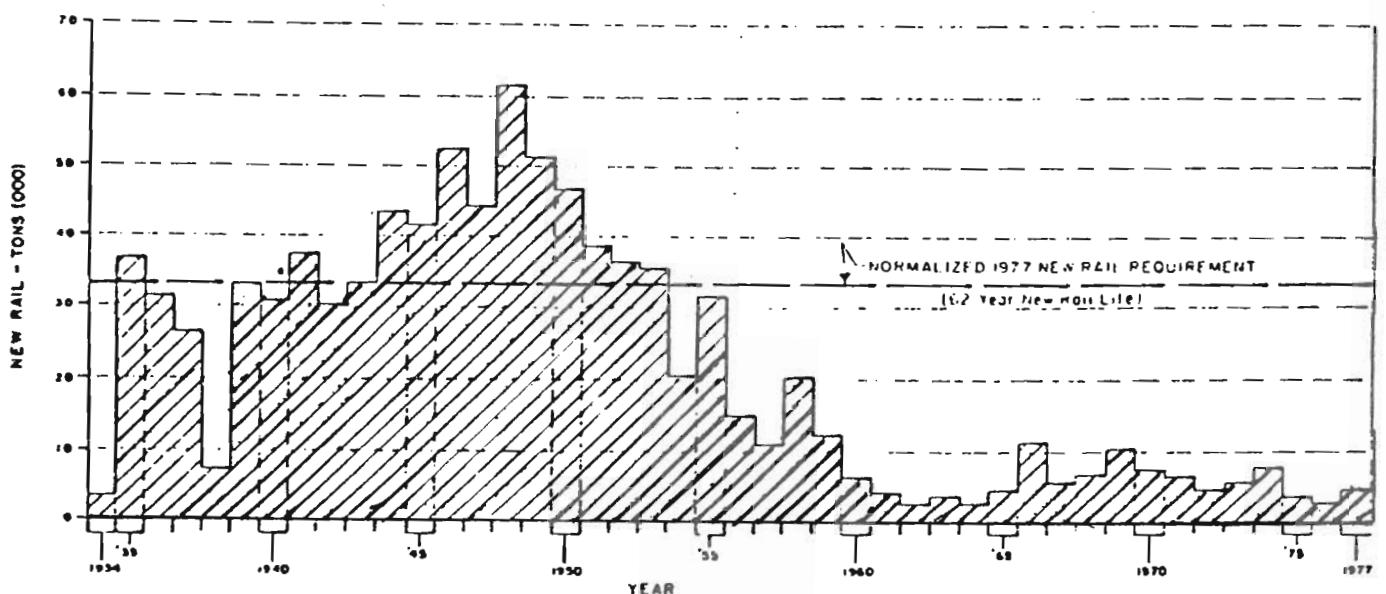
- 95/ Abandonment Proceeding, Great Falls Exhibit, "A Question of Public Interest," Milwaukee Road position paper on the proposed merger of the Great Northern, Northern Pacific, and Chicago, Butlinton and Quincy Railroads, 1970
- 96/ District Court, Slip Opinion, November 23, 1979, p.7
- 97/ See e.g., Allegheny Corporation v. Breswick and Co., 353 U.S. 151 (1957)
- 98/ See e.g., 49 U.S.C. 11343
- 99/ See e.g., McCormick on Evidence, revised ed. Section 340(b)

EXHIBIT II-A

EXHIBIT IV
Milwaukee Road Rail
and Tie Installations



MILWAUKEE RAILROAD
TIE INSTALLATIONS
1934-1977



MILWAUKEE RAILROAD
NEW RAIL INSTALLED
1934-1977

COMPARISON OF SYSTEM AND MILES CITY WEST
CARLOAD & REVENUE TRENDS

Year	Systems Carloads	Miles City West Carloads	%	Adjusted System Revenues	Adjusted Miles City West Revenues	%	Rate Conversion Factor
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970	1,028.3	156.6	15.2	484.4	151.6	31	1.7416
1971	967.8	173.7	17.9	461.9	168.7	37	1.5617
1972	962.1	186.4	19.4	471.6	180.6	38	1.5172
1973	1,009.4	198.1	19.6	524.1	200.9	38	1.4747
1974	957.4	175.2	18.3	493.6	169.6	34	1.2506
1975	832.6	156.7	18.8	419.0	140.4	34	1.0782
1976	891.5	202.5	22.7	440.2	160.6	36	1.0000
1977	849.8	197.7	23.3	406.3	155.3	38	.9476
<hr/>							
% 1970--							
1977	-17%	+26%	+53%	-16%	+3%	+22%	

- (1) System Carloads; Source: Glenn Reynolds Verified Statement (p.4)
- (2) Miles City West Carloads; Source: Exhibit 54, Milwaukee Road Internal Memo, January 18, 1978 (p.16)
- (3) (2) as % of (3)
- (4) System Revenues; Source: ICC R-1 Report Account 501; Adjusted to 1976 Rate Levels
- (5) Miles City West Revenues; Source: Exhibit 54, Milwaukee Road Internal Memo, January 18, 1978, (p. 18); Adjusted to 1976 Rate Levels
- (6) (5) as % of (4)
- (7) Conversation Factor for 1976 Rates; Source: Exhibit 54, Milwaukee Road Internal memo, January 18, 1978, (p.18)

NOTE: All figures are rounded off and stated in thousands

EXHIBIT II-CREVENUE/COST DATA 1/

(Thousands of Dollars)

	<u>System</u>	<u>West of Miles City</u>	<u>Balance of System</u>
<u>1976</u>			
Revenues	\$440,233	\$159,065	\$281,168
Costs	<u>459,579</u>	<u>149,146</u>	<u>310,433</u>
NROI	\$ (19,346)	\$ 9,919	\$ (29,265)
<u>1977</u>			
Revenues	\$444,502	\$160,231	\$284,271
Costs	<u>500,423</u>	<u>152,191</u>	<u>348,232</u>
NROI	\$ (55,921)	\$ 8,040	\$ (63,961)
<u>1978</u>			
Revenues	\$439,201	\$154,115	\$285,086
Costs	<u>513,601</u>	<u>154,561</u>	<u>359,040</u>
NROI	\$ (74,400)	\$ (445)	\$ (73,954)

1/ Based upon version 4 of Appendix K; AB-7 (Sub.No.86-F), Exhibit 69.

REVENUE/COST PERFORMANCE RATIOS
BASED ON EXHIBIT II-B 1/

	<u>System</u>	<u>West of Miles City</u> (App.K)	<u>Balance of System</u>
1976	.958	1.067	.908
1977	.888	1.053	.820
1978	.855	.997	.794
% Rate of Decline in Revenue/ Cost Ratio 1976-1978	5.5%	3.3%	6.5%

1/ Each column corresponds to same column in Exhibit B;
All figures based upon version 4 of Appendix k; AB-7
(Sub.No.86-F), Exhibit 69

EXHIBIT II-E

NET RAILWAY OPERATING INCOME (NROI) ESTIMATES 1/
(\$ millions)

<u>SYSTEM</u>	<u>NROI</u>	<u>NROI IMPROVED</u>	<u>NROI ADJUSTED FOR DEPRECIATION</u>
<u>Louisville Transcon</u>			
1977 Level	(36.1)	(29.0)	(18.7)
Long Term	+2.9	+15.0	+25.8
<u>Milwaukee II 2/</u>			
1977 Level	(34.1)	(25.4)	(16.4)
Long Term	(5.7)	+7.2	+16.4
<u>PCE 3/</u>			
1977 Level	(7.8)	(10.6)	(8.7)
Long Term	+9.4	+7.5	+9.6

1/ Based on Exhibit D, verified statement of Lee A. Bertman, AB-7, Sub.No. 86-F, Exhibit 106. and Booz, Allen & Hamilton, Strategic Planning Studies May, 1979

2/ Miles City Subcore + Kansas City Subcore - Subcore

3/ Louisville Transcon - Kansas City Subcore

MARKET OPPORTUNITIES ANALYSES 1/

	Louisville Transcon	Milwaukee II <u>2/</u>	PCE <u>3/</u>
<u>CARLOADS</u>			
1977 Level Traffic	571,871	534,127	91,800
Market Opportunities	125,697	120,644	19,074
PERCENT INCREASE (from 77)	22.0%	22.6%	20.8%
Long Term Market Opportunities	190,692	186,108	23,008
PERCENT INCREASE (from 77)	33.3%	34.8%	25.1%
<u>REVENUE (\$000)</u>			
1977 Level Traffic	271,136	203,788	103,021
Market Opportunities	81,709	54,961	37,787
PERCENT INCREASE	30.1%	27.0%	37.7%
Long Term Market Opportunities	119,591	87,024	50,299
PERCENT INCREASE	44.1%	42.7%	48.8%

1/ Based on Exhibits E and F, Verified Statement of Lee A. Bertman, Bertman, Clark and Associates, AB-7, Sub No.86-F, Exhibit 106 and Booz, Allen & Hamilton, Strategic Planning Studies; May, 1979, pp.

2/ Miles City Subcore + Kansas City Subcore - Subcore

3/ Louisville - Transcon - Kansas City Subcore

III. NEW MILWAUKEE LINES -- THE PROPONENT OF THE PLAN

New Milwaukee Lines (NewMil) is a non-profit corporation formed under the laws of the State of Washington in June, 1979. A copy of its Articles of Incorporation and related corporate documents is attached. Appendix E. The organization was formed by a coalition of employees of the Milwaukee Road, and by shippers who use the railroad's services, joined by representatives of concerned states in the northern tier. A list identifying NewMil's Board of Directors and officers is attached as Appendix B.

NewMil's formation reflected a broadening in the range of interests, and also a broadening in the geographic scope of concern, of those who believed that retention of essential Milwaukee service in key portions of the system is imperative. The employees that had banded together previously to form the SORE group joined with a wide range of shippers, representatives of government, and employees from other parts of the Milwaukee's system to investigate and urge alternatives to the reorganized system proposed by the Trustee.

In particular, NewMil was formed for the purpose of forming, obtaining funding for, and acquiring necessary licenses and agency certifications for a new company (designated the "New Railroad" in this Plan) that will purchase and operate a substantial portion of the present Milwaukee system. For these

reasons, NewMil has prepared and hereby submits the present Employee-SHIPPER Ownership Plan.

If the proposals contained in this Plan are approved and implemented, it is contemplated that New Milwaukee Lines will cease to exist. The system proposed in this Plan will be acquired, owned, managed and operated by a New Company described in following portions of this Plan.

The Role of the Consulting Center

As an integral step in the preparation of a detailed and analytically sound Plan, New Milwaukee Lines retained the Consulting Center, Inc., an Alexandria, Virginia-based firm of transportation and financial consultants with a national reputation for excellence, to conduct a study to determine whether a viable railroad which included the Milwaukee's western lines could be created out of the present Milwaukee Railroad.

The Consulting Center was asked in September, 1979, to identify such a system and determine its economic potential in detail. More specifically, the Consulting Center was asked to:

- (1) Study and analyze a railroad system built around the "Louisville-Transcon" option, the system configuration identified by Booz, Allen & Hamilton in a study undertaken for the Milwaukee Trustee as having the best long-range income potential of eight systems analyzed in detail.

- (2) Define a reorganizable system that would include essential Milwaukee lines west of Miles City, Montana.
- (3) Develop pro forma financial statements for that system.
- (4) Determine the funding necessary requirements necessary to launch and sustain the system until self-sustainability could be achieved. This analysis was to include detailed estimates of: necessary working capital, funds to cover initial operating losses, equipment requirements, and rehabilitation requirements.
- (5) Work with staff of NewMil to assess the availability of private and public financial assistance to meet New Railroad's funding requirements.
- (6) Work with staff of NewMil to determine a means by which the Milwaukee-owned rail assets needed to operate the system could be acquired.
- (7) Work with staff of NewMil and others to develop a plan by which New Railroad could be converted into an "employee or employee-shipper owned company."
- (8) Develop a capital structure for New Railroad.

The Consulting Center was instructed to complete its analysis in sufficient time to present its findings to the Board of Directors and to incorporate its findings into a Reorganization Plan to be filed with the ICC pursuant to the requirements of the Milwaukee Railroad Restructuring Act (P.L.96-101).

The Consulting Center presented its findings to the NewMil Board on November 27, 1979. The Board unanimously approved the findings and authorized the filing of the present Plan in a resolution adopted on that date. The Consulting Center work product appears as Chapters IV - VIII of the present Plan.

IV. BRIEF SUMMARY OF FINANCIAL AND OPERATING PLAN

The New Milwaukee Lines Employee-shipper Ownership Plan calls for the establishment of a new company to acquire and operate a transcontinental railroad system of main and secondary main lines from Louisville, Kentucky to Chicago to Portland, Seattle and Tacoma. An additional number of contingent lines will be included in the system if it can be determined that the line will make a positive contribution to the system (whether from operating revenues, surcharges, or external subsidy), if any required rehabilitation is borne by a third party such a state agency or shippers, and if the inclusion of such lines in aggregate does not adversely affect system performance or requirements. At the time of submission of this Plan, these lines are still being analysed.

The point of departure for analysis and development of rehabilitation requirements, equipment requirements, employee requirements, financial projections, and other matters was the "Louisville-Transcon" configuration studied in depth by Booz-Allen. The Consulting Center, Inc., revised and refined Booz-Allen analysis in various specific ways discussed more fully below. In each case CCI refinements were based on actual data coupled with a conservative probability discounting procedure.

The base system proposed by NewMil consists of approximately 2900 main line route miles and 650 miles of lighter density or branch lines, as compared with the 9,000 mile plus system operated by the Milwaukee in 1978. The Plan contemplates the conveyance to the New Railroad of all equipment presently owned by the Milwaukee Road. An aggressive equipment leasing and rebuilding program is contemplated to augment and restore the current fleet.

Rehabilitation requirements for the New Railroad were based on Booz-Allen and Milwaukee data for each line segment in question. The projected rehabilitation level was based on a specific analysis of the competitive requirements of each line segment. The fundamental rehabilitation strategy is to institute immediately a program of normalized maintenance on all line segments coupled with rehabilitation expenditures over and above a normalized level where required to restore major line segments to 25 mph. The total rehabilitation expenditures necessary to achieve long term market opportunities and economic growth is estimated at \$211.3 million (in 1977 dollars).

The total labor force required for the New Railroad is estimated at 7,905 for 1980 and 9,035 by 1982. These estimates were based on the Milwaukee's 1977 employee mix and various Booz-Allen data.

The assets to be acquired by the New Railroad include land, rights of way, track, ballast, trackage rights, equipment, leaseholds, inventory material and supplies, and a motor transportation subsidiary. These assets are valued on the basis of net liquidation value essentially established in the Ford, Bacon, and Davis report.

The financial projections developed for the New Railroad's base system indicate that the railroad will realize positive income from operations beginning in 1982 and generate positive cash flow from operations beginning in 1983 and in each year thereafter. Expenses were analyzed and significant unit cost improvements were projected from the aggregate effect of specifically analysed factors, including improved equipment utilization, productivity gains, use of higher capacity equipment and benefits accruing from rehabilitated physical plant.

Operating revenues are projected to increase, in constant dollar terms, from \$344.9 million in 1980 to \$853.2 million in 1986. The increases in revenue are attributable to the aggregate effect of various factors including the restoration of traffic to "normalized" 1977 levels, the achievement of specifically analysed market opportunities, long term projected economic growth and authorized selective rate increases.

The projected effects of inflation are addressed in the Plan. These effects will be mitigated for the New Railroad

because of a relatively strong projected operating ratio and the performance of major rehabilitation work in the early years and the benefits are achieved in the later years when expenses are higher.

The capital needs of the new company are projected to be met through a combination of private and public financing. Sources of private money include an equity contribution through an ESOP, and a modest amount of shipper-contributed venture capital. Sources of public money include federal funds available under Sections 505 and 511 of the RRRR Act, state and local funds available for support of the light density lines, and a joint Economic Development Administration and Farmers Home Administration loan to the ESOP to finance its equity contribution.

V. PHYSICAL DESCRIPTION OF THE NEW RAILROAD

System Configuration

NewMil proposes to establish and operate a transcontinental railroad extending from Louisville, Kentucky, through Chicago, Milwaukee and the Twin Cities to Seattle and Tacoma, Washington and to Portland, Oregon. The selection of lines to be included in the system was based upon the degree to which the traffic potential of each line contributed positively to the long term viability of the system as a whole. Unfortunately, time did not permit a complete assessment of the full system-wide effects of including a number of lighter density or feeder lines of interest to particular shippers or governmental authorities. For this reason, the system proposed by New Milwaukee Lines includes a Base System plus certain Contingent Lines over which service will be provided if the contingencies described below are met. The lines included in each category are detailed below.

Base System

The principal segments of New Milwaukee Lines' base system, including trackage rights, extends from Louisville through Chicago, Milwaukee, the Twin Cities to Duluth; from Chicago to Rockford and then northward through Beloit, Janesville and

Madison to Portage; from Milwaukee through Green Bay to Marinette, Wisconsin; from the main line in New Lisbon, Wisconsin to Tomahawk; from the Twin Cities to Seattle with service to Billings, Montana, Bovill, Idaho, Spokane, Coeur D'Alene, Royal City, Snoqualmie Falls, Bellingham, Longview and Hoquiam, Washington. The system, exclusive of trackage rights comprises approximately 3550 route miles. Map A of this Plan details in black lines the New Milwaukee Line's base system.

The 205 mile line from Harlowton to Great Falls, Montana, (including the branch to Heath) is a special case. The analysis performed to date indicates that, viewed separately, the line's performance appears to warrant inclusion in the base system. However, the very substantial traffic volume of the line requires additional analysis including incorporation of the traffic flow into the blocking and scheduling analysis in order to determine the effect upon the base system's financial performance of inclusion of the line. In addition, the line needs substantial rehabilitation. Representatives of New Milwaukee Lines have discussed with officials of the State of Montana the likelihood of receiving state assistance for the necessary rehabilitation, and it appears likely that such assistance will be available.

Therefore, this line has been moved out of the "Contingent Line" category discussed below and is expected, upon completion of the necessary analysis and agreement with Montana state

officials as to receipt of rehabilitation funding, to be included in the base system. The effect of this line is not included in the rehabilitation program discussed in the Chapter or the financial projections contained in Chapter VII. However, it has been included in Chapters X and XI. This line is shown as a dotted black line.

Contingent Lines

NewMil also proposes to include in New Railroad up to 1470 miles of other lines if they meet certain contingencies. These contingent lines are identified in green on map A . The contingent lines include lines that appear on the basis of preliminary analysis to offer significant traffic potential or are of explicit interest to particular shippers or governmental authorities. They are identified as contingent lines because there has not been enough time to analyze fully the effect of including the lines on the financial projections for the Base System.

These lines include:

1. Bellingham to Sumas;
2. Port Angeles to Port Townsend;
3. Frederickson to Morton;
4. Worden to Moses Lake and Marcellus;
5. Great Falls to Agawm;
6. McLaughlin to new England;
7. Aberdeen to Mitchell to Canton and then Sioux City to Trent;

8. Farmington to Austin to Jackson;
9. Green Bay to Ontonagon;
10. Madison to Richland Center; and
11. Davis Junction to Kansas City.

The following is a Brief description of these line segments, including the estimates developed from CCI research performed to date and Milwaukee rehabilitation estimates made in April 1979 and computed in 1977 unit costs. NewMil has not independently verified those costs and includes them only for general information purposes.

1. Bellingham to Sumas

This line segment extends 24.6 miles from Bellingham to Sumas, Washington with a 5.3 mile branch from Hampton to Lyndon. At Sumas the line connects with two Canadian railroads, Canadian Pacific (CP) and British Columbia Hydro and Power Authority Railroad (BCE). Traffic on the line between Bellingham and Sumas is generated at Lyndon and Strandell. Conversations with the principal on-line shippers indicate that traffic from these points should total 1,461 cars and produce revenue of \$2 million annually.

In addition to traffic generated from intermediate stations on line, there is potential to generate a modest volume of interchange traffic with connecting Canadian railroads at Sumas. According to the BCR, ot interchanges 13,000 carloads annually at Sumas (not including transcontinental lumber from British Columbia Railway("BCR")) with the Burlington Northern

and Milwaukee Road that are not subject to routing restrictions.

CCI estimates that in 1977 the Milwaukee handled approximately 2000 of these cars. In addition, in 1977 the Milwaukee received 761 loads of transcontinental lumber from the BCE at Sumas and interchanged 875 carloads with the Canadian Pacific.

The Milwaukee and Booz Allen also identified two market opportunities that apply to the Sumas gateway.

The New Railroad has the potential to participate in BCE interchange to a greater extent if adequate service is forthcoming. The Council of Forest Industries of British Columbia has indicated that New Railroad could receive a commitment of 4000 annual loads of transcontinental lumber at Seattle or Sumas. New Railroad should investigate the comparative costs of such lumber traffic via carfloat (Seattle) or rail at Sumas. The Council of Forest Industries indicated that it would support a Sumas routing for transcontinental lumber and attempt to receive adequate car handling from local Canadian carriers.

The estimated total rehabilitation requirements (1977 \$) to upgrade this line segment to Class II FRA standards (25 mph) is as follows: Bellingham - Sumas - \$678,255; and Hampton - Lyndon - \$447,182.

2. Port Angeles to Port Townsend

This is a 50.8 mile branch line on the Olympic Peninsula in Washington. There are basically ten shippers located on this

line that produce lumber, plywood, pulp, paper, newsprint and paper products. The lumber is marketed on a nationwide basis but primarily in the midwest, with pulp, paper and newsprint products being marketed locally in the Pacific Northwest, and in California. Only two stations on this line make any significant contribution to both originating and terminating traffic, those two stations being located on the opposite ends of this branch, namely Port Townsend, and Port Angeles.

A study of the shippers and traffic potential of this line identified a maximum rail potential of 5000 carloads at Port Angeles and 1750 carloads at Port Townsend. Estimated potential revenue to New Railroad from the operation of this branch is approximately \$5 million in 1977 dollars. Against this must be balanced the necessary carfloat and rehabilitation expenses in addition to normalized maintenance, transportation, equipment and traffic expenditures. Annual cost of the barge at full capacity would approximate \$1.0 million. Rehabilitation requirements for Class II were estimated to be \$3,193,033. This line has been recommended for rehabilitation assistance in the Washington State Rail Plan.

3. Frederickson to Morton

This is a 53.1 mile branch line extending from the main line at Frederickson, Washington to Morton. There are seven principal shippers on the line of finished lumber and forest

products. In 1977 the Milwaukee originated 2875 carloads at Morton and accrued net freight revenue of \$1.392 million. In addition a substantial volume and potential of local log movements (estimated to be approximately 40,000 carloads and \$3 million revenue) exists for this line.

It is not clear that the handling of the log volume is profitable to the railroad. In addition the line requires \$1,906,935 in rehabilitation to meet a 30 mph standard.

4. Warden to Moses Lake and Marcellus

This line extends 47.2 miles from the main line at Warden, Washington, to Marcellus with a branch extending 20.0 miles from Tiflis to Moses Lake. In 1977 approximately 5000 carloads were originated or terminated on this branch with net freight revenue for the Milwaukee of \$4 million. Subsequent to 1977 the largest shipper on the line, C&I Sugar at Scalley, Washington, has ceased to operate its sugar mill. The sugar mill accounted for 1944 inbound loads and \$544,874 revenue to the Milwaukee in 1977 and an undetermined number of outbound loads. Booz-Allen identified significant market opportunities for this line.

The Moses Lake segment has been recommended for financial assistance in the Washington State Rail Plan. The estimated rehabilitation requirements are \$725,700 between Warden and Tiflis and \$1,249,594 between Tiflis and Moses Lake for a total of \$1,975,294.

5. Great Falls to Agawam

This line segment extends 52.0 miles from Great Falls to Agawam, Montana. Three stations on the line Agawam, Choteau and Fairfield, contribute the bulk of the traffic on the line. All the industries are grain elevators that merchandise both malting and feed barley as well as winter wheat. Inbound shipments consist of fertilizer and miscellaneous commodities including agricultural machinery.

A survey of the principal grain shippers indicated that if normalized rail service from New Railroad was available they would annually ship 3.6 million bushels of malting barley eastbound to Minneapolis and Chicago and 1.9 million bushels of winter wheat westbound to Seattle. Current revenues from this traffic that would accrue to the New Railroad exceed \$6 million. The branch requires \$2,799,120 in rehabilitation to a 25 mph condition level.

6. McLaughlin to New England

This line extends 133 miles from the mainline to New England, North Dakota. In 1977 it generated approximately 2000 carloads, mostly grain, moving to St. Paul. Estimated rehabilitation expenditures are \$9,581,628.

7. Aberdeen to Mitchell, to Canton and Sioux City to Trent

This line extends from the mainline at Aberdeen, South

Dakota 128 miles south to Mitchell, then 80.3 miles east to Canton. The line from Sioux City to Trent is approximately 120 miles, for 328 total route miles. Estimated rehabilitation costs are \$22,966,413.

8. Farmington to Austin to Jackson

This line extends from Farmington, Minnesota approximately 74 miles south to Austin, then 106 miles west to Jackson with a 7.6 mile branch from Wells to Minnesota Lake. Total route mileage is 187.6. Estimated rehabilitation costs are \$14,724,589.

9. Green Bay to Ontonagon

This line extends 209.8 miles from Green Bay, Wisconsin to Ontonagon, Michigan. Estimated rehabilitation costs are \$10,288,353.

10. Madison to Richland Center

This line extends 59.2 miles from Madison to Richland Center, Wisconsin with a 9.4 branch line from Menominee to Sauk City. Estimated rehabilitation costs are \$2,589,491.

11. Davis Junction to Kansas City

This line extends 58 miles west from Davis Junction to Savana, Illinois then southwest approximately 298 miles to

Kansas City, Missouri. Although the Milwaukee Chief Engineer's estimate of rehabilitation costs for this line is \$16,291,643. the Reorganization plan projected a rehabilitation cost of \$12,000,000. for the same line.

Each of the contingent lines will be reviewed to determine if it meets the following four conditions:

- (1) the revenues attributable to the line exceed the costs plus a reasonable return on value for the line taking into account, to the extent applicable, data from the Milwaukee Road's management accounting system and data developed from the methodology contained in Subpart D of 49 C.F.R. part 112b and, if not shippers or a state agency agree to pay a surcharge or operating subsidy equal to any such deficit.
- (2) any required rehabilitaion of the line will be borne by a third party, such as a state agency or shipper;
- (3) all contingent lines meeting tests (1) and (2) when added to the system do not adversely affect the overall revenue and expense structure of the system as a whole; and
- (4) arrangements for compensation to the estate for lines meeting tests (1), (2) and (3) do not adversely affect the cash flow or financial position of the New Railroad during its first six years of operations.

Under the acquisition plan described in Chapter X and under the principles of fairness and equity described in Chapter XI, NewMil expects that, to the extent contingent lines meet each of the first three tests, they will be acquired from the estate with consideration in the form of accepting responsibility for claims against the estate. In order to meet the fourth test,

those claims would have to have no effect on the New Railroad's cash flow for the first six years. NewMil has identified approximately \$58 million in claims that appear to meet that test.

The process for resolving the inclusion of a contingent line is described in Chapter X.

"401" Lines

"401" category lines constitute a distinct and important part of the New Milwaukee Lines plan. The uncertainty surrounding the Rock Island operations particularly in the state of Iowa, and the potential impacts of redistributed traffic flows on the viability of both Milwaukee and Rock Island lines in that area, provide an opportunity to accomplish a successful restructuring.

NewMil is vitally interested in participating in the restructuring process conducted by the Secretary of Transportation under section 401 of the RRRR Act. Lines have been identified on Map B which are felt to have potential to enhance the economic viability of the NewMil system. By working with the Federal Railroad Administration, state Departments of Transportation and other rail carriers, a proper determination can be made regarding the ultimate resolution of these lines.

Milwaukee Lines identified for consideration by NewMil under the "401" process are as follows:

Austin	-	Mason City		
Sioux City	-	Omaha		
Canton	-	Marquette	-	La Crosse
Marquette	-	Savanora		
Council Bluffs	-	Cedar Rapids	-	Savanna
Aberdeen	-	Edgeley		
Spencer	-	Albert City		

In addition, if the Davis Junction - Kansas City line is not finally included in NewMil's system, NewMil is interested in considering acquiring either an ownership position or trackage rights over the Rock Island mainline between Mason City, Iowa and Kansas City.

Through the "401" process, those lines which are eventually determined to be important contributors to the National rail system will be candidates for acquisition, with the possible use of restructuring monies made available under the RRRR Act. A through evaluations of new and potential traffic flows, which are facilitated by realigning lines through the "401" process with the most appropriate system, will result in additional opportunities for the New Railroad.

The Rock Island main line between Mason City and Kansas City would provide the best alternative for the New Railroad to be competitive in this important market. The reduction in mileage via Rock Island trackage compared to Milwaukee's present route and the reduced operating expense could substantially

alter the economics of traffic presently considered marginal.

If coal traffic develops in the west as anticipated, major volumes are projected to move south and this route could be an essential line in the total energy delivery system.

Sioux City - Omaha

The alternative to operating directly to Kansas City is to establish an effective service route with a strong north/south carrier. The Milwaukee's line from Sioux City to Omaha provides an opportunity to establish such a service route with the Missouri-Pacific. The route could also be a valuable outlet to the south central part of the United States for low sulphur western coal.

Canton - Marquette - La Crosse -

Spencer - Albert City

These important Iowa grain lines have traditionally provided seasonal traffic moving primarily to the Mississippi River and the Gulf. During recent years the grain movement has tended to stabilize and movements generally flow during most months of the year.

The recent development of grain trade with the Pacific Rim Countries and the growing obsolescence of the Panama Canal have provided incentives for grain to move west from Iowa and other midwestern locations to West Coast Ports. This trend is

expected to continue and it will provide new opportunities for traffic to flow over the transcontinental system.

In addition, if the New Railroad is no longer an East/West carrier through Council Bluffs, the only access to Wyoming will be through Sioux City, Iowa and movement east over the northern Iowa line. This traffic would substantially increase the revenue flow over these lines and help stabilize seasonal traffic flow. These routes are potentially strong contributors to the transcontinental flows and will be studied in detail to assess properly their full potential. These routes are also the subject of State-shipper rehabilitation programs which could possibly be extended to assist with the expensive additional rehabilitation required.

Aberdeen - Edgeley

NeMil is interested in retaining a connection with the Soo Line in North Dakota to attract fertilizer movements from Canada and North Dakota grain movements to the West Coast. The Milwaukee presently interchanges traffic with the Soo Line at Monango, North Dakota. This branch line has light rail and is not well suited for movement of 100 ton cars without extensive rebuilding. An alternative to rebuilding Milwaukees present route is to seek coordination with the Chicago and North Western Railroad to Oaks, North Dakota in connection with Soo Line and Burlington Northern. Rehabilitation funds could then

be spent on C&NW's line with both carriers benefiting from the expenditure.

Council Bluffs - Cedar Rapids - Savanna

This line services a territory paralleled by Rock Island in a "Corridor of Excess Capacity" as defined by FRA. Some additional traffic opportunities could be available as a result of loss of the Rock Island.

Comparison To Present Milwaukee Railroad and Milwaukee II

The NewMil base system consists of approximately 2900 main line route miles and 650 miles of lighter density or branch lines. By contrast, the Milwaukee Road operated 3047 miles of main line and 6779 miles of branch line at the close of 1978. The essential difference between these two systems, therefore, is the elimination of a substantial number of low density lines, lines which contribute greatly to the losses currently being sustained by the present system.

The system proposed in the Reorganization Plan also calls for a substantial reduction in branch line mileage. That system represented 3200 route miles. While the mileage is similar, the system is actually quite different. The NewMil plan includes the lines west of Miles City, Montana to the Northwest to build a long haul transcontinental configuration. The Trustee's system, stops at Miles City, Montana, and is essentially designed to be a short-haul midwestern carrier.

Equipment Requirements

This Plan contemplates the conveyance to New Railroad of all equipment owned by the Milwaukee Road. Such equipment includes, but is not limited to, freight cars, locomotives, cabooses, vehicles of all description, work equipment, computers, data processing equipment, tools, shop machinery, power plant machinery, fleet equipment and miscellaneous equipment such as computers, radios, and office equipment. According to the most current Equipment Register, the Milwaukee Road currently owns 21,381 freight cars, 397 cabooses, and approximately 705 locomotives. All equipment is to be acquired subject to existing equipment obligations.

The existing fleet of locomotives and cabooses is sufficient to meet the projected requirements of New Milwaukee Lines through 1986. This assumes, as NewMil proposes, that a program for replacing obsolete equipment will be undertaken and that a program designed to solve the deferred maintenance problem will be implemented during the years of 1980 and 1981.

The New Milwaukee Lines plans to take in conveyance all existing equipment as cited above. However, due to the age and condition of the equipment, the present freight car fleet is not sufficient to support projected traffic on New Milwaukee Lines, even during the first year of operation. Accordingly, NewMil intends to retire certain obsolete equipment as soon as financial arrangements can be made and delivery obtained on

modern replacement freight cars. The current plan calls for the acquisition by lease of 1,347 boxcars, 99 gondolas, and 290 open top hoppers in 1980. It also includes a plan to rebuild 3,000 boxcars during the years 1980 and 1981. [By 1982 an additional 4,071 boxcars, 879 gondolas and 64 open-top hoppers will be acquired. From 1983 through 1986 3,765 boxcars, 398 gondolas and 382 open top hoppers would be acquired . Boxcars to be acquired are assumed to be primarily 50 foot 70 ton cars. The gondolas and open top hoppers are assumed to be of 100 ton capacity. The capital cost of the Acquisition Plan plus the rebuilding of boxcars in 1977 dollars, is approximately \$421 million. It is anticipated that these acquisitions will be financed via leveraged leases on effective nominal rates approximating 6% over 15 years. The rate assigned was consistent with projected interest rates adjusted for the tax shelter enjoyed by the owner. Furthermore, it has been assumed that the boxcar rebuild program will be financed via sale and leaseback at a nominal rate of 9.2% to the New Railroad over a 10 year term.

It should be recognized that the equipment acquisition plan described above is flexible with regard to equipment type. For example, Railbox recently has developed a substantial program of boxcar acquisitions which might reduce the need of New Railroad to acquire some of their own boxcars. Similarly, various railroads have announced plans to acquire a substantial

number of gondolas which might have a similar effect upon New Railroad's needs. Although initial analytical results suggest that the current fleet of covered hoppers is adequate, shippers have complained of an insufficient supply of covered hoppers, which suggests that the need for this type of car may be in excess of that computed from the data currently available. Although the precise details of equipment requirements might change with experience, the total dollar impact probably is reasonably accurate relative to forecasted commodity flows.

Rehabilitation Requirements

Rehabilitation requirements for the physical plant the NewMil were developed from data furnished by Booz-Allen and the Milwaukee Road for specific line segments. The magnitude of rehabilitation required was estimated by Booz-Allen and the Milwaukee based on the level of work necessary to bring track to a defined condition level. Specifically, rehabilitation estimates were based on the requirements to achieve 60 mph freight speed on the primary mainline east of Miles City, Montana and 40 mph west of Miles City. For secondary main lines and primary branch lines the desired level of track condition ranged between 40 and 25 mph. On most branch lines the rehabilitation estimates provided for 25 mph speeds.

A strategy of accelerated rehabilitation has been designed for the NewMil. The strategy reflects the immediate

requirements for maintenance expenditures over and above a normalized level to restore quickly all major line segments to safe operation at 25 mph by the end of the first year. In subsequent years major attention is focused on raising track standards so that by the end of 1982 New Railroad will have a minimum main line speed of 40 mph. The accelerated rehabilitation of the transcontinental route is mandatory if the NewMil is to offer reliable and competitive transit times and thereby achieve identified market opportunities that are contingent on service improvements.

Total rehabilitation expenditures of \$211.3 million (in 1977 dollars) are necessary for the NewMil Railroad to achieve a physical condition that permits long term market opportunities and economic growth to be realized. This amount will be reduced, however, by projected normalized maintenance expenditures over the 1980 and 1986 period of up to \$145.3 million. In inflated dollars the total rehabilitation investment required to this plan's financial objectives amounts to \$215.5 million. The projected rehabilitation expenditures will be made over a seven year period. At the end of 1982 over one-third of the necessary work will have been completed. By the end of 1984, 85 percent of the New Railroad will have been physically rehabilitated to competitive track conditions. The end result will be a physical plant capable of providing reliable transit times and sustaining significantly increased

traffic levels. The program of rehabilitation called for in this Plan's projections is a necessary condition to the successful operation of a transcontinental New Railroad into a money-making privately owned railroad.

Labor Force

The total labor force estimated for the New Railroad by functional category, is contained in the Exhibits. These estimates indicate that 7,905 employees will be needed in 1980 and 9,035 by 1982. This estimate was based on the Milwaukee's existing employee mix for 1977 and on average compensation levels for each functional category. Booz-Allen's distribution of labor expenses by these functional categories was used to corroborate judgments made regarding the future distribution of professional, clerical and general employees.

NEW MILWAUKEE LINESREQUIRED LABOR FORCE

	Number of Employees (mid-month)	Labor Compensation (1977 \$000)	Average Compensation (1977 \$000)	Labor Compensation 1980 (1977 \$000)	Labor Force 1980 <u>2/</u>	Labor Compensation 1982 (1977 \$000)	Labor Force 1982
<u>Milwaukee Railroad</u>							
Total Reported <u>1/</u>	11445						
Executive	469	12454	26554				
Prof/Clerical/General	2363	37692	15951				
Maintenance of Way	2118	33960	16034				
Maintenance of Equipment	1967	32036	16287				
Transportation	4528	95299	21047				
TOTAL:	11445	211441					
Re-distributed							
Traffic and G&A	1615		16284				
MOW	2511		16021				
MOE	2065		16271				
Transportation	5254		20828				
	11445						
<u>New Milwaukee Lines</u>							
Traffic and G&A		16284	16729)	1027	20985	1289	
MOW		16021	33213)	2073	36133	2255	
MOE		16771	23557)	1448	25871	1590	
Transportation		20828	69918)	3357	81242	3901	
				7905		9035	

1/ Source: Monthly Report of Employees-R-1

2/ As of September 1979 (mid-month) total employment equaled 11,096. Exec, G&A and traffic were 1,112; MOW 2,947; MOE 2,344; and transportation 4,693

Chapter VI

ASSET VALUES TO BE ACQUIRED

The assets required to operate the system proposed to be operated by New Railroad are described in Chapter X. A list of the net liquidation values for categories of assets to be acquired is set forth in Chapter VI-A. These values were derived from a report on the estimated liquidation value of the entire assets of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company as developed by the Ford, Bacon and Davis Construction Corporation for the Trustee.

The values listed are taken directly from the Ford, Bacon and Davis report where the report valued all the property of a certain type. To value properties included in aggregated values in the Ford, Bacon and Davis report, individual segment values were established by proration. Accordingly, liquidation values of real estate and roadway property were based on a pro rata share by mileage of the total Ford, Bacon and Davis value for the Milwaukee's real and roadway property. The liquidation value of equipment was taken from the Ford, Bacon and Davis Report and is based on the assumption that New Railroad will acquire all the equipment of Milwaukee. Since New Railroad intends to assume liabilities secured by that equipment, the liquidation value for equipment is net of those liabilities. Road Property valuations reflect the system configuration described in Chapter V.

All materials and supplies are valued in accordance with the Ford Bacon and Davis report, but inventory and price levels are adjusted to reflect the projected levels at the time of acquisition.

Investments in affiliated Companies are reflected at their book values except where the Ford Bacon and Davis report assigned a value to such investments.

EXHIBIT VI-A

ESTIMATED LIQUIDATION VALUES BY ASSET CATEGORIES

TO BE ACQUIRED

(\$ thousands)

I.	Real Estate and Roadway Property:	\$180,290
	Land	
	Track	
	Signals and Communications	
II.	Rail and Other Equipment net of Obligations	141,350
III.	Materials and Supplies	39,000
IV.	Milwaukee Motor Transportation Co.	1,330
V.	Property Owned by Milwaukee Land Co:	
	Tacoma Yard Site Properties	500
	Rail Equipment Net of Obligations	5,853
		<hr/>
		6,353
VI.	Investments in Affiliated Companies:	
	Longview Switching Co.	11
	Delta Alaska Terminal, Ltd.	1
	Minneapolis Eastern Railway Co.	24
	Minnesota Transfer Railway Co.	284
	Chicago Union Station Co.	11,484
	Indiana Harbo Belt RR Co.	3,985
	Davenport, Rock Island & Northwestern RR.Co.	3,092
	Trailer Train Corporation	561
		<hr/>
		19,442
	TOTAL:	<u>\$387,765</u>

VII. FINANCIAL PROJECTIONS AND DETERMINATION OF SELF-SUSTAINABILITY

Results of Financial Projections

The financial projections developed for the New Railroad's base system indicate that the railroad will realize positive income from operations beginning in 1982 and generate positive cash flow from operations beginning in 1983 and in each year thereafter. Exhibits VII -A and VII -B portray the projected financial condition of the New Railroad for the years 1980-1986.

As can be seen from Exhibit VII -A, New Railroad's operations improve from a net loss of \$73.2 million in 1980 to positive earnings of \$63.6 million by 1986. Much of the initial gain reflects the recapturing of traffic lost since bankruptcy and the realization of existing market opportunities lost to competitors due to poor service and lack of sufficient equipment to meet shipper needs. Once these initial increases have been achieved, traffic is expected to grow at rates consistent with general economic forecasts.

The projected traffic gains will be realized as a result of substantially cutting down the total system being operated and getting better use of available equipment, and by offering more reliable and more frequent service. Service improvements will continue as the benefits of increasing maintenance of way expenditures to "normalized levels" and implementing a

rehabilitation program are felt. Improvement in income is also a product of improved blocking and scheduling, better equipment utilization, and commitments on the part of labor to increase labor productivity.

It should be emphasized that these income projections reflect higher than current Milwaukee expense levels in three areas. First, maintenance of way expenditures have been increased to normalized levels. Second, maintenance of way expenses include those annual expenditures made under the rehabilitation programs which are considered expenses under ICC rules of accounting. Third, net rents reflect the acquisition, through the assumption of long term leases, of all new equipment required by New Milwaukee over the forecast period.

As can be seen from statement of sources and uses contained in Exhibit VII -B, the New Railroad needs to borrow a total of \$148.2 million over the first three years of operation to finance this growth. The bulk of this financing is expected to be provided by the federal government through 4R Act financial assistance programs. The level of borrowings needed by the New Railroad assumes the company can acquire the initial rail assets needed to operate the system in the manner described in Chapters X and XI.

These borrowings, together with cash generated from operations, will enable the New Railroad to complete the following programs over the 1980-1986 period:

- (1) A capital expenditures program, including construction of a new yard at Tacoma, totalling \$57.9 million (current dollars).
- (2) A plant rehabilitation program totalling \$215.5 million (current dollars).
- (3) An equipment additions program via leases equivalent to \$553.6 million (current dollars).
- (4) An equipment rehabilitation program totalling \$16.67 million (current dollars).
- (5) A boxcar rebuilding program totalling \$63 million (current dollars).

Comparison of Results to Milwaukee II

A comparison of the New Railroad's inflated income projections to those of Milwaukee II indicates that initially greater losses for Milwaukee II than for New Railroad. During the 1980-1984 period, the New Railroad will experience a cumulative (net railway operating losses) of \$206.3 million, excluding the labor productivity adjustment, versus \$193.1 million projected for Milwaukee II. New Railroad's cumulative losses, including the productivity improvements, total \$113.8 million.

There are several reasons why the Milwaukee II projections may be unrealistic and not directly comparable to New Railroad. A review of Milwaukee II projected expenses indicates that maintenance of way outlays are sharply below the normalized level outlined by Booz-Allen for the system lines included in

Milwaukee II by at least \$10 million per year. New Railroad's maintenance of way expenditures reflect normalized levels in addition to an accelerated seven year rehabilitation program.

The Milwaukee II's traffic projections were based on growth levels derived by Booz-Allen. Yet the Milwaukee II figures assume that Booz-Allen's long-term traffic levels as of 1986 can be achieved in 1984. Such acceleration is unrealistic because it implies the compression of long-term macro-economic growth factors. It would appear, therefore, that the Milwaukee II's 1984 projected carloads and revenues are overstated, particularly in view of a statement in the Reorganization Plan (page 33) that no significant market opportunities are included in the projections. Yet Milwaukee II's 1984 forecasted carloadings are nine percent greater than Booz-Allen's 1986 carloadings for a similarly constructed system; similarly, 1984 net freight revenues are \$17 million higher.

The cumulative impact of these and other deficiencies within the Milwaukee II pro forma projections results in an overstatement of net railway operating income by at least \$67 million (inflated) over the five year period beginning in 1980. As a result, one could argue that the Milwaukee II projections should reflect a \$260 million cumulative earnings deficit over the 1980-1984 period.

Basis of Change in Performance Over the Forecast Period

The proceeding discussion presented summary highlights of the financial results projected for New Railroad. The following discussion presents a more detailed discussion of the specific factors responsible for the improvement.

Revenues

Current dollar projections include an increase in operating freight revenues from \$344.9 million in 1980 to \$853.2 million in 1986. In constant 1977 dollars, operating revenues increase \$173.5 million or 67 percent over the 1980 to 1986 period. The increase in constant dollar operating revenues results from the restoration of traffic to a "normalized" 1977 level, followed by the achievement of specific market opportunities for additional traffic, long term projected economic growth and authorized selective commodity rate increases. Less than four percent or \$6.7 million of the increase is attributable to authorized selective rate increases. The majority of growth occurrence is attributable to expected improvements in service levels and competitive standing relative to other railroads operating in markets served by the New Railroad. The achievement of market opportunities over and above restoration of traffic to 1977 levels also reflects improvements related to the rehabilitation program. The additional traffic resulting from the realization

of market opportunities accounts for over 65% of the total growth in revenue between 1980 and 1986. Long-term economic growth accounts for less than thirty percent of the increase in net freight revenues during this period.

Despite a significant reduction in mileage, the revenue forecasts call for the New Railroad to handle a substantial portion of the traffic currently being carried by the Milwaukee Railroad. Booz-Allen projected that the Louisville-Transcon configuration would have handled 571,971 carloads and earned \$252.1 million net freight revenue in 1977 compared to 867,061 carloads and \$408.0 million net freight revenues for the Milwaukee RR. Base year projections for the New Railroad indicate the system will carry approximately 63 percent of the carloads and revenues of the Milwaukee Road's 1977 base. The volume of traffic and revenue forecasted for the New Railroad in its initial year of operations (expressed in 1977 equivalents).

The major proportion of market opportunities reflected in the Plan came from Booz-Allen's marketing assessment of the New Railroad's competitive position and realistic prospects for attracting new business beyond the level handled in 1977. The Booz-Allen conclusions were studied extensively in an effort to identify potential new business over and above these levels.

During the process of contacting shippers to identify additional opportunities, shippers expressed a general commitment

to support a rehabilitated New Railroad by restoring Milwaukee handled traffic to 1977 levels. Because these commitments of traffic did not represent new market opportunities relative to the "normalized" 1977 levels already assumed, however, they were not included traffic forecasts. Only where substantial new traffic was identified as realizable and where such traffic either had not moved in 1977, had moved at distinctly lower volumes, or had been previously identified by Booz-Allen as new traffic and included in their analysis, did the Consulting Center make probability assessments of the New Railroad's potential.

Expenses

The projected turnaround for the New Railroad also results from operating improvements related to economics of scale and density. Thus, as additional traffic is attained by the system, the increasing car sizes of the fleet enable the New Railroad to carry the new traffic without adding trains, except in one circumstance. Even though some expenses increase with additional volume, significant reductions are obtained by using larger cars to carry increasing tonnages. Other expense reductions result from improvements in equipment utilization made possible by the vast reduction in system mileage and the elimination of many light-density branch and feeder lines. Another significant reduction in expenses contained in the

forecast concerns labor productivity improvements unions have agreed to try to attain.

Maintenance of equipment expenses also show reductions because the Plan calls for the relatively rapid replacement of old equipment with new equipment. The maintenance of equipment improvement is somewhat offset by higher lease expenses.

To some extent, however, total operating expenses mask these improvements because they also reflect the increases in maintenance of way expenditures associated with the plant rehabilitation program. A better way of viewing these improvements is to look at the ratio analysis discussed in the next section.

Ratio Analysis

In order to assess the reasonableness of the forecast, an analysis of the New Railroad's operating performance ratios was performed. This comparison (Exhibit VII -E) was made for the constant dollar statistics to better ascertain the effects of efficiencies built into the forecast. Since a comparable trend for the other carriers for 1980-86 is not available, 1977 figures were used.

The ratio analysis highlights a basic difference between the Consulting Center's forecast and Booz-Allen's due to different assumptions regarding car sizes of new equipment. Effects of buying increasingly larger cars is the New

Railroad's lower maintenance of equipment ratio but, as just described, these gains are somewhat offset in the net rent account where lease expense is incurred as new equipment is obtained. This aspect also shows up in the comparison with the Union Pacific Railroad. The effect of the productivity program on the operating ratio is equal to about 3 percentage points. The overall improvement in operation ratios is readily explainable and not unreasonable, particularly in view of New Railroad's simplified operating pattern and trimmed down system size.

Effect of Inflation

Historically, inflation has had a debilitating effect on the railroad industry because inflated real cost increases exceeded rate recoupments through general Ex-Partes. The cost insulation and revenue recoupment forecasted indices show that the industry will suffer from earnings erosion due to inflation; as costs grow 205% freight rates increase only 196% by 1986. When the effects of inflation on the balance sheet accounts and the industry's 1977 deficit earnings position are included, a disastrous picture is depicted for the industry. However, the effects just described do not affect all railroads equally. Earnings of railroads with better than average operating performance may increase as a result of inflation due to the fact that rate increases are granted on an average industry basis.

Because the New Railroad will enjoy a turnaround and a superior operating ratio, the earnings of the carrier will improve relative to inflation in the later years. The change in net railway operating income including labor productivity between current and constant dollars for 1986 equals \$51.2 million. This gain is attributed to two major factors; one being that New Railroad achieves a 72.7 operating ratio by 1986 which when compared with the operating performance for other carriers shown in Exhibit VIII-E places it in a relatively strong position. Second, the Milwaukee has undertaken an extensive plant rehabilitation and equipment additions and modernization program. Most of these improvement are performed in the early years when inflation is lower and the benefits are achieved in the later years when expenses are higher due to inflation.

External Financing Requirements

The extent to which the New Railroad needs to obtain external financing during the forecast period is based on the difference between the total funding requirements projected for the new company and the funds available from internal operations to meet those needs. The process involves matching up annual sources and uses of cash to determine the extent of any "shortfalls". The manner in which the shortfalls are met depends upon the availability, cost and effect of different

forms and sources of financing. Projections of the New Railroad's Sources and Uses of Funds are contained in Exhibit VIII-B. Each category is discussed below.

Uses of Funds

The uses of funds include both capital requirements and the need to cover operating losses during the turnaround period. The projections are presented in current dollars; they thus reflect the impact of inflation on operating results and capital needs. Major uses of funds are:

Start Up Cash and Contingent Funds -- This Plan calls for the establishment of an entirely new railroad company, not the reorganization of an existing one. As a consequence, the New Railroad's capital requirements include the need for operating cash. Based on ICC recommendation that the cash account contain funds equivalent to 15 days operating expenses, New Milwaukee's initial cash needs have been forecast at \$17 million. In addition to this amount, New Milwaukee should have funds to meet initial start up expenses, to cover timing delays and lags between the occurrence of expenses and the collection of revenues, and to cover other costs associated with the transition from a larger Milwaukee system to the smaller New Railroad system. The level of contingent funds needed by the New Railroad was forecast as \$35 million, an amount equal to ten percent of the new firm's initial year's operating

expenses. It should be emphasized that these estimates of cash needs reflect two related assumptions: (1) that New Railroad will acquire the Milwaukee Road's existing inventory of materials and supplies as part of its acquisition plan; and (2) that New Railroad will not acquire any current liabilities outstanding against the Milwaukee Road as of the transfer date.

Interim Cash Losses -- Although the forecasts project a turnaround for the new system, losses will be sustained until potential traffic growth and operating improvements begin to take full effect. These cash losses will have to be covered by external financing. Interim losses for which external financing is needed amount to \$117.9 million over the years of the forecast period. These losses represent the sum of net losses and all non-cash expenses, including depreciation and accrued reserve accounts.

Rehabilitation of Plant -- Rehabilitation requirements of the New Railroad's physical plant to achieve improvements adequate to permit the realization of market opportunities and long term traffic potential total \$145.8 million in 1977 dollars and \$215.5 million in current dollars. These expenditures represent "net rehabilitation;" that is, they are in excess of normalized maintenance of way expenditures. The program is greater than the \$128 million net rehabilitation estimate by Booz-Allen because it assumes a seven-year accelerated rehabilitation program versus a ten-year period assumed by Booz-Allen.

The rehabilitation requirements for the New Railroad include: 2,303,358 cross ties; 575.3 miles of rail; 1341.7 ballast miles; and 219.4 miles of surface correction. Total outlays include (in 1977 \$000): \$57,580 - cross ties; \$13,244 - switch and bridge ties; \$47,673 - rail; \$4,529 - turnouts; \$21,467 - ballast; and \$1,316 - surface correction.

NewMil retained as its expert track inspector Mr. Elmer G. Lottes, former Milwaukee Road Roadmaster and Division Maintenance Engineer. Mr. Lottes was retained to provide a mile-by-mile analysis of mainline track conditions between Miles City, Montana and Maple Valley, Washington. A letter summarizing the findings of Mr. Lottes is attached as Exhibit VII-H.

The Milwaukee Road has experienced years of deferred maintenance. It is in need of modern mechanized roadway machinery and trained forces. In 1978 the Milwaukee Road installed 777,242 cross ties, 86 miles of rail and surfaced 108 miles of track. These amounts were below normalized requirements. Notwithstanding a reduction in system route miles by approximately 1/3 under the proposed Milwaukee II configuration, normalized maintenance and an aggressive rehabilitation program are proposed. The Consulting Center doubts that the production objectives implied within the Milwaukee II accelerated programmed rehabilitation can be achieved in the ensuing years immediately following

reorganization. As a result the Consulting Center believes that MIIW II will not achieve its accelerated rehabilitation objectives and market opportunities with timing that is forecasted in the proposed Milwaukee II Reorganization Plan.

The rehabilitation program designed for the New Railroad is specifically intended to overcome the deficiencies contained in the Milwaukee II program. Rehabilitation requires acquisition of raw materials, adequate machinery and a trained and well supervised work force. The highly interdependent aspects of mechanized maintenance-of-way production, and the uncertainty as to availability of critical inputs and production capabilities greatly influence rehabilitation accomplishments. The New Railroad's rehabilitation program reflects both the pressures to accomplish quickly enough rehabilitation to achieve market opportunities and the dictates of realistic production capabilities.

The rehabilitation requirements for the New Railroad were made in conformance with Booz-Allen estimates which in turn reflect the physical condition of the railroad in 1978. Since the rehabilitation estimates were prepared, parts of the physical plant have further deteriorated while other segments have benefited from an accelerated rehabilitation program financed under Title V of the Railroad Revitalization and Regulatory Reform Act. The net effect of less than normalized maintenance on some portions of the physical plant while

extensively rehabilitating another section is that overall system rehabilitation requirements are reduced.

Equipment Requirements -- The equipment program discussed in Chapter V will cost \$372.5 million in 1977 dollars. It is anticipated that these acquisitions will be financed via leverage lease on effective nominal rates approximating 6% over 15 years. That rate is consistent with projected interest adjusted for the tax shelter enjoyed by the owner. Furthermore, it has been assumed that the boxcar rebuilding program will be financed via sale and leaseback at a nominal effective rate of 7.2% to the New Railroad over a 10-year term. (Exhibit VII-F)

Since it has been assumed that this equipment would be acquired through leases, the need to finance new equipment does not appear as a separate item in the statement of sources and uses. Lease expenses, however, are included in the net rents account of the income statement; thus, both the equipment acquisition program and the rebuilding of 3000 boxcars are financed with operating income.

Rehabilitation of Equipment Requirements -- The equipment fleet is in need of substantial upgrading to alleviate the problems of deferred maintenance and resulting equipment operating problems. According to estimates of NewMil's consultants, New Railroad should rebuild 3,000 boxcars at a cost of \$63 million (in 1980 dollars) over the years of

1980-1982. An analysis of the remaining freight car fleet, particularly after the massive planned retirement program, shows deferred maintenance for all revenue equipment in the approximate amount of \$4.478 million (in 1980 dollars). The estimated deferred maintenance on cabooses amounts to \$778,000. The estimated deferred maintenance requirements for locomotives amounts to \$10,675 million (in 1980 dollars). This estimate reflects the Milwaukee Road's current overhaul of 111 units, that maintenance of equipment expenses, and historic experience of the distribution of units requiring heavy overhaul. The total figure assumes an average deferred maintenance cost of \$35,000 per unit. The sum of deferred maintenance for all equipment is approximately \$15.93 million and is to be alleviated during the years 1980 and 1981.

Capital Additions -- In addition to the capitalized portions of the rehabilitation program, the Plan calls for the New Railroad to expend \$61.5 million (current dollars) over the 1980-1986 period of capital additions. Exhibit VII-G shows the details of this program. Of this total, \$24.5 million is associated with the need to build a new yard in Tacoma. The yard is to be constructed at Fife, adjacent to the Tacoma Port, and is expected to be built over a three-year period. The bulk of the financing for the construction of the new yard is expected to come from the Section 511 program.

Sources of Funds

The Plan calls for the requirements just described to be met from a combination of sources including internally generated funds, private sector financing and public sector financing. These are discussed below.

Internally-Generated Funds -- Internally-generated funds constitute one of New Railroad's funding sources despite the level of losses incurred during the first two years. The net amount of funds expected to be generated over the period is \$40.8 million. This amount is equal to the sum of net income (loss) after payment of interest on new and old debts, and all non-cash items.

Private Sector Financing:

Equipment Financing -- By far the largest amount of private sector financing called for in the Plan is that associated with the acquisition of equipment. As described earlier, the plan calls for New Railroad to acquire over \$300 million (1977 dollars) of equipment over the period. Due to the unique nature of and history of the railroad equipment financing market, New Railroad should not have difficulty obtaining financing because the equipment serves as its own collateral. Moreover, due to incentives provided by, among other things, investment tax credits and depreciation, private investors are more than willing to purchase railroad equipment and lease it to operating railroads. In view of the railroad's projected

initial losses, however, and consequent tax position, New Railroad's equipment financing would be cheaper if leased rather than purchased.

Shipper Assistance -- The Plan includes a \$10 million equity contribution from shippers on Milwaukee's lines. While the exact nature of the investment security has not yet been established, the Plan projects a contribution to be made in exchange for preferred stock bearing a dividend rate of 12%. The stock will carry a proviso, however, that no dividends will be paid or accrued until retained earnings of the new company become positive.

Federal Financial Assistance:

Until the benefits of consolidation, rehabilitation, traffic growth and operating improvements are realized, short-term operating losses, together with the uncertainty associated with launching any new enterprise and the difficulty railroads in general have in obtaining funds from the capital markets, limit the amount of private financing that can be called upon to meet the New Railroad's needs. As a result, the Plan assumes that substantial funding will be provided by the federal government under existing railroad financial assistance programs. These programs provide interim and permanent financing to railroads and state and local governments for a variety of purposes. Federal funding assumed in the Plan totals \$124.3 million in current dollars (excluding

support for the ESOP loan).

ESOP -- The Plan calls for establishing an employee stock ownership plan. The company would sell off \$15 million of common stock which would be paid for from the proceeds of a loan guaranteed by the Economic Development Administration or Farmer's Home Administration or both of them. The New Railroad would make annual payments to the trust equal to the annual principal and interest payments on the loan. As the loan is retired, stock will be released to the ESOP and distributed to all employees.

RRRR Act Section 505 -- The Plan calls for New Railroad to borrow \$101.5 million over the 1980-1981 period from the government under Section 505 of the RRRR Act. Under this section, funds are made available in exchange for redeemable preference shares, a statutorily described security. New Railroad will use the funds to support road and rehabilitation, capital additions and improvements, and acquisition of new or rebuilding equipment. For purposes of this Plan it was assumed that no interest would be paid or accrued before the seventh year and preferably until the eleventh year.

RRRR Act Section 511 -- The Plan calls for New Milwaukee to borrow a total of \$21.7 million under Section 511 of the RRRR Act during the second and third years of operations. Under this section, funds are issued in the form of guaranteed loans

and interest rates are tied to prevailing rates of comparable Treasury bonds. Terms and conditions of the loans are determined by the Department of Transportation. New Milwaukee intends to use funds borrowed under this program to finance equipment rehabilitation expenses and the construction of a new yard facility in Tacoma, Washington. For purposes of preparing NewMil's financial forecasts, it was assumed the \$19.4 million borrowed in 1981 would be a 10-year loan bearing a 10 3/8% rate of interest. The \$3.1 million borrowed in 1982 was assumed to be a 20-year loan bearing a 12 3/8% interest. The assumption was also made that interest for both loans will be accrued but not paid until 1984.

Economic Development Authority and Farmers Home

Administration -- As described earlier, the plan calls for employees, through an ESOP, to make a \$15 million equity contribution. To obtain the funds needed to make this contribution, however, the ESOP will in turn seek a federally guaranteed loan under a program jointly sponsored by the Economic Development Administration and the Farmer's Home Administration. The NewMil Plan assumes the ESOP loan will carry a 13 1/2% rate of interest and be amortized over a 10-year period.

Capital Structure

New Railroad's capital structure was designed with several purposes in mind: to meet the requirements of the Milwaukee

Railroad Restructuring Act; to maximize New Railroad's financial flexibility and chances of becoming self-sustainable; to meet the railroad's near term projected funding requirements; to provide security for projected debt and equity holders; and to preserve unused borrowing capacity for future long term financing needs.

As described in more detail in Chapter X, the Plan calls for the transfer of rail and equipment assets necessary to the operation of New Railroad's base configuration in exchange for assuming existing equipment obligations, reducing existing claims against the Milwaukee estate and relieving the estate of the need to incur further liabilities and erosion as a result of having to implement the Trustee's Reorganization Plan. Since these considerations enhance the value of the residual estate available to satisfy existing claimants by an amount greater than the net liquidation value of the properties transferred to New Milwaukee Lines, no further compensation is contemplated.

Thus, other than equipment, the capital structure proposed for New Milwaukee contains no securities or debt instruments tied to the acquisition of initial assets. As a result, the bulk of New Milwaukee's assets can be used to secure financing obtained to meet the New Railroad's capital needs. Undoubtedly, therefore, the acquisition plan enhances the financial flexibility and long term borrowing capacity of the

railroad, and adds to the new company's chances of becoming self-sustainable.

The debt portion of the capital structure proposed for New Railroad under this Plan is primarily a function of projected funding requirements and available sources to meet those requirements as described in the preceding section of this Chapter. The equity portion of the capital structure would consist of redeemable preference shares, preferred stock or other equity securities issued to contributing shippers and common stock issued to the employees via an ESOP trust.

Determination of Self-Sustainability

Section 6(a) of the MRR Act requires that an employee-shipper ownership plan contain a comprehensive evaluation of the prospects of self-sustainability of the system created from the Milwaukee Road. From the point of view of a financial analyst, there are three elements to the test of financial self-sustainability. First, is the company able to provide a return on equity? Second, is the company able to service its debt? Third, does the company have sufficient capital after debt service and payment of a return on equity to enable the financing of future capital requirements? The answers to these questions require examination not only of the company's positive net income, but also the length of time needed to affect the turnaround to profitability.

From the pro forma financial statements contained in Chapter VII for the base system, particularly the statements of projected income (Exhibit VII-A), and sources and uses of funds (Exhibit VII-B), the Consulting Center, Inc. concludes that the New Railroad can become self-sustaining as that term is used in the preceding paragraph.

Further, self-sustainability will not be compromised if lines currently denoted as contingent are incorporated into the system since, under the plan, this will occur only if, and to the extent that, doing so does not adversely affect the system reflected in the financial statements.

The financial forecasts contained in this Plan demonstrate that by the sixth year, there are net cash flows sufficient to service adequately debt instruments contemplated by the Plan. The net cash flow estimates are \$60.3 million by 1986 and 0 in 1980. More importantly, these years signal the beginning of a trend which should result in net cash flows continuing at a minimum, at 1986 levels. Such cash flows are sufficient adequately to service the equity and debt securities proposed for the New Railroad as well as to provide additional funds to meet future capital needs of the firm.

As of 1986, annual principal repayments would amount to \$1.41 million and annual interest expenses to \$4.75 million, including \$2.38 million required for the service of the initial loan issued by the ESOP trust. These obligations do not

include, however, any charges associated with funds obtained from the federal government under section 505 of the RRRR Act, nor do they include paying any dividends on other preferred or common stock. Servicing of these obligations would add approximately \$10 million per year to cash outflows, leaving approximately \$50 million per year in cash for future capital investments in property and equipment, a more than adequate amount to enable the New Railroad to continue to be self-sustaining.

Confidence in Financial Forecast

As mentioned above, the finding as to self-sustainability is also underpinned by a belief that the financial forecasts themselves are conservative. Some of the reasons which contribute to the conservatism and which raise the credibility of the forecasts are discussed below.

Much of the data used in the development of the forecasts was obtained from a long term study of the Milwaukee system and various alternative configurations undertaken by Booz-Allen and Hamilton for the Trustee. Although the forecasts in this plan were prepared over a relatively short period of time, the results actually incorporated many of the detailed findings from the Booz-Allen study. The existence of a cost program, a blocking and scheduling scheme and

base traffic forecast were major assets to this planning study and established a base point from which modifications could be made with confidence.

All of the net cost reductions due to car sizing were not taken into account. As described elsewhere in the Report, one of the more significant factors underlying projected operating improvements involves the replacement of old rolling stock with larger car sizes. As this occurs, carloadings naturally decline. The Booz-Allen study made no changes related to car sizing. For the forecasts in this plan, therefore, carloadings were reduced throughout the forecast years 3.5%. This adjustment is conservative because calculations indicate that projected fleet sizes could reduce carloadings by 8.5% from those contained in the Booz-Allen forecast. Although the full level of potential reduction would significantly lower operating expenses it was decided not to pass all of them through in order to be conservative in the outlook.

Cash value from scrapping of equipment was not acknowledged. Although obtaining all the Milwaukee's equipment is essential to the flexibility necessary to the Plan, if new equipment is acquired as forecast, all of the initial equipment assumed from the Milwaukee may not be required. In the event of a surplus, excess equipment could be disposed of and cash made available to the extent of as much as \$12 million. This potential cash flow was not taken into account since initial needs for new equipment are large and the scheduled retirement

of older equipment is dependent upon the delivery of required equipment.

Plant rehabilitation is greater than that assumed in the Booz-Allen Study for a comparable system. During the planning process, the effect certain traffic routing and density variations would have on rehabilitation costs was measured and factored into estimates of track rehabilitation requirements. As modifications were made to the base network, which would have lowered rehabilitation costs associated with certain line segments, however, no adjustments were made to total rehabilitation costs. As a consequence, the New Milwaukee Lines rehabilitation program is as much as \$11 million (1977 dollars) greater than Booz-Allen's program for the Louisville- Transcon. This process was adopted to accomodate the continued deterioration of the plant since 1977.

Net car hire is understated. In determining net car hire, the effect of having a substantially new fleet available for car hire was not reflected in the forecasts. This assumption is conservative because the newness of the fleet will attract foreign users and provide higher time and mileage receivables.

Acknowledgment of existing selective rate increases on certain commodities was not made. Even though significant selective rate increases have occurred since 1977 (wood chips (26%), logs (54%), and grain (13.3%)), no adjustments were made

to revenues since these specific traffic flows were difficult to isolate from the base traffic flows. Nevertheless, such traffic is in the system and would be generating additional revenues.

Selective increases in coal traffic were not passed through fully. One selective rate increase which was included in the forecast involves coal. Application of the 22% selective rate increase for coal was made only to single car rate movements; however, no adjustment was made to revenues on coal moved under annual volume contracts. Coal moved under multiple car contracts represents about 40% of total movements. While such an adjustment would not be unreasonable, none was taken.

No future selective rate increases were taken yet they should be expected to occur. The prospect of selective increases is indeed high because of the following circumstances: further selective increases on coal traffic are already being discussed; certain traffic is highly susceptible to the imposition of commodity or territorial surcharges to compensate for unique services or non-remunerative movements; contract rates are likely to become more predominant in the future, a trend which should make railroad revenues more remunerative since contracts will guarantee volumes, automatic rate increases, lower interest charges, and balanced directional movements; rail deregulation is expected to occur in the near

future which will give railroads more freedom to raise rates to full economic cost and competitive levels. All these considerations were ignored in projecting future revenues for this Plan.

Revenues from market opportunities which were acknowledged by Booz-Allen are probably understated. The Milwaukee staff priced Booz-Allen's market opportunity traffic by average system commodity rate levels, not by actual tariffs. Pricing this potential traffic by actual tariff for the origin and destinations studied indicated that considerable increases in revenues could be anticipated. In fact, the difference in revenues based on 1979 tariffs, Ex Parte 368, to Booz-Allen's 1977 estimated revenues, was a full \$35 million. All of that could not be solely attributed to rate increases from 1977 to 1979. Nevertheless, no adjustment to revenue was made since the process to duplicate the exact tariff rates prevailing in 1977 was excessively time consuming.

The labor productivity program is reasonable. The \$12 million (uninflated) adjustment to expenses for improved labor productivity is quite reasonable as discussed elsewhere in this Plan. Moreover, the savings are undoubtedly more achievable than otherwise might be the case given labor's equity interest in the success of the enterprise.

Shipper involvement underpins the market opportunity expectations. Shipper contributions to the New Railroad are

expected to enhance the general receptiveness of shippers to the efforts of the New Railroad to improve service and attract new traffic. This involvement or at least awareness may increase traffic beyond forecast levels.

The more recent consensus of economic forecasts is not substantially different from that used by Booz-Allen and the Consulting Center for their projections. The macroeconomic forecast reported by Chase Econometrics in December, 1978 has been used for the econometric commodity based growth and inflation rates to insure consistency with the Trustee's forecasts. More recent projections call for slightly lower growth and slightly higher rates of inflation. The differences, however, are not substantial and should not change the basic trends shown in the financial statements. This is particularly so because 1980 traffic levels were adjusted downward to reflect near term regional economic conditions and a \$35 million contingency factor was built into the 1980 cash flow statement.

The absence of a Kansas City line is not viewed as a serious problem. Concern has been expressed over the possible loss of traffic on the New Railroad destined for Kansas City if no access to that gateway is included in the system. While some traffic originating on the New Railroad will be destined for Kansas City, it is not at all obvious that its loss would be

harmful (i.e., some of it is reputedly underpriced and non-remunerative), or that it would be readily lost to a competitor or that reasonable divisions of the rates could not be negotiated. Nevertheless, to counter the prospect of loss of traffic serious attention will be given to the Kansas City route either as becoming part of the New Railroad or as a cooperative venture with other regional railroads. With a positive determination of the contribution of either of these options, one will be taken.

New Milwaukee Lines
Pro Forma Income Statement (Incl. Rehab.)
 (Current Dollars in Thousands)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Operating Revenues							
Freight	301620	411826	548629	592594	649228	711732	779151
Other Freight	18533	22681	26739	28928	31395	33939	36744
Passenger	24701	26578	28518	30515	32681	34936	37321
	<u>344854</u>	<u>461085</u>	<u>603886</u>	<u>652037</u>	<u>713304</u>	<u>780580</u>	<u>853216</u>
Operating Expenses							
MOW - Normal	66414	72957	80567	87075	94206	101664	108433
Rehab	22004	29527	33551	36072	32442	26911	7625
Depr	129	397	685	993	1321	1669	2037
Total MOW	92331	105994	118608	127253	131082	133357	121940
MOE - Normal	55573	70500	74594	82381	90804	99822	109844
Depr	6680	6405	6144	5897	5662	5439	5227
Total MOE	62253	76905	80738	88278	96466	105261	115071
Transport	160009	208696	240118	262756	287049	313032	341386
Traffic, G&A	35443	45495	50712	55606	59061	63669	68537
Total Operating Expense	<u>346252</u>	<u>433977</u>	<u>486371</u>	<u>530780</u>	<u>570545</u>	<u>612196</u>	<u>643089</u>
Payroll Tax	28745	34775	38807	42031	45272	47567	49488
Property Tax	4421	4697	4967	5242	5536	5849	6177
Income Tax	--	--	--	--	--	--	--
Total Tax	33166	39472	43774	47273	50808	53416	55665
Net Rent	<u>55939</u>	<u>72210</u>	<u>84218</u>	<u>94691</u>	<u>102332</u>	<u>100850</u>	<u>118736</u>
Net Rail Operating Income	(90503)	(84574)	(10477)	(20707)	(10381)	4618	35726
Total Other Income	<u>4322</u>	<u>4708</u>	<u>5224</u>	<u>5473</u>	<u>5928</u>	<u>6509</u>	<u>7140</u>
Income available for FC	(86181)	(79866)	(5253)	(15234)	(4453)	11127	42866
Equipment Int.	226	52	8	--	--	--	--
Other Int.	2381	3444	4689	4873	4873	4873	4745
Total Int.	<u>2607</u>	<u>3496</u>	<u>4697</u>	<u>4873</u>	<u>4873</u>	<u>4873</u>	<u>4745</u>
Net Income	(88788)	(83362)	(9950)	(20107)	(9326)	6254	38121
Adjustments (Productivity Program)	15610	16916	18355	19970	21688	23488	25438
Adjusted Net Income	<u>(73178)</u>	<u>(66446)</u>	<u>8405</u>	<u>(137)</u>	<u>12362</u>	<u>29742</u>	<u>63559</u>

NEW MILWAUKEE LINES
PRO FORMA CASH FLOW STATEMENT
 (Current Dollars in Thousands)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
SOURCE OF CASH							
Net Income	(88788)	(83362)	(9950)	(20107)	(9326)	6254	38121
Productivity Adj.	15610	16916	18355	19970	21688	23488	25438
Depreciation	6809	6847	6829	6890	6983	7108	7264
Change in Reserves	2817	4721	5239	1233	1328	1423	1532
Accrued Interest		1063	2308	2492	(5863)		
Funds from Operations	(64070)	(53815)	22781	10478	14810	38273	72355
ESOP Equity	15000						
Sale of Equity	10000						
Sale of Debt - S505	39753	61847					
S511		18587	3071				
TOTAL DEBT	64653	80434	3071				
Salvage Proceeds	599	614	644	682	709	746	784
Sale & leaseback	12000						
TOTAL SOURCES	13700	27233	26496	11160	15519	39019	73139
USES OF CASH							
Investment - Road Equip.	13445	22152	13788	10015	9783	9282	5792
Total Investment	--	--	--	--	--	--	--
Total Investment	13445	22152	13788	10015	9783	9282	5792
Debt Repayment						1291	1412
Equip. Debt Repayment	3949	1042	233	--	--	--	--
Total Debt Repayment	3949	1042	233			1291	1412
Beginning Cash	16922						
Contingency Expenses	35000						
Other Uses							
Change in working Cap.	(55616)	4039	12485	(302)	2733	3842	5615
TOTAL USES	13700	27233	26496	9713	12516	14415	12819
Net Cash	0	0	0	1447	3003	24604	60320

DEBT AND SECURITY DETAIL
(Current Dollars in Thousands)

		<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>DEBT AND SECURITIES</u>								
ESOP Equity	1/	15000						
Sale of Equity	2/	10000						
Pref. Section 505	3/	39653	61847					
Debt Section 511			18587		3071			
Total		<u>64653</u>	<u>80434</u>		<u>3071</u>			
<u>INTEREST EXPENSE OTHER THAN EQUIPMENT</u>								
Payment to ESOP Trust Fund	4/	2381	2381	2381	2381	2381	2381	2381
Section 505 Debt								
Section 511 Debt								
1981 - \$8,800	5/		457	913	913	913	913	806
1981 - \$9,787	6/		606	1211	1211	1211	1211	1186
1982 - \$3,071	7/		184	368	368	368	368	372
Total		<u>2381</u>	<u>3444</u>	<u>4689</u>	<u>4873</u>	<u>4873</u>	<u>4873</u>	<u>4745</u>
<u>PRINCIPAL PAYMENT</u>								
Total						1291	1412	

- 1/ Source of loan is EDA and Farmers Home Loan. Duration of loan is 1 years at 13½% interest.
- 2/ Equity sales consists of either common or preferred stock issued to shippers. Preferred stock would yield 12% per year except that no payment is to be made until retained earnings is positive.
- 3/ Redeemable preference shares are issued for road rehabilitation, the general capital program and other authorized purposes. No interest will be paid or accrued before the seventh year and preferably later. A 27 year is assumed.
- 5/ This 511 debt is to finance the equipment rehabilitation expense for 1981 estimated to be \$8.8 million. It is a 10 year loan at 10% interest plus 3/8% serving cost. Interest will be accrued until 1985 when payments, including amount accrued, will begin.
- 6/ This 511 debt is to support the Tacoma Yard project. The loan is for 20 years at 12% plus 3/8% service fee. Payment terms the same as in footnote 4. Principal and interest paid during last 16 years.
- 7/ This 511 debt is for the same purpose and identical terms as expressed footnote 5.
- 4/ Includes principal payment but included in interest account since it is a taxable expense.

NEW MILWAUKEE LINE

PRO FORMA INCOME STATEMENT (INCL. REHAB.)
(1977 Dollars in Thousands)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Operating Revenues							
Freight	228327	288798	360940	365348	375928	386811	397729
Other Freight	12217	13855	15323	15536	15832	16062	16338
Passenger	17497	17497	17497	17497	17497	17497	17497
	258041	320150	393760	398381	409257	420370	431564
Operating Expenses							
MOW - Normal	52111	53338	54564	55010	55460	55916	56374
Rehab	17724	21830	23077	23140	22537	14982	3934
Depreciation	104	312	520	728	936	1144	1352
Total MOW	73651	78673	81872	82071	82126	75235	65369
MOE - Normal	46069	51338	50431	51715	53033	54382	55767
Depreciation	6680	6405	6144	5897	5662	5439	4545
Total MOE	52749	57743	56575	57612	58695	59821	60994
Transportation	116842	138305	147022	148526	150050	151595	153161
Traffic, G&A	27891	33256	34479	34598	34718	34838	34959
Total Operating Exp.	267421	304784	316237	319614	322396	318296	310608
Payroll Tax	23577	26023	27015	27243	27474	27107	26480
Property Tax	4744	4744	4744	4744	4744	4744	4744
Inc Tax	-	-	-	-	-	-	-
Total Tax	28321	30767	31759	31987	32220	31851	31224
Net Rent	49011	60342	67755	73900	77341	80830	84643
Net Rail Oper. Inc.	(86712)	(75743)	(21991)	(27120)	(22700)	(10607)	5089
Total Other Inc.	4355	4438	4554	4603	4623	4665	4663
Inc Avail for FC	(85400)	(74188)	(20320)	(25400)	(20960)	(8825)	6869
Equip Int.	226	52	8	-	-	-	-
Other Int							
Total In							
Net Income Adjustments	12000	12000	12000	12000	12000	12000	12000
Adj. Net Income							

SELECTED RAILROAD RATIOS1977

<u>CARRIER</u>	<u>OPERATING RATIO</u>	<u>TRANSP. RATIO</u>	<u>MAINT. OF WAY RATIO</u>	<u>MAINT. OF EQUIP. RATIO</u>	<u>TRAFFIC & GSA RATIO</u>
Milwaukee RR	87.0	44.7	18.2	15.2	8.8
BN	83.1	38.4	19.7	18.6	6.4
UP	74.5	34.5	14.2	17.9	7.9
CNW	81.6	41.5	16.3	17.0	6.9
BOOZ ALLEN LTC Long Term	78.6	38.0	15.3	17.1	8.4
Industry	81.5	39.2	17.3	18.0	7.0
New Mlw 1980	104.9 ^{2/}	45.3 ^{3/}	28.5 ^{3/}	20.4 ^{3/}	10.8 ^{3/}
1982	81.1 ^{2/}	37.3 ^{3/}	20.8 ^{3/}	14.4 ^{3/}	8.8 ^{3/}
1986	72.7 ^{2/}	35.5 ^{3/}	15.1 ^{3/}	14.1 ^{3/}	8.1 ^{3/}

- 1/ Operating expenses used to derive ratio
exclude net rents and payroll taxes
- 2/ Operating expenses are net of productivity program
- 3/ Ratios representing sub sets of total operating
expenses do not include reductions from
productivity program

Note: Source of historic data is computerized ICC R-1 Data (FRA file KSTATX)

	EQUIPMENT FLEET COST AND ANNUAL EXPENSE FOR LEASED AND REBUILDS (1977 \$) (millions)						
	1980	1981	1982	1983	1984	1985	1986
Capital Cost (1977 \$)	57.18	82.79	82.79	37.44	37.44	37.44	37.44
	(Current \$)						
Capital Cost (current \$)	73.48	113.20	119.88	57.25	60.23	63.18	66.40
Effective Lease Rate ^{1/}	5.59	4.36	4.36	4.29	4.36	4.42	4.42
Lease Expense ^{2/}	3.68	12.58	23.33	31.49	36.89	42.59	48.58
Annual Cost - Rebuilds ^{3/}	5.39	10.78	10.78	10.78	10.78	10.78	10.78
TOTAL:	9.07	23.36	34.11	42.27	47.67	53.37	59.36

- 1/ Effective Lease Rate is conservatively based to equal 65% of the rate for equipment trust certificates as forecast by Chase Econometrics.
- 2/ Lease expense derivation employed a 15 year life and half convention in the first year
- 3/ Rebuild program is for 3,000 cars costing \$63 million in 1980\$. The cars sold for \$12.0 million and leased back at an effective rate of 7.2% and for 10 years.

TOTAL CAPITAL PROGRAM
($\$$ in thousands)

$\$$ 1977

	<u>Capitalized Rehabilitation Portion of Program</u>	<u>General Capital Program 1/</u>	<u>Tacoma Yard Addition</u>	<u>Total</u>
1980	2578	3113	5000	10691
81	3176	3113	10000	16289
82	3357	3113	3000	9470
83	3366	3113	-	6479
84	3279	3113	-	6392
85	2180	3113	-	5293
86	572	3113	-	3685

$\$$ Current

1980	3201	3874	6370	13445
81	4296	4176	13680	22152
82	4881	4476	4431	13788
83	5248	4767	-	10015
84	4720	5063	-	9783
85	3915	5367	-	9282
86	1109	5683	-	5792

1/ Depreciation expense increased for a 15 year life and half year convention in the first year.

November 30, 1979

Mr. William H. Brodsky
Executive Vice President
New Milwaukee Lines
119 South Main Street
Seattle, Washington 98104

Dear Bill:

Relative to our understanding I recently completed a mile-by-mile inspection trip of the Milwaukee Road's mainline between Miles City, Montana and Maple Valley, Washington. My inspection began November 14, 1979 and was completed November 22, 1979. The inspection was made in the company of Mr. N. E. Smith, Assistant Chief Engineer, Milwaukee Road, and Mr. D. E. Ringlebauer, General Roadmaster.

Based on my inspection trip I am prepared to advise you of the following:

- 1) While the mainline is in a state of considerable deferred maintenance, it can be brought back to acceptable standards with a conscientious tie replacement and surfacing effort.
- 2) Certain areas require immediate attention. However, these areas are isolated locations where conditions can be stabilized in a very short period of time.
- 3) Rail conditions are generally good and should not be a major concern during the first two years of the rehabilitation program. Some short 100# rail areas will require relaying to provide necessary repair rail.
- 4) Tie replacement requirements for various FRA track classifications are as follows for an average over the entire mainline west of Miles City, Montana:

November 30, 1979

a)	Class I	400 ties/mile
b)	Class II	945 ties/mile
c)	Class III	1083 ties/mile
d)	Class IV	1625 ties/mile

5) Major surfacing and track raising cannot be accomplished efficiently until we reach a Class III tie condition. Once that condition is met, we will require approximately 6 cars of ballast per mile for Class III.

The detail of my analysis is being forwarded to you and includes a mile-by-mile evaluation of rehabilitation requirements. Based on my 43 years of experience in the Maintenance of Way Department of the Milwaukee Road, during which time I have been foreman of all types of track gangs, been General Foreman during construction of the railroad's largest hump yard at Bensenville, Illinois, been Roadmaster for twenty-four years and General Roadmaster in charge of training, worked on Milwaukee's RRRR Act program and was Division Maintenance Engineer, I believe the transcontinental mainline can be rehabilitated to acceptable competitive standards over a five-year program. Track conditions can be generally stabilized in three to four months with concentration of tie replacement in the spot areas of extremely bad tie condition.

If I can be of further assistance, please advise.

Sincerely,



Elmer G. Lottes

CHAPTER VIII - DEVELOPMENT OF THE PRO FORMA PROJECTIONS

Summary

The pro forma financial statements contained in this report were developed through a series of steps either utilizing work previously done for the Trustee by Booz Allen & Hamilton or independently deriving the basis for a particular calculation. This process is illustrated in Exhibit VII-A. A brief descriptive overview of this process follows.

The Chase Econometrics December, 1978 macroeconomic forecast utilized by Booz-Allen in its study for the Trustee was also adopted for this planning effort since it is reasonably representative of more recent forecasts and offered the advantage of being consistent with that used by the Trustee.^{1/} The network referred to as the Louisville-Transcon option by Booz-Allen in its March, 1979 report to the Milwaukee Railroad Trustee was selected as the basic network for this planning effort. This network was identified by Booz-Allen as having the best long term prospects for net railway operating income.

Certain aspects of this study represent significant departures from that undertaken by Booz-Allen. Major differences were: adjusting expenses for both the near and longer terms as a result of increasing revenue equipment capacity as new equipment is acquired (an adjustment which lowers both revenues and costs); establishing an equipment lease acquisition program which negates an extensive equip-

ment rehabilitation program; the presentation of complete financial pro forma statements enabling a clear perception of the Plan's merits; and most particularly having financial pro formas in current dollars to permit a proper assessment of the new rail line's financial viability. These key aspects, along with other important elements, are highlighted in Exhibit VIII-A.

The detailed analyses of revenues, traffic forecast, and development of capital and operating costs underlying Booz-Allen's conclusions for the Louisville Transcontinental network were carefully scrutinized. Their projections and calculations with certain adjustments described in this Plan were deemed sound. The adjustments to their forecast consisted partially of steps advocated by Booz-Allen in that economic growth and market opportunities, they acknowledged, need to be taken into account. The other adjustments consisted of a downward adjustment of traffic for the initial year of operations -1980- to reflect current traffic levels and then additions to traffic based on market opportunities identified by the Consulting Center and not identified in the Booz-Allen study.

Forecasts of traffic revenue and costs were determined for three distinct years, 1980, 1982 and 1986. Estimates for the intervening years, except estimates of rehabilitation of physical plant, were made through interpolation by computing the compound growth curve for each element. Constant dollar forecasts were first derived and then costs

were inflated. This was followed by revenue adjustments due to freight and passenger rate and subsidy increases to recoup such cost increases. As is normal for the industry, the revenue increases do not exceed cost percent increases. However, the selective rate increases which have occurred since 1977 that were taken into account improved the outlook for the prospective operation.

Once the current dollar financial pro forma is developed the cash flow needs are defined. This established in turn the need for external financing, the determination of a capital structure, and finally the operating and cash flow statements.

A more detailed discussion of the development of the more significant elements in the financial projections follows:

Development of Revenues

The development of pro forma revenue projections began with an assessment of the base volume of traffic and revenue that would be available to a new system comprised of Milwaukee lines pared down and restructured into a transcontinental configuration. In other words, the first step consisted of "assessing" the degree to which traffic carried by the entire railroad in a representative year could be "retained" by a trimmed down transcontinental railroad. Due to the limited time available for analysis, estimates of the base traffic levels compiled by Booz-Allen for their Louisville-Transcon configuration were used as a starting

point. Having established a base level of traffic for the system on a pre-bankruptcy basis, the next step was to acknowledge recent experience and to assess the ability of the New Railroad to recover traffic lost since bankruptcy, to return to pre-bankruptcy levels and to forecast the amount of future traffic anticipated for the transcontinental system. More specifically, this process included:

1. forecasting the recovery of traffic in relation to pre-bankruptcy levels that could be handled by a reorganized transcontinental network undergoing extensive physical rehabilitation and service improvements;
2. identifying new areas of revenue and traffic improvement that could be achieved over and above a level of "normalized" pre-bankruptcy traffic; and
3. forecasting increases in traffic as a result of the impact of long-term economic growth projections on the demand for commodities carried by the New Railroad.

1977 data was used to develop base levels of traffic and revenue because 1977 traffic levels represent the most recent annual data before bankruptcy and because recent acute service disruptions have drastically altered shipper routing preferences and Milwaukee Road service levels. The pre-bankruptcy level of traffic available to the New Railroad was constructed by Booz-Allen from a four-month sample of Milwaukee 1977 settlement files.

According to Booz-Allen, a Louisville-Transcon configuration in 1977 would have handled 571,871 carloads and earned net freight revenues of \$252.1 million. Based upon a review of 1979 tonnages and carloadings, the condition of the physical plant and shipper preferences, the Consulting Center forecasts that the startup volume of traffic for the New Railroad in 1980 would be less than the 1977 level forecasted by Booz-Allen. The level of traffic available to the New Railroad in the first full year of operation would be 549,640 carloads (530,148 after adjusting for fleet sizing) or \$228.3 million net freight revenues.

This volume reflects the partial recovery of transcontinental freight business (excluding Canadian lumber) to 80 percent of 1977 levels as a result of a re-establishment of 1977 train frequencies, aggressive resolicitation of traffic from the Ports of Seattle and Tacoma and other major points on the transcontinental system, and immediate reallocation of existing and forthcoming rehabilitated equipment and roadway resources to critical and currently inadequately served transcontinental points.

Because the Milwaukee has almost completely exited from the Canadian transcontinental lumber market since 1977, with the exception of traffic received at Duluth, the Consulting Center's estimate of 1980 transcontinental carloadings reflects this reduction of Canadian transcontinental lumber traffic. While initial discussion with the Council of Forest Industries of British Columbia and officials of Canadian

railroads indicated that potential lumber traffic in 1980 could equal or approach 1977 levels, further investigation revealed that a significantly lower and more selective volume of Canadian lumber carloadings would be more advantageous in terms of maximizing earnings from this traffic. The Council of Forest Industries indicated that 4000 such loads of British Columbia transcontinental lumber would be made available to the New Railroad once 1977 levels of service were restored. Other 1977 level British Columbia lumber carloads previously handled through Seattle or Sumas, Washington, would continue to be solicited through the Duluth gateway.

Consulting Center estimates of the volume of traffic that will be handled by lines east of Miles City in 1980 is based on the assumption that recovery to 1977 levels can be achieved after the first year of operation. As service commitment and capabilities improve, carloadings will increase as a result of realization of market opportunities identified by Booz-Allen and the Milwaukee as well as economic growth.

1982 estimated carloadings for the New Railroad will be greater than 1977 as a result of full recovery of 1977 level transcontinental business (less permanently foregone or diverted Canadian lumber) and modestly increased system carloadings as a result of real near-term economic growth projections. The New Railroad's 1982 carloadings and revenue reflect the result of an ongoing extensive physical

rehabilitation program and service improvements. They incorporate the estimated market opportunities identified by Booz-Allen achievable in 1981 for the Louisville Transcontinental configuration, forecasted economic growth, and the Consulting Center's probability assessments of additional traffic developed from direct communication with shippers and the Ports of Seattle and Tacoma.

The Milwaukee has historically participated in a substantial volume of transcontinental import/export traffic through the Ports of Seattle and Tacoma to mid-western origins and destinations. The dramatic growth of these ports is discussed in Chapter VII of this Plan. Forecasted increases in containerized volume, automobiles and grain for these ports, together with information produced from discussion with shippers and Milwaukee traffic officers, has convinced the Consulting Center that additional transcontinental traffic opportunities exist for the New Railroad beyond previously identified sources of new traffic. The aggregate traffic estimates from these sources were reduced to reflect any Booz-Allen market opportunities already included in 1982 transcontinental carloadings and the Consulting Center's pragmatic assessment of the probability that the traffic growth could be handled by the New Railroad.

The Consulting Center conservatively projects that the New Railroad could expect to realize an additional 14,100 market opportunity carloads in 1982 over the 1977 base. The traffic consists of 7200 carloads of TOFC/COFC,

3400 carloads of automobiles and 3500 carloads of grain. Estimates of market opportunity TOFC/COFC and automobile traffic were developed from Milwaukee Road traffic records and the Ports of Seattle and Tacoma by comparing 1977 volumes with potential volumes realizable with normalized service levels. Increased grain movements include a new movement of Montana wheat to Seattle and the dramatic growth of a large corn and soybean export market at Seattle in which the New Railroad would be a participant. This shift in the market is discussed in Chapter VII of the Plan. Shipper assurances with respect to corn traffic have been solicited and reflected; their responses are in the Consulting Center projections.

An extensive effort by the Consulting Center to identify specific new movements of coal in which NML could reasonably participate did not reveal new substantial market opportunities in this area beyond existing flows. While there is a great deal of optimism that the New Railroad would participate in new coal movements, the Consulting Center could not validate the existence of any additional coal volumes in the near term for the New Railroad beyond those currently in existence or known to be forthcoming.

The New Railroad's carloadings and net freight revenues for 1986 were derived from the realization of Booz-Allen long-term market opportunities, and forecasted economic growth. The incremental 1982 market opportunities identified by the Consulting Center were increased to reflect the same

forecasted long-term economic growth used by Booz-Allen for these commodities. The Consulting Center believes that this is a very conservative approach relative to the recent and projected growth of Pacific Rim imports and exports, including the development of a major new midwestern corn export market at the Port of Seattle. As a result of applying aggregate long-term economic growth projections to the New Railroad's 1982 traffic base, 1986 carloadings are forecasted to increase 3600 carloads over 1982. The New Railroad's carloadings and net freight revenues in 1986 are forecasted to be 778,079 (750,846 after fleet sizing) and \$397.7 million, respectively.

The Booz-Allen study was performed using average commodity revenues in existence in 1977 as reported in the Milwaukee annual commodity statistics report and financial report (R-1). However, to date, various commodities groups handled by the Milwaukee Railroad have incurred ICC authorized selective commodity rate increases. The Center has identified three distinctive major commodity groups for traffic moving on the New Railroad which individually have experienced from 13 to 54% upward adjustments in tariff rates. These selective rate increases are as follows: 22% for non-contract coal movements; 40% for Wisconsin sanitary paper products; and an effective 13.3% for removal of incentive grain rates. These selective rate increases when applied to the New Railroad traffic profile are conservatively estimated to provide \$3.9 million in 1980 and \$6.7 million in 1982 and

1986 as expressed in average 1977 dollars.

While the Center is aware of additional selective Ex Parte increases in process or proposed by the industry, we only incorporated those increases actually authorized by the ICC.

The New Railroad and the rail industry's ability to maintain economic self-sufficiency will ultimately be determined by its inherent ability to market and price its services effectively, competently and profitably. To achieve this goal, the New Railroad must place determined emphasis on thorough market research, cost analysis and pricing strategies. Moreover, the New Railroad must initiate a long-range marketing program directed at identifying those markets and commodities where its rail resources can compete profitably. This requires the identification and analysis of its customers' unique inventory shipping and equipment demands, availability, price and service, strengths and weaknesses of alternative modes of transportation, and institution of an accurate and timely cost information system. Given the capital commitment and earnings requirement of the New Railroad, it is mandatory that an improved computerized cost system be developed and coupled with an innovative pricing program.

The regulatory reform changes affecting pricing recommended by both the DOT and ICC should vastly improve the marketing pricing and earnings potential of the NEW Railroad. Some of the changes the Center has discussed with

shippers, such as long-term multi-shipper contract rates, seasonal, and peak-period pricing, and imposition of an inflation plus 4% no-suspension rate zone, have been favorably received. The achievement of meaningful regulatory reform can therefore be expected to generate additional traffic and improved earnings for the New Railroad.

The final step in computing New Milwaukee Lines' annual freight operating revenues in constant 1977 dollars involved the application of a tonnage elasticity rate factor corresponding to the initial fleet sizing adjustments discussed below. In forecasting revenues for the Louisville Transcon option, Booz-Allen applied a constant average 1977 revenue per carload to their projections. However, as noted by the ICC in Ex Parte 270 and 271, the application of a constant revenue per ton or per carload factor will tend to overstate actual revenue per ton mile, because continuing, long-term trends, such as increases in average commodity lading weight per car and increases in length of haul, tend to reduce revenue per ton mile.

This declining pattern is a general characteristic of the railroad rate structure, which provides for lower incentive revenue yields per ton mile as loading per car and length of haul increases. In particular, the existing trends of increased freight car capacity has exacerbated this revenue tapering effect; shippers have been induced to load the larger cars more fully by these rate incentives and railroads have experienced lower unit operating costs.

The ICC has previously undertaken to analyze the effect of this phenomenon on railroad revenues. In a statistical analysis, the ICC measured the rate relationship of cents per 100 pounds to actual tonnage and mileage moved for the rail carrier 1% universe of waybill traffic in 1966 and 1969. This analysis resulted in a series of commodity specific elasticity factors which quantified the influences that a change in length of haul (mileage elasticity factor) or loading per car (tonnage elasticity factor) had on rates. The results of this study were further analyzed, reviewed and incorporated by DOT in their 504 presentation of industry financial projections.

The Booz-Allen study for the LTC option provided no data on a commodity specific basis so that the Center was required to compute an aggregate tonnage elasticity factor and apply this to all traffic for the New Railroad. The determination of the aggregate tonnage elasticity factor was performed by weighting the individual commodity elasticity factors by the railroad industry's reported tonnages in 1977. This process produced an average elasticity factor of -.365, which means for every 1% increase in average tons per car there would be a corresponding .365% decrease in average revenue per ton.

The Center applied the aggregate revenue tonnage elasticity factor to the 3.65% forecasted increase in average freight car capacity of the New Railroad due to the initial year's fleet sizing assumptions. This computation yielded

a revenue adjustment factor of .987 which was applied to each year's freight operating revenues. Subsequent annual changes in the New Railroad's average freight car capacity beyond the forecasted 3.63% increase were not incorporated in revenues or transportation costs because of the incapacity to make such changes except by manual simulation, which would have questionable results. Since the rate discounts that ensue from increased car capacity are more than matched by operating economies, the New Railroad's earnings are conservatively underestimated in 1982-1986.

Other freight revenues include switching, demurrage and miscellaneous items. These revenues were based on the amounts computed by Booz-Allen for the Louisville Transcon configuration, with adjustments to reflect the Center's net change in carloads after fleet sizing. The final revenue item was passenger related revenues and subsidies, which we, like Booz-Allen, maintained at the Milwaukee's 1977 reported amounts.

Development of Expenses

General Approach

The general approach was to attempt to estimate the costs for the New Railroad that would have been generated under the Booz-Allen Louisville Transcon computer simulation model as a result of the changes made to the carloads and revenues for the years 1980, 1982, and 1986. For this effort, the BAH 1977 simulations were used as the starting point for

year 1980 costing; the BAH short term simulations were used for year 1982 costing; and the BAH long term simulations were used for year 1986 costing.

BAH Methodology

The BAH computer computations consist of two basic components that required several different modeling efforts. The first component produced the operating (e.g., car miles, ton miles, crew starts etc.) and revenue characteristics of the Louisville Transcon system under each of four traffic level scenarios. The second component developed the costs associated with each of the operating and traffic level scenarios. The base data of this component consisted of unit costs, ratios and absolute fixed cost dollars for various cost elements. The operating and revenue characteristics from the first component were applied to these data to develop the BAH cost estimates.

Operating and Cost Changes

Under the BAH methodology, the adjustments in carloads and the associated tonnage discussed above under Development of Revenues, would have been incorporated into the operating computer models and a new set of output units produced. However, lacking such a model, time constraints prohibited the preparation of a manual approximation of the full BAH operating simulation. Therefore, the results of the operating model for 1986 (the BAH long term scenario) were reviewed in detail to identify the impact of the New Railroad traffic changes in the BAH costs.

Wherever possible, the BAH unit costs were applied to the revised output units to determine the change in the BAH direct costs applicable to the New Railroad lines for 1980, 1982, and 1986. In the case of overhead type accounts, the ratios used by BAH were applied to the changed dollars of direct cost. To determine the labor portion of the direct and overhead costs it was assumed the ratio of labor to total costs produced by the BAH model would apply to the adjusted costs.

Maintenance-of-Way

The pro forma projections for the New Railroad include maintenance-of-way (MOW) expenses on a normalized basis. Normalized MOW expense is defined as the average annual cost to maintain the physical plant over the long term in a desired condition level. For the New Railroad the desired condition level is 60 mph mainline condition east of Miles City, 40 mph west of Miles City, 40 mph for most secondary main and primary branch lines, and 25 mph for branch lines.

The annual normalized MOW expenses for the Louisville Transcon configuration were developed by Thomas K. Dyer, Inc. for Booz-Allen. These estimates were developed in accordance with the condition of the existing physical plant, projected traffic volumes and plant condition levels, and a ten-year physical rehabilitation program. Normalized MOW expenses were calculated on the basis that 50 percent remaining life of the physical plant would result from the long-term installation of the annual requirement of track materials.

Density

The BAH maintenance-of-way and structure costs are a function of speed, signalling and density factors. Of these the speed and signalling factors are considered to be constant throughout all scenarios and therefore the cost changes are totally related to density changes. The changes in density attributed to increased volume that would occur on the line between Seattle and Bensenville (Chicago) in year 1986 were analyzed. This analysis indicated that the incremental transcontinental traffic additions would cause the density on three line segments to increase to a slightly higher level. An adjustment to reflect the change was made to the 1986 maintenance-of-way and structure costs. This analysis did not give consideration to the reduction in density that could occur on any line segments as a result of the overall reduction in carloads carried.

A detailed analysis of density changes for years 1980 or 1982 was not undertaken. This is because the net reduction in both revenue tons and carloads under the revised 1980 scenario indicated that density changes would result in lower maintenance-of-way costs. The revised 1982 scenario produces an increase in revenue tons and a decrease in carloads and car miles. In total this would produce an increase in density on the transcontinental line segments and could produce a decrease in density on the other system line segments.

In addition, the relatively small change in maintenance-of-way costs of \$511,000 or 0.8 percent of the BAH costs that resulted from the more detailed 1986 analysis, led us

to conclude that similar analyses of density changes was not undertaken for either of those years, the BAH 1977 and short term maintenance-of-way costs were assumed to be applicable to the New Railroad for years 1980 and 1982, respectively. If such an analysis were made, it is anticipated that the results would indicate a reduction in the 1980 maintenance-of-way costs of no more than 6 percent and an increase in the 1982 maintenance-of-way costs equal to or less than that calculated for 1986.

Normalized MOW expenditures were not reduced to reflect any synergistic effects of an accelerated rehabilitation (seven years for the New Railroad versus ten years forecasted by Booz-Allen) or rehabilitation in progress between Chicago and St. Paul.

The Consulting Center reduced the total normalized MOW projections for the New Railroad configuration to include the net reduction of track mileage operated as a result of the coordination of Milwaukee Road and Consolidated Rail Corporation between Gibson, and Terre Haute, Indiana. Annual normalized maintenance expenditures for approximately 132 route miles between Gibson and Fayette, Indiana were deducted from the estimates for the New Railroad furnished by Booz-Allen.*

* Tackage rights expenses incurred by the New Railroad for operation over ConRail between Gibson and Terre Haute are included in the Pro Forma Income Statement.

Transportation Expenses

The Consulting Center reviewed the transportation expenses for the Base System that were developed from a computer simulation of train operations by Booz-Allen. By reviewing the output of the computer simulation, the Consulting Center was able selectively to incorporate into the existing transportation outputs and expenses the incremental traffic volumes that will accrue to the New Railroad as a result of the realization of additional market opportunities in the transcontinental corridor.

The impact of the increase in carloadings, as a result of additional market opportunities, upon transportation expenses was relatively insignificant. The relatively small increment of additional transcontinental traffic, including a unit grain train, had, for all practical purposes, no impact on the existing blocking and scheduling program.

The small increases in net transportation expenses largely resulted from lumps of additional traffic that could not be handled in existing trains such as a unit train of corn to Seattle and increases in fuel, loss and damage, etc. These additional expenses were largely offset by a reduction in total transportation expenses that resulted from larger car sizes and therefore a reduction in cars. The average freight carload reduction factor used was .965 which understates the reduction actually forecasted from changes in the equipment size as a result of larger cars. The net effect of changes in (1) the number of carloadings on transcontinental

transportation expenses from additional market opportunities and (2) the number of cars handled as a result of forecasted changes in car size was that transportation expenses for the New Railroad increased very slightly over the level forecasted by Booz-Allen.

Other Expenses

The Consulting Center reviewed the Booz-Allen projections for Traffic and General and Administrative expenses to reflect changes in activity levels and attributable expenses for these categories. Traffic expenses for the New Railroad are slightly different from the level forecasted by Booz-Allen as a result of projected differences in carloadings and tonnage. Traffic expenses for 1980 are forecasted (in 1977 \$) to be \$625,200 less as a result of lower carloadings. The realization of additional market opportunities in 1982 by the New Railroad increases traffic expenses \$717,800 over that forecasted by Booz-Allen. Similarly, traffic expenses incurred by the New Railroad are \$919,500 greater than that forecasted by Booz-Allen in 1986.

General and Administrative expenses were forecasted to reflect changes in maintenance-of-way and equipment, accelerated rehabilitation, and changes in traffic and transportation. General and Administrative expenses for the New Railroad are forecasted to be greater than the Booz-Allen projections because of differences in the level of underlying expense categories. General and Adminstrative expenses for the New Railroad are increased 1.7 million in 1980 and \$2.2 million

in 1982 and \$1.0 million in 1986 over Booz-Allen levels.

Application of Inflation Factors

The preparation of financial forecasts in 1977 constant dollars is useful in evaluating the New Railroad's traffic, revenue, operating and capital assumptions over the planning period. However, financial viability analysis requires that the New Railroad's cash flows be adjusted for the effects of inflation. This adjustment is particularly important when one reviews the relative cost and revenue experience of the railroad industry during the past decade of high inflation. During that period, industry revenues have increased in response to accelerating industry costs, largely as a result of ICC authorized general rate increases premised on recovery of inflated costs. For a variety of reasons, the revenues accruing to the industry have failed to offset the cost inflation affecting the industry. Moreover, the relative inflation experience of railroads, indicates that stronger carriers have preserved and somewhat enhanced their financial performance while weaker carriers have suffered dramatic setbacks.

The most direct effect of inflation in the New Railroad's financial performance will be an increase in its operating expenses. To project annual inflated railroad expenses, the Consulting Center applied component annual price inflation indices to the major cost elements. (Exhibits VIII-B and VIII-C) These component inflation forecasts for labor, materials and capital elements were derived for 1978 and 1979 from AAR

and Milwaukee Road data. Annual inflation forecasts for 1980 through 1986 utilized DOT's 504 industry study, whereby specific econometric price equations were applied to the Chase January 1978 macroeconomic forecast.

Similarly, the Center applied the general average freight rate increases and effective dates of authorization (resulting in a six month lag) estimated in the DOT report for the years 1980 through 1986 to constant freight revenues (Exhibit VIII-D). The actual general freight Ex Parte rate increases granted by the ICC from mid-1977 through November 1979 were incorporated. All the aforementioned annual rate increases were reduced by 7% to recognize the historic trend of the western region's interstate delays together with carrier commodity flagouts. Current dollar annual passenger revenues were derived by applying the composite average rate of inflation projected in the DOT study for the years 1979 through 1986. Actual increase in direct unit passenger revenues and subsidies incurred in 1978 were appropriately included.

Roadway Rehabilitation Program

The Consulting Center developed a rehabilitation program for the New Railroad based on rehabilitation estimates that were computed by Booz-Allen and the Milwaukee Road. The estimates for rehabilitation are derived from visual inspection of most of the line segments together with assumptions about the quantity, quality, timing, and cost of acquisition and installation of material necessary to bring track up to a

predefined condition level.

While the Consulting Center accepted the rehabilitation estimates of Booz-Allen, developed in conjunction with the Milwaukee, it should be noted that these estimates are based on a sampling of track condition. Another sample of Milwaukee trackage condition, which consisted of a detailed walking of segments of the Milwaukee between Harlowton and Great Falls, Montana, produced material quantity estimates that were considerably less than that estimated by Booz-Allen. Because Booz-Allen/Milwaukee rehabilitation estimates were system wide, roughly comparable, and used in the Reorganization Plan, the Consulting Center accepted these estimates as the most conservative basis for developing a rehabilitation strategy and program for the New Railroad.

Booz-Allen developed two estimates of rehabilitation for Milwaukee Road system configurations. Gross rehabilitation for was that expenditure necessary to bring track segments up to a predefined standard of condition at the end of 1977. Net rehabilitation was the total rehabilitation expenditures in excess of ten years of normalized maintenance-of-way (MOW) expenditures necessary to achieve a particular system standard of track condition.

The Consulting Center developed gross rehabilitation estimates for the New Railroad based on a detailed compilation of individual line segments (or portions thereof) included in the New Railroad. The gross rehabilitation requirements for individual line segments for the New Railroad were reduced to net unit requirements on the basis of a seven year

rehabilitation program and normalized MOW expenditures. The resulting units of rail, ties, and ballast were then scheduled according to estimates of material availability and production capabilities relative to the need and timing of rehabilitation on main line segments so that critical service reliability and improvements could be achieved in the first two years of the program.

The gross and net rehabilitation requirements for the New Railroad are shown in Exhibit VIII-E. The unit requirements were programmed for specific line categories on the basis of the magnitude and degree of current slow orders and maintenance needs for the line segments to be operated by the New Railroad. A review of slow orders and the current condition of New Railroad trackage in conjunction with shipper demands for consistent transit times indicated that the most immediate needs for programmed rehabilitation lie in the area of cross tie and ballast on the main line. An accelerated rehabilitation program with emphasis on attaining 45 mph minimum mainlines speeds by the end of 1982 was developed, followed by attention to secondary main and primary branch lines. A schedule of rehabilitation expenditures and units is contained in Exhibit VIII-F. The cost of the program in 1977 dollars is reflected in Exhibit VIII-G.

Development of Equipment Requirements

The process by which equipment requirements, including net rents, were developed began with an analysis of the base equipment fleet owned by the Milwaukee Road as shown by

the Equipment Register of October 1979. We have analyzed that equipment in detail producing a planned retirement of 5,740 cars which are obsolete or beyond economic limit of repair. These cars will be retired as they fall into bad order and replacement equipment is obtained. Equipment supply also considers routine retirements which have been calculated through 1986 in detail by car type and retirements due to casualties. It has been assumed that all containers, racks and TOFC trailers will be obtained via short and medium term lease.

Since the present supply of locomotives is more than sufficient to meet the projected needs of the New Railroad, it is assumed that all locomotives will be conveyed and that certain locomotives will be retired over time as the deferred maintenance is alleviated. Sufficient cabooses are available to meet the projected needs of the New Railroad through 1986, assuming that deferred maintenance is eliminated.

Development of Equipment Retirement Program

We have reviewed all of Milwaukee Road's equipment in detail, using internal company records and information contained in the Equipment Register. This detailed analysis, by car series number, has considered actual experience in retirement of each car series over the last several years, the age of the car series and the type of equipment. Through combining this information and applying professional judgment, it was possible to estimate which equipment should

be (1) upgraded, (2) retained, and (3) retired once it falls into bad order. It was also possible to develop a routine retirement program for this equipment.

Using these techniques, we have estimated that approximately 5,746 cars will be retired, due to a culling of the fleet, within the first 1-3 years of operation, as cars fall into bad order and new replacement equipment is received. Details of this proposed culling are shown in Exhibit VIII-H.

The total Milwaukee fleet of approximately 705 locomotives will be conveyed to the New Railroad. 289 units will be sold or scrapped once the locomotive fleet is upgraded and the out-of-service ratio is improved substantially. Units to be retired include obsolete equipment and consideration will be given to the sale of General Electric locomotives in order to concentrate repair facilities on General Motors equipment (Exhibit VIII-I).

The estimate of locomotives to be retained is based upon the requirement of 416 units by 1986, according to Booz-Allen, and includes our own analysis of each locomotive type.

Of the 397 cabooses to be conveyed, approximately 34 units will be retired, as the remaining equipment is rehabilitated.

Computation of Car Size, Impact on Transportation Costs, Maintenance Costs, and Related Factors

The increased car carrying capacity of the culled down fleet and new equipment has a substantial impact on transportation and maintenance costs. These improvement factors for 1980 produced an overall cumulative improvement of 3.7% in 1980, 5.5% in 1982 and 9.4% in 1986, assuming that 39.5% of car loadings would be accounted for by system cars and the remaining 61.5% would be accounted for by foreign and private cars. Small improvements in aggregate average carrying capacity by foreign and private cars were also incorporated by taking into account the national trend of about 3/4% increase per year.

Maintenance of equipment was computed using the 1977 baseline cost for the Milwaukee Road as a starting point. These baseline costs, covering accounts 301-337 (excluding depreciation), were computed by factoring down locomotive maintenance cost based upon the reduction in volume carried compared to those base periods.

It was assumed that in 1977 dollars each freight car would bear a normalized maintenance and inspection cost of \$1,060 per year plus a 28% overhead factor to cover all related accounts. Locomotives were based upon the 1977 operating cost prorated and marked up by the 28% overhead factor. The cost of the deferred maintenance program also was included in the 1980 estimate (Exhibits VIII-J and K).

It should be recognized that these estimates probably

are higher than actual costs which will be experienced, since the fleet in 1980 and later years will be improved substantially due to the deferred maintenance program, the culling of obsolete equipment and equipment in poor repair, and purchase of new equipment.

Computation of Net Rents Payable

Net rents payable were computed using the 1977 Milwaukee Road R-1 as the baseline. Six categories were considered, including private cars, Trailer Train equipment, other trailers and containers, general per diem and mileage cars, existing and new car leases and existing and new locomotive leases.

Rents payable for private cars, TTX and trailers, and containers were computed based upon a prorated share of total traffic multiplied by the 1977 base, and adjusted for inflation (Exhibits VIII-L, M and N).

Under current Milwaukee Road operations, there is an approximate balance between system cars off-line and foreign cars on-line, yet the relationship between per diem payable and per diem receivable concerning railroad owned equipment is approximately 1.8 to 1, in favor of the foreign roads. Apparently, this relationship is due to the advanced age of the Milwaukee Road equipment, since per diem and mileage charges are largely a function of original costs plus rebuilds and OT37-B repair expenditures. The culling of the fleet and purchase of new equipment, along with a substantial rebuild program, will have a decided impact upon per diem

receivables. For example, the Milwaukee's R-1 for 1978 shows a depreciation base of approximately \$147.5 million for freight cars. Under the plan developed in this study, we expect to spend approximately \$540 million for new equipment, and perhaps as much as \$63 million for equipment upgrading during the first year and a half of operations. These expenditures will increase the base cost of all equipment substantially, even considering retirements. Given the traffic level estimated for 1980, approximately 63.2% of the 1977 level for the Milwaukee Road, we would expect a substantial turnabout in the per diem payable and receivable balance. Using a conservative judgment, we have assumed that net per diem for 1980 will be 63.2% of that of the 1977 base multiplied by 50% (to adjust for the net impact of new equipment purchase and old equipment retirements) and adjusted for inflation. We have assumed net per diem balances for railroad equipment for 1982 and 1986. However, given the substantial pattern of purchases over those years, the New Railroad might well experience a net per diem balance in its favor during these later years.

Working Capital

Working capital is a firm's current assets, including cash, short term investments, accounts receivable and materials and supplies, less its current liabilities. The amount of working capital needed by a company depends on the degree of liquidity a management feels it should maintain to meet its current obligations. According to the ICC, railroads should maintain a minimum cash position equal to fifteen days of total cash operating expenses and a current ratio, the ratio of current assets to current liabilities, greater than 1.0

The development of the New Railroad's working capital was based on the following primary assumptions:

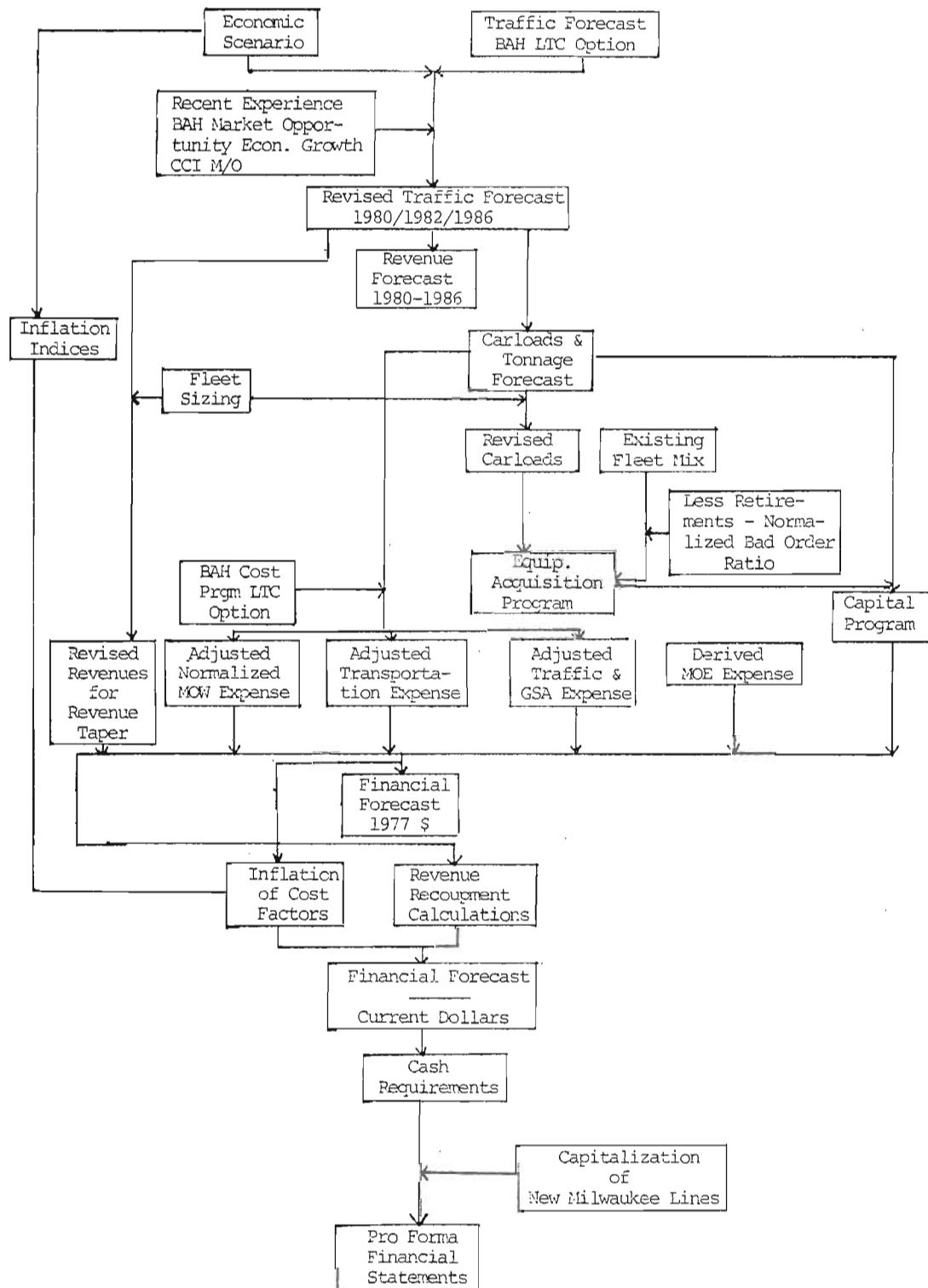
- (1) cash balances equal to 15 days total cash operating expenses (excluding depreciation but add total rents and taxes) would be maintained;
- (2) materials and supplies equal to the June 1979 levels would be acquired from the Milwaukee estate by the New Railroad as part of its initial acquisition program. Thereafter, it was assumed that the account would be maintained at a level consistent with historic experiences of other western regional carriers.
- (3) no current liabilities against the Milwaukee estate would be assumed by the New Railroad.

- (4) contingency funds equal to ten percent of the initial year's operating expenses would be required to fund one time start up expenses and cover transition effects.
- (5) projections for individual current asset and current liability accounts initially and over time were based on the assumption that these items would reflect levels typically maintained by other western region railroad companies. Specifically, the 1977 experience of the Milwaukee itself as well as the CNW, BN and UP.
- (6) Casualty Reserves

Casualty reserves measure the amount of accumulated and undistributed personal injury and loss and damage claims accrued but not expected to be paid within one year. The Center assumed a normalized industry annual casualty payout. In addition, the start up nature of the New Railroad will generate a gradual three year build up in these long term accounts.

Exhibit VIII-A

DEVELOPMENT OF PRO FORMA FINANCIAL STATEMENTS



NEW MILWAUKEE LINES
ANNUAL COMPONENT INFLATION RATES
(Percentage change)

	1978A	79A	80	81	82	83	84	85	86
--	-------	-----	----	----	----	----	----	----	----

Expenses

Rail	11.3	14.2	7.6	6.8	6.4	5.7	5.3	4.9	4.9
Ties	2.0	(1.2)	8.2	8.0	6.9	6.8	7.3	7.2	7.2
Ballast	8.7	11.4	8.2	5.7					
Labor	6.8	10.0	10.7	8.4					
Health & Welfare	2.9	6.3	6.7	6.8					
Injuries	8.0	7.4	8.6	8.7					
Payroll Taxes	7.6	5.9	7.0	9.6					
Materials	6.4	9.3	7.0	7.8					
Other	7.5	7.7	6.4	6.3					
Loss & Damage	7.0	6.7	5.9	5.8					
Fuel	3.2	55.4	12.9	10.7					
Property Taxes	(14.2)	-	6.4	6.3					
Per Diem	8.5	5.8	4.5	4.5					
Composite Exp.	8.2	14.8	9.7	7.6					

1980 39.4% 64%

Capital

ETC Int Rate (%)	8.4	11.5	8.6	6.7	6.7	6.6	6.7	6.8	6.8
TCI Int Rate (4-6m CP) (%)	8.0	10.0	8.0	7.5	6.8	6.3	6.1	6.1	6.4
Freight Cars	9.5	10.2	6.5	6.4	5.9	5.6	5.2	4.9	5.1
Locomotives	9.8	10.2	6.0	5.6	5.2	5.0	4.8	4.8	4.8

Rates

Lagged Effec									
Freight Rates (Ex Partes)	6.2	11.5	11.6	7.9	6.6	6.7	6.5	6.5	6.5
Other Freight	21.9	11.5	11.6	7.9	6.6	6.7	6.5	6.5	6.5
Passenger	12.1	14.8	9.7	7.6	7.3	7.0	7.1	6.9	6.8

Source: Actual results for 1978 and 1979 are extracted from AAR Wage and Price Reports, Ex Parte Rate Summaries and actual Milwaukee Road results.

Annual forecasted rates of change are based on individual factor price equations applied to Chase's December 1978 Standard Long Term Economic Forecast.

NEW MILWAUKEE LINES

ANNUAL CUMULATIVE INFLATION RATES

(Compound change from 1977)

	1978A	79A	80	81	82	83	84	85	86
--	-------	-----	----	----	----	----	----	----	----

Expenses

Rail	1.113	1.2710	1.3676	1.4606	1.5541	1.6427	1.7297	1.8145	1.9034
Ties	1.020	1.0079	1.0906	1.1778	1.2591	1.3447	1.4428	1.5467	1.6581
Ballast	1.087	1.2109	1.3102	1.3783	1.439	1.5066	1.5774	1.6595	1.7458
Labor	1.068	1.1748	1.3005	1.4097	1.5296	1.6642	1.8073	1.9573	2.1198
Health & Welfare	1.029	1.0938	1.1671	1.2465	1.32	1.3913	1.4581	1.5266	1.5984
Injuries	1.080	1.1599	1.2597	1.3693	1.4911	1.6358	1.7928	1.9613	2.1437
Payroll Taxes	1.076	1.1395	1.2192	1.3363	1.4365	1.5428	1.6477	1.7548	1.8689
Materials	1.064	1.1630	1.2444	1.3414	1.438	1.5315	1.6264	1.721	1.8257
Other	1.075	1.1578	1.2319	1.309	1.3855	1.4617	1.5436	1.6315	1.7229
Loss & Damage	1.070	1.1417	1.209	1.2792	1.3495	1.4238	1.4964	1.5697	1.6419
Fuel	1.032	1.6037	1.8106	2.0043	2.1847	2.3726	2.5719	2.7854	3.0166
Property Taxes	.876	.876	.932	.990	1.047	1.105	1.167	1.233	1.302
Per Diem	1.085	1.1479	1.200	1.254	1.310	1.369	1.431	1.495	1.562
Composite Expenses	1.082	1.2421	1.3626	1.4662	1.5732	1.6833	1.8029	1.9273	2.0583

Capital

ETC Int Rate (%)	8.4	11.5	8.6	6.7	6.7	6.6	6.7	6.8	6.8
TCI Int Rate (4-6m CP) (%)	8.0	10.0	8.0	7.5	6.8	6.3	6.1	6.1	6.4
Freight Cars	1.095	1.2067	1.2851	1.3673	1.4480	1.5291	1.6086	1.6874	1.7735
Locomotives	1.098	1.2100	1.2826	1.3544	1.4249	1.4961	1.5699	1.6432	1.7220

Rates

Lagged Effec.									
Freight Rates (Ex Partes)	1.062	1.1841	1.321	1.426	1.520	1.622	1.727	1.840	1.959
Other Freight	1.219	1.3592	1.517	1.637	1.745	1.862	1.983	2.113	2.249
Passenger	1.121	1.2889	1.4117	1.5190	1.6299	1.744	1.8678	1.9967	2.133

Source: Actual results for 1978 and 1979 are extracted from AAR Wage and Price Reports, Ex Parte Rate Summaries and actual Milwaukee Road results.

Exhibit VIII-C

Annual forecasted rates of change are based on individual factor price equations applied to Chase's December 1978 Standard Long Term Economic Forecast.

AVERAGE EX PARTE RATE INCREASES SINCE 1977
FOR THE WESTERN CARRIERS

<u>ICC Docket</u>	<u>Effective Date</u>	<u>% Increase</u>	
EP336	1-7-77	3.9	
343	11-30-77	4.7	
349	6-17-78	3.6	
357	12-15-78	6.5	
311 (Fuel pass through sur- charge)	6-5-79 7-7-79 7-28-79 9-14-78	1.2 1.4 1.0 1.1	Applies to all rates
368	10-15-79	7.8	

<u>Year</u>	<u>Rate Index</u>	<u>1/</u>	<u>Cumulative Effective Rate Index</u>	<u>/2</u>	<u>Annual % Change</u>	<u>Annual Effective Rate Change</u>
1977	1.043		1.040		---	
1978	1.112		1.104		1.0662	1.0615
1979	1.248		1.231		1.1223	1.1115
1980	1.402		1.374		1.1234	1.1116
1981	1.518		1.482		1.0827	1.079
1982	1.623		1.579		1.0692	1.066
1983	1.735		1.684		1.0690	1.067
1984	1.854		1.794		1.0686	1.065
1985	1.980		1.911		1.0680	1.065
1986	2.114		2.036		1.0677	1.065

1/ Derived by Consulting Center

2/ Use a 93% district yield factor which is consistent with FRA504 analysis and history

NEW MILWAUKEE LINES
ANNUAL COMPONENT INFLATION RATES (cont'd)
(Percentage Change)

Selectives

Coal (single) 22.0
Sanitary paper (Wisc.) 40.0
Wood chips 26.0
Logs (St. Mary's, Id.) 54.0
Grain (Corn - Incent Expired) 13.3

REHABILITATION OF NEW MILWAUKEE LINES ROUTES

Track Classification	Mileage	Speed Max/Min	Total Rehabilitation (000 omitted, 1977\$)		Net Rehabilitation Unit Requirements*			Surface Correction Mil
			Gross	Net	Ties (000)	Rail Miles	Ballast Miles	
MAIN LINE	2689.1	60/40	152.0	104.8	1,731	2596	1,144	
SECONDARY MAIN LINE	424.7	50/30	27.3	18.8	242	127.4	197.7	95.4
PRIMARY BRANCH LINES	112.0	40/25	14.4	10.0	129.3	90.0		111.8
BRANCH LINES	326.0	35/20	17.6	12.1	200.6	98.3		12.2
TOTAL	3551.8		211.3	145.8	2,303	575.3	1,341.7	219.4

*Does not include material units for switch and bridge ties and turnouts but which cost estimates are included in Total Rehabilitation

Exhibit VIII-F

REHABILITATION PROGRAM FOR NEW MILWAUKEE LINES

LINE SEGMENT:	YEAR	1980	1981	1982	1983	1984	1985	1986	Total Units	Total Unit \$ (000, 1977)	Total Net Rehabilitation \$ (000, 1977) *
MAIN LINE											
MAIN LINE											
Cross Ties (000)	400	400	300	300	200	131	--	--	1,731	43.282	
Rail Miles	25	50	50	50	50	34.6	--	--	259.6	30.373	
Ballast Miles	300	250	250	250	94	--	--	--	1144.0	18.304	
											104.801
SECONDARY MAIN LINE											
Cross Ties (000)	--	--	100	100	42.2	--	--	--	242.2	6.055	
Rail Miles		25	25	25	25	27.4			127.4	6.981	
Ballast Miles		50	50	50	47.7	--			197.7	3.163	
Surface Correction Miles					95.4	--	--	--	95.4	.572	
											18.827
PRIMARY BRANCH LINES											
Cross Ties (000)				25	25	100	29.3		129.3	3.233	
Rail Miles						25	15		90	4.932	
Surface Correction Miles						61.8	50		111.8	.671	
											10.047
BRANCH LINES											
Cross Ties (000)						58	100	42.6	200.6	5.015	
Rail Miles						15	30	53.3	98.3	5.387	
Surface Correction Miles							12.2		12.2	.073	
											12.139
TOTAL NML											
Cross Ties (000)	400	400	400	400	400.2	260.1	42.6	2,302.9		57.585	
Rail Miles	25	75	75	100	115	117	68.3	575.3		47.673	
Ballast Miles	300	300	300	300	141.7	--	--	1,341.7		21.467	
Surface Correction Miles					157.2	62.2	--	219.4		1.316	
											145.814

VIII-37

*Total Net Rehabilitation includes switch & bridge ties, calculated at 23% of cross ties, and turnouts, calculated at 9.5%

Exhibit VIII-G

COST OF
REHABILITATION PROGRAM ^{1/}
 (millions 1977 \$)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>Total</u>
<u>EXPENSE</u>								
Labor	6.550	7.962	8.412	8.412	8.393	5.522	1.401	46.652
Health & Welfare	2.260	2.731	2.881	2.881	2.906	1.903	.475	16.037
Total:	8.810	10.693	11.293	11.293	11.299	7.425	1.876	62.689
Material:	9.622	12.208	13.033	13.033	12.450	8.460	2.340	71.146
Timber	5.460	5.460	5.460	5.460	5.460	3.558	.582	31.440
Rail & O&M	1.762	4.348	5.173	5.173	5.668	4.827	1.758	28.709
Stone	2.400	2.400	2.400	2.400	1.322	.075	-	10.997
Other	1.870	2.105	2.180	2.180	2.067	1.277	.290	11.969
Total:	<u>20.302</u>	<u>25.006</u>	<u>26.506</u>	<u>26.506</u>	<u>25.816</u>	<u>17.162</u>	<u>4.506</u>	<u>145.804</u>
Total in current dollars:	<u>22.0</u>	<u>29.5</u>	<u>33.5</u>	<u>36.1</u>	<u>32.4</u>	<u>26.9</u>	<u>7.6</u>	<u>\$188.00</u>

1/ Does not include contingency lines. Assumes normalized maintenance of way expenditures.

SUMMARY OF EQUIPMENT
NEW MILWAUKEE LINES

<u>Box Cars</u>	<u>Included Repaired</u>	<u>Excluded When Bad Order and Replacement Equipment Available</u>
40 ft. XM	1252	3407
50 ft. XM	4282	423
60 ft. XM	325	
40 ft. XL	23	
50 ft. XL	494	70
60 ft. XL	125	
86 ft. XL	61	
40 ft. XP	53	
50 ft. XP	312	4
60 ft. XP	184	
86 ft. XP	64	
40 ft. RBL Type	9	250
50 ft. RBL Type	879	
Miscellaneous	<u>40</u>	
TOTAL	8103	4154
<u>Covered Hopper Cars</u>		
50 Ton	132	
70 Ton	1178	
100 Ton	<u>2521</u>	
TOTAL	3831	

Gondolas

50 Ton - 40 to 50 ft.	101	150
70 Ton - 40 to 50 ft.	401	96
100 Ton - 40 to 50 ft.	295	
70 Ton - 60 to 65 ft.	112	
100 Ton - 60 to 65 ft.	191	
Ore Jennie - 70 Ton	—	20
TOTAL	1100	266

Flat Cars

50 Ton	1271	715
70 Ton	315	
90 To 100 Ton	349	
Heavy duty	15	
Miscellaneous	39	—
TOTAL	1989	715

Open Top Hopper

50 Ton	406	508
70 Ton	54	103
100 Ton	150	—
TOTAL	610	611

Tank Cars

8000 Gallon	2	
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Caboose

N100	363	34
GRAND TOTAL	15,998	5,780

DESCRIPTION OF LOCOMOTIVE FLEET

<u>Type</u>	<u>Number</u>	<u>Units to be Retained</u>
SD40	89	89
SN39	10	10
SD10	18	18
SD 9	13	
SD45	10	10
FP45	5	
U36C	4	
U30C	12	
SD 7	7	
GP40	72	72
GP38	16	16
GP35	11	
GP30	16	
GP20	54	54
U30B	10	
U28B	12	
U25B	11	
U23B	5	
GP 9	72	63
F 9	8	
F 7	56	
SESG	5	5
MPISC	64	64
SW12	50	15
NWTR	20	
SWI	14	
FM	<u>41</u>	—
TOTAL	705	289

MAINTENANCE OF EQUIPMENT
 (Accts. 301-337 less depreciation)
 (Millions of 1977 Dollars)

	<u>1980</u>	<u>1982</u>	<u>1986</u>
Freight Cars ¹	\$ 23.616	\$ 29.181	\$ 32.855
Locomotives ²	16.179	21.250	22.912
Deferred Main- tenance Program	15.931 ³	-----	-----
	<hr/>	<hr/>	<hr/>
	\$ 55.726	\$ 50.431	\$ 55.767

¹Based upon \$1,060/freight car + 28% overhead factor to include accounts 311 and 314.

²Based upon \$20 million base, carload pro rate + 28% factor.

³Two year program, 1980 expenses \$7.9655 million (1980 \$) and 1981 is \$7.9655 million (1981 \$).

Freight Car Repair Program

Deferred Maintenance

(1980 dollars)

<u>Type</u>	<u>Total Number</u>	<u>1980</u>	<u>1981</u>
XM Box	100	\$ 253,000	\$ 253,000
XL Box	200	650,000	650,000
Gondolas	100	340,500	340,500
Covered Hoppers	175	605,500	605,500
Flats	300	390,000	390,000
Caboosees	96	389,000	389,000
Locomotives	1)	<u>5,337,500</u>	<u>5,337,500</u>
		\$7,965,500	\$7,965,500

1) 416 less 111 already overhauled times 35,000/unit

NET RENTS PAYABLE (Million of 1977 \$)

	<u>1977 Base</u>	<u>1980 (.632)</u>	<u>1982 (.830)</u>	<u>1986 (.895)</u>
Private Car Line	5.934	3.750	4.925	5.317
TTX	11.847	7.487	9.833	10.603
Trailers & Containers	4.753	3.004	3.945	4.254
Per Diem & Mileage	14.115	4.460	-----	-----
TOTAL	36.649	18.701	18.703	20.174

NEW MILWAUKEE LINES
NET RENTS DETAIL
(1977 \$ in thousands)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Net Car Hire	18701	19150	18703	19084	19447	19820	20174
Car Leases - Base	9966	9913	9838	9809	9793	9777	9762
Car Leases - New	7060	17940	25570	31100	34210	37330	40800
Total Cars:	<u>35727</u>	<u>47003</u>	<u>54111</u>	<u>59993</u>	<u>63450</u>	<u>66927</u>	<u>70736</u>
Joint Facil. ^{1/}	457	457	707	707	707	707	707
Other net ^{2/}	4900	4900	4900	4900	4900	4900	4900
Locos Lease-Base	8300	8300	8300	8300	8300	8300	8300
Leases-new	-	-	-	-	-	-	-
Total Locos	<u>8300</u>						
Loco credits ^{3/}	<u>(373)</u>	<u>(318)</u>	<u>(263)</u>	<u>(65)</u>	<u>(16)</u>	<u>(4)</u>	<u>-</u>
Total Rents	<u>49011</u>	<u>60342</u>	<u>67755</u>	<u>73900</u>	<u>77341</u>	<u>80830</u>	<u>84643</u>

1/ Reflects the estimated amount paid to Conrail for trackage rights operating over the Chicago-Terra Haute Line at \$2.10/train mile

2/ Utilized Booz Allen & Hamilton's other net amounts

3/ Loco Fleet - base of 416 units exceeds 1977 levels, the excess units are assumed to be leased to a third party at a rate of \$60/day

$$\begin{array}{rcl} 1980 & 416 - 3999 & = 17 \times 365 \times \$60 = 372.3 \\ & 82 & 416 - 404 = 12 \times 365 \times \$60 = 262.8 \end{array}$$

Interpolate interim years

NEW MILWAUKEE LINES
NET RENTS DETAIL
 (Current Dollars in Thousands)

		<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Net Car Hire		22444	24014	24501	26126	27829	29631	31512
Car Leases - Base		9966	9913	9838	9809	9793	9777	9762
Car Leases - New		9070	23360	34110	42270	47670	53370	59360
Total Cars		<u>41480</u>	<u>57287</u>	<u>68449</u>	<u>78205</u>	<u>85292</u>	<u>92778</u>	<u>100634</u>
Jt. Facilities	1/ 4/	582	625	1044	1119	1201	1285	1360
Others - Net	2/	6036	6414	6789	7162	7564	7994	8442
Locos Lease - Base		8300	8300	8300	8300	8300	8300	8300
Leases - New		---	---	---	---	---	---	---
Total Locos		<u>8300</u>	<u>8300</u>	<u>8300</u>	<u>8300</u>	<u>8300</u>	<u>8300</u>	<u>8300</u>
Loco Credits	3/	<u>(459)</u>	<u>(416)</u>	<u>(364)</u>	<u>(95)</u>	<u>(25)</u>	<u>(7)</u>	<u>---</u>
Total Rents		<u>55939</u>	<u>72210</u>	<u>84218</u>	<u>94691</u>	<u>102332</u>	<u>110350</u>	<u>118736</u>

- 1/ Reflects the estimated amount paid to Conrail for trackage rights operating over the Chicago-Terra Haute Line at \$2.10/train mile
- 2/ Utilized Booz Allen's other net amounts and inflated at rate for OTHER
- 3/ Inflated at rate for OTHER
- 4/ Inflated at composite MOW

NEW MILWAUKEE LINE

WORKING CAPITAL DERIVATION
(Current Dollars in Thousands)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Cash	16922	21383	24140	26465	28479	30544	32160
Material & Supplies							
Total O.E. - Depr. - Pro	323833	410259	461187	503920	541874	581600	610387
Milw. Factor	1/.091	.091	.091	.091	.091	.091	.091
Total Material & Supplies	29469	37334	41968	45857	49311	52926	55545
Other Current Assets							
Total Revenues	344614	460840	603608	651739	712975	780263	852814
Rev. Factor	1/.144	.144	.144	.144	.144	.144	.144
Total Other Current Assets	49624	66361	86920	93850	102668	112358	122805
Current Liabilities							
Total Exp. - Depr. - Pro							
+ Rents							
+ Taxes							
Total CL Factor	1/.230	.230	.230	.230	.230	.230	.230
	94930	119954	135419	148461	159764	171342	180409
Beginning Year							
Cash	<u>16,922</u>	<u>16922</u>	<u>21383</u>	<u>24140</u>	<u>26665</u>	<u>28479</u>	<u>30544</u>
Material & Supplies	<u>39,779</u>	<u>29469</u>	<u>37334</u>	<u>41968</u>	<u>45857</u>	<u>49311</u>	<u>52926</u>
Other	<u>---</u>	<u>49624</u>	<u>66361</u>	<u>86920</u>	<u>93850</u>	<u>102668</u>	<u>112358</u>
Total Current Assets	<u>56,701</u>	<u>96015</u>	<u>125078</u>	<u>153028</u>	<u>166372</u>	<u>180408</u>	<u>195828</u>
Total Current Liabilities	<u>---</u>	<u>94930</u>	<u>119954</u>	<u>135419</u>	<u>148461</u>	<u>159764</u>	<u>171342</u>
ΔCA-CL		(55616)	4039	12485	(302)	2733	3842
C.R.		1.01	1.04	1.13	1.12	1.13	1.14
							1.17

1/ Based on analysis of UP/BN/CNW and Milw 1977 data

IX. ASSESSMENT OF OPERATING PRACTICES AND ROLE OF THE ESOP

A. Assessment of Present Operating Practices

An assessment of all of the Milwaukee Road's present operating practices reveals that they are beset by the enormous operating inefficiencies inherent in the system's deteriorated plant and equipment. No railroad's operating practices can overcome the inefficiencies inherent in a deteriorated and underutilized plant. Likewise, no change in system operating practices is as important to achieving more productive utilization of the railroad's massive capital investment than rehabilitation of the physical plant and equipment designed to permit more intensive use of the system. Capital is the scarcest commodity of all in the rail industry. The inefficient utilization of capital associated with 10 mile-per-hour track, 50% bad order locomotive ratios, and thousands of parked but repairable cars is a far more important barrier to enhanced productivity than any other aspect of the railroad's operations. The Task Force on Railroad Productivity concluded in 1973 that:

more frequent train service is probably the single most important factor affecting promptness and dependability of delivery, in turn the most important factor in quality of rail service. Thus, increasing train frequency is thought to be the most important operational reform the industry can make to preserve and even enlarge its share of the freight market. Additionally, increasing the frequency of train service will improve freight car utilization.^{1/}

The objective of this Plan is to create a rehabilitated system that will concentrate all of the Milwaukee Road's present operating resources, and a massive amount of new equipment as well, on maximizing the railroad's long-haul traffic over the system's main arteries. To the greatest extent possible, emphasis will be placed upon obtaining maximum utilization of the system's capital investment and rolling stock. The objective will be to use the system as much -- not as little -- as possible.

The Plan provides for immediately increasing maintenance expenditures to normalized levels. Moreover, the Plan calls for a substantial investment in track rehabilitation, over and above normalized maintenance, designed to ensure that (i) all major line segments can be safely operated at speeds of 25 miles per hour by the end of the first year, (ii) the system will have a minimum mainline speed of 40 miles per hour by the end of 1985, and (iii) 85% of the system will be rehabilitated to fully competitive standards by the end of 1984.

Plant rehabilitation and a return to normalized maintenance will reduce transit times, vastly improve equipment turn-around, and will have the effect of making substantially more equipment available for loading, even if no additional cars were added to the fleet.

But cars will be added to the system. The present Plan calls for the acquisition of approximately \$542 million worth

of modern replacement freight cars and rebuilt boxcars, as well as a major rehabilitation program targeted at the system's locomotive and caboose fleet. As a result of the increased traffic flows that these changes will make possible, the New Railroad's revenues are expected to increase from approximately \$344 million in 1980 to \$852.8 million in 1986 -- a 67% increase over the seven-year period when measured in constant dollars.

The transformation of the railroad's operations that will be caused by the programs proposed in this Plan will make possible improvements of profound importance in the productive utilization of plant, equipment and personnel.

From the perspective of operating practices, this will mean labor will become part of a system with service capabilities that will transform the nature of the employees' work experience: the Milwaukee's employees will be given an opportunity, for the first time in many years, to demonstrate what they can do with a system that is as good as they are.

Certain aspects of the system's present practices have particularly significant implications for the goal of maximizing labor productivity and deserve separate assessment. The Milwaukee Road has always been a railroad known for its innovation and service. Shippers in recent ICC abandonment proceedings testified repeatedly that the Milwaukee personnel they deal with have been remarkable for their attempts to

provide quality service despite the ongoing deterioration in the railroad's system and equipment.

Nevertheless, the present Milwaukee Road's deteriorated plant and equipment, the major reductions in traffic volumes flowing over the system in recent years, the system's reduced service capability, and the general crisis of confidence in the railroad's potential for successful future operations have all combined to prevent the railroad from realizing the full benefits of several highly innovative agreements that have been negotiated previously between labor and management. These agreements remain available as sources of important productivity gains -- if the railroad can be restructured in a manner that will take advantage of the potential of these agreements.

During the early 1960s Milwaukee management initiated an innovative program of expedited train service between Chicago and the west coast. Labor's cooperation contributed greatly to the success of the program. Restrictions on train size, preferential blocking, and expedited handling of these trains through terminals combined to make this service innovation a solid operating success. Actual performance consistently bettered the published 53 hour schedule, which itself represented a full day reduction from the previous schedules, and established a benchmark for competing carriers to emulate. During the ten years following the implementation of this expedited service, traffic on the Milwaukee's transcontinental

line increased by more than 100%, while traffic on the rest of the system was increasing at a rate of approximately 40%.

During the years that this service flourished, and in more recent years as well, rail labor on the Milwaukee Road consistently demonstrated a willingness to work toward agreements on a wide range of specific subjects designed to improve the system's service capabilities. Three aspects of these past agreements are particularly significant for present purposes:

- (1) Interdivisional Run-Through Agreements;
- (2) The Reduced Crew-Consist Agreement; and
- (3) Labor-Management Task Force Programs.

Interdivisional Run-Through Agreements. In order to further develop the potential of the expedited transcontinental service described above, the Milwaukee Road reached agreement with the United Transportation Union and the Brotherhood of Locomotive Engineers in the early 1970's to abolish intermediate terminals in selected territories. This allowed the railroad to close a number of expensive terminals and to operate train crews over substantially longer distances. These changes permitted crews to lengthen their average trips to distances ranging from 160 to 220 miles, depending upon the territory. Before these agreements were negotiated, territorial boundaries often limited crews to runs of approximately 100 miles -- and in some cases, workdays involving only four or five productive

hours. As a result of the interdivisional run-through agreements, the number of crews required to operate trains over the various routes could be reduced and substantial improvements in train movements could be realized.

Reduced Crew-Consist Agreement. In April, 1978, the Milwaukee Road became the first railroad in the United States to sign a reduced crew-consist agreement. This agreement provides the railroad with an opportunity to operate its trains with one less brakeman than had previously been required. Since the Milwaukee achieved this breakthrough agreement with rail labor, Conrail and the Canadian National have each signed similar agreements. In addition, the Milwaukee has negotiated certain specific train movements to provide for only a 2-man train crew. These are typically specialty trains such as mini-grain trains, stone trains, and the intermodal Sprint trains. In the case of the Sprint train operation, interdivisional runs have been combined with the 2-man train crew to optimize productivity and asset utilization.

Labor-Management Task Force Programs. The labor-management task force concept has proven to be an extremely effective mechanism for resolving difficult problems that concern both rail labor and management, and that often involve multi-carrier issues. Task Force programs, for example, led to significant changes that helped to rationalize and streamline terminal practices in the Chicago terminal, a multi-railroad facility

that had previously been plagued by a variety of complicated and inefficient jurisdictional and operating requirements.

Comparable task force programs have been highly effective in other terminal facilities elsewhere in the country.

Similarly, a task force program sponsored by the Federal Railroad Administration as well as labor and management was instrumental in formulating and negotiating the numerous specific implementing agreements necessary to putting the intermodal Sprint trains discussed above into service.

Major improvements in car movement through terminals, and a variety of other important innovations, have resulted from the efforts of other labor-management task forces.

B. Opportunities for Improved Productivity.

The deteriorated condition of the Milwaukee Road's present system and equipment, and the resulting reductions in the level of service provided across the system, have seriously hampered the railroad's ability to take full advantage of the opportunities for significantly improved labor productivity made possible by the presently existing agreements discussed above.

In particular the significant expansion of transcontinental traffic that was achieved by the expedited service provided between Chicago and the Puget Sound area during the 1960s and early 1970's was seriously impaired by the general collapse of the physical plant that began in approximately 1973.

The resulting reductions in system traffic levels largely vitiated the importance of the interdivisional run-through and reduced crew-consist agreements.

Mounting deferred maintenance and resulting track deterioration resulted in slower train speeds that undercut the assumptions upon which the interdivisional run-through agreements had been negotiated: Trains could no longer operate between many of the new terminals that had been established under those agreements within the statutory twelve-hour maximum period prescribed by Federal law for the operation of any one crew. As a result, the practice of "dog catching" became commonplace. A second crew often had to be transported by automobile, and in some instances even by airplane, to a point where the train had to be stopped at the end of the original crew's maximum twelve-hour run; the new crew would then have to bring the train into the next terminal. In many cases the cost of operating on an interdivisional basis today has become more expensive than would have been the case had the agreements never been implemented.

The restructuring of the system proposed in the present plan is designed to permit significantly improved running times for the new system's trains. This change in the system's operating practices will enable the new railroad to take full advantage of the present interdivisional run-through agreements. Such changes will not only help the railroad save the substantial costs incurred in present "dog catching"

operations, but also will permit the new system to fully realize, for the first time, the potential benefits and efficiencies inherent in the longer crew runs made possible by interdivisional run-throughs.

Similarly, the present Milwaukee System has yet to experience the potential benefits that can be derived from the reduced crew-consist agreements. With certain exceptions, the benefits of these agreements can be derived only to the extent that available employees are used in full crew service in preference to operating reduced crews. In general, the railroad must exhaust its "extra-board" employees in full crew service before the agreements permit the railroad to operate reduced crews. Because the railroad has been experiencing steadily reduced levels of service over much of the system since these agreements were negotiated, the Milwaukee has not been in a position to exhaust the "extra-board" employees in full crew service frequently enough to derive significant advantage from the opportunity to then employ reduced crews.

The major rehabilitation of the system's plant and equipment that would be undertaken if NewMil's Plan is approved and implemented would allow the new system to begin to realize the substantial benefits made possible by the reduced crew-consist agreements. Service capabilities and train frequencies will significantly improve. Substantially increased traffic levels will be carried over the lines to be operated.

This increased level of service, when coupled with the level of employment projected in the Plan, would permit the new system to take full advantage of the opportunities inherent in the reduced crew-consist agreement. As new trains are added to handle the additional traffic, more and more 2-man train crews will be operated. This factor alone should help improve substantially the new system's labor productivity and overall operating efficiency.

C. New Agreements

In addition to the productivity benefits to be derived from the restructuring of the system proposed in the present Plan, NewMil also anticipates that significant productivity benefits will be derived as a result of implementation of important new agreements with rail labor. The proponents of the NewMil Plan and the Railway Labor Executives Association, the recognized bargaining agent for rail labor on all matters of wages, rates and working conditions, have agreed to participate together in an unprecedented management-labor task force designed to address a wide range of specific target areas where concrete productivity changes will be implemented. An initial letter of understanding, signed by Fred J. Kroll, as president of the Brotherhood of Railway and Airline Clerks and as Chairman of the RLEA Transportation Policy Committee, reflecting this arrangement is attached to this Plan as Exhibit

IX-A. A more detailed letter of intent will be filed with the Commission no later than December 14, 1980.

The new Labor-Management Task Force to be created pursuant to the requirements of subparagraph 6(a)(3)(E) of the MRRA will play a vital role in the turn-around strategy proposed by the present Plan for a reorganized Milwaukee system. The specific projects to be addressed by the Task Force will include work rule and productivity changes designed to enhance the efficiency of the system's operations, improved incentive provisions, changes designed to enhance manpower utilization, and innovations that will permit improved career path opportunities. Labor and management will, in effect, create an ongoing institution directed toward continuous efforts to eliminate redundant non-productive work time. Every effort will be made to retain the individual earning capacity for each employee and to fashion a climate in which labor and management share joint responsibility for continuous review, experimentation, and innovation intended to result in improved productivity, a stronger railroad, and genuinely secure and productive employment opportunities.

D. Role of the Employee Stock Ownership Plan

One of the unique and important features of this Plan is the fact that it includes in its capital structure an Employee

Stock Ownership Plan (ESOP) holding the New Railroad's common shares for the benefit of its employees. From the outset of their active involvement, the Milwaukee employees seeking a solution to the financial crisis have made the creation of an ESOP an important element of their objective. The ESOP feature was part of the original SORE proposal and it continues as part of SORE's plan for reorganization of the Milwaukee.^{2/} For the reasons discussed below, NewMil also includes an ESOP as part of its capital structure.

The Benefits of an ESOP

The ESOP proposed by NewMil will, through a tax-exempt trust, borrow funds to purchase common shares in New Railroad and pledge those shares as security for the loan. The New Railroad will guarantee that its contributions to the trust will be adequate to service the loan. In this instance, as discussed in the section on the capital structure and implementation of the Plan, the loan to the ESOP will also be federally-guaranteed.

The benefits of this arrangement are many and varied, and must be viewed in the particular context of the rail industry and the Milwaukee Road. The rail industry was one of the first major U.S. industries to have the majority of its work force represented by labor unions. The powerful role of railroads in our nation's economy during the first quarter of this century

and its large union-represented labor force led to enactment of the Railway Labor Act, which established among other things the collective bargaining rights of railroad employees. This 1926 law was followed in 1935 by the Railroad Retirement Act and in 1939 by the Railroad Unemployment Insurance Act. These laws, coupled with the Federal Employers Liability Act enacted in 1908, which provides an exclusive remedy for injuries to railroad employees, have resulted in a distinctive body of federally-protected rights for railroad employees, apart from those applicable in other industries under the Labor-Management Relations Act. This body of railroad employment law has generally provided the framework for all decisions concerning labor-management relations, particularly those relating to compensation. Thus, having a known and workable structure for handling such matters, railroads and their employees traditionally have not experimented with approaches available under other federal laws in developing such things as deferred compensation plans.

However, the situation now facing all of the Milwaukee Road employees, both union and nonunion, has prompted consideration of an ESOP as a means of enabling railroad employees to participate in the long-term growth of the company while helping the company achieve that growth. First, the Trustee's Reorganization Plan calls for reduction of the Milwaukee labor force to roughly 6000 employees over the period from 1980 to 1984 from

the 11,436 employees receiving pay in June, 1979. ^{3/} This reduction will apparently affect union employees in a somewhat greater proportion than non-union employees.^{4/} Moreover, given the service to be provided under Milwaukee II, the impact of the reduction will obviously be most severe in the northern tier. Where the displaced employees are less likely to find new rail employment in the areas where they now work, and therefore must either undergo substantial dislocation or seek employment in another industry.

Given the fact that the median age of Milwaukee employees is 39 years and the median years of service is approximately 11 years, the potential displacement under Milwaukee II poses an even greater threat than the employment figures would suggest.

Added to these cold statistics is the fact that in a surprising number of instances, Milwaukee employees are second and third generations of families whose livelihood has always been attached to the Milwaukee. These employees have long bitter-sweet attachments to the railroad that are simply not transferable. Nor are they really compensable in a labor protection sense. For these reasons, and likely others, employees from all over the Milwaukee's system have sought a continuation of the railroad. Even those whose jobs were not likely to be adversely affected, at least in the near-term, by the Trustee's proposed transition to Milwaukee II have still given strong support to the employee coalition seeking continuation of a transcontinental Milwaukee Road.

This is not to suggest that the primary motive in seeking this continuation of service has been narrow self-interest. To the contrary, these employees who have intimate knowledge of the transportation and public interest functions provided by the Milwaukee also have strong views on why the current bankruptcy has occurred and what is needed to turn the railroad around. As discussed above, the employees represented by their international unions have been willing to adopt highly innovative agreements to improve their productivity and thereby improve the performance of the railroad. Indeed, all Milwaukee personnel have a reputation among the public they serve for being innovative and determined to improve the quality of service and overall performance of the railroad.

It is in this context that the ESOP is being proposed as part of the capital structure for New Railroad. In the first instance, it is a mechanism for enabling the employees and their families to reap the long-term benefits of a successful reorganization of the Milwaukee Road. This is particularly important where the productivity gains projected for the New Railroad will contribute to the realization of those benefits. The employees will, in effect, earn an equity interest in the New Railroad through their service for the New Railroad. Their benefits will accrue as the ESOP loan is repaid and the stock of New Company is released to accounts maintained in the ESOP trust for each of them. As the company becomes more successful

and the stock grows in value, the value of the employees' ownership interest will increase accordingly. Naturally, these benefits will be supplemented by any dividends distributed on the stock once New Railroad becomes profitable. Moreover, although the employees' benefits under the ESOP will increase yearly, the value of those benefits is not taxable until an employee's stock is distributed to him, and at that point it receives favorable tax treatment.

New Railroad will also realize separate but complementary benefits from the use of the ESOP. The ESOP is an important vehicle for obtaining initial working capital for New Railroad, without looking to the employee-owners for a cash outlay. It is a well known and sound financing device that, for the reasons discussed above, is especially appropriate in this instance to a venture having the risk characteristics, and the public interest aspects, that New Railroad possesses. The ESOP is particularly important as a means of raising capital by reason of the availability of a Federal guarantee from the Economic Development Administration or the Farmers Home Administration or both for this purpose.^{5/} As the New Railroad becomes profitable, the ESOP feature will provide a range of tax benefits for the company, not the least of which is the fact that payments of principal on the loan, made in the form of contributions to the ESOP, will be entirely deductible. This deduction is also applicable to any additional contributions

made to the trust up to 15% of all participants' total compensation for a year, and additional deductions -- as well as such tax benefits as extra investment credits -- could be achieved through subsequent modifications in the basic ESOP structure.

It is also critical to note that New Railroad will be making major capital investments in plant and equipment. Under the terms of the Internal Revenue Code, these capital investments create an investment tax credit for the New Railroad; these investment tax credits can be used in the future to reduce Federal income taxes, thereby enhancing the railroad's profitability. The ESOP would entitle New Railroad to claim an additional investment tax credit (above the normal investment tax credit for which every company is eligible) each year. This will have the dual effect of maximizing New Railroad's tax savings and providing a greater stock interest (and motivation) for the employees.

Basic Features of the ESOP

The details and documentation for the ESOP that NewMil proposes are considerable, and, are for the most part, dictated by the applicable provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code. Thus, at this stage it is appropriate to indicate only the most basic features of the anticipated ESOP.

First, as shown in the capital structure, the purchase price for the stock acquired by the ESOP would be \$15 million. The ESOP would borrow the money for the acquisition of New Railroad stock, with the repayment of the loan being guaranteed by New Railroad, with additional guarantees for the ESOP loan being anticipated from the EDA or FmHA. The actual repayment terms for the ESOP loan would be determined at the time the loan is made, subject to any special restrictions imposed by the rules and regulations of the Federal agency providing the loan guaranty and the requirements of ERISA and the Internal Revenue Code. The ESOP would use the loan proceeds to purchase stock from New Railroad. Thereafter, New Railroad would make annual contributions to the ESOP in an amount sufficient to permit the ESOP to repay this indebtedness.

Second, NewMil expects the ESOP to cover all employees of New Railroad, both union and non-union. This is consistent with the basic goal of establishing an employee-owned company to create for all employees the incentive to achieve productivity gains and in general seek the best possible performance for the company. It is also consistent with the structure of the ESOP as a deferred compensation program that supplements but does not displace any other compensation to which the employees are entitled under employment and collective bargaining agreements or under applicable Federal and state law.

Third, NewMil expects the provisions of the ESOP establishing eligibility and vesting requirements to provide appropriate credits for prior service with the Milwaukee Road. Such an approach is consistent with the successor interest of New Railroad and recognizes the value to New Railroad of the dedication and experience of the Milwaukee Road employees whose loyal support will enable New Railroad to prosper.

Finally, NewMil recognizes the very strict fiduciary and related requirements applicable to the establishment and operation of an ESOP. These requirements, enforced by the Labor Department, the Internal Revenue Service and the federal judiciary, will assure that the interests of all employees in the ESOP, and thus their interest in New Railroad itself, will be vigorously and responsibly protected in the operation of the ESOP.

Impact of ESOP on Productivity

The ESOP Feature of the Plan has important productivity implications. The fact that the employees will share directly in the results of the company's improved performance is only the most obvious. Through the ESOP, the employees will know that when their efforts succeed the rewards can be distributed to them immediately, in dividends on their company stock. In the meantime, the value of that stock will grow as the railroad begins to prosper with the support of its work force. Giving

the new railroad's employees a stake in the ownership of the new company represents a major and important innovation that can reasonably be expected to produce significant improvements in the new system's future operating practices, and in the general climate in which such practices are negotiated and implemented.

This important advantage of ESOP programs, when properly designed and instituted in appropriate circumstances, has been documented repeatedly in case studies of ESOP programs that have been instituted in a variety of industries. The Senate Finance Committee recently surveyed 75 companies that have instituted ESOPs. The Committee staff described the results as follows:

At the time of the ESOP installation, which took place an average of three years ago, the typical company had been in business for 24 years and had attained annual sales of \$19,596,000. This company employed 438 people and averaged \$44,700 sales per employee. This generated an annual profit in the three years prior to the ESOP installation of \$794,000 per year and the company paid taxes which averaged \$312,000 per year.

Over the past three years, an average of 7% of the ownership of the company has been transferred each year; today, the Employee Stock Ownership Plan now has an average of 20.6% of the company stock. The incentive provided by this ownership has resulted in sales increasing to \$33,780,000 -- up 72%. This created the need to increase the number of employees to 602 employees, an increase of 37%. The average sales per employee increased to \$56,000 (+25%). The combination of this increased productivity and higher level of sales increased the profits of the company in the three years following ESOP installation to an average of \$2,039,000 -- up 157% -- and the typical company paid an average of \$780,000 per year in taxes -- up 150%.6/

A University of Michigan study^{7/} concludes that the positive correlation between increased profits and employee ownership appears to be particularly likely where, as the present Plan proposes for New Railroad, the employees have a high percentage of the company equity.

The Michigan study also reported that "perhaps the most unequivocal support for the effectiveness of the plan comes from the employees themselves, who indicate through interviews an unusually high level of morale, motivation, and commitment to the success of the company."^{8/} The study supports the findings of the Senate Finance Committee survey by pointing out that employee-owned companies are 1.5 times more profitable than their non-employee owned counterparts. The tangible results, taken separately, are subtle, but significant. Employees are more concerned to prevent waste and conserve company equipment and resources, absenteeism and turnover may decline, special types of incentives may be part of the ESOP itself, and creative new approaches to the development and performance of various tasks may grow out of the workers' direct interest in the ultimate outcome. Taken together, the enhanced dedication of the railroad's employees to successful operation of their company, and the enhanced mutual respect and cooperation among the employee-owners of the company, shows great promise of translating into a more efficient, productive railroad.

Although the precise savings to be achieved as a result of the creation of the ESOP feature proposed in the present Plan are difficult to quantify with precision at the present time, previous experiences with employee ownership indicate that the productivity benefits to be derived from this innovation are real and will constitute an important area of potential improvement in New Railroad's capability for achieving more productive and efficient operating practices.

E. The Significance of Productivity-Related Changes.

Precise quantification of the financial significance of the productivity-related changes that will accompany implementation of this Plan is difficult. On the other hand, the impact on productivity that will result from enhanced application of the interdivisional run-through and reduced crew-consist agreements alone clearly will be very significant, and implementation of the ESOP and Task Force program will also make important contributions to productivity. The Consulting Center has concluded that it is appropriate to include a small line-item savings adjustment of \$12 million (uninflated 1977) dollars in the financial projections contained in the present Plan. This figure amounts to approximately 3% of the system's total operating expenses. The projected reduction in operating expenses for New Railroad is comparable to the \$11.58 million figure shown in the Trustee's Reorganization Plan but is not

intended to include the specific line item changes in such Plan. Rather, the Consulting Center estimate reflects the combined effort that labor and management will undertake to increase productivity on a system-wide basis.^{9/} NewMil and rail labor both regard this estimate as a prudent and conservative attempt to value the likely efficiencies resulting from the productivity-related changes that will attend implementation of this Plan. (See Exhibit IX-A.)

FOOTNOTES

- 1/ Final Report of the Task Force on Railroad Productivity to the National Commission on Productivity and the Council of Economic Advisors, Washington, D.C., November 1973, at 219. [Emphasis added.]
- 2/ Finance Rocket No. 28640 (Sub-No. 5).
- 3/ Reorganization Plan at 10 and 28; Exhibit 34.
- 4/ Id., at 29.
- 5/ However, it should be noted that if for some presently unforeseeable reason the ESOP were not established, this would not adversely affect the capital structure or cash flow of New Railroad since money would be available from the Federal Railroad Administration (FRA), EDA or FMHA for a comparable purpose and at the same cost.
- 6/ Senate Finance Committee Summary dated October 25, 1979.
- 7/ Survey Research Center, Institute for Social Research, University of Michigan, Employee Ownership -- Report to the Economic Development Administration, United States Department of Commerce (1978), reprinted in Hearing on S.388 before the Select Committee on Small Business, United States Senate, 96th Cong., 1st Sess., 152-218, at 190 (February 27, 1979).
- 8/ Id., at 218.
- 9/ Reorganization Plan at 32.



BROTHERHOOD OF RAILWAY, AIRLINE AND STEAMSHIP CLERKS,
FREIGHT HANDLERS, EXPRESS AND STATION EMPLOYES

AFL-CIO — CLC

F. J. KROLL, International President

November 29, 1979

Mr. William H. Brodsky
Executive Vice President
New Milwaukee Lines
119 South Main Street
Seattle, Washington 98104

Re: Milwaukee Railroad Restructuring Act

Dear Mr. Brodsky:

Under Subparagraph 6(a)(3)(E) of the Milwaukee Railroad Restructuring Act, as explained in the Conference Report, the employee-shipper ownership plan filed pursuant to that statute must include "an assessment of all operating practices" together with "letters of intent" expressed in some appropriate form covering arrangements for implementation of changes designed to achieve productivity increases.

Based upon our meeting with you and other representatives of New Milwaukee Lines, and our review of drafts of pertinent portions of New Mil's Employee-Shipper Ownership Plan, we are confident that a task force approach to the practices and procedures of the entire railroad will capture the knowledge, the experience, and know-how of the labor force working with a new management force and will contribute to the viability of the New Milwaukee Railroad. The task force is an innovative approach to attacking a wide range of problems affecting efficient operations and management of railroads. It is an established procedure which has worked with great success in St. Louis, Houston, Chicago, and other parts of the country. We believe that the Milwaukee offers a golden opportunity for the application of these techniques throughout the entire Milwaukee system.

As you know, it will be necessary to complete a variety of steps in order to work out the details of a formal letter of intent. Nevertheless, we expect that such a letter detailing the main points of this program will be made available to the Interstate Commerce Commission no later than December 14, 1979.

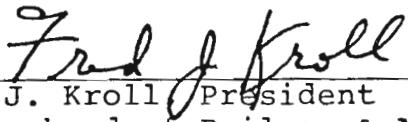
William H. Brodsky

- 2 -

November 29, 1979

In addition to the benefits that will result from this letter of intent, which are contemplated, we in rail labor are optimistic that the new management, rehabilitated plant and improved equipment proposed in the Plan will make significant improvements in the railroad's productivity. When the proposed rehabilitation and reorganization of the system along with the substantial improvements which should result from the task force approach are considered together, it appears to us that the Plan's \$12 million estimate (in 1977 dollars) of the likely financial significance of these developments is conservative and is within the reach of the reorganized railroad as proposed. Rail labor will continue to do its part to help save the railroad.

Sincerely,



Fred J. Kroll, President
Brotherhood of Railway & Airline
Clerks
Chairman, Transportation Policy
Committee, RLEA

X. METHOD OF IMPLEMENTATION

A. Summary of Implementation Procedure

Upon completion of the proceedings in the Interstate Commerce Commission and the Reorganization Court prescribed in MRRA, it is proposed that this plan be implemented in the manner outlined in this section. In substance, the implementation of the plan requires the transfer by the Trustee to New Railroad of good and clear title to those assets necessary for operation of the railroad system described herein the ("New System") and the assumption by New Railroad of certain specified liabilities or obligations. The balance of the assets and liabilities and obligations will remain with the bankruptcy estate (the "Estate"). The necessary transfer would be accomplished by a series of conveyances and assignment documents, appropriate to the particular category of asset involved, executed by the Trustee and vesting good and clear title in New Railroad. New Railroad would contractually assume those liabilities identified in the Plan.

It would simplify and reduce the cost of the actual transfer process if such a transfer and assumption could be accomplished by a plan which minimizes the need for such individual asset transfers. An alternative approach, discussed in Section X.B.8 below, would be the rearrangement of the corporate structure and ownership of assets and the incidence of

liabilities within the Estate followed by a merger of the New Railroad with the Milwaukee, in which the Milwaukee would survive. The following discussion describes the stages proposed for acquiring assets. Because it would offer significant practical advantages, if it could be effectively accomplished, the rearrangement-merger alternative is also described in some detail. During the first phase, the management of the New Railroad will work closely with the authorized representatives of rail labor to implement, through the task force described in Section IX, a program to achieve the productivity gains which NewMil and rail labor anticipate and which are reflected in the pro-forma statements.

The Plan will be implemented in two phases. The principal object of the first phase is the preparation and presentation to the Reorganization Court of the comprehensive acquisition plan described below (the "Acquisition Plan") which sets forth acquisition procedures in considerable detail. A secondary object to be accomplished in the first phase is a determination of whether uncertainties about the efficacy of an alternative rearrangement-merger format can be resolved. During Phase I consideration can be given to whether legislation should be sought to enhance the implementation of the Acquisition Plan. Those steps will be accomplished as soon as practicable after completion of the proceedings prescribed in MRRA but in no event later than April 1, 1980. The second phase shall commence upon

the submission of the Acquisition Plan to the Reorganization Court and shall continue until the effective date of the transaction (the "Effective Date"), which is not expected, in any event, to be later than June 1, 1980.

B. Matters to be Accomphished in Phase I

1. Identification in Detail of Assets to be Acquired by New Railroad and Retained by Estate

For the ultimate consummation of the Plan, it is necessary to vest in the New Railroad good and clear title to the following assets owned by Milwaukee, directly or indirectly (the "New System Assets"):

(a) The entire inventory of material, stores, parts, and supplies of every description wherever located, existing on the Effective Date, whether deemed usable or obsolete, and whether or not appearing upon the books of account or other records of the Milwaukee;

(b) All interests in real estate necessary or desirable for the operation of New System, including fee simple, leasehold interests, easements, rights of way and any other interests, whether in land, roadways, terminals, buildings, offices, fixtures, trackage, tunnels, signals, communication systems, bridges, trestles, and any other improvements located therein or thereon;

(c) All tangible personal property including without limitation equipment, rolling stock, shop and power plant machinery, work equipment, office equipment, furnishings, track, ballast, vehicles, vessels, computers and associated programs and software, and trade fixtures, whether usable or obsolete and whether or not reflected in the books of account or other records of the Milwaukee (the "New System Equipment");

(d) All intangible assets, including patents, patent applications, inventions, manufacturing processes,

know-how, trade names, trademarks, trademark registrations, trademark applications, certificates, operating authorities, licenses, permits, and all interests in pending litigation or regulatory proceedings of Milwaukee selected by New Railroad;

(e) All books, documents, records, files, and operating technical data, including all route and tariff data, operating procedures, and all customer, sales and purchasing lists, correspondence, and accounting books and records.

(f) The following assets, title to which is vested in Milwaukee Land Company, directly or indirectly:

(i) All railroad equipment owned by Milwaukee Land Company;

(ii) The real estate in the Fife, Washington, area related to the proposed construction of a new yard and terminal facility and adjoining industrial park site; and the real estate in Pierce county, Washington, proposed as an alternate site for such facility.

(iii) All of the assets of Washington, Idaho and Montana Railway Company;

(g) All of the assets of the following wholly owned subsidiaries of Milwaukee:

(i) The Milwaukee Motor Transportation Company;

(ii) MTI, Inc.;

(iii) Bremerton Freight Car Ferry, Inc.;

(h) All of the interest of the Milwaukee, direct or indirect, in the following entities, including all of the outstanding securities of and investments of Milwaukee in and advances by Milwaukee to such entities:

(i) Davenport, Rock Island & Northwestern Railway Company;

(ii) Chicago Union Station Company;

- (iii) Indiana Harbor Belt Railway Company;
- (iv) The Minnesota Transfer Railway Company;
- (v) Minneapolis Transfer Railway Company;
- (vi) Longview Switching Company;
- (vii) Delta Alaska Terminal Limited;
- (viii) Trailer Train Company.

(i) Rights of the Milwaukee in, to and under leases of personal property, pension plans, contracts, agreements, and arrangements with insurers, employees, suppliers, vendors, customers, other railroads, and other parties necessary to the operation in the ordinary course of business by New Railroad of the New System (the "New System Contracts"), provided, however, that New Railroad will not acquire the interest of Milwaukee under its trustee non-contributory qualified defined benefit pension plans unless the Trustee contributes sufficient assets thereto to fund all benefits which would be guaranteed by the Pension Benefit Guaranty Corporation under the provisions of the Employee Retirement Income Security Act of 1974 had such plans terminated immediately prior to their assumption by New Railroad.

(j) All other assets, except those identified below as retained, necessary or desirable the operation of the base lines and any contingent lines identified in the manner described below for addition to the New System.

The New System Assets do not include the following assets ("Retained Assets"):

- (a) All of the outstanding securities of Milwaukee Land Company owned by Milwaukee;
- (b) Accounts receivable and associated rights of Milwaukee arising out of its operations prior to the Effective Date;
- (c) Cash & cash equivalents of Milwaukee.

As the initial step in Phase I, NewMil and the Trustee with the assistance of the staff of the Milwaukee will jointly prepare schedules indentifying in further detail both the New System Assets and the Retained Assets. In addition, in the event any of the New System Assets are not physically located on real estate which is included in the New System Assets, the representatives of NewMil and the Trustee shall determine a procedure, and cost sharing arrangements for the gathering and transporation of those assets to real estate which is so included.

2. Nature of Title to be Acquired by New Railroad

The plan presented hereby contemplates that the Trustee will convey "good and clear title" to the New System Assets to the New Railroad. As used herein, good and clear title means the full right, title and interest of the Estate, the Trustee and Milwaukee in and to all of the New System Assets, free and clear of: (a) any lien, mortgage, security interest, claim or encumbrance of any kind, whether voluntarily created by the Trustee, the Estate or Milwaukee, or attaching to any of the New System Assets by operation of law, which secures a payment or performance obligation of the Trustee, Estate, or Milwaukee, except those liens or security interests securing the indebtedness to be assumed by New Railroad as described in Section 3(a) of this plan; and (b) any interest of any of the creditors of Milwaukee.

3. Assumption of Liabilities by New Railroad

New Railroad shall assume the following liabilities of Milwaukee ("Assumed Liabilities") and no others:

- (a) Obligations secured by rolling stock included in the New System Equipment having an approximate outstanding balance at December 31, 1978, of \$14 million;
- (b) Obligations of Milwaukee for payment and performance from and after the Effective Date under New System Contracts;
- (c) Obligations from and after the Effective Date under certificates of public convenience and necessity and other regulatory licenses, approvals and authorities granted to Milwaukee by the ICC or any other state, local, or federal regulatory body if and to the extent that such authorities relate to authority and obligation for service to the New System;
- (d) Disclosed liabilities, except to Milwaukee or its affiliates, of those wholly owned subsidiaries of Milwaukee whose assets are acquired hereunder, which are reflected in financial statements of such subsidiaries (such financial statements to be identified and agreed upon during Phase I) and changes in the ordinary course of business (which are not materially adverse) after the date of such statements.

4. Preparation and Submission of the Acquisition Plan

The representatives of NewMil and the Trustee shall jointly prepare the Acquisition Plan to be submitted to the Reorganization Court. That document, with appropriate recitation of the background and premises for the transaction, shall include the following:

- (a) A request for an order of the Reorganization Court;
 - (i) Authorizing and directing the conveyance of good and clear title to the New System Assets, with reference to schedules developed in accordance with

Section X.B.1., above, by the Milwaukee to the New Railroad;

(ii) Authorizing the retention by Milwaukee of sole responsibility for all of its obligations and liabilities other than the Assumed Liabilities;

(iii) Confirming in New Railroad, upon execution of the actions described in the Acquisition Plan, of good and clear title to the New System Assets;

(iv) Authorizing, approving and fixing the effective date and time of the acquisition of the New System Assets by the New Railroad and authorizing the Trustee to execute all documents and to take all other steps necessary or convenient to the consummation thereof;

(v) Ordering, pursuant to Section 5 of MRRA, the abandonment of service on all lines not included in the New System;

(vi) Approving and authorizing the Trustee to perform the Acquisition Plan.

(b) A specific listing of those obligations and liabilities to be assumed by New Railroad.

(c) Procedures which contemplate that, at least initially, the transfer documents to be delivered by the Trustee to the New Milwaukee will be general in nature; good and clear title to the New System Assets will be conveyed by reference to a general description of the New System Assets contained in this Plan. Detailed procedures will be developed in the Acquisition Plan for confirmation and correction of good and clear title to the New System Assets in New Railroad and the making of any necessary filings and recordings in connection therewith. A procedure must also be developed to provide for resolution of any disputes which may arise between the Trustee and NewMil concerning the inclusion or exclusion of a particular asset within the New System Assets.

(d) Detailed accounting procedures for identifying the transactions and events occurring prior to and after the Effective Date.

(e) Procedures for facilitating the collection after the Effective Date of receivables and other assets for the account of Milwaukee and the compensation of New Railroad for providing that service.

(f) Mutually satisfactory arrangements for access by Milwaukee to and use of manual and computerized files and records acquired by New Railroad hereunder, and the basis for sharing the expenses of joint maintenance and retrieval of files and records.

(g) A procedure for the equitable proration of property and ad valorem and similar types of taxes levied against the New System Assets by the states and other governmental authorities for the tax year which includes the Effective Date, the purpose and intent of such proration being that as to the taxes or portions thereof determined to be fairly attributable to the New System Assets, the Estate should bear the liability for any such taxes accruing on or prior to the Effective Date and New Railroad should bear the liability for any such taxes accruing after the Effective Date. The tax proration procedure to be developed will provide:

(a) Prior to Effective Date, a good faith estimate (subject to later adjustment to reflect actual 1980 taxes) will be made of such taxes accrued but unpaid prior to the Effective Date; and

(b) The Estate will on the Effective Date pay such estimated amount into an escrow fund to be held for the purpose of paying the taxes when they become due.

(h) Procedures for obtaining consents of other parties to the transfer and assignment of the New System Contracts to the New Railroad, or Court orders respecting the same.

(i) Procedures whereby the Trustee will compensate New Railroad for any sums paid by New Railroad for any of the types of liabilities described in 45 U.S.C.A. 721(h)(1)(A). While the Trustee has the sole obligation to see that such liabilities of the Estate are paid, it is possible that, in the exercise of sound business judgment and in order to continue the effective operation of the New System Assets, the New Railroad may make some of such payments. Such procedures may include a combination of a cash deposit by the Trustee with New Railroad to be held in escrow

to meet such claims and the grant to New Railroad of a high priority position against the Estate for any such payments.

(j) Absent legislation of the type contained in Section 45 U.S.C. 743(e), procedures for allocating liability for and payment of transfer taxes or fees upon the transfers contemplated by the Acquisition Plan.

(k) The following exhibits:

(i) The proposed form of the orders to be entered by the Reorganization Court;

(ii) The form of instruments of conveyance and assumption to be executed pursuant thereto.

5. Contingent Lines Inclusion Determinations

Not later than April 1, 1980, the review by NewMil of the inclusion in the system of contingent lines shall be completed and the results thereof reported to the Trustee, the ICC and the Reorganization Court. This report on the selection of contingent lines shall include the following:

(a) The identification of any contingent line meeting the standards described elsewhere herein and selected for inclusion in the New System by NewMil;

(b) A statement demonstrating the basis for NewMil's conclusion that the contingent lines so selected would meet such standards including a description, where appropriate, of any undertakings by private or governmental authorities necessary to the satisfaction of such conditions;

(c) A statement describing the procedure by which New Railroad would compensate the Estate for the inclusion of such contingent lines.

Such contingent lines shall be included with the base lines in the New System for all purposes within the Acquisition Plan.

6. Financing the New Railroad

The pro forma financial statements of the Plan indicate a need for \$150 million in external financing. This financing would be obtained from three different federal programs as well as from private sources. The following discussion describes the nature and availability of these various sources of funds, and the steps to be taken during Phase I to obtain this financing at the time the funds are projected to be needed.

(a) Section 505 Redeemable Preference Share Financing

(i) Source and Purposes - The pro forma financial statements indicate that the New Railroad will issue redeemable preference shares authorized under section 505 of the Railroad Revitalization and Regulatory Reform Act of 1976 (RRRR Act), in the amount of \$101 million over the years 1980 and 1981. The proceeds of these securities are to be used for the purpose of facilitating the rehabilitation and improvement of Milwaukee Road lines that are transferred to the New Railroad and carried not less than an average of 3 million gross tons of freight per mile per year during the previous 3-year period. This funding will be available for this purpose as a result of the amendment of section 505 by section 16 of MRRA to establish special and expedited financing provisions. Section 16 of MRRA also established a limitation upon the amount of funds that can be made available at any time for the purchase of redeemable preference shares from any single railroad undergoing restructuring to 50% of the total funds available. According to the Federal Railroad Administration, under existing law and appropriations, there is \$203 million dollars available under section 505. Thus, the amount the New Railroad seeks meets the 50% statutory limitation.

(ii) Essential terms - Deferral of Dividends and Redemption. The terms of the funding and the rights and interests of the holders of redeemable preference shares are prescribed by section 506 of the RRRR Act. Of particular significance is the fact that dividends do not begin to accrue until the tenth anniversary of the issuance of the shares and mandatory redemption is not required by law to begin until the eleventh anniversary. Thus, the average annual cost of this financing to the New Railroad over a 30-year term would be 2.3%.

(iii) Application and approval procedures and timing. - As a result of the amendment to section 505 of the RRRR Act by section 16 of MRRA, the procedure for application and commitment of the funds can now be greatly expedited. It is NewMil's understanding that the Federal Railroad Administration is in the process of revising its application procedures to take into account the expedited basis under which funds are available pursuant to section 505(f). NewMil expects that these regulations will indicate the type of information required to establish the basis for this funding and that an appropriate application can be made shortly after the decision by the reorganization court required by the MRRA on January 10, 1980. Given the fact that this legislation has removed the requirements of sections (a) through (e) of section 505, other than subsection (d)(3), NewMil is not aware of any reason that a firm commitment could not be made by the Federal Railroad Administration under this program by April 1, 1980. Further, since the amendment made by the RRRR Act removes the requirement under subsection (c) of section 505 for an agreement for financing meeting the requirements of subsection (f), NewMil envisions that the process obtaining the financing can occur on a much more expedited basis and will in any event be completed within 60 days after April 1, 1980.

(b) Section 511 Loan Guarantees

The capital structure for NewMil calls for the borrowing of \$8.8 million in 1981 for the purpose of equipment rehabilitation and an additional \$14 million for

building a new yard at the Port of Tacoma. For the latter project, \$10.6 million would be drawn down in 1981 and \$3.4 million would be borrowed in 1982.

i) Amendment of Pending Equipment rehabilitation Loan Guarantee Application - With respect to the equipment rehabilitation program, NewMil proposes that it would apply for guarantee of obligations in that amount by means of an amendment to the application which the Milwaukee has already filed with the Federal Railroad Administration requesting a loan guarantee of \$32 million for rehabilitation of equipment over a two-year period. NewMil would revise that program to be consistent with its equipment program, which is designed to replace rather rebuild the Milwaukee's low-capacity fleet. This revision would be made immediately after the approvals of this Plan by the ICC and the Reorganization Court and would be carried out with the cooperation of the Milwaukee Road staff. NewMil believes that, since the Federal Railroad Administration will have already committed its obligation guarantee authority up to the \$32 million for the Milwaukee's equipment rehabilitation program, this modification and the necessary funding commitment can be made without any substantial problems by April 1, 1980.

(ii) New Tacoma Yard Financing - With respect to the Tacoma yard project, an application would be submitted that meets the requirements of section 511 and the applicable regulations shortly after the railroad begins operations. It is expected that the procedure for approving this application under existing law would require a number of months. However, it is clear that, since the project is in essence the establishment of a new railroad facility - a new yard at Fife adjacent to the Part of Tacoma - funds borrowed pursuant to section 511(a) can legally be used for that purpose. Moreover, it is also clear from the studies performed for NewMil in preparation of this Plan, that complete documentation can be submitted to the Secretary that will enable him to make the applicable fundings required by section 501(g).

(iii) Essential terms of Loan Guarantee Financing.

As in the case of section 505, most of the terms of the financing are specified by statute. The loan would be for 20 years and bear interest at the rate of 12%, which is the current rate of interest applicable to such obligations, plus a 3/6% annual premium charge as required by the section 511(1).

It is current Federal Railroad

Administration practice to permit the borrower to defer servicing the debt for a short period of years if requiring payment would necessitate additional borrowing.

Accordingly, NewMil's Plan would be to defer such service until 1983 when it is achieving positive operating income. Based upon conversation with F.R.A. officials as to the available obligation guarantee authority, it is a virtual certainty that adequate funding will be available when the New Railroad applies

(c) Economic Development Administration and Farmers Home Administration ESOP Loan Guarantee

(i) Source of ESOP Funds - The capital structure of the Plan calls for the sale of \$15 million of common shares to an Employee Stock Ownership Trust under an ESOP to be established for all of the New Railroad's employees (see discussion in Chapter IX). These shares will be paid for by the Trust from the proceeds of a loan in a like amount which will be guaranteed by EDA and FmHA. These two agencies have coordinated on such loans in various cases in the past. FmHA would be acting under its Business and Industrial Loan Program established pursuant to the Farm and Rural Development Act of 1972, 7 U.S.C. 1980 et. seq., 7 CFR Part 1980 Subpart E. At this time there is \$1.1 billion in loan guarantee authority available under that program for this purpose. Based on discussions with FmHA officials, both the amount and purpose of the financing that the New Railroad would need for this purposes are within the established loan guarantee requirements and practices.

EDA would be acting under its Development Financing Program under Title II of the National Public Works and Economic Development Act of 1979 which is about to be considered by Conference Committee of the Congress. The House version of this Act (H.R.2063 §211) will establish a minimum set-aside of 5% of the appropriate guarantee authority to be used for financing ESOPs. EDA is currently acting under a continuing resolution until this new law is passed which is expected to occur by January 1, 1980. If EDA's authority is not so enacted by January 1, 1980, NewMil could still seek the EDA portion of this loan guarantee from existing EDA authority under the Public Works and Economic Development Act of 1965 as amended. 42 U.S.C. 3142. However that program, under continuing resolution, is limited to obligations equal to 1/12 of its total outstanding obligation authority in any month. That amount would be approximately \$16 million per month. Since NewMil would seek a guarantee from EDA of not more than \$7.5 million (and possibly less) it is clear that there is sufficient authority in either event under EDA to participate in NewMil's proposed financing.

(ii) Essential Terms - The terms of such a joint loan guarantee are largely established by federal law. The Plan has projected a 15-year pay-back schedule in order to maximize the incentives available to the employees as they become owners of the shares when the loan is serviced. The interest rate has been projected at 11 1/2% which currently is the rate on loans guaranteed by FmHA under its Business and Industrial Development Loan Program. In addition, a 15-year term could be extended depending on the collateral available and the overall results of the negotiations with the two agencies. Therefore, NewMil believes that it is clear that the financing will be available from one or both of these agencies under terms that are consistent with the cash flow projections shown in this Plan.

(iii) Application Procedures - The process for obtaining this loan guarantee would begin with the submission by NewMil, on or about December 3, 1979, of a joint letter to the Assistant Secretaries of the Departments of Commerce and Agriculture that respectively head EDA and FmHA requesting that they guarantee the above-described loan. If the agencies are interested in considering such a financing, they will invite NewMil submit a formal application. NewMil would expect such a response to be forthcoming not later than the middle of January. Once NewMil has been invited to apply, the application, which would already be undergoing preliminary preparation, would be submitted promptly. Based on its understanding of the agencies' processes and given the time demands of this proceeding under the MRRA a commitment for the financing could be made on or before April 1, 1980, which is consistent with the time frames for processing such applications at the Farmers Home Administration. Funding could follow their commitment within 60 days which is consistent with the anticipated timing for the second phase of the Plan. It should be noted that both agencies testified in June to Congress on their willingness to consider this concept under their financing programs.

(d) Private Financing

Shippers have provided special support to the efforts of NewMil. NewMil expects their support will continue by, among other things, committing to invest funds in the New Railroad. Principal shippers on the NewMil Board of Directors with the assistance of Dean, Witter, Reynolds, Inc. are surveying the largest shippers on the Milwaukee to obtain an assessment of the likelihood that capital can and will be raised for the New Railroad. The results of those efforts will be filed with the Commission no later than December 14, 1979. Naturally, until shippers have had an opportunity to digest the NewMil Plan they would be unable to invest their funds in the New Railroad. Thus promptly after filing this Plan, it will be circulated among all interested shippers. If the Plan is found to be fair and equitable by the Commission and the Reorganization Court, an appropriate financing vehicle will be developed. At this time, for purposes of the capital structure reflected in the pro forma financial statements, that vehicle has been assumed to

be a 12% non-cumulative preferred stock. The pro forma statements assume the commencement of the declaration of a preferred dividend when it is projected that income will be available for the preferred. In the opinion of NewMil, this conservatively states the form of and affect on cash flow of that portion of the capital that would be raised from private sources. The Board of Directors of NewMil has decided that up to 50% of the equity should be sold to shippers, and it further believes that it is not unlikely that once the Plan is distributed and its projections understood, \$15 million can be raised in a form of equity consistent with approximately equal ownership of the company by the employees and the shippers respectively. However, the exact nature of the securities that would be sold to shippers and their amount must await the results of the circulation of the Plan and the decisions by the Interstate Commerce Commission and the Reorganization Court. If those decisions are favorable there is every reason to believe that at least \$10 million of equity capital can be raised from shippers and more likely \$15 million. If, on the other hand, less than \$10 million were raised from shippers, the shortfall could be included in the ESOP loan-guaranteed portion of the financing without significant change in the projected cash flow for the New Railroad, particularly given the flexibility of the terms for that guarantee program.

(e) Other Sources of Financing - Immediate and Long Range

The foregoing discussion has set forth a description of the form and nature of the financing necessary to support the proposed capital structure contained in this Plan. It should be recognized, however, that other financing programs and sources also exist. In the first instance there are additional funds available under section 505 and section 511 of the RRRR Act which could be expected to be available in the coming years. The Administration has proposed in its rail regulatory reform bill a provision which would extend in a somewhat different from the section 505 program and make the funds available for restructuring purposes. Recently Senator McGovern inserted an amendment which was approved by the full Senate to the windfall profits tax legislation that would set aside \$600 million for the purpose of rehabilitation and improvement of railroads under a program which would

require additional authorizing and appropriating legislation but funds could become available as early as September 1, 1980. Finally, as discussed respectively in the sections on contingent lines and "401," lines there may be assistance available from the States or from the Federal government for purposes either of operating light-density lines and rehabilitating those lines, which would be particularly applicable to the contingent lines as well as through the section 401 process. However, each of these financing vehicles would not be expected to affect the overall capital structure, but rather preserve that structure in precisely its format shown in this Plan in the event that additional lines, whether contingent or section 401 process lines, were taken into the system. NewMil also believes that once New Railroad has begun operations and has met the goals projected for it, substantial amounts of capital could be available from the private market, given the fact that it would have a relatively low debt to equity ratio and have already achieved the kind of restructuring that few railroads have had. This might include an additional loan to the ESOP trust which would not be necessarily federally guaranteed. It might also include issuance of debt securities since there would be very few liens on the property of New Railroad. Finally, of course, there is the possibility of equity financing although that would likely be well into the future when some of the long-term benefits of the rehabilitation program and potential coal traffic have begun to have their effects and would support this.

7. Selection and Recruitment of Management for New System

The quality of management is one of most important factors in the long term success of any company. In a turn-around situation -- that is, where a bankrupt company must be reorganized into a profitable one -- the quality of management, and management's commitment and ability to execute the turn-around strategy, are critical to achieving the reorganized company's performance forecasts. Mergers and reorganizations

have failed frequently when hold-over management was unable or unwilling to carry out the turn-around strategy designed for the surviving company. On the other hand, a wholesale management turnover is no panacea either. Many mergers and reorganizations have also failed where new management was brought in that did not understand the business of the company, or was unable to grasp the operating complexities of the company's business in time to make the turn-around strategy work.

For these reasons New Milwaukee Lines believes that effective implementation of the proposals contained in this Plan, and in particular implementation of its turn-around strategy, will require a management that is both knowledgeable about railroading and the Milwaukee Road as well as committed to executing the turn-around strategy.

New Milwaukee Lines has on its Board of Directors persons who know the value of and have substantial experience in selecting top management officials. NewMil's Board includes the presidents and other top officers of large and sophisticated enterprises. These include the Anaconda Copper Company, the Montana Power Company, the Knife River Coal Mining Company, and others that span a variety of different industries, including lumber and grain as well as coal, utilities and copper production. Likewise, the cabinet officers of the state governments in the northern tier who serve on NewMil's board

have substantial experience in selecting key personnel. From a different perspective, the Milwaukee Road's employee members on the New Milwaukee Lines Board have a keen appreciation not only of the need for strong, capable and committed management, but also of the need for management leadership. Indeed, probably more than any of NewMil's other board members, the Milwaukee Road employees have seen over their many years of experience the direct effect on operations of the absence of a sound management plan for improving the railroad's fortunes.

The NewMil Board of Directors is committed to beginning a thorough and unbiased process of evaluating and selecting a top management structure that it feels would contribute best to the long term success of this Plan. That process will begin with the hiring of persons from outside the Milwaukee Road and outside the present Board and staff of NewMil, to become the New Railroad's chief executive officer and chief operating officer. It is expected that these individuals would include at least one experienced railroad person having some familiarity with the peculiar problems presented by a bankrupt railroad such as the Milwaukee. It is expected that each will have a proven success record in his or her own management history with another railroad. Steps have already been taken to identify candidates for these positions and initial contacts have been made with several executives, presently employed in senior positions with other railroads, who appear to meet these

criteria. NewMil Lines is confident that in a short period of time after approval of the Plan by the Interstate Commerce Commission and the Reorganization Court it will be possible to hire such individuals and entrust to them the task of assembling a management team for the New Railroad.

The process of selecting a management team and evaluating staffing needs will be part of the responsibilities of the executives chosen to become the New Railroad's chief executive officer and chief operating officer.

NewMil also anticipates that it will seek assistance in the evaluation of existing Milwaukee Road management and in the search for outside persons to fill key positions that will assure the successful implementation of this Plan. NewMil expects in the near future to employ an executive search firm for this purpose.

New Milwaukee Lines recognizes that much of the existing Milwaukee management can make an important contribution to the success of the company. Like employees throughout the Milwaukee, many of these officials have years of experience and service with the Milwaukee and have performed admirably under adverse conditions. New Milwaukee Lines expects that many of them will be offered the opportunity to participate in managing the execution of this plan.

8. Consideration of the Merger Plan

Implementing the acquisition by means of a merger offers significant advantages over the above-described method of transferring assets from the Estate to the New Railroad. Among these are the following:

(a) It permits the operation of, and expeditious assumption of service by, the New Railroad under currently existing state, federal and local regulatory approvals and authorities in the possession of the Milwaukee;

(b) It eliminates the need for a multitude of individual conveyances and transfer documents relating to the New System Assets and the local recording thereof;

(c) It accomplishes, in effect, the assignment to the New Railroad of complex varieties of interests under the Milwaukee's agreements and arrangements with other parties without having to obtain the consent of such parties.

NewMil recognizes that the advantages of a merger plan are presently offset by the uncertainty surrounding the answers to the complex legal, tax and accounting problems that would arise in implementing a railroad reorganization of this magnitude by merger. If those problems can be addressed and resolved to the satisfaction of the Trustee and NewMil during Phase I, NewMil would much prefer the ease, economy, and speed of a merger format. The problems include, for example, questions as to:

(1) the effect of a merger on the retention in the Estate and use by the corporate group of which it is a part of presently existing net operating loss carry forwards; (2) whether the

Reorganization Court in this case can order a transfer of liabilities to a new corporation, order a merger and discharge the former Estate shell from all debts and liabilities as part of a plan of reorganization; and (3) how the Estate-restructuring and merger transactions are to be accounted for on both a financial and tax basis.

It should be noted that these problems may not be insurmountable. Aside from resolution of such problems under the law as it presently stands, the possibility exists that Congress, recognizing the substantial advantages in speed and economy of a merger procedure, could resolve them through new legislation. The Conrail legislation is precedent for the proposition that Congress can provide legislative relief where it recognizes the difficulties that arise in a railroad reorganization of this size and complexity. Congress could, for example, exercise in full its power under the Commerce Clause to render compliance with many burdensome procedures of unnecessary (such as it did in 49 U.S.C. §11341). Legislation could also deal with the broad questions of the tax effects of the various transactions involved in a merger plan, tax basis of assets transferred and retained, and the ability of the Reorganization Court to approve the merger plan and order all transactions contemplated thereby (such as it may under 11 U.S.C. §1123(a)(5)(C)). Certainly the need for regulatory

approvals under §77, the MRRA and the Interstate Commerce Act (for the merger, for example) could be coordinated and clarified.

In such a merger plan the corporate structure and ownership of assets and the incidence of liabilities within the Estate would first be rearranged by order of the Reorganization Court. The rearrangement would consist of the transfer of all but the New System Assets and Assumed Liabilities to a newly formed subsidiary of the Milwaukee ("New Subsidiary"). There would then be a merger of the New Railroad with the Milwaukee, in which the Milwaukee would survive. The Milwaukee would become the employee-shipper owned railroad contemplated by MRRA, and New Subsidiary would continue as the Estate (less the New System Assets and Assumed Liabilities). The plan would proceed through Phase I just as the asset acquisition would, except that the merger plan would include (a) Orders of the Reorganization Court substituting New Subsidiary as the debtor in the reorganization proceeding and making effective upon it prior orders in the proceeding, and authorizing the release of Milwaukee from and assumption of all of the Estate's obligations and liabilities by, New Subsidiary; and (b) an additional exhibit regarding articles of merger. Phase II would be identical to that Phase of an asset acquisition.

C. Matters to be Accomplished in Phase II

1. Implementation of Acquisition Plan

Activities in Phase II shall consist principally of the accomplishment of those actions described in the Acquisition Plan. All such actions will be accomplished through the entry of an order by the Reorganization Court authorizing and approving the Acquisition Plan and directing the parties within the Court's jurisdiction to take the action necessary to implement it, and by the action of those parties and others to execute the documents and take the other actions contemplated in the Acquisition Plan and in such orders.

(a) Nature of Proceedings in the Reorganization Court

At the conclusion of the proceedings in the ICC and the Reorganization Court prescribed in MRRA, it is anticipated that orders will issue approving this Plan and authorizing and directing the Trustee to proceed with the implementation described in this Chapter X. Proceedings in the Reorganization Court during the second phase will be exclusively concerned with the form of implementing orders and documents and other details of implementing this plan, the substance of which shall have been previously approved.

(b) Specific Matters to be the Subject of Reorganization Court Implementing Orders

(i) Abandonment of Service on Lines not Included in the New System

As soon as the process of selecting contingent lines to be included in the New System described in paragraph X-B.5 above the Trustee shall be ordered to seek authorization pursuant to the MRRA for the abandonment of that service which is not included in the New System.

(ii) Implementing Orders Contemplated in the Acquisition Plan

It is anticipated that promptly after the submission of the Acquisition Plan to the Reorganization Court, the Reorganization Court will issue an order establishing procedures for further proceedings and that such order will limit the proceedings as described in X.C.1(a) above, and provide an opportunity for interested parties to be heard within an expedited schedule. At the conclusion of those proceedings, it is anticipated that the Reorganization Court will enter the orders contemplated in the Acquisition Plan, the proposed form of which shall have been a part of the Acquisition Plan.

(iii) At the conclusion of such proceedings, the parties will consummate the transactions contemplated in the Acquisition Plan and prior orders of the Reorganization Court.

XI. FAIRNESS AND EQUITY OF THE PLAN

As discussed in Chapter II of this Plan, asset valuations based on capitalization of the projected earnings of the reorganized entity have been the primary method of valuation in cases applying the requirements of Section 77(e) of the Bankruptcy Act. The holding in the New Haven Inclusion Cases, 399 U.S. 392 (1970), however, establishes -- at least in cases where the estate has no earning power -- that the "fair and equitable" test of Section 77 may require a valuation of the estate on a net liquidation basis. The Reorganization Court has indicated that the "fairness and equity" of this Plan "cannot be evaluated in the abstract" and must be found to be "at least as favorable to the creditors as any other plan which is brought to the attention of the ICC or the court." (Slip Op. at 13)

In order to apply these legal principles to the proposals contained in the present Plan, NewMil asked the Consulting Center to perform valuation analyses that compare (i) the present value of the Estate if the Trustee's Reorganization Plan is implemented and achieves the financial performance he has projected for it, with (ii) the present value of the assets that will be retained by the Estate if this Plan is adopted and implemented.

The Consulting Center performed these analyses on both a capitalized earnings and a net liquidation value basis.

1. The Capitalized Earnings Comparison

The Consulting Center capitalized the cash flows projected for the Trustee's Milwaukee II system and compared these to the capitalized earnings that would be made available to the Estate under the provisions of the New Milwaukee Lines Plan. The Consulting Center also compared the level of claims that would be imposed upon the Estate under each reorganization alternative.

The results of this comparison indicate that the present value of the anticipated cash flows, before deductions for claims, is significantly greater under the Plan proposed by NewMil than the comparable figure projected for the Milwaukee II proposal. Moreover, implementation of the Trustee's reorganization proposal would result in the imposition of much higher claims against the Estate than will result for the Estate if the NewMil Plan is adopted.

a. Methodology Employed in the Capitalized Earnings Comparison

(i) Estate with Milwaukee II

The Consulting Center conducted its comparison of the Estate's capitalized earnings by developing the present value for the operating and property sales cash flows that were projected in the Trustee's Reorganization Plan for Milwaukee II. The Consulting Center projected cash flows for the

Milwaukee II system over a ten-year period beginning in 1980, and also added to that value the present value for the same period of the cash flows of the Milwaukee Land Company and the Milwaukee Motor Transportation Company, using appropriate discount rates.

Having arrived at a present value for all projected cash flows if Milwaukee II is operated and succeeds as projected by the Trustee, the Consulting Center then determined the full value of all claims against the Estate net of any amounts paid from cash flow over the ten-year term. These claims are the sum of the claims identified in the Reorganization Plan as outstanding on June 30, 1979 (Exhibit 10 of the Reorganization Plan), plus the increase in those claims to April 1, 1980, plus the additional obligations that the Milwaukee II system is projected in the Reorganization Plan to incur over the ten-year period.

(ii) Estate Without a Railroad

The Consulting Center then proceeded to value the cash flows anticipated to result for the Estate if the NewMil Plan is adopted. The analysis was conducted in precisely the same fashion described above with the following exceptions:

(1) it was assumed that immediately after the division of assets proposed in the NewMil Plan the Estate would commence an expeditious program to liquidate the assets that will be left for it; the cash flows projected to result from such a

liquidation program were then discounted to present value in order to develop a value for the Estate's cash flows minus the assets to be acquired by the New Railroad; (2) the cash flows of the Trustee's proposed Milwaukee II system, and of the Motor Company, were removed; (3) a 13% discount rate was used because under the NewMil Plan, the Estate will not be operating a railroad; rather, the assets conveyed to the Estate as part of the Plan will presumably be available for liquidation in a manner analogous to the property sales projected in the Trustee's Reorganization Plan and discussed above; (4) the claims were reduced to eliminate those obligations that would not be incurred because the Estate, under the NewMil proposal, will not be operating a railroad after the property division.

Exhibit XI-A shows the present value of the cash flows that will be generated for the Estate if Milwaukee II is operated. Exhibit XI-B shows the similar valuation of the cash flows that result for the Estate if this Plan is found fair and equitable. Exhibit XI-C shows the total claims that will be outstanding against the Estate if the Trustee's Reorganization Plan is implemented and performs as projected. Exhibit XI-D shows the claims against the Estate that will be outstanding if the NewMil proposal is adopted.

(b) Results of the Capitalized Earnings Comparison

The results of the Consulting Center's capitalized earnings comparison were as follows:

(i) Present value of cash flows before deductions for any claims:

The Estate will attain cash flows having a present value of \$120.8 million, before deductions for any claims, if the Trustee's Milwaukee II system is operated for the projected period. In sharp contrast, the cash flows that will be made available from a liquidation of the assets left with the Estate under the provisions of NewMil's Plan have a present value of \$204.8 million before deduction for any claims.

The present value of the cash flows before claims thus differ substantially under the two alternatives. Adoption of the NewMil Plan would result in a contribution of \$84 million to the present value of the cash flows that would otherwise be attainable for the Estate if the Trustee's Reorganization Plan were adopted (and the Milwaukee II system were to perform precisely as projected in that Plan during its first ten years of operation).

(ii) Effect of Plan on Level of Claims

The capitalized earnings comparison conducted by the Consulting Center also indicated that adoption of the NewMil Plan would result in the imposition of substantially reduced claims upon the Estate. The Consulting Center found that operation of the Milwaukee II system would result in total claims against the Estate, excluding labor protection claims (class k), of \$548.6 million. If the proposals contained in

the NewMil Plan were implemented, however, and the Estate were relieved of its obligation to operate any railroad system as provided in the Plan, the Consulting Center found that total claims against the Estate would total \$417.4 million. Again, this is without labor protection claims. Thus, operation of the Milwaukee II system, even if that system performed up to the standards projected in the Trustee's Reorganization Plan, would result in the imposition of approximately \$130 million of additional claims, not counting labor protection, that must be deducted from the value of the projected cash flows in order to calculate the true capitalized earnings attainable for the Estate.

(iii) Impact of Labor Protection Claims

The Consulting Center also found that the spectre of liability for labor protection affects the two systems very differently. The Trustee's Reorganization Plan assumes that Milwaukee II will employ approximately 5800 employees and apparently assumes that approximately 4090 eligible employees will be severed as a result of the transition to Milwaukee II. The Trustee's Reorganization Plan estimates that the labor protection claims asserted by these employees would total approximately \$325 million. (See the Trustee's Reorganization Plan, at 50-52)

It is possible, however, that total labor protection liabilities for the Milwaukee II system might be less than this amount because the MRRA provides a federal loan in the amount of \$75 million to finance severance benefits under a labor protection program created pursuant to Section 9 of the statute. Section 22 of the statute provides that each severed employee is permitted an election as to whether to seek benefits under the program set up under Section 9 -- which provides that no employee may receive more than a lump sum payment of \$25,000 -- or to continue to pursue his ordinary statutory claim for labor protection. Thus, although the new statute does not enact a limit on the potential labor protection claims against the proposed Milwaukee II system, the statute does create a procedure, and provide funding, that makes it at least possible that the \$325 million worth of potential claims estimated by the Trustee might be "bought off" in return for early and certain payments under the federally-financed program totalling approximately \$75 million. Section 15 of the MRRA provides that the \$75 million provided by the federal government to finance this optional labor protection program must be an expense of administration against the Estate. These various considerations indicate that, in addition to the claims against the Estate discussed above, implementation of the Trustee's Milwaukee II proposal would result in additional labor protection claims on the Estate totalling from \$75 million to \$326 million.

On the other hand, if the proposals contained in the NewMil Plan are adopted, the Estate, which would again have the benefit of the statutory program enacted by the MRRA, will apparently face labor protection claims from not more than 1,985 employees. (The Trustee's Plan appears to assume that 9,890 employees are protected on the present system: Milwaukee II will employ 5,800 employees and the Trustee's Plan assumes that 4,090 others will have protection benefits.)

NewMil's Plan estimates that the New Railroad will employ 7,905 employees in its first year of operations. It is not clear, however, that the remaining 1,985 employees will all seek or receive protection benefits. The NewMil Plan proposes substantially increased employment levels as the New Railroad's service levels increase. By 1982, for example, the New Railroad will require a work force of 9,032 employees. Moreover, these figures assume only the employment levels required to operate the base system, i.e., these numbers assume that none of the "contingent lines" shown on the New Railroad's System Map will ultimately remain in the system. NewMil believes that in actuality these considerations make it unlikely in the extreme that the number of employees needing protection benefits will remotely approach the hypothetically possible figure of 1,985.

Assuming the same range of possible protection payments per employee that was assumed in the analysis of the labor

protection implications of the Trustee's Reorganization Plan, the Consulting Center concluded that adoption of the proposals contained in the NewMil Plan would expose the Estate to maximum "worst case" potential labor protection claims of approximately \$160 million (assuming a payment of \$79,706 to each of the 1,985 severed employees -- the same amount assumed by the Trustee to calculate the \$326 million figure). If, however, the protected employees severed by reason of the adoption of the New Milwaukee Lines Plan all opt to seek immediate severance payments pursuant to the statutory program created by the MRRA, and assuming that each receives the same average payment that would result if the Trustee were able to use this \$75 million program to completely "buy off" the labor protection claims generated by adoption of his Milwaukee II system (\$18,337), the labor protection claims against the Estate attending adoption of the NewMil proposal would result in labor protection claims against the Estate totalling approximately \$36.6 million. Moreover, if inclusion of "green lines" in the NewMil System and/or anticipated expansions in the work force required by the New Railroad reduce the number of severed employees seeking protection benefits, as opposed to jobs, adoption of the NewMil proposal would further reduce the Estate's labor protection liability. NewMil believes that both of these developments are likely.

After considering all of these figures, the Consulting Center reached some conclusions as to the impact upon the net present value of the Estate that would be brought about by adoption of each of the two proposed plans of reorganization. Assuming a "worst case" estimate of the potential labor protection claims, i.e., that all employees severed under each alternative who are eligible to receive protection benefits opt to eschew the \$75 million fund to be created pursuant to the MRRA and instead pursue their statutory labor protection claims in litigation and recover an average of \$79,706 each, adoption of the NewMil Plan will result in an improvement in the net present value of the Estate of over \$400 million. On the other hand, assuming a "best case" labor protection scenario, in which each eligible severed employee is assumed to opt for early payment in an average amount of \$18,337 under the \$75 million fund created by the MRRA in lieu of pursuing their larger but more uncertain statutory claims, adoption of the New Plan would enhance the net present value of the Estate by approximately \$295 million.

c. Assessment of Risk

Moreover, these comparisons do not take into account the real difference in risk that the two plans pose for the Estate. As Chapter VII brings out, the Milwaukee II system is highly unlikely to achieve even the forecasted levels of income contained in the Reorganization Plan. Failure to attain these

projections would have a double-barrelled effect on the actual valuation of the Estate. First, it will increase dramatically the amount of claims necessary to sustain the Milwaukee II system even to the projected year five; second, it will cause a like increase in the claims against the Estate because of the need for additional borrowing to finance ongoing operations. The Estate can anticipate not only that its capitalized earnings before claims will be greater if the NewMilPlan is adopted and that claims against the Estate will be substantially reduced, but by adoption of the NewMil proposal the Estate would also dramatically reduce the risks inherent in undertaking operations of the sort proposed by the Trustee's Reorganization Plan for the account of the Estate. Under the NewMil proposal, the Estate would be relieved of all liability for unanticipated claims and operating losses associated with the continued operation of a railroad system after the property division. This proposal, in addition to protecting the value of projected cash flows by eliminating anticipated losses, also lifts from the Estate the risk that it might be required to endure wholly unanticipated burdens if the Trustee's Reorganization Plan is implemented, particularly where the government is its major creditor.

2. Net Liquidation Value Comparison

In addition to comparing the net present value of the

Estate under the Trustee's Reorganization Plan and under the NewMil Plan on a capitalized earnings basis, the Consulting Center also attempted to analyze the likely net liquidation value of the Estate on the assumption that each plan is adopted and implemented. This analysis differed somewhat from the capitalized earnings approach described above because in the earnings analysis of the Trustee's Milwaukee II system it was necessary to assume that the system would perform up to the standards forecasted in the Trustee's Reorganization Plan and earn the projected cash flows throughout the study period. In order to prepare a proper net liquidation analysis, however, it is necessary to assume that after transition to and operation of the Milwaukee II system for an appropriate period of time, events begin to occur making it clear that the forecasts contained in the Trustee's Reorganization Plan are unrealistic and unattainable. The analysis must also assume that when this "point of no return" is perceived, the Trustee would then seek appropriate regulatory and judicial approvals for permission to abandon and liquidate the system, and would then commence a program of actual liquidation. (See the discussion of the plan approved in the New Haven Inclusion Case, 399 U.S. 392 (1970) and of U.S.R.A.'s Final System Plan contained in Chapter II, supra.)

For purposes of the present liquidation analysis, the Consulting Center hypothetically assumed that the initial

perception that the Milwaukee II system would inevitably fail would be reached somewhere near the end of the system's fourth year of operation, which corresponds to the "turn-around" point described in the Trustee's Reorganization Plan. (Reorganization Plan, Exhibit 22) It was assumed that if the turn-around point were reached, but actual results indicated that performance was not keeping pace with the forecasted projections, this event might give rise to intensive reassessment of the potential viability of the Milwaukee II system.

The starting point for the Consulting Center's analysis of the net liquidation value of the Estate under the Trustee's proposal is the Ford, Bacon and Davis estimate that the entire Milwaukee system had a total liquidation value of \$832 million as of December 31, 1977. As indicated above, the Consulting Center found that total claims against the Estate on April 1, 1980, that would not be satisfied from cash flow, are expected to total \$417.4 million. As a result, the net liquidation value of the Estate as of that date, and before considering any other possible deductions against this amount, would total approximately \$415 million.

It must be noted, however, that this figure does not include any recognition of labor protection claims. As noted in the discussion above, the labor protection claims of the 4,090 workers that the Trustee anticipates will be severed and eligible for protection as a result of the adoption of the

Milwaukee II system is expected to yield claims against the Estate falling somewhere between \$75 million ("best case") and \$326 million ("worst case"). Conservatively, assuming the "best case" labor protection scenario, the Trustee would be able to "buy off" all labor protection claims attributable to the transition to Milwaukee II by incurring an expense of administration totalling \$75 million. Deduction of this amount from the April 1, 1980 liquidation value of the Estate leaves an Estate with a net liquidation value of \$340.

If the Milwaukee II system were operated to its assumed fourth year "point of no return," however, the Estate would bear the burden of projected operating losses totalling \$211.7 million (Reorganization Plan, Exhibit 22), and new debt of \$151.9 million (Id., at page 32). It will have attained a total four-year positive cash flow of \$3.4 million solely because it will have sold off a total of \$208.9 million worth of the Estate's real property and roadways (Id., Exhibit 28). The result of these activities would be to greatly erode the Estate and assure that for most classes of creditors, satisfaction of their claims would be a very faint hope. Even if the extremely conservative assumption were made that the only erosion in the value of the Estate caused by these developments is the figure represented by the new debt that the system would have assumed, the Estate's net liquidation value would be reduced from the \$340 million NLV assumed after a

"best case" labor protection settlements as of April 1, 1980 to \$190 million. Moreover, it must be noted that presumably such a hypothetical "point of no return" would not be perceived if the Milwaukee II system were performing precisely as forecasts contained in the Trustee's Reorganization Plan indicate. If the Milwaukee II system were performing on schedule, presumably the architects of those projections would not then recommend its immediate liquidation. Rather, it seems prudent to assume that the putative "point of no return" would not in fact be perceived unless the system performed substantially below the Trustee's projections. Thus, it also seems prudent to assume that by the time the hypothetical "point of no return" is reached, the system will have incurred losses, cash flow, and therefore very possibly additional new debt and perhaps property sales substantially greater than those forecast in the Trustee's Reorganization Plan. Such unanticipated deficits, debts, and dilution of the Estate would further reduce its net liquidation value.

Coupled with the erosion problem would be the fact that the Trustee would not be legally permitted to abruptly discontinue operations on the Milwaukee II system immediately after perceiving the "point of no return." Rather, appropriate regulatory and judicial approvals would be required; this process would certainly take time. The Estate would continue to bear the burden of all the ongoing erosion during the period

required to obtain such approvals. A decision to finally liquidate the system after reaching the "point of no return" and securing of the necessary permission to cease operations would immediately expose the Estate to additional labor protection obligations to the 5,800 employees, where the Trustee's Reorganization Plan estimates (at page 28) will then be working for the Milwaukee II System. Liquidation of the Milwaukee II System would trigger labor protection obligations ranging from the approximately \$106 million to \$462 million if the "the best case" and "worst case" assumptions discussed above are employed, created by Section 9 of the MRRA, or any like alternative, would be available at that time to fund a program by which the Estate could attempt to "buy off" these employees of full statutory claims.

If the NewMil Plan is adopted, however, the results of a net liquidation value analysis are very different. In this case the Consulting Center's determination that total claims against the Estate would total \$417.4 million dollars on April 1, 1980 must be compared with the striking fact that the assets that will be retained by the Estate if NewMil's plan is implemented have a net liquidation value of \$445 million. Thus, the new Milwaukee Lines proposal will leave the Estate with assets that exceed the value of all the claims, net of labor protection, by approximately \$28 million.

It must be noted that the \$417.4 million figure showed above for "claims" has of April 1, 1980 includes the Estate's \$51.9 million (par value) of preferred stock. Thus, under the New Milwaukee Lines Plan the assets held by the Estate not only substantially exceed the aggregate of creditors claims but also leave a significant fund for the shareholders.

The \$417.4 million figure for April 1 claims does not, however, include potential labor protection claims arising from the fact that the New Railroad will not offer employment to all of the present system's employees that are currently in a protected status. As explained above, the terms of the New Milwaukee Lines Plan will permit the Estate to retain the benefit of the \$75 million labor protection funding program created by Section 9 of the MRRA. This program will enable the Estate to offer employees that are not offered comparable employment with the New Railroad immediate cash payments as an alternative to lengthy and uncertain litigation on these employees statutory labor protection entitlements. As noted above, if these employees elect to take advantage of the \$75 million program, they could receive immediate payments averaging slightly more than \$18,000 per person with a resulting liability to the Estate of approximately \$36 million. Although it cannot be predicted with certainty whether these employees will find the prospect of such immediate payments more attractive than the chance of obtaining a larger recovery

through litigation, the risk that substantial number of employees would prefer delay and litigation to an immediate, and large, cash payment is not a risk of the same order of magnitude as the enormous uncertainties that currently beset the Estate. Moreover, even if the "worst case" employee protection scenario described above were to eventuate, i.e., every one of the 1,985 employees that may be severed as a result of the creation of the New Railroad elects to litigate rather than accept an early payment from the \$75 million fund and each such employee ultimately recovers an average payment of \$79,706, the total liability resulting to the Estate would amount to approximately \$160 million. If this amount is deducted from the \$445 million net liquidation value of the assets that will be assigned to the Estate under the provisions of the New Milwaukee Lines plan, the Estate would still be left with sufficient assets to pay its creditors approximately 78 cents on the dollar for their presently deferred claims.

Finally, in looking at this apparent "wash" of claims and liabilities for the Estate under the NewMil Plan, consideration must be given to the reorganizability of the Estate around the remaining assets. Instead of having a large asset suffering huge cash losses, it will have an asset generating substantial positive cash flow -- the Land Company. This, combined with residual tax benefits, can provide a nucleus for a very successful enterprise that leverages these assets into other businesses.

EXHIBIT XI-A

NET PRESENT VALUE OF CASH FLOWS TO THE MILWAUKEE ROAD
ESTATE UNDER THE TRUSTEE'S REORGANIZATION PLAN IN 1980
DOLLARS.

	<u>(Millions \$)</u>
NPV of Cash Flows from RR operations and projected property sales <u>1/</u>	22.0
NPV of Scheduled Borrowings, financing charges, and debt repayments <u>2/</u>	22.4
NPV of Cash Flows from land and motor company dividends	<u>76.4</u>
NPV of Total Flows to the estate	\$120.8

1/ Discounted at 20%

2/ Discounted at 11%

3/ Discounted at 9%

EXHIBIT XI-B

NET PRESENT VALUE OF CASH FLOWS TO THE MILWAUKEE ESTATE
ASSUMING IMPLEMENTATION OF THE NEW MILWAUKEE LINE'S PLAN
IN 1980 DOLLARS.

	<u>(Millions \$)</u>
NPV of Cash Flows from projected property sales <u>1/</u>	184.8
NPV of Scheduled Borrowings, financ- ing charges, and debt repayments	-107.8
NPV of Cash Flows from Land Company dividends	64.2
NPV of Residual Value after reconcil- ing total assets and liabilities with New Milwaukee's aquisition assumptions	63.6
TOTAL	204.8

1/ Discounted at 13%

EXHIBIT XI-C

OUTSTANDING CLAIMS AGAINST THE ESTATE AWAITING SETTLEMENT
AS OF A 1985 CONSUMMATION DATE UNDER THE TRUSTEE'S REORGANI-
ZATION PLAN. 1/

(Millions \$)

CLASS A CLAIMS	4.6
CLASS B CLAIMS	25.1
CLASS C CLAIMS	20.1
CLASS D CLAIMS	12.8
CLASS E CLAIMS	54.1
CLASS F CLAIMS	19.6
CLASS G CLAIMS	68.5
CLASS H CLAIMS	188.8
CLASS I CLAIMS	55.6
CLASS J CLAIMS	38.5
CLASS K CLAIMS	0
REDEEMABLE PREFERENCE SHARES	9.0
PREFERRED STOCK	51.9
TOTAL:	548.6

1/ Includes outstanding claims as of April 1, 1980 as adjusted for repayments scheduled to be made during the 1980-1985 period and new obligations assumed during the 1980-1985 period as adjusted for principal repayments made during those years.

EXHIBIT XI-D

OUTSTANDING CLAIMS AGAINST THE ESTATE AWAITING SETTLEMENT AS OF A 1985 CONSUMMATION DATE UNDER NEW MILWAUKEE LINE'S PLAN. 1/

(Millions \$)

CLASS A CLAIMS	4.6
CLASS B CLAIMS	25.1
CLASS C CLAIMS	20.1
CLASS D CLAIMS	12.8
CLASS E CLAIMS	54.1
CLASS F CLAIMS	19.6
CLASS G CLAIMS	68.5
CLASS H CLAIMS	57.6
CLASS I CLAIMS	55.6
CLASS J CLAIMS	38.5
CLASS K CLAIMS	0
REDEEMABLE PREFERENCE SHARES	9.0
PREFERRED STOCK	51.9
 TOTAL	 <hr/> 417.4

- 1/ Includes outstanding claims as of April 1, 1980 as adjusted for repayments, including \$41 million for labor protection, scheduled to be made during the 1980-1985 period and new obligations assumed during the 1980-1985 period as adjusted for principal repayments made during those years.

APPENDIX A

APPENDIX A

FEDERAL REGISTER NOTICE
BEFORE THE
INTERSTATE COMMERCE COMMISSION

Finance Docket No. 29171

RICHARD B. OGILVIE, TRUST OF THE PROPERTY
OF CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC
RAILROAD COMPANY -- SUBMISSIONS UNDER SECTION
6 OF THE MILWAUKEE RAILROAD RESTRUCTURING ACT

AGENCY: Interstate Commerce Commission

ACTION: Receipt, on November 1, 1979, of Reorganization Plan submitted by New Milwaukee Lines, pursuant to section 6 of the Milwaukee Railroad Restructuring Act, Public Law No. 96-101.

SUMMARY: The Milwaukee Railroad Restructuring Act, Public Law No. 96-101, provides, Inter alia, an opportunity for certain organizations to convert all of a substantial part of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company (MILW) into an employee or employee-shipper owned company. Pursuant to section 6 of P.L. 96-101 New Milwaukee Lines, a non-profit corporation, filed with the Commission on December 1, 1979 a plan for the reorganization of MILW as a transcontinental railroad.

DATES: Pursuant to P.L. 96-101, the plan was filed December 1, 1979.

FOR FURTHER, INFORMATION CONTACT:

SUPPLEMENTARY INFORMATION:

Section 6 of the recently-enacted Milwaukee Railroad Restructuring Act, Public Law No. 96-101, provides that no later than December, 1, 1979, an association composed of representatives of national railway labor organizations, employee coalitions, and shippers (or any combination of these) may submit to the Interstate Commerce Commission (ICC) a single plan to convert all or a substantial part of the MILW into an employee or employee-shipper owned company, and a method for implementing the plan. The plan must include a comprehensive evaluation of the MILW's prospects for financial self-sustainability. The legislation further provides that within 30 days of submission of such a plan the ICC must approve the proposal if we find the plan feasible. The ICC finding respecting feasibility must be made pursuant to section 554 of the Administrative Procedure Act, 5 U.S.C. 8554.

New Milwaukee Lines ("NewMil") is a non-profit corporation formed under the laws of the state of Washington in June, 1979. New Milwaukee Lines, 119 South Main Street, Seattle, Washington, 98104, is made up of representatives of the government, shippers and past and present MILW employees. NewMil was formed for the purpose of forming, obtaining funding for, and acquiring necessary licences and agency certifications for a new company to purchase and operate a substantial portion of the present MILW system. If the proposals in its Plan are approved and implemented, it is contemplated that New Milwaukee Lines will cease to exist. The system proposed in the Plan will be acquired, owned, and operated by the New Railroad described

therein.

2

The New Milwaukee Lines Employee-shipper Ownership Plan calls for the establishment of a new company to acquire and operate a transcontinental railroad system of main and secondary main lines from Louisville, Kentucky to Chicago to Portland, Seattle and Tacoma. An additional number of contingent lines will be included in the system if it can be determined that the line will make a positive contribution to the system (whether from operating revenues, surcharges, or external subsidy), if any required rehabilitation is borne by a third party such a state agency or shippers, and if the inclusion of such lines in aggregate does not adversely affect system performance or requirements. At the time of submission of this Plan, these lines are still being analysed.

The point of departure for analysis and development of rehabilitation requirements, equipment requirements, employee requirements, financial projections, and other matters was the "Lousville-Transcon" configuration studied in depth by Booz-Allen. The Consulting Center, Inc., revised and refined Booz-Allen analysis in various specific ways discussed more fully below. In each case CCI refinements were based on actual data coupled with a conservative probability discounting procedure.

The base system proposed by NewMil consists of approximately 2900 main line route miles and 650 miles of lighter density or branch lines, as compared with the 9,000 mile plus system operated by the Milwaukee in 1978. The Plan contemplates the conveyance to the New Railroad of all equipment presently owned by the Milwaukee Road. An aggressive equipment leassing and rebuilding program is contemplated to augment and restore the current fleet.

Rehabilitation requirements for the New Railroad were based on Booz-Allen and Milwaukee data for each line segment in

question. The projected rehabilitation level was based on a specific analysis of the competitive requirements of each line segment. The fundamental rehabilitation strategy is to institute immediately a program of normalized maintenance on all line segments coupled with rehabilitation expenditures over and above a normalized level where required to restore major line segments to 25 mph. The total rehabilitation expenditures necessary to achieve long term market opportunities and economic growth is estimated at \$211.3 million (in 1977 dollars).

The total labor force required for the New Railroad is estimated at 7,905 for 1980 and 9,035 by 1982. These estimates were based on the Milwaukee's 1977 employee mix and various Booz-Allen data.

The assets to be acquired by the New Railroad include land, rights of way, track, ballast, trackage rights, equipment, leaseholds, inventory material and supplies, and a motor transportation subsidiary. These assets are valued on the basis of net liquidation value essentially established in the Ford, Bacon, and Davis report.

The financial projections developed for the New Railroad's base system indicate that the railroad will realize positive income from operations beginning in 1982 and generate positive cash flow from operations beginning in 1983 and in each year thereafter. Expenses were analyzed and significant unit cost improvements were projected from the aggregate effect of specifically analysed factors, including improved equipment utilization, productivity gains, use of higher capacity equipment and benefits accruing from rehabilitated physical plant.

Operating revenues are projected to increase, in constant dollar terms, from \$344.9 million in 1980 to \$853.2 million in 1986. The increases in revenue are attributable to the

aggregate effect of various factors including the restoration
of traffic to "normalized" 1977 levels, the achievement of
specifically analysed market opportunities, long term projected
economic growth and authorized selective rate increases.

4

The projected effects of inflation are addressed in the Plan. These effects will be mitigated for the New Railroad because of a relatively strong projected operating ratio and the performance of major rehabilitation work in the early years and the benefits are achieved in the later years when expenses are higher.

The capital needs of the new company are projected to be met through a combination of private and public financing. Sources of private money include an equity contribution through an ESOP, and a modest amount of shipper-contributed venture capital. Sources of public money include federal funds available under Sections 505 and 511 of the RRRR Act, state and local funds available for support of the light density lines, and a joint Economic Development Administration and Farmers Home Administration loan to the ESOP to finance its equity contribution.

APPENDIX B

NEW MILWAUKEE LINES

Board of Directors and Officers

Board of Directors

W. Paul Schmechel, Chairman of the Board
President, Montana Power Company
40 East Broadway
Butte, Montana 59701
(406) 723-5421, ext. 2113

C. K. Clover
General Chairman, Brotherhood of Locomotive Engineers
Lines West
2510 David Court Place East
Tacoma, Washington 98424
(206) 922-7631

Lloyd Hanson
General Chairman, United Transportation
Union Lines West
1505 Lilac Lane
Liberty Lake, Washington 99010
(509) 255-6324

P.H. Jacobson
Assistant General Chairman
Brotherhood of Maintenance of Way Employees
2305 N. 12th Street
Coeur d'Alene, Idaho 83814
(208) 667-7227

Joe P. Shannon
Local Chairman, Brotherhood of Railway and Airline No. 66
P.O. Box 9
Denton, Montana 59430
Office: (406) 567-2280
Home: (406) 567-2525

Andrew T. Nelson
Manager, Transportation Research, Grain
P.O. Box 43594
Saint Paul, Minnesota 55164
(612) 646-9433

NEW MILWAUKEE LINES

Board of Directors and Officers

Board of Directors (continued)

William J. Arnold
President, Fife Community Credit Union
4410 20th Street East
Tacoma, Washington 98424

Peter Field
President, Cameron Forest Industries
P.O. Box 490
New Castle, Wyoming 83701
(307) 746-4497

Dominick Costello
Division Chief, Marketing for the Department of Agriculture
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Arthur S. Kane
President, Knife River Coal Mining Company
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Bismark, North Dakota 58501
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Director, Montana International Trade Commission
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Kenneth B. Jones
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Yankton, South Dakota 57078
(605) 665-7866

Shirll Boyce
Idaho Department of Transportation

James Morrison
President, Anaconda Copper Company

NEW MILWAUKEE LINES

Board of Directors and Officers

Officers

President: William J. Arnold
President, Fife Community Credit Union
4410 20th Street East
Tacoma, Washington 98424

Executive Vice President: William H. Brodsky
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Ilasca, Illinois 60143
(312) 773-2180

Vice President, Financial Planning: J. Fred Simpson
P.O. Box 10629
Bainbridge Island, Washington 98110
(206) 842-4310

Vice President: John A. Wall
President, Power Townsend Company
P.O. Box 5087
Helena, Montana 59601
(406) 442-2770; 442-2771

Vice President: Daryl W. Dewald
General Secretary-Treasurer,
United Transportation Union Lines West
P.O. Box 97
Alberton, Montana 59820
(406) 722-4462

Treasurer: Michael T. Fitzgerald
Director, Montana International Trade Commission
Suite 415, Power Block Building
Helena, Montana 59601
(406) 443-7910; 442-6554

Secretary: W. Paul Schmechel
President, Montana Power Company
40 East Broadway
Butte, Montana 59701
(406) 723-5421, ext. 2113

APPENDIX C

PROJECT STAFF

The Consulting Center was given the responsibility for assembling a team of experts and for orchestrating the development of pro forma projections for the New Milwaukee Lines and for assessing the selfsustainability of the Railroad pursuant to the requirements of the Milwaukee Road Restructuring Act of 1979, P.L. No. 96-101. The Consulting Center study was done under contract with New Milwaukee Lines.

The Alexandria, Virginia, branch of the Consulting Center, Inc. performed the bulk of the work on this project with members of its own professional staff. In addition, on certain aspects of the Plan we were assisted by a number of professional consultants retained specifically to work on this project. The attached resumes highlight the qualifications of those individuals who worked on this assignment.

The Alexandria Office of the Consulting Center is comprised of senior staff with significant railroad experience - both within the industry and within governmental agencies dealing with railroads. Collectively, we have conducted analyses of railroad operations, evaluated alternative rail investments, designed a financial forecasting model for the rail industry, evaluated loan applications, and been instrumental in developing regulatory reform proposals and other government policies affecting the rail industry.

CONSULTING CENTER PERSONNEL WHO WORKED ON THIS PROJECT:

Russell F. Murphy
Richard G. Trenery
Jane E.M. Holt
Kevin H. Horn
Carolann H. Sharp

In addition to Consulting Center personnel, the following consultants assisted in the study:

Lee A. Bertman on Equipment Requirements,
Bertman, Clark and Associates

Carl M. Snavely, Jr. on Operating Expenses,
Snavely, King, Harris and Associates, Inc.

Judith F. Mazo on E.S.O.P.
Burns Jackson Miller Summit & Washington

Gene Rademacher on critique of Booz Allen &
Hamilton market opportunities
Radermacher and Associates

RUSSELL F. MURPHY

Executive Vice President

As Executive Vice President, Mr. Murphy's primary responsibility is to foster the firm's domestic business, particularly in the field of transportation. Toward that end, Mr. Murphy brings extensive expertise in dealing with the management of complex transportation analyses and the evaluation and determination of solving issues.

Mr. Murphy has been the project manager of all the domestic transportation studies undertaken by the Consulting Center.

Prior to joining the Consulting Center, Mr. Murphy was Vice President, Finance and Operations at the United States Railway Association with responsibilities that included the monitoring of Conrail's operational and financial performance. While the Director of the Office of Financial Analysis, Mr. Murphy's primary responsibilities were to forecast earnings, cash flows, and investment needs for the Consolidated Rail Corporation and any strategic alternative under consideration. Prior to joining USRA, Mr. Murphy was Chief of the Industry Analysis Division in the U.S. Department of Transportation and in that capacity was extensively involved in analyses of the transportation industry.

Educational Background:

B.A., Aeronautical Engineering (1958), Polytechnic Institute of Brooklyn
M.B.A., (1963), Harvard Graduate School of Business

JANE E. M. HOLT

Director

Mrs. Holt joined the Consulting Center as Senior Policy and Financial analyst in April of 1977. To date she has been a key participant on contracts involving policy and financial analyses of the railroad and trucking industry, including the assessment of the railroad industry's future capital needs for the FRA.

As do other members of the firm, Mrs. Holt brings extensive experience in the field of transportation to the firm. Immediately prior to joining the firm, Mrs. Holt was employed by the United States Railway Association as a financial consultant. In that capacity, she participated in most of the major financial decisions involved in the creation of Conrail as well as in support activities such as developing the process by which the proforma financial statements would be generated, and evaluating the Conrail alternatives. In addition, she wrote the bulk of the Financial Analysis Chapter of the PSP and much of the Capital Structure and Financial Programs Chapter in the PSP.

Prior to this, Mrs. Holt was employed in the office of the Assistant Secretary for Policy at the DOT, where she conducted financial and policy analyses involving all modes of transportation and was awarded a Special Achievement Award and the Secretary's Award for Meritorious Achievement.

Educational Background:

B.A., General studies (1966)....Harvard University

M.B.A., Finance (1970)....Boston University

Executive Education Program....Harvard Business School

RICHARD G. TRENEY

Director

Mr. Trenery joined the Consulting Center as senior policy and financial analyst in 1977. To date, he has been a key participant on contracts involving cost analyses, econometric financial forecasting of trucking and railroad industries. In addition to general financial and economic expertise, Mr. Trenery brings extensive experience in statistical analyses.

Prior to joining the Consulting Center, Mr. Trenery, while employed by Conrail, was responsible for the design and implementation of a computerized model which generated multiple year financial forecasts. While at USRA he had comparable responsibilities and was also engaged in a broad based analysis involving the propensity for rail traffic to be diverted to regulated and non-regulated motor carrier transportation.

Educational Background:

B.S., Finance and Economics, (1968), American University
M.B.A., Finance (1972), American University

CAROLANN H. SHARP

Mrs. Sharp has six years experience as a rail market and rate analyst. She recently joined the Consulting Center staff as a part-time consultant.

Mrs. Sharp has been a key participant in studying the potential traffic available to the New Milwaukee Lines from the Port of Seattle and from Pacific Northwest coal mines.

Prior to joining the Consulting Center, Mrs. Sharp was a Commerce Officer for the Southern Railway System, where she was responsible for drafting and submitting testimony in railroad commodity rate cases before the ICC and state regulator commissions. Before her commerce work, Mrs. Sharp was a Rate Officer at Southern, assigned to a commodity rate desk with pricing responsibilities for metal products. Prior to her pricing responsibilities, she worked as a research assistant.

Educational Background:

B.A., History, Math (1969) Western College, Oxford, OH
January 1978 completed course requirements for M.A. in Economics at George Washington University, Washington, D.C.

KEVIN H. HORN

Mr. Horn has had ten years of varied experience with railroads and government agencies pertaining to railroads. The Consulting Center recently hired Mr. Horn as a part-time consultant.

Mr. Horn has been a key participant in the development of revenue projections, MOW forecasts and rehabilitation requirements for the New Milwaukee Plan.

In addition to his work with the Consulting Center, Mr. Horn is an Assistant Professor of Marketing and Transportation at George Mason University, Virginia. Prior to this time he worked as a Senior Policy Analyst for the Association of American Railroads with responsibility for analyzing intercity truck movements for rail competitive and public policy implications. He worked at the ICC as an Economist in the Rail Services Planning Office before joining the AAR. Other experience includes work in the Operating and Maintenance of Way Departments of the Norfolk and Western, Monon and Erie-Lackawanna Railroads.

Educational Background:

B.S., Transportation (1969), Indiana University
M.B.A., Transportation and Physical Distribution
(1971) Indiana University
Ph.D., Transportation, Marketing and Economics,
(1975) The Pennsylvania State University

PROFESSIONAL QUALIFICATIONS OF

LEE A. BERTMAN

Mr. Bertman currently is a partner in the transportation and telecommunications consulting firm of Bertman, Clark & Associates.

Prior to establishing his firm, Mr. Bertman served as a consultant and certified public accountant. In that capacity, he participated in a number of communications projects, including assisting the City of Alexandria, Virginia in the evaluation and selection of cable television applicants. Clients included the National Telecommunications Information Administration, in which capacity he assisted that organization in developing common carrier legislation and evaluating means of promoting competition in the common carrier sector.

He served two years with Consolidated Rail Corporation, first as Assistant Director of Economic Analysis, and then as Director of Capital Planning and Control. In this capacity, he was responsible for the corporation's capital budgeting and financial analysis organization. Duties included development of the one billion dollar capital budget and the Five-Year Capital Plan. In addition, he was responsible for the review and approval of all investment proposals and post completion audits of capital projects.

Mr. Bertman worked for four years with the MITRE Corporation as a Project Leader and Financial Analyst. In this capacity, he served a number of clients, including the Corporation for Public Broadcasting, the Canadian Department of Communications, the Office of Telecommunications Policy, and the cities of Palm Springs, CA; Columbia, MO and Grand Rapids, MI. Communication assignments ranged from assisting cities in cable television planning and negotiations, to feasibility of satellite networking. He also pursued projects in fuel acquisition and generating planning strategy for electric utilities, and evaluation of captive coal mines.

Prior to his association with the MITRE Corporation, Mr. Bertman served as an economist with Robert R. Nathan Associates, during which time he worked on a number of studies, including a review of the Medicare reimbursement system and a cost-benefit analysis of deepwater ports.

He also worked as a member of the marketing and sales staff of Israel Aircraft Industries. Mr. Bertman is a member of the American Finance Association, the American Economic Association, the Maryland Association of Certified Public Accountants and the American and D.C. Institutes of Certified Accountants.

His educational background includes an A. B. magna cum laude in economics from Cornell University. He holds an MA degree in economics and an MS in transportation from Northwestern University. His accounting education was obtained at Georgetown University, where he earned an MSA degree.

CARL M. SNAVELY, JR.
Snavely, King, Harris & Associates, Inc.
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 466-8135

Mr. Snavely is President of Snavely, King, Harris & Associates, Inc. He has twenty-one years of experience in all phases of transportation economics including pricing, costing, and financial analysis. He has appeared before the Interstate Commerce Commission and various state regulatory agencies as an expert witness on these matters.

From April 1977 through March 1964, Mr. Snavely was employed by the Association of Southeastern Railroads in Washington, D.C. His primary duties were the preparation of cost and statistical data pertinent to railroad and motor carrier operations. In April 1964, he joined the consulting firm of W.B. Saunders & Company as a transportation economist. This firm was merged into EBS Management Consultants and he became Director of Transportation with responsibility for all transportation studies conducted by EBS. On April 1, 1970, Mr. Snavely established his own firm.

Mr. Snavely is an acknowledged authority on rail cost development. During the span of his experience he has acted as head analyst and expert witness in matters involving major divisions of revenue disputes, rail line abandonments, volume movement rate formulations and general freight rate increases. Additionally, he has directed management and governmental policy studies involving both freight and passenger issues.

In April 1975, under appointment by the Governor General in Council of Canada, Mr. Snavely was named Chief Commissioner of a Federal Inquiry Commission convened to investigate and determine the costs incurred and revenues received by the Canadian railways for transportation of grain and grain products moving under statutory rates. This inquiry encompassed a detailed examination of the operating, traffic, financial, and cost characteristics attendant to the transportation of grain by rail in Western Canada under present conditions and under alternate rail configurations. The conclusions of the "Snavely Commission" will exert a substantial influence on future cost-development and subsidy policies in Canada.

Mr. Snavely received his B.A. in business and economic statistics from The George Washington University.

Mr. Snavely's society memberships include:

Transportation Research Forum

Railway Systems and Management Association

APPENDIX D

Appendix D

Legal Counsel

Wickwire, Lewis, Goldmark
and Schorr
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Seattle, Washington 98104

James Wickwire
O. Yale Lewis
Thomas J. Brewer

Witkowski, Weiner, McCaffrey
and Brodsky, P.C.
1750 K Street, N.W. Suite 1130
Washington, D. C. 20006

R. Lawrence McCaffrey, Jr.
James A. Brodsky
Peter A. Gilbertson

Quarles & Brady
780 North Water Street
Milwaukee, Wisconsin 53202

Robert H. Diaz, Jr.
W. Stuart Parsons
Robert J. Kalupa
Fred G. Groiss
John A. Hazelwood
Arthur B. Harris
Patrick M. Ryan

Burns, Jackson, Miller,
Summit and Washington
1025 15th Street, N.W.
Washington, D. C. 20005

Judith F. Mazo

APPENDIX E

APPENDIX E

ARTICLES OF INCORPORATION

FILED

OF

JUN 21 1979

MILWAUKEE LINES WEST

SECRETARY OF STATE
STATE OF WASHINGTON

The undersigned, in order to form a nonprofit corporation under Chapter 24.03 of the Revised Code of Washington, hereby signs and verifies the following Articles of Incorporation:

ARTICLE I

The name of the corporation is MILWAUKEE LINES WEST.

ARTICLE II

The duration of the corporation shall be until December 31, 1979.

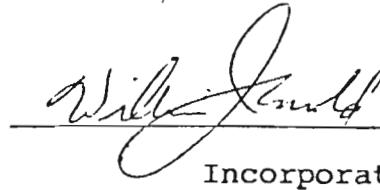
ARTICLE III

The corporation is formed to undertake and coordinate federal, state, local and private efforts to provide for continued competitive railroad service in regions currently serviced by the Milwaukee Railroad, and to that end the corporation will:

1. Develop an organizational, financial, management and marketing plan for a shipper- and employee-owned railroad;
2. Advance and protect the interests of the corporation in proceedings before the state and federal courts, the Interstate Commerce Commission, and other state and federal agencies;
3. Negotiate with appropriate persons for acquisition of necessary railroad assets;
4. Work with the appropriate federal agencies including without limitation the Departments of Transportation, Commerce, Agriculture, Energy and Defense, the Interstate Commerce Commission and the Securities and Exchange Commission and with the Congress to develop a viable railroad organization;
5. Work with appropriate state and local officials to coordinate these efforts with state rail plans and to insure compliance with applicable state and federal laws;

of liquidation, dissolution or abandonment of the corporation,
its assets remaining after payment of, or provision for payment
of, all debts and liabilities of this corporation shall be
distributed to the parties who have contributed to the
corporation in the ratio of their contribution to the total
contributions.

EXECUTED IN TRIPPLICATE this 21st day of June, 1979.

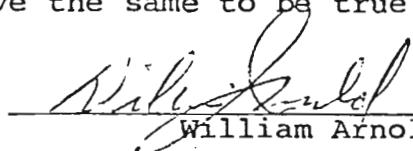


Incorporator

STATE OF WASHINGTON)
) ss.
COUNTY OF PIERCE)

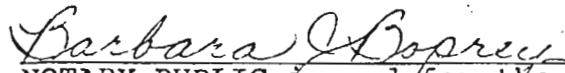
WILLIAM ARNOLD, being first duly sworn, on oath deposes
and says:

I am the incorporator of the above-named corporation;
I have read the foregoing Articles of Incorporation, know the
contents thereof, and believe the same to be true.



William Arnold

SUBSCRIBED AND SWORN to before me this 21st day of June,
1979.



Barbara J. Bosley
NOTARY PUBLIC in and/or the State
of Washington, residing at Tacoma

D290026
FILE NUMBER

APPENDIX E

DOMESTIC



STATE OF WASHINGTON | DEPARTMENT OF STATE

I, BRUCE K. CHAPMAN, Secretary of State of the State of Washington and custodian of its seal, hereby certify that

ARTICLES OF INCORPORATION

of _____ MILWAUKEE LINES WEST _____
a domestic corporation of _____ Seattle, Washington,

was filed for record in this office on this date, and I further certify that such Articles remain on file in this office.



In witness whereof I have signed and have affixed the seal of the State of Washington to this certificate at Olympia, the State Capitol,

June 21, 1979

A handwritten signature of Bruce K. Chapman.

BRUCE K. CHAPMAN
SECRETARY OF STATE

BYLAWS
OF
MILWAUKEE LINES WEST

ARTICLE I

Board of Directors

I.1 Powers and Qualifications. The affairs of the corporation shall be managed by the Board of Directors, who shall be appointed as follows:

1. The governors of each of the following states may appoint one director:
 - a. Idaho
 - b. Iowa
 - c. Minnesota
 - d. Montana
 - e. Nebraska
 - f. North Dakota
 - g. Oregon
 - h. South Dakota
 - i. Washington
 - j. Wyoming
2. The Milwaukee shippers shall select three directors.
3. The Milwaukee employees shall select three directors.

I.2 Number. The number of directors of the corporation shall be not less than nine. The Board of Directors by amendment of these bylaws may increase or decrease the number of directors.

I.3 Executive Committee. The Board of Directors by resolution adopted by a majority of the directors in office may designate and appoint an executive committee which shall consist of as many directors and which shall have and exercise such

authority of the Board of Directors in the management of the corporation as may be specified in said resolution; provided, that no such committee shall have the authority of the Board of Directors in reference to amending, altering or repealing the bylaws; electing, appointing or removing any member of any such committee or any director or officer of the corporation; amending the articles of incorporation; adopting a plan of merger or adopting a plan of consolidation with another corporation; authorizing the sale, lease, exchange or mortgage of all or substantially all of the property and assets of the corporation; authorizing the voluntary dissolution of the corporation or revoking proceedings therefor; adopting a plan for the distribution of the assets of the corporation; or amending, altering or repealing any resolution of the Board of Directors which by its terms provides that it shall not be amended, altered or repealed by such committee. The designation and appointment of any such committee and the delegation thereto of authority shall not operate to relieve the Board of Directors or any individual director of any responsibility imposed upon it or him by law.

I.4 Vacancies. The Board of Directors shall have the power to fill any vacancy occurring in the Board by reason of an increase in the number of directors by amendment of these bylaws. Any vacancy created by any resignation or by the inability of a director to perform his duties shall be filled by the organization or political division or subdivision originally responsible for his appointment.

I.5 No director with an interest in conflict with the reorganization and rehabilitation of the Milwaukee Western Lines shall be seated.

ARTICLE II

Meetings of Board of Directors

II.1 Monthly Meetings. The Board of Directors shall meet at least monthly at the time and place specified by the Chairman.

II.2 Special Meetings. Special meetings of the Board of Directors may be held at any place, at any time, whenever called by the president or secretary, or any two (2) or more Directors.

II.3 Notice of Meetings. Notice of the monthly meetings of the Board of Directors shall be given ten days in advance by the Secretary. Notice of the time and place of any special meetings of the Board of Directors shall be given by the secretary, or by the person or persons calling the meeting, by mail, telegram, or by personal communication over the telephone or otherwise, at least three (3) days prior to the date on which the meeting is to be held. Attendance of a director at any meeting shall constitute a waiver of notice of such meeting, except where the Director attends a meeting for the purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted nor the purpose of any meeting of the Board of Directors need be specified in the notice or any waiver of notice of such meeting.

II.4 Quorum. A majority of the Directors in office shall constitute a quorum for the transaction of business. The act of the majority of directors present at a meeting at which a quorum is present shall be the act of the Board of Directors. At any meeting of the Board of Directors at which a quorum is present, any business may be transacted, and the board may exercise all of its powers.

ARTICLE III

Actions by Written Consent

Any corporate action required or permitted by the articles of incorporation or bylaws, or by the laws of the State of Washington, to be taken at a meeting of the directors of the corporation, may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the directors entitled to vote with respect to the subject matter thereof. Such consent shall have the same force and effect as a unanimous vote, and may be described as such.

ARTICLE IV

Waiver of Notice

Whenever any notice is required to be given to any Director of the corporation by the articles of incorporation or bylaws, or by the laws of the State of Washington, a waiver thereof in writing

signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be equivalent to the giving of such notice.

ARTICLE V

Indemnification of Directors and Officers

Each director or officer now or hereafter serving the corporation and each person who at the request of or on behalf of the corporation is now serving or hereafter serves as a trustee, director or officer of any other corporation, whether for profit, or not for profit, and his respective heirs, executors, and personal representatives, shall be indemnified by the corporation against expenses actually and necessarily incurred by him in connection with the defense of any action, suit or proceeding in which he is made a party by reason of being or having been such trustee, director or officer, except in relation to matters as to which he shall be adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of duties; but such indemnification shall not be deemed exclusive of any other rights to which such person may be entitled under any bylaw, agreement, vote of Board of Directors, or otherwise.

ARTICLE VI

Officers

VI.1 Officers Enumerated. The officers of the corporation shall be a president, one or more vice presidents, a secretary, a treasurer, and such other officers and assistant officers as may be deemed necessary by the Board of Directors, each of whom shall be annually elected by the Board of Directors and shall serve until their successors are duly elected and qualified. Any two or more offices may be held by the same person, except the offices of president and secretary. In addition to the powers and duties specified below, the officers shall have such powers and perform such duties as the Board of Directors may prescribe.

VI.2 The President. The president must be a director of the corporation. He shall exercise the usual executive powers pertaining to the office of president. He shall preside at meetings of the Board of Directors.

VI.3 The Vice President. In the absence or disability of the president, the senior vice president present shall act as president.

VI.4 The Secretary. It shall be the duty of the secretary to keep records of the proceedings of the Board of Directors and of the membership, to administer the membership register, to sign all certificates of membership, when not signed by the president, and when requested by the president to do so, to sign and execute with the president all deeds, bonds, contracts, and other obligations, or instruments, in the name of the corporation, to keep the corporate seal, and to affix the same to certificates of membership and other proper documents.

VI.5 The Treasurer. The treasurer shall have the care and custody of and be responsible for all funds and investments of the corporation, and shall cause to be kept regular books of account. He shall cause to be deposited all funds and other valuable effects in the name of the corporation in such depositories as may be designated by the Board of Directors. In general, he shall perform all of the duties incident to the office of treasurer.

VIII.6 Vacancies. Vacancies in any office arising from any cause may be filled by the Board of Directors at any regular or special meeting.

VIII.7 Salaries. The salaries of all officers and agents of the corporation shall be fixed by the Board of Directors.

VI.8 Removal. Any officer elected or appointed may be removed by the Board of Directors whenever in its judgment the best interests of the corporation will be served thereby. The removal of an officer shall be without prejudice to the contract rights, if any, of the officer so removed; provided, that election or appointment of an officer or agent shall not of itself create contract rights.

ARTICLE VII

Administrative and Financial Provision

VII.1 Fiscal Year. The fiscal year of the corporation shall end on May 31.

VII.2 Loans Prohibited. No loans shall be made by the corporation to any officer or to any trustee.

VII.3 Books and Records. The corporation shall keep current and complete books and records of account and shall keep minutes of the proceedings of its Board of Directors and committees having any of the authority of the Board of Directors. All books and records of the corporation may be inspected by any active member, or his agent or attorney for any proper purposes at any reasonable time.

VII.4 Amendment of Bylaws. These bylaws may be altered, amended or repealed by the affirmative vote of a majority of the directors in office at any annual or special meeting of the board.

VII.5 Rules of Procedure. The rules of procedure at meetings of the membership and of the Board of Directors of the corporation shall be the rules contained in Roberts' Rules of Order on Parliamentary Procedure, as amended, so far as applicable and when not inconsistent with these bylaws, the articles of incorporation or with any resolution of the Board of Directors.

SEP 11 1979

SECRETARY OF STATE
STATE OF WASHINGTON

ARTICLES OF AMENDMENT
OF
MILWAUKEE LINES WEST

Pursuant to the provisions of RCW 24.03 of the
WASHINGTON NONPROFIT CORPORATION ACT, the undersigned
adopt the following Articles of Amendment to the Articles
of Incorporation:

ARTICLE I

The name of the corporation is MILWAUKEE LINES WEST.

ARTICLE II

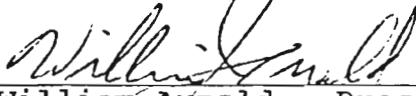
The following amendment of the Articles of Incorporation was adopted by the Board of Directors of the corporation on August 2, 1979:

ARTICLE I shall now read as follows:

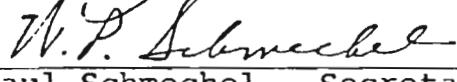
The name of the corporation is NEW MILWAUKEE LINES.

ARTICLE III

A quorum was present at the meeting. The votes cast by the Board of Directors present at such meeting or represented by proxy who were entitled to vote were unanimously in favor of this amendment. No membership vote is required as the corporation has no members.



William Arnold - President



Paul Schmechel - Secretary

STATE OF WASHINGTON)

: ss

COUNTY OF PIERCE)

WILLIAM ARNOLD, being first duly sworn, on oath, deposes and says: That he is the president of MILWAUKEE LINES WEST;

that he has read the within and foregoing Articles of Amendment of Milwaukee Lines West; knows the contents thereof, and believes the same to be true and correct.

William Arnold
William Arnold

SUBSCRIBED AND SWORN to before me this 28 day of August, 1979.

Baldwin Hussey
Notary Public in and for the State of Washington, residing at Seattle.

My term expires: 6-30-83

D290026
FILE NUMBER

DOMESTIC



STATE OF WASHINGTON | DEPARTMENT OF STATE

I, BRUCE K. CHAPMAN, Secretary of State of the State of Washington and custodian of its seal, hereby certify that

AMENDED

ARTICLES OF INCORPORATION

of MILWAUKEE LINES WEST

a domestic corporation of Seattle, Washington,
(Changing name to NEW MILWAUKEE LINES)

was filed for record in this office on this date, and I further certify that such Articles remain on file in this office.

In witness whereof I have signed and have affixed the seal of the State of Washington to this certificate at Olympia, the State Capitol,

September 11, 1979

A handwritten signature of Bruce K. Chapman.

BRUCE K. CHAPMAN
SECRETARY OF STATE