AB-7 (Sub-No. 86F)
Witness: Nugent
Exhibit No. 4

TESTIMONY OF R. V. NUGENT, JR.

My name is Richard V. Nugent, Jr. I reside in Park Ridge, Illinois. I am the Trustee's Vice President - Finance. My duties as Vice President - Finance require a complete understanding of the financial and accounting aspects of the operation of the Milwaukee Road. Prior to joining the Milwaukee I was a manager with the firm of Arthur Andersen & Co. I am a C.P.A. and have an M.B.A. Degree in Finance.

My responsibilities for the Trustee have included working with the firm of Booz, Allen & Hamilton in the preparation of their Report and the development of the Reorganization Plan which the Trustee filed with the Court on August 10, 1979. I had broad responsibilities in the preparation of the Plan and most of the financial data therein. I was principally responsible for the preparation of Section IV and related exhibits of the Plan concerning the potential proceeds from the sale of the Railroad's assets, for the preparation of Section VI and related exhibits of the Plan which deals with Financial restructuring and for the development of all of the cash forecasting in the Plan. In preparing the cash forecasts I worked from the income forecasts prepared by Mr. Power. I also contributed information to other sections of the Plan. The information set forth in the Plan is true and correct to the best of my knowledge and belief with the exception of a few supplementary comments made herein and certain corrections offered in testimony by my colleagues during this proceeding

Today I will describe the Milwaukee's current cash position and the circumstances which lead me to believe that the Milwaukee is facing an imminent exhaustion of cash which would make continued operations impossible. As of July 31, 1979, our book cash was about $3.8 million, which was basically as forecasted in the Plan after drawing down $5 million of the $20 million ERSA loan authorized in Order 167A. In August we have received another $5 million under this authority. As of August 24, when this testimony was prepared, cash levels appear to be running about $5 million higher than anticipated. Accordingly, we expect that the end of the month book cash levels will be approximately $8 million without the additional $5 million drawdown under the ERSA loan which was contemplated in the forecast.

If the improved August cash level holds, we would anticipate that the remaining $10 million authorized will suffice to maintain operations until some time in October. Our year end cash position will be a deficit of approximately $18 to $23 million without further funding depending upon how much of the $5 million improvement is retained. This deficit may be reduced somewhat by an estimated increase in revenues of $6.5 million which may result from the Commission's granting a pending ex parte rate increase. On the other hand, the impact of a severe recession would be somewhat offsetting.

None of the factors alter my judgment that at least $40 million of borrowings in addition to those presently authorized are necessary this year if operation of the system is to be sustained into the early part of 1980.

I have considered the availability of further borrowings to continue operation after the exhaustion of the presently authorized ERSA funds. In view of the position taken by the United States Department of Transportation on behalf of the Executive branch of the Federal Government, I do not believe that any additional operating funds are available from the Federal Government for the entire Milwaukee. I have exhaustively explored the availability of other sources of funds to operate the Milwaukee. On several occasions since the signing of the petition for reorganization we have made inquiries of commercial sources with respect to the availability of such funds and have been told that no funds could be obtained. As of September 30 the funds in escrow in the property sale account and in our subsidiary, Milwaukee Land Company, are estimated to approach $15 million. I am not aware of any other source of borrowings that would be available on a timely basis except that $5 to $10 million may become available at some time in the fourth quarter from additional property sales and Milwaukee Land Company income.

As shown in the Reorganization Plan the Milwaukee is currently in a situation where the hopeless condition of the entire Railroad does not justify total liquidation but instead mandates a suspension of operations on the nonviable portions and ultimately redeployment of those assets to permit the reorganization of the viable remainder, Milwaukee II. This concept is consistent with the position taken by the United States Department of Transportation in determining that funds can be made available only for the viable portions of the railroad. However, the expenses inherent in the transition from operating the entire Milwaukee to operating Milwaukee II equate to the types of wind down expenses described in the Court opinion. I estimate that these expenses will be on the order of $20 to $25 million, an amount which substantially exceeds the sums available in the Land Company and property sale escrow account.

A further indication that the Milwaukee presently is facing imminent cashlessness is the limited amount of funds in the ERSA program. The Reorganization Plan assumes that the entire $30 million presently authorized under ERSA can be provided to the Milwaukee. However, the Department of Transportation has indicated that other railroads in reorganization may need some or all of those limited ERSA funds. Therefore, it is unlikely that all of the $20 to $25 million of transition funds needed by the Milwaukee could be obtained under ERSA. Accordingly, the existing funds in the Land Company and property sale accounts are necessary to guarantee sufficient transition money to assure long term operation of Milwaukee II. Those funds must not be wasted by continuing the present noncompetitive and hopeless operation of the entire system.

The track conditions described by Messrs. Cruikshank and Williamson are a further reason for finding cashlessness at the time the presently authorized FRSA funds are exhausted. As Mr. Cruikshank's testimony shows, millions of dollars would be needed solely for the purpose of bringing lines outside of Milwaukee II into compliance with category 1 of the FRA's track safety standards. This is the lowest of the FRA's track categories and permits operation at only 10 mph. As a result much of the cash in the Land Company and escrow accounts may be necessary simply to restore track conditions if abandonment is denied.

The Reorganization Plan outlines the Milwaukee's transition into a revitalized financially viable Railroad. However, as I have discussed above, the time is fast approaching, within only months, when the Milwaukee may be unable to continue operation of the full system, and the Milwaukee II reorganization will be seriously jeopardized.

Denial of this abandonment proposal would further erode the business base in the areas both inside and outside the Milwaukee II configuration. Assuming that external funds would be available, if the Milwaukee were required to operate the full system for all of 1980, the requirements to cover the cash drain anticipated for 1980 would be between $150 million and $175 million. A simple proration of the cash drain estimated for 1980 reflects a cash drain for the first quarter of 1980 of between $38 million and $44 million. However, Milwaukee experience and the problems encountered during the winter suggest an even greater cash drain during .

the first quarter of 1980.

Among the direct financial benefits of abandonment is release of our investment in track, track structures and related materials west of Miles City. I estimate the net liquidation value of these materials at about $75 million. We calculated this amount by deriving the quantities of materials -- such as rail, angle bars, tie plates and crossties -- for approximately 50 line segments west of Miles City. For each type of material on each segment, we used system averages to distinguish scrap from reuseable material and applied a unit cost based on current market value. This is the same methodology used in the Ford, Bacon & Davis Report on our liquidation value.

While I have based my testimony on cash considerations relating to the future operation of Milwaukee II and my view of cashlessness as a financial matter, I also think it relevent that the Commission consider the effect of compelling further operating losses upon the various classes of creditors and shareholders. The Reorganization Plan already contemplates that the holders of the common stock of the railroad will receive nothing. If another $200 million in additional borrowings were required in late 1979 and 1980, it would appear likely that the interests of the preferred shareholders would also be wiped out and that interests of certain classes of creditors would be eliminated or severely impacted.

In conclusion I believe that the cash situation facing the Milwaukee compels abandonment of the Pacific Coast

Extension. If abandonment is not granted, much of the financial resources available to the Milwaukee will be exhausted in a fruitless effort to maintain operations which are currently noncompetitive and hopeless in the long term. Such a result benefits no one, including the public.

VERIFICATION

STATE OF ILLINOIS)
)SS
COUNTY OF C O O K)

RICHARD V. NUGENT being duly sworn deposes and says that the foregoing statement is true and correct to the best of my knowledge and belief.

R.V. Nugent Jr.
(Signature)

Subscribed and sworn to before me a notary public in and for the State and County above named, this 31th day of August, 1979.

Barbara Genibal
Notary Public

My commission expires: Dec. 28, 1980