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

IN THE MATTER OF	)	
	)	
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,	)	In Proceedings for the Reorganization of a Railroad
	)	
Debtor.	)	
	)	NO. 77 B 8999

SUPPLEMENTAL AFFIDAVIT OF J. FRED SIMPSON
IN SUPPORT OF

(1) SORE'S MOTION FOR LEAVE TO INTERVENE, AND

(2) SORE'S MOTION FOR AN ORDER FOR SPECIAL NOTICE ON CERTAIN MATTERS

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

J. FRED SIMPSON, being first duly sworn, deposes and says:

1. I have reviewed the memoranda filed on February 26, 1979, by the Trustee and the Indenture Trustees in opposition to SORE's motion for permission to intervene in these proceedings and in opposition to SORE's motion for notice on certain matters, and have also reviewed the affidavits and exhibits filed in support of those memoranda. I submit this supplemental affidavit in support of SORE's two motions in order to respond to and amplify certain issues raised by these opposition papers. In Part I below (¶¶ 2-7) I address some of objectors' concerns as to SORE's membership, organization, and independence. Part II (¶¶ 8-28) responds to objectors' questions respecting SORE's true

purposes and objectives, and also describes certain very recent events that are pertinent to the issues before the Court. Part III (¶¶ 29-35) responds to certain misleading factual allegations made by objectors in their affidavits and discusses certain facts relating to the revised form of Notice Order SORE proposes. I have personal knowledge of the matters stated herein and, if sworn, could testify completely thereto.

I. SORE

2. I have been employed by SORE since the formation of the association in September 1978 and am familiar with the activities of the association since its inception, as well as with its membership and organizational activities. All of the members of SORE are either present or retired employees of the Milwaukee Railroad or are individuals who were previously employed by the Milwaukee Railroad until very recently, and would be still but for the recent reductions in force imposed by the Trustee that caused these persons to lose their jobs. The majority of SORE's members are also members of labor organizations, although there are some members who hold exempt non-union positions with the railroad and therefore are not members of any labor organizations.

3. SORE is an unincorporated association that has not adopted bylaws. The organization is composed of groups of

members in the principal terminals of the railroad on Lines West. The members at each terminal have elected a representative to coordinate the activities of the members in that terminal with the other SORE groups located on Lines West. Meetings are held from time to time in the various terminals to advise the membership as to the status of SORE's activities, to discuss the condition of the Milwaukee's Lines West, to review alternatives for future action by SORE, and to make decisions to take various actions.

SORE's goals and general policies are established by the consensus of the membership expressed at the membership meetings. Mr. Brodsky and myself are employed by SORE to implement the goals and policies as established by the membership and our activities are subject to regular review by the membership.

4. SORE is a voluntary membership association in which each of the members have the absolute right to terminate his or her participation at any time. If SORE's members were to withdraw, its funding would be terminated and the association would go out of existence.

5. As described in detail in my affidavit dated February 2, 1979, and filed herein on February 8, 1979, SORE's members have authorized SORE to seek intervention in these proceedings in order to represent their interests in preserving their jobs on the Milwaukee's western lines and in order to propose an alternative plan calling for reorganization of the Milwaukee's western

lines into a separate operating company. The membership controls and determines the actions and positions taken by SORE. Since the positions advocated by SORE appear to be promotive of a broad range of public and private interests in the affected western states, it is altogether likely that persons other than SORE's members may benefit if SORE's representation successfully attains the objectives set by the membership. Because of the coincidence of these mutual interests, SORE makes every effort to coordinate its activities with affected shippers and public agencies. SORE has continually urged both shippers and public agencies to support SORE's efforts and SORE in turn has attempted to assist public agencies, shippers and shipper associations. Although others may benefit from SORE's efforts, SORE represents only the interests of its members and is not a spokesman or representative of any other interests.

6. I am familiar with the news article appearing in the Journal of Commerce on December 15, 1978, by Helen Ericson, entitled "Milwaukee Road Employees Planning Purchase of Track." A great number of articles have appeared in newspapers and other periodicals concerning the activities of Trustee Hillman, SORE, shippers and government agencies concerned with the Milwaukee lines west. It is unfortunately the fact that from time to time such articles have contained inaccuracies. The above-referenced article, which was attached to the Trustee's Memorandum as Appendix

B, contains a number of such inaccuracies. For example, at the time the article was written, SORE had approximately 500 members who had pledged $15 per month for six months, as opposed to the 150 employees referred to in the article. Similarly, the article indicates that SORE's plan would call for only 200 people to run its railroad. This is obviously a misstatement, as the western lines could not possibly be operated properly with any less than the existing 2,000 employees. If the article gives the impression that approximately 100 shippers and three utility companies in North and South Dakota have joined SORE, that is incorrect and should be clarified. As previously stated, SORE is composed exclusively of present employees and some past employees of the Milwaukee Railroad. As explained above, SORE has actively solicited the cooperation and support of shippers that will be affected, and SORE intends to coordinate its efforts with those of shippers, and any other entities having interests consistent with obtaining the goals of SORE. None of these other interests belong to SORE, however, nor do they direct its activities. I am not sure whether the article's report that "Trustee Hillman has announced that (sic) it (sic) will probably call for abandonment of about half of the railroad's system, including the lines west of the Twin Cities" accurately quotes the Trustee or not.

7. As recognized by Trustee Hillman, Milwaukee employees have a great deal of pride in the Milwaukee Railroad and in the

portions of the railroad with which they are associated. Many members of SORE represent the third generation of families that have been employed on Lines West of the Milwaukee Railroad and therefore have an interest in the success of lines west that goes beyond the immediate economic interest that is ordinarily associated with the preservation of a job. For example, one member of SORE has related to me that his grandfather was employed in constructing the union passenger station in Spokane, and his parents both worked throughout their working lives for the Milwaukee on the Avery Hill. This employee has worked his full career with the Milwaukee and is now approaching retirement. His son is presently employed by the Milwaukee. Such years and generations of commitment to the success of Lines West of the Milwaukee are a heritage which build a fierce pride and loyalty often absent in traditional employee-employer relationships. For that reason the members of SORE are committed to a successful reorganization of Lines West as a profitable and independent railroad company. SORE's members' belief in the position they have taken and vigorously advocated, and SORE is not a front for shippers or any other group.

II. SORE'S CONCERNS

8. In particular, the interests that SORE's members have in these proceedings, and their decision to authorize SORE to intervene on their behalf here, were and are independent decisions

taken in response to the disturbing fact that no one in these proceedings is actively representing the importance of preserving service on the Milwaukee's western lines. On the contrary, the shareholders, the creditors, the Trustee and management have seemed resolved since last August to abandon or liquidate the western lines through a program of piecemeal sales and abandonments. In view of the enormous financial gains that the shareholders and bondholders stand to realize if the Milwaukee is liquidated, SORE's members were and are concerned that neither of these groups could be counted upon to propose meaningful alternatives to the Trustee's plans to liquidate the western lines. Indeed, in view of the substantial contributions Lines West make to the entire system's revenues and overhead, SORE's members are concerned that the present move to liquidate Lines West is but a prelude to liquidation of the entire railroad. The economic interests I refer to are as follows: The shareholders apparently would realize a return on their investment in the range of 1600% if the Milwaukee were to be liquidated; the reasons why this is true are explained in a Wall Street Journal article of January 9, 1979, a copy of which is attached hereto as Exhibit A. The bondholders are holding bonds returning interest rates generally below 5% and which are not redeemable until well into the future. If they could get that money now via a liquidation this money could be reinvested at present market interest rates, which are much

higher. SORE seeks to intervene because of its members' concern that unless someone presents the case for continued service on the western lines, the present parties' economic interests will inevitably lead them to urge liquidation.

9. These concerns were intensified by the manner in which the Trustee arrived at the August decision to dismember Lines West. At no time has the Trustee, prior Milwaukee management, or any other group conducted a detailed traffic study to determine whether or not sufficient traffic is available to Lines West to support a viable railroad. To my personal knowledge, such a study is not available to the Milwaukee Railroad. At a hearing I attended in Butte, Montana, on February 24, 1979, chaired by United States Senator Max Baucus of Montana, Senator Baucus asked the Trustee's representative at the hearing in Butte for the basis of the abandonment decision. The Trustee's representative stated that three studies had been made with regard to the viability of the western lines of the Milwaukee. The spokesman said that Booz, Allen & Hamilton had made an abbreviated preliminary review in 1978, that the Interstate Commerce Commission had made a study some fifty years, ago and that apparently one other study had been done. Obviously, a study made by the Interstate Commerce Commission 50 years ago can have little bearing on the present economic viability of the railroad. The preliminary review by

Booz, Allen & Hamilton, which according to the Trustee's representative resulted only in a letter to the Trustee and did not exist as a formal study, did not contain any detailed traffic analysis. To my knowledge the Booz, Allen & Hamilton study made use of the historic traffic records of the Milwaukee and may have been supplemented by several shipper interviews but did not include a detailed traffic study. This was confirmed by another witness at Senator Baucus' hearing, Mr. Rudy Scharar, the transportation manager of the Anaconda Copper Company, one of the Milwaukee's principal shippers. Mr. Scharar stated that his company had not been consulted as to their present or future operations and the traffic that would be available to a reorganized Milwaukee.

The third study referred to by the Trustee's representative could have been the study conducted by the Milwaukee traffic department during 1978 to determine additional traffic that would be available to the Milwaukee if additional cars were provided on lines east and west of Minneapolis. That study, which showed an additional revenue of $64 million available if additional equipment were provided west of Minneapolis, was related only to equipment availability and did not consider other service factors and potential future growth of the respective industries. It is more likely that the Trustee's representative was referring to a study performed by Mr. G. A. Kellow which analyzed each of the Milwaukee corridors to determine the contribution to system overhead made

by the traffic generated in each corridor. Again, that study included no traffic study beyond historic records. Traffic based on historic records, of course, reflects the deteriorated condition of the railroad and does not reflect growth which has occurred subsequent to the date of the traffic records used. As reflected by the Trustee's report to the Court of June 16, 1978 and reiterated in Mr. Cruikshank's Affidavit filed with the Trustee's Memo opposing intervention, "in recent times demand has far exceeded the Milwaukee's ability to provide an adequate freight car supply," or serviceable locomotives. The freight actually handled by the Milwaukee thus is not a sound indication of the traffic that was or is available.

The members of SORE therefore are extremely concerned that no proper analysis has been done on the viability of Lines West and that their cause has therefore not received a fair hearing from either management or the Trustee.

10. SORE's members are not alone in their concerns. Rep. Marlenee of Montana, in a statement reproduced in the February 8, 1979, Congressional Record, attached as Exhibit A to SORE's Reply Memo in Support of its motion for the requested Notice Order, graphically expresses his concerns, which are shared by a very large number of citizens of Montana and other states that I have spoken with recently, and mentions that he is preparing legislation on the subject.

Rick Applegate, Director of the Center for Balanced Transportation of Bozeman, Montana, in a recent and widely circulated thirty-two page status report on the Milwaukee Railroad and the Burlington Northern mergers, reviews in detail the conditions leading up to the bankruptcy of the Milwaukee and the consideration being given to alternatives to abandonment of the Western portions of the Milwaukee. Mr. Applegate's report, filed with the I.C.C. in the Burlington Northern-Frisco merger case, questions apparent attempts by Milwaukee management to stifle the efforts of Milwaukee employees to develop alternatives to abandonment and recommends a concerted effort by the Montana congressional delegation to save the Milwaukee in the face of what Mr. Applegate sees as strong company opposition. Mr. Applegate also explains that the I.C.C. "study" (actually only a news release) referred to in Mr. Cruikshank's Affidavit and the Trustee's Memo in Opposition to SORE's motion for the requested Notice Order as supposedly demonstrating that management has maintained acceptable service on the western lines was a slipshod and hurried effort, based on extremely incomplete field reports. I have been informed that this I.C.C. news release failed to reflect substantial evidence of severe deterioration reported by I.C.C. field personnel whose reports were submitted after the release was rushed into print. I attach Mr. Applegate's study as Exhibit B.

At the February 24 Baucus Hearing, Terry Whiteside of the Montana Department of Agriculture, assigned by Governor Judge to coordinate state efforts with regard to the fate of Milwaukee Lines West, raised the concern that unless an adequate market study could be completed by June 1, 1979, there might well never be an opportunity to present a reorganization plan for Milwaukee Lines West due to the apparent unwillingness of Trustee Hillman to provide such a study and to consider alternatives to cessation of Milwaukee operations as a Transcontinental Railroad.

Many other interests are investigating and pursuing steps to try to preserve service on Lines West. I also understand that legislation and hearings on the subject are being considered by several senators and congressmen.

11. Subsequent to the preparation of SORE's pleadings seeking intervention, counsel for Trustee announced at a hearing before the Interstate Commerce Commission on February 6, 1979, that the Trustee would severely curtail the protective conditions which he would seek in the I.C.C.'s Burlington Northern Merger case. Counsel announced that the Trustee does not seek conditions to strengthen and preserve the transcontinental operations of the Milwaukee, nor would he seek inclusion of the total Milwaukee in the B.N. system. The failure to pursue the opportunity presented by condition 33 further reinforces SORE's concern that Milwaukee Lines West is not receiving serious consideration for continued

operation from the Trustee. Indeed, the Trustee went so far as to request "market swaps" with the B.N. that would strengthen the eastern portion of the Milwaukee by "swapping" vitally important markets on Lines West. For additional discussion of the importance of this matter see pages 17 to 24 of Exhibit B. Pertinent excerpts from the statement of counsel for the Trustee at the I.C.C.'s pre-hearing conference on the reopened B.N. Inclusion Case are attached as Exhibit C.

12. The western extension of the Milwaukee constitutes a great and possibly irreplaceable national asset which would cost billions of dollars to replace once dismantled, but which could be rehabilitated for less than two hundred million dollars to provide the best line of railroad serving the northern tier of states and connecting the North Pacific Coast ports with the population centers of America. The Milwaukee was the last railroad built west, and as a consequence previously unavailable surveys were available for selecting a superior route through the mountain ranges in Montana, Idaho and Washington. The line constructed provided the shortest mileage, the least grade and the best curvature of the northern railroads. In addition, the Milwaukee was then a wealthy and profitable company and therefore built to high standards.

It is generally accepted today that the cost of railroad construction is approximately $1,000,000 per mile. The western

lines of the Milwaukee exceed 4,000 miles of track, parts of it through difficult mountain territory. This four billion dollar replacement cost estimate does not include the possibility that sections of the right of way through national forests and wilderness areas and along protected rivers may be impossible to replace at any price.

The present condition of the Milwaukee track in the western states is deteriorated, but salvageable for a mere fraction of replacement cost. Generally the rail is of heavy weight and in good condition, as are necessary bridges and tunnels. The majority of rehabilitation work is limited to tie and ballast work, a relatively inexpensive part of initial construction.

Faced with the threatened destruction of such an asset it is understandable when public officials and others concerned with transportation matters question the decision of Trustee Hillman, his failure to produce supporting data to justify the necessity for the decision, and the apparent failure to take necessary steps to stabilize the rapid deterioration of the property and its operation.

13. The Milwaukee Railroad is the sixth largest U.S. rail system and has the longest operating mainline in the country, extending from Louisville, Kentucky to Portland, Oregon. Approximately 40% of the Milwaukee system track miles are west of St. Paul, Minnesota. The Western Lines which generated $166 million

of freight revenue in 1977 are of singular importance to the economic well-being of the states served. In 1977, the Milwaukee had 2,678 employees in Washington, Idaho, Montana and North and South Dakota, with a payroll of $48.9 million. In addition to the direct payroll there are obviously many secondary jobs dependent upon Milwaukee employment; grocery stores, banks, and auto dealers. There are whole towns such as Harlowton, Deer Lodge and Alberton, that depend upon the Milwaukee as a source of employment. The Milwaukee's liquidation will leave many such communities destitute. The same states and communities will also lose the taxes paid by the railroad which in 1976 totaled $1,866,000.

14. Equally impacted are the industries that have been induced to locate on the lines of the Milwaukee. The Gearheart Farms Elevator Company, for example, recently located a new grain elevator on the Milwaukee at Beverly, Washington. Haynes Gearheart, the proprietor stated that it is uneconomic to truck to market from his elevator and that his investment will be destroyed if service is not continued over the Milwaukee's line.

In Montana there are thirty-one public warehouse and grain dealer facilities with a storage capacity of 4,332,000 bushels that would be without rail service in the event the Milwaukee's lines are abandoned. Not only will the value of industrial investments be reduced or destroyed, but the employment they provide will be lost, and the service performed rendered less effective or useless.

15. The abandonment of the Milwaukee's operations will significantly reduce transportation competition in the region served. In the west where distances are vast and the commodities produced such as grain, lumber and coal, are heavy and bulky, railroads are the only economically practical means of shipment. To be sure, trucks are able to skim a small percentage of such traffic as backhauls, or when business is slow, but in general the great preponderance of the traffic must and does, move by rail. This is very different from the situation that prevails in the mid-west and east where rail hauls tend to be relatively short, the river and highway systems are highly developed and many of the commodities to be transported can move as economically by truck or barge as by rail, and often far more expeditiously. The short haul, congested, and relatively high cost operation of eastern and midwestern railroads is easily and often supplanted by other modes. In the West transportation characteristics have closely limited such intermodal competition.

The presence of effective intermodal competition is reflected in the depressed rate structure under which the midwestern and eastern railroads struggle, often unsuccessfully, to survive. The failures of the eastern railroads are well documented as are the massive annual subsidies Congress must appropriate to sustain Con-rail. In the midwest, the Rock Island has been in bankruptcy since March 1975. The Milwaukee followed in December of 1978,

and other midwestern carriers are not strong. By contrast the railroads operating west of the Missouri River, with the exception of the Milwaukee, are all healthy and growing in economic strength.

Handling a car load of transcontinental freight results in a relatively high contribution to overhead, often approaching or exceeding $1,000. By contrast, the contribution produced by a car load handled in the midwest under the competitively compelled rate structure is often less than $100.

The transportation dominance retained by the western railroads and reflected in the rate structure makes intra-modal competition a vital force to restrain rate levels and assure efficient levels of service. In the absence of competition from a second railroad, the remaining carrier has a wide range of discretion in matters of pricing, service level and car supply, even with the regulatory supervision provided by state and federal agencies.

The apparent present necessity for retaining rail competition will be rendered imperative if the Congress accepts the Department of Transportation's proposal to deregulate railroads. See the February 12, 1979, article from Traffic World, attached as Exhibit D.

16. The capacity of the transportation system in the northern tier of western states is presently under a strain perhaps greater than ever previously eperienced. Shippers at the February 24 Baucus hearing repeatedly emphasized the inability

of the existing railroads to handle the traffic that had to be moved.

17. Mr. Viggo Anderson, a grain farmer from Great Falls, Montana and Montana Grain Growers Association Transportation Chairman stated at the hearing that the inability of the railroads to move Montana grain was playing havoc with grain marketing efforts; that elevators are simply full and many will buy no more grain until present holdings can be moved; that those elevators still buying will do so only at a substantial discount and for future delivery with the selling farmer required to provide interim storage. Mr. Anderson further stated that as many as 25% of the elevators are facing bankruptcy caused by the fact that grain purchases had been financed on credit with interest accuring until the grain could be moved to markets and sold. The inability to move the grain makes it impossible for the elevator operators to sell the grain and pay off their purchase obligations and thereby terminate the interest accruals.

18. Mr. Tom Templeton, executive secretary of the Montana Grain Grower's Association, and previously employed by Western Wheat Associates, to work with the marketing of U.S. grain in the Orient, stated at the hearing that 70 to 80% of Montana's grain was now being exported to the Pacific Rim Countries and that the projections of Western Wheat Associates forecast that Asian Grain imports would increase by 53% between 1978 and 1983. Mr. Templeton

expressed grave doubts about the capacity in the transportation system to handle the grain that is and will be available for movement out of Montana.

The Port of Seattle, in a study referred to in my previous affidavit has expressed analogous concerns about the apparent inability of railroads to handle the projected volume of container traffic anticipated to move through the Port's facilities by 1980. Recent events concerning the recognition of Mainland China and normalization of trade relations with that country will add even greater volumes of traffic than could have been anticipated in August 1978 when the Port study was completed.

19. The Western Energy Company through a statement by Mr. Bruce Graving, stated at the Baucus hearing that in 1978 that company had failed to meet the requirements of one of its contracts due to the inability of the railroads to move the required volume of coal from Montana mines. The contract called for the delivery of 11.6 million tons of coal, but the railroads were able to transport only 10.6 million tons, leaving a one million ton deficit. Mr. Graving stated that the failure to move the coal resulted in a loss to the State of Montana of one million dollars in coal severance tax; a loss to the mine employees of $500,000 in payroll; and a loss to the rail carriers of eight million dollars in freight revenue. Mr. Graving stated that the Burlington Northern was presently handling all of the coal that it could and

forecast a continued growth in demand for rail service to move Montana coal. He further stated that Western Energy Company had 500 million tons of lignite coal reserves in South Eastern Montana that had been purchased because of the existence of the Milwaukee tracks and were dependent for development upon the continued operation of the Milwaukee's line.

The capacity problems faced by western shippers will be intensified to the extent that the present oil scarcity continues to escalate oil prices, causing the demand for Western coal to grow and making trucks which use, proportionately, 3 to 4 times as much fuel as railroads to move a net ton of freight, even less competitive.

Indeed, Mr. Mike Fitzgerald, Director of the Montana International Trade Commission, in his testimony at the February 24 Baucus hearing, stated that competitive rail transportation was critical to the future economic well-being of his State, and that the potential loss of Milwaukee transcontinental rail service was one of the most serious economic adversities perceived by himself and others concerned with Montana's economy. The basis of the region's economy being the production of wheat, lumber, coal, and metals, all of which can only be marketed at distant points, makes adequate, efficient and low cost rail systems essential to allow competitive pricing of those products at market.

20. The present deteriorated condition of Milwaukee western lines is thus not due to any shortage of demand for profitable rail freight services. It is SORE's position that the present condition is a result of decisions made in the late 1950's and throughout the 1960's when the demand for rail services on the Milwaukee's western territories was far lower than today. At that time the judgment was apparently made that consolidation of rail plant and increases in traffic base would be necessary, and a program to accomplish merger of the Milwaukee with some other railroad was begun.

21. During the lengthy merger negotiations that preceded the Milwaukee's abortive attempt to merge with the Chicago Northwestern Railroad in 1969, the Milwaukee management was under substantial pressure to make the Milwaukee finances appear attractive. There were two immediate consequences to these pressures. First, dividends were paid to stockholders when the cash position of the company did not justify such payments. Second, necessary maintenance was systematically deferred in order to free up cash and improve the annual income statement.

22. The impact with regard to track maintenance was particularly pronounced. The company's renewal of cross-ties fell from approximately 800,000 cross-ties per year in 1957 to 500,000, in 1958 and to 400,000 in 1960. After 1961 the renewal continued somewhere around 300,000 ties per year until 1968 and 1969, when

600,000 and 800,000 respectively were installed. Treated cross-ties have a life of approximately 30 years. It is possible to avoid installing ties for several years in succession without serious problems. The failure to install new ties will, however, reach a point, in approximately ten years, where at least a third of the ties require replacement and one can expect to begin having operating difficulties such as derailments and lower track speeds. It is interesting to compare expenditures for maintenance of way and structures by the Milwaukee with the similar expenditures by the competing N.P. and G.N. In 1956 the Milwaukee expended $4,000 per mile, the N.P. $4,000 per mile and the G.N. $6,000 per mile (approximate figures). In 1960 the Milwaukee spent $3,100 per mile as compared with approximately $4,000 per mile for the N.P. and $4,700 per mile for the G.N. The Milwaukee expenditure averaged less than $3,000 per mile up through 1968 while the N.P. averaged approximately $4,500 per mile, as did the G.N. The company was operating on approximately 10,500 miles of track during that period and by reducing expenditures $1,500 per mile, avoided an annual expenditure of some $12.5 million. This figure probably understates the underexpenditure because both the N.P. and the G.N. were also under pressure during the period and probably were deferring track maintenance.

22. Following the merger of the G.N., N.P., and C.B. & Q. into the Burlington Northern in 1970, the divergence between the

maintenance expenditures of the Milwaukee and the new company became far more extreme. In 1974 the Milwaukee spent $6,000 per mile while the B.N. spent $9,000 per mile. In 1976 the Milwaukee spent $6,400 per mile while the B.N. spent $12,500 per mile, nearly double the Milwaukee expenditure.

As a result of this decision to defer normal track maintenance, the Milwaukee over the fifteen years from 1960 to 1975 went from a condition where a derailment was an extremely unusual event of major proportions to one where derailments became a common and daily occurance. In August of 1973, there were thirty-one derailments in twenty eight days on the hill at Avery, Idaho.

23. As the frequency of derailments increased and train speeds were slowed, two serious cost problems began to occur. The first was the direct expense associated with equipment and lading damage and the growing reluctance of shippers to tolerate the service irregularities and to submit their wares to such exposure. The second, less visible, but perhaps even more serious cost impact was the increasingly poor utilization of equipment and personnel caused by slow turn-around. In 1978 the Milwaukee was using one-third more engines to move essentially the same tonnage that had been moved in 1973 between the Twin Cities and the West Coast. In the early 1960's the Milwaukee's fast freights operated between Seattle and Chicago in 53 hours. The time now exceeds 100 hours. An engine traveling 10 m.p.h. during large

parts of the trip obviously takes longer to cross the system and will move less tonnage in a given time period than a faster moving engine. The same impact can be seen in the movement of cars and the turn-around time associated with each load. If a car can make 17 trips per year it obviously has far greater load-carrying capacity than if it is able to make only 12 trips per year. The seriousness of equipment utilization impacts is due to the magnitude of the capital investment associated with cars and locomotives. A unit of a diesel electric locomotive now costs approximately $700,000 and a modern rail car varies in cost between $30,000 and $70,000. Not only does the railroad earn a reduced return on its own equipment if it makes fewer trips per year, but it is also required to seek additional equipment from other sources if it is to continued to move the same total tonnage.

Over the period from 1960 to 1975, the Milwaukee went from a position where it was a net creditor railroad receiving money from others for using the Milwaukee's equipment to a position where the Milwaukee now pays out in excess of 60 million dollars per year in locomotive and car per diem and rents.

23. It should be mentioned that railroads use a system of accounting prescribed by the Interstate Commerce Commission known as "betterment accounting" as opposed to "depreciation accounting." Under betterment accounting principles railroad track structures are not depreciated. The initial construction is capitalized and

it is assumed that the railroad then maintains the plant at a like-new condition. Since various parts of the track structure have different life expectancies the assumption is also made that the railroad replaces the different parts on a basis so that the plant never wears out. For example, treated cross-ties with a 30-year life expectancy would be replaced 1/30th each year. Rail with a longer life expectancy would be replaced at a slower rate. The replacement of ties and rail each year are treated as a current operating expense and charged directly against income. If there is any particular reason to want the income account to appear better in a given year there is a great temptation to defer maintenance work until a later accounting period. Because of the long life of the track components there is little noticeable effect if one or two years of a tie or rail program are omitted. In the case of the Milwaukee this provided a continuing pressure from 1960 until the bankruptcy occurred, and it is apparent that the plant was essentially being consumed. If depreciation accounting had been used with an annual charge against income for depreciation of the plant then deferral of maintenance for 15 years would have been reflected in a greatly reduced investment basis. I attach a Business Week article on this subject as Exhibit E.

24. Following the failure of the Northwestern merger in 1969, the Milwaukee faced a major decision as to whether to seek some other merger partner or to concentrate on building up the

Milwaukee as an independent railroad. The decision of the board of directors and the management was to seek another merger partner. The pressures to cut costs therefore continued, thereby placing the income statement in as attractive a setting as possible. By 1970 the track structure was beginning to seriously show the effects of the past ten years' deferred maintenance. The tonnage on the transcontinental line had continually grown, surging to a peak in 1973 which was 207% of the tonnage which had been handled in 1960. The impact of the ever increasing tonnage and continually deferred maintenance essentially caused the collapse of the physical plant in 1973, with a serious increase in the number of derailments and slow orders. At the same time there was a general downturn in the business cycle and the revenues of the company began to decline.

25. As a result, management sought other means of reducing costs. The main method chosen to do this was to defer repairs of system-owned freight cars. The Milwaukee at that time had one of the larger fleets of general purpose cars of any of the western roads. The decision was made that any system car sustaining damage of $500 or more would be parked rather than repaired. This had the immediate effect of allowing car repair employees to be removed from the payroll. After a period of time, however, the company was required to depend more and more on foreign cars for which daily per diem was paid to the owning carrier. The

result is reflected in the escalation of net rent paid for locomotives and cars from a credit balance to 60 million dollars per year, paid out to others. A less noticable effect was that the terminals of the company became clogged with "bad-order" cars which in some instances severely restrict the ability of the yard to function efficiently. There are presently literally thousands of cars stored all over the Milwaukee system and until last summer, no accurate records existed as to the exact identiy and location of such cars and the extent of repairs that would be required to return any particular car to service.

The failure to repair system cars permitted some short run savings but these were quickly overwhelmed by the increased costs associated with the loss of revenues from those cars and the requirement to hire foreign equipment or purchase new.

26. The final savings program adopted in the operating budget was the "run to failure" locomotive program. $700,000 locomotive units were placed in service and allowed to run without more than patch work maintenance until a major failure rendered them inoperable, contributing to the extraordinary bad order ratio which exceeded 50% in the winter of 1977-1978.

27. Deferral of track maintenance and the resultant lowering of track speeds resulted not only in less efficient equipment utilization but also had a similar effect on employee productivitiy. At slower speeds employees obviously will travel a

shorter distance in a given amount of time. In addition, the federal hours of service law prohibits a train crew employee from serving more than 12 consecutive hours. At the end of the 12th hour an employee must stop the train regardless of location and wait until a replacement is provided. The stopping of trains short of their destination terminal, and the necessity for the railroad to call a second crew and transport that crew out to the train and return the stranded crew to the terminal, is called "dog catching." If a crew has a very short run then the 12-hour law will have little impact even with 10 m.p.h. track. In the case of the Milwaukee, however, labor agreements were negotiated several years ago providing the railroad with the right to run a given train crew through a historic terminal and on to a second terminal if the work could be accomplished within the 12-hour law. Under the auspices of the run-through agreements, the Milwaukee arranged for what were known as inter-divisional runs of its trains. For example, crews which originally had worked only from Tacoma to Cle Elum as a day's run now work from Tacoma to Othello as a day's run. The railroad abolished the Cle Elum terminal with the anticipation of significant cost savings. The result has been, however, that with deteriorated track conditions crews have difficulty reaching the Othello terminal prior to the expiration of the 12-hour law. Dog catching has become a regular occurrence at great expense to the railroad.

28. The downward spiral of deteriorating service has reached a point where the operation is in externis. Joe Brand, a Montana state legislator, UTU official and long time Milwaukee employee presented testimony at the Baucus hearing indicating that Milwaukee traffic on the mainline through Harlowton, Montana had shrunk from 5,804 loaded cars in August 1978 to 3,661 cars in January 1979 and further to 2,273 cars in February. Similarly the number of loaded cars handled from Harlowton to and from the northern Montana branchline shrank from 746 cars in October 1978 to 336 cars in January 1979. These figures are consistent with going from two and one-half trains per day on the transcontinental line in August to two-thirds of a train per day in February, which appears to be the present service level. The reduction on the branch line is particularly disturbing in light of the continuing orders from shippers on the line for cars to load. It is estimated that daily orders have been holding constantly in the vicinity of 700 cars. Milwaukee service has been reduced by more than one-half in Montana at a time of unprecedented demand. This situation is apparently confirmed in the affidavits of Mr. Cruikshank and Trustee Hillman.

III. AFFIDAVITS OF OBJECTORS

29. The affidavit of Mr. Cruikshank offers several statistical comparisons using February 1978 as a base period. The winter of 1977-1978 was unusually severe in the Dakotas causing operating problems for the railroads operating there. During the winter

the Milwaukee reached a point where in excess of 50% of its road locomotives were out of service, either snowbound in the Dakotas or damaged and inoperable. Operations on Lines West were essentially at a standstill and therefore operating statistics from that period are extremely unreliable. The early 1978 statistics were further skewed by the reactions of management to the December bankruptcy and attendant cash flow crisis. Work force reductions had been implemented, reducing maintenance personnel without regard to the actual on-going operational requirements of the railroad. Any comparisons of locomotive or work force statistics from that period are essentially useless.

30. Mr. Cruikshank does refer to an on-going program of locomotive rehabilitation. In order to deal with the overwhelming locomotive bad order ratio facing the Trustee when he was appointed, one of his first acts was to increase the locomotive maintenance budget from $2.6 million to $3.2 million per month. According to the Trustee's reports, this budget item was intended to reduce the bad order ratio from the March level of 45%. In addition, the Federal Railroad Administration advanced monies, to completely rehabilitate 111 road locomotives. That program was to rebuild five units per month to a high degree of reliability. When those two programs are taken together it is difficult to understand how there can only be enough locomotives available in the west at the present time to handle less than one-half the number of car loads

that were handled last August. Mr. Cruikshank's use of percentage figures and atypical base periods makes his figures unhelpful.

In order to determine what the actual status of the locomotive fleet is and how the fleet is allocated over the system it is necessary to have actual numbers of operable locomotive units that are assigned to the particular territories. The Milwaukee routinely maintains information that could easily be used to ascertain the information SORE seeks with regard to locomotive availability. The Railroad's Power Desk prepares twice-daily spread sheets showing where the Milwaukee's power is at any given time. These are submitted daily to the General Manager and to the Assistant Vice President -- Transportation. It is a simple matter to ascertain the total number of serviceable locomotive units on line, and the number of such units assigned to transcontinental service west of St. Paul, by looking at these sheets.

The figures on those sheets will show the allocation of serviceable power between Lines West and the rest of the system, but will not show locomotive units shopped or stored. The Assistant Vice President -- Mechanical, however, routinely prepares a monthly report, called the Locomotive Shop Report, which shows the numbers of locomotives undergoing repairs, and stored, at all locations on the system.

Mr. Cruikshank refers to the relocation of the G.E. Locomotive Power to Tacoma. The implication should not be made that this

represents a significant increase in serviceable locomotives available in the west. I am advised that the G.E. Locomotives, prior to being moved west had been stored in inoperable condition in the east and require extensive repairs to be made serviceable. The Locomotive Shop Report will provide clarifying information in this regard to allow a determination of precisely what power is available in serviceable condition in the west, and on the system as a whole.

31. Mr. Cruikshank refers to his legal obligations to equitably distribute car supply, but does not explain why the amount of rolling stock available is now sufficient for two-thirds of a train per day on the transcontinental line, but provided for two and one-half trains per day in August of last year. This is particularly incongruous when coupled with the assertion that new cars are being acquired and only totally deteriorated cars are being scrapped. The Trustee has indicated in his prior reports to the court that a major effort is being made to repair bad order system cars that had previously been allowed to sit idle, and that a F.R.A. financed car rehabilitation program was also underway. It would appear, contrary to Mr. Cruikshank's affidavit, that the useable system car fleet is expanding but that cars available on Lines West is being drastically reduced.

It would be quick and inexpensive for the Trustee to provide the facts to resolve the apparent paradox. The Superintendent of Transportation for the Milwaukee can request at any time a computer print-out showing (1) the total number of cars on line throughout the Milwaukee system, and (2) the total numbers of cars on Lines West of St. Paul.

32. The assertion of Mr. Cruikshank that sidings are removed to provide materials for installation of new sidings is not supported by any evidence that new sidings are being installed, anywhere in the west. There do not appear to be any such sidings being installed. It does appear that materials may be being removed from the West for use on the Chicago to Omaha Line, which would be a case of dismembering Lines West prior to the presentation of any plan of reorganization to the I.C.C. While any particular siding may be dispensible, a concerted program of removing many sidings in the West will render operation by a reorganized company expensive if not impossible until necessary sidings are replaced to handle the demonstrated volumes of traffic available.

33. Similarly the Trustee's statement that Sales of Real Estate do not impair operations of the railroad nor prevent sale of substantial portions misses the point. Real estate which may not be essential to the railroad in its present deteriorated condition and with its inadequate level of operations, may well

be critical to the viability of a rehabilitated railroad operating at a level that traffic volumes appear to demand. A case in point would involve the Tacoma yard and alternative Fife yard site. Efficient operations at a volume level required to handle available traffic necessitates the construction of a modern yard on the Fife site, which was obtained only after costly negotiations and litigation, extending over a period of five years. Sale of that unique site would not interfere with present limited operations, but would render reorganization far more costly and perhaps impractical. By the same token the Trustee has conducted extensive negotiations with the Port of Tacoma for the sale of the Tide Flats yard which is the Milwaukee's principal western terminal. It is possible that the Trustee intends to sell the existing yard and protect present limited operations with some sort of lease back arrangement. A tenant position may be reasonable for a short term limited existence; it would not be acceptable for location of a major terminal required for a reorganized company. A reorganized company would require the right to expand and modify the yard in ways that would not be feasible in a typical lease arrangement. Until a plan of overall reorganization is determined upon and approved, all of the yard sites must be preserved. Other parcels of real estate have similar significance to a reorganized company that may not be apparent to an abandoning company.

34. The figures provided by Mr. Cruikshank in his affidavit concerning levels of maintenance of way and maintenance of equipment forces are not helpful, not only for the previously mentioned reason that the base period is atypical but also because they present the numbers for "authorized" force, rather than "actual" force. I am advised that in the Bitteroot Mountains of Montana and Idaho, maintenance of way forces were reduced to 5 protected positions in February. This is a territory extending from Alberton, Montana to St. Maries, Idaho through some of the most difficult mountain territory on the Milwaukee system. The present force level certainly indicates a propensity not to continue operations. Furthermore, I am advised that a portion of the maintenance forces in the West have been employed in dismantling the plant rather than maintenance work. The Milwaukee's Labor Relations & Personnel Department maintains up-to-date computerized listings showing all authorized employment positions throughout the system, and also showing authorized positions west of St. Paul. The payroll department maintains computerized records of which positions are filled and it would not appear a difficult task to provide periodic reports on the status of employment levels on the system and on Lines West by job functions.

35. The inventory records of maintenance materials and tools are certainly necessary for the rational management of the company and will also reflect whether any particular territory is

receiving disproportionate downgrading. SORE has no need for notice of day-to-day material withdrawals or additions. What is required is periodic inventory reports by territory together with notice of anticipated major discretionary shifts.

DATED: March 4, 1979.

J. Fred Simpson

J. FRED SIMPSON

SUBSCRIBED AND SWORN to before me this 4th day of March, 1979.

D. Yale Lewis Jr.

NOTARY PUBLIC in and for the State of Washington, residing at Bainbridge Island, Washington