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MILWAUKEE RAILROAD FINANCIAL CRISIS

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HEARING

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BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION

OF THE

**COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION**

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

**OVERSIGHT HEARING ON THE
MILWAUKEE RAILROAD**

MAY 21, 1979

Serial No. 96-30

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THE MILWAUKEE RAILROAD FINANCIAL CRISIS

MONDAY, MAY 21, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, D.C.

The subcommittee met at 10 a.m. in room 235, Russell Senate Office Building, Hon. Russell B. Long (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR LONG

Senator LONG. This hearing will come to order. We will have a lot of witnesses here this morning. Accordingly, I am going to invoke the 10-minute rule on witnesses' statements. When the green light is on, the time is all their own. The yellow light is a caution light just as it is in traffic, and that means you ought to be concluding. The red light means your time expired.

I will ask all witnesses to look at their statements and highlight the main points. I am, in the main, as chairman, going to not interrogate witnesses so they can all be heard. Those we want to interrogate, we will either submit questions or call them back for interrogation. That way everyone will have a chance to make a presentation in the morning session.

Let me first announce that the witnesses' entire statements will be put in the record as well as any responses, written or otherwise, to inquiries by Senators.

We will also keep the record open for a few days after this hearing for any additional information anyone wants to submit as a result of these hearings.

This morning's hearings will focus on another financial crisis within the rail industry. It is my understanding this is the most recent bankruptcy filing by the Milwaukee and it is the third such bankruptcy of this railroad in the last 60 years, for that same railroad.

While the prior reorganization didn't have a significant effect on the size of the Milwaukee rail system, the trustee of today's bankrupt Milwaukee petitioned to the court for an embargo on 7,000 miles of the 10,000-mile rail system.

The reaction to the trustees' petition and the threat such an embargo presents to the rail service and jobs has resulted in numerous suggestions for action by this subcommittee and Congress which runs the gamut from doing nothing to a complete bailout of the Milwaukee through direct subsidies, soft loans, guaranteed loans and/or grants.

The problems of the Milwaukee are not new, unheard of, or unprecedented. We recall the Penn Central crisis in 1970 and, more recently, the threat of service discontinuances on the Delaware & Hudson Railroad last year. In each of these cases, and it appears that whenever a railroad finds itself in severe financial difficulties, those to be affected by a cessation of service look to the Federal Government, to the poor old taxpayer, to bail the railroad out.

It is my thought that if the transportation services provided by a railroad are so vital to the shippers or rail labor, they ought to be willing to contribute some cold cash to a financial solution to the problem.

While I think the Federal Government has an interest in the ability and efficiency of the rail industry to move commodities essential to the national economy, it is far from clear that what is good for the Milwaukee Railroad must be good for the entire country.

That being the case, before this subcommittee could justify putting Federal dollars in a program to continue operations over any of the Milwaukee's tracks, we must be able to assure the taxpayer that, first, the direct benefactors of the service are making a contribution to the cost and, second, any Federal money put into the Milwaukee system would not be only a first installment of a really big treasury drain we cannot afford.

With these thoughts in mind, I hope the witnesses today will provide us with some evidence of whether or not the public interest requires the general taxpayers' support for continuing the Milwaukee's present system or some portion of it, and whether there is a reasonable relationship between the traffic base and the required investment which, if made, would result in a self-sustaining system.

Now, I first hoped to call Senator George McGovern of South Dakota if he were here. Is Senator McGovern here?

John Culver will be—well, John Melcher?

The Honorable Max Baucus?

We will hear from these gentlemen as they arrive and work them in during the day.

Next I will call Mr. Stanley Hillman, trustee of the Milwaukee, and Mr. Charles W. Hoppe, vice president, Booz-Allen & Hamilton, Inc.

STATEMENT OF STANLEY E. G. HILLMAN, TRUSTEE OF THE PROPERTY OF THE CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD, CHICAGO, ILL.; ACCOMPANIED BY JOHN ROWE, COUNSEL; THOMAS F. POWER, JR., SPECIAL ASSISTANT; AND CHARLES W. HOPPE, VICE PRESIDENT, BOOZ-ALLEN & HAMILTON, INC., BETHESDA, MD.

Mr. HILLMAN. Good morning. I have with me John Rowe, my attorney, and Tom Power, my special assistant.

Mr. Chairman, I am Stanley Hillman. Since February of 1978 I have been trustee of the property of the Milwaukee Road. I am an officer of the Federal court.

At present the Milwaukee operates approximately 9,800 miles of route and has approximately 10,000 employees. Many of the services which the Milwaukee provides, many of the lines of railroad

which it operates, are essential to the economic viability of the railroad's territory and, in fact, to the entire Nation. Yet many of its services and lines are by no means unique nor irreplaceable nor even essential.

In many respects the services duplicate those of other carriers. The territory which the Milwaukee serves is also quite well served by other modes of transportation.

The Milwaukee is the seventh longest railroad in the Nation, based on 1977 route mileages. It ranks but 15th, however, among all class 1 railroads in total operating revenues. In 1975, 1976 and 1977 combined, the Milwaukee lost approximately \$100 million. It lost \$82 million in 1978. I estimate that it will lose \$150 million or more in 1979 if its entire system remains in operation.

As the Milwaukee is presently being operated, its losses continue at the rate of a half million dollars per working day.

The Milwaukee Road is bankrupt. It has been unable to meet all of its financial obligations since December of 1977. Quite likely it will exhaust the last of the cash available to it from internal sources, including \$35 million borrowed so far this year, around the end of this month. To see the end to all of the Milwaukee's service is neither my desire nor in accord with the plans which I have been attempting to make for the future of the railroad. An effort to reorganize the Milwaukee under the Federal Bankruptcy Act is well underway.

For many reasons, including the public interest in the orderly continuance of essential rail services and the preservation of jobs, reorganizing at least part of the Milwaukee as an operating railroad is preferable to a total termination of service and a liquidation. But at present my ability to achieve a reorganization in the future is severely limited by the lack of cash and by my obligation, and that of the court, to safeguard the constitutional rights of the railroad's creditors.

The secured creditors, the trustees of the railroad's mortgage and debenture indentures, have a motion before the court to stop all noncommuter operations because, in their view, further losses from operations represent an unconstitutional taking of their property.

Judge McMillen, in speaking in the court last week to Senator Melcher, described the Milwaukee as a very sick railroad. It needs not only a tourniquet, but a transfusion, Judge McMillen said. He asked Senator Melcher to bring that message back to the Congress.

I most wholeheartedly concur in the description. If the Congress is of a mind to help the Milwaukee, any help must be prompt. None of us is privileged to wait, nor to seek delay rather than immediate aid. Time is cash.

Yet, giving the Milwaukee even a massive transfusion, and doing that alone, would not solve the railroad's fundamental problem.

Indeed, loaning money to the Milwaukee, and doing nothing more, would merely postpone a solution and would reduce the opportunity which, I believe, we may have to reorganize the Milwaukee and make it self-sufficient.

I would point out to you that in the past 15 months I have caused \$100 million to be provided for the Milwaukee, yet the property and service continue to deteriorate.

As I indicated, private sources of funds are exhausted. Future assistance must come from the Federal Government. Yet sufficient funds do not exist under present law to rehabilitate the Milwaukee so that it can increase its earning power and become self-reliant, at least as a 9,800-mile railroad.

I see few, if any, realistic signs that sufficient funds could be made available soon enough to prevent the collapse of the entire railroad.

Moreover, the funds which are available through the Emergency Rail Services Act of 1970 subordinate the position of the secured creditors to that of the Federal Government. The secured creditors, in the past, have found this to be unacceptable.

The dilemma which faces us calls clearly for more than a tourniquet and a transfusion. It calls also for radical surgery. I am seeking radical surgery in order to save my patient's life. I am seeking an embargo, effective at the end of this month, on all but 2,500 of the Milwaukee's 9,800 route miles.

For most of last week the court heard arguments pro and con on my request. The court expects to rule on my petition for an embargo very shortly.

However unprecedented such an embargo may be, I believe it to be the sole available answer to the Milwaukee's problem under existing law.

Only with respect to a small segment of the present Milwaukee Road can the risk of investing millions of dollars in rehabilitation be reasonably equated with potential return.

With the help of my consultants, Booz-Allen & Hamilton, I have identified what I believe may be an economically viable core. I must immediately reduce the Milwaukee to this core.

The radical surgery is the tourniquet, if you will. The radical surgery reduces greatly the need for transfusions. To attempt to operate the entire Milwaukee Road for the balance of the year will require \$80 million to \$90 million more than the railroad itself will be able to generate.

I believe that the core of the Milwaukee might require only \$20 million, for which I am in the process of preparing an ERSA application, and perhaps an additional \$10 million later in the year.

For the Interstate Commerce Commission to direct service where necessary on the embargoed portions of the Milwaukee, under statutory authority which it already has, would by the Commission's own estimate require perhaps \$30 million.

There will, of course, be an impact from the embargo on employees. I estimate, as does the Commission, that perhaps 2,800 jobs will be affected adversely. Yet the only available alternative, which is to allow the Milwaukee to die, would affect 10,000.

As the Commission and the Department of Transportation can testify, the embargo which I seek produces no great commercial problem nor no significant gaps in the Nation's transportation network. The Commission plans to direct service on 75 percent of the embargoed lines and still provide over 99 percent of service to shippers. The embargo is, in fact, responsive to a need to rationalize out of our national railroad system a redundancy of thousands of miles of underutilized track.

In my opinion, the immediate needs of the Milwaukee create only one problem of a magnitude sufficient to require the concern of the Congress, and that is the problem of how to soften the economic impact of necessary actions on the employees who would be affected.

I would recommend that the Congress enact legislation which, while permitting the Milwaukee to pursue its private sector solution to the problem of preserving the self-supportable portion of the railroad, would, for a reasonable period, provide Federal assistance to employees who must inevitably be removed from the payroll.

I believe that an immediate commitment by the Congress to the spirit of such legislation would help greatly to resolve the larger problems which the Milwaukee faces.

If this subcommittee were to indicate its awareness that the one problem for which a Federal solution is necessary is the problem of labor protection, and indicate its dedication to developing a solution to that problem, I believe that the resistance to the embargo, which I must impose to save anything at all of the Milwaukee, might be greatly diminished.

I urge upon the subcommittee this course of action above all others. I urge that it be done with great dispatch.

Mr. Chairman, I have filed with the subcommittee staff for the record a copy of the Booz-Allen & Hamilton Strategic Planning Studies and copies of the testimony presented to the court pertinent to my request for an embargo and directed service.

My officers and I are available at any time to you and your colleagues. Thank you for your interest and concern.

Senator LONG. Thank you. You are appearing with Mr. Hoppe. Does Mr. Hoppe care to make a statement at this time?

Mr. HOPPE. No, sir. I will be available for questioning.

Senator LONG. I indicated I wasn't going to interrogate the witnesses at this time, but would call some back. If you gentlemen would like to see some questions I have in mind, I will submit them to you now. I plan to call you back at the end of the hearing, but I would like the other witnesses to have a chance to comment. I believe we could do it more expeditiously if we heard all the witnesses first. Thank you very much.

I would like to ask you to be available to us after we hear the other witnesses.

[The following information was subsequently received for the record:]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question. Mr. Hillman, in light of the nation's concern about energy, how does your plan eventually to eliminate the Milwaukee Road's lines west of Miles City affect the ability of the railroads of the West to transport coal?

Answer. First, the fact that I must remove the lines west of Miles city from the Milwaukee Road's system does not mean, necessarily, that they will be removed from the nation's rail system. I expect to be able to sell significant portions of these lines to other railroads which will continue to operate them. But beyond that, I do not see the elimination of the western lines from the Milwaukee Road's system as having much if any effect on coal transportation. There is only one operating coal mine on the Milwaukee west of the Twin Cities, at Gascoyne, North Dakota. The Milwaukee would continue to serve that mine. There are no operating mines on the Milwaukee in Montana. Nor, to the best of my knowledge, is there the prospect that any other mines will be completed and shipping coal quickly enough so that the revenues from their shipments, were they to be available to the Milwaukee, would

help the Milwaukee in its present circumstances. If one were to study a map, one would quickly see that the Milwaukee is effectively blocked, by the location of the Burlington Northern's main lines and the Yellowstone River, from Montana's existing mines. The coal which we haul to the east out of Montana comes to us in interchange from the Burlington Northern at Miles City. We would be able to continue this operation. There is no immediate prospect of a westbound coal movement out of Montana, and even if there were, that movement would be captive to the Burlington Northern.

Question. Mr. Hillman, some of the employees of the Milwaukee's western lines, through their organization known as SORE, are advocating the establishment of an Employee Stock Ownership Plan so that they could acquire and continue to operate the lines west of the Twin cities. Would you care to comment on this idea, please?

Answer. My basic reservation about an ESOP is the same as that which the United States Railway Administration placed on the idea in its search for a way to fund Conrail. And that is, while an ESOP may be fine for broadening among employees the ownership base of a company which is financially self-sufficient, an ESOP should not be used to generate a new company's initial capital. I should think that one would want to know whether SORE's proposal will result in a consistently profitable railroad before placing the taxpayer's money behind an ESOP for it. I could not support the ESOP idea for SORE until this determination is proven. On the other hand, while it is far too early to know what might be the future value of the Milwaukee Road's existing stock in a plan of reorganization, should it become appropriate to do so, and should the Milwaukee become profitable after it has been reduced to its viable core, I would certainly consider and probably support an ESOP for the core railroad as part of a reorganization plan.

Question. It is said by some, Mr. Hillman, that the Booz, Allen analysis and your own statements are in error as to the profitability of the Milwaukee's lines west of the Twin Cities. Would you comment, please, on your view as to whether the western lines could ever become profitable?

Answer. Essentially, Booz, Allen's findings were that if we could wait long enough, and if we were privileged to commit sufficient funds for rehabilitation, any portion of the present Milwaukee Road might in time generate net railway operating income—passing over the question whether it could ever repay both the debt necessary to finance the rehabilitation and the existing debt on the company. But let us consider the lines in the West as a separate railroad. First, from what we can tell from the SORE proposal, SORE has failed to consider significant costs of acquisition from the railroad's present owners and creditors. Then, it has based its revenue projections on rates of growth which no railroad in recent times has even remotely enjoyed. SORE envisions a level of operations, and therefore costs, which could not possibly be sustained on the revenues that, realistically, it could earn. As a separate railroad, SORE would find itself in competition with the far stronger, far more established Burlington Northern and Union Pacific. It would have to establish working arrangements with its connections at the Twin cities and Sioux City which in some instances would require that its connecting railroads agree to short-haul themselves. It would have to convince shippers that it could perform as well as do other railroads, which it could not do except after massive rehabilitation, the full cost of which is not reflected in its economic projections. I have no doubt that if SORE's railroad comes into existence with the sponsorship of the Federal Government it will be a continuing drain on the Federal treasury.

Question. Mr. Hillman, you have selected from among the eight configurations identified by Booz, Allen & Hamilton a 2,500-mile system which extends no farther west than Miles City, Montana. By your own statements, its future potential for profitability is limited. Yet there is another configuration contained in the Booz, Allen report, a 3,900-mile line which would extend all the way to the Pacific Coast, which appears to have more potential than any other which has been studied. Would you care to comment on why your choice was the configuration with the smaller potential for profit?

Answer. Future profitability of any segment is only one part of the equation with which I must concern myself. The cost of attaining that future profitability—the cost of rehabilitating the railroad—as well as whether that investment capital could be obtained, is the other. It is true that Booz, Allen indicated that a transcontinental railroad might, in the long run, produce somewhat higher net railway operating income—which, we must remember, is stated before the cost of debt service and is therefore not what we commonly call profit—than the core configuration which I have selected. But in the short range, and we must remember that we are compelled to deal first with a short-range problem, the transcontinental configuration would have higher negative NROI. I must of course consider the position of the creditors

relative to further losses. Then, and most importantly, let us look at what would be required to rehabilitate these two configurations and the risks involved in making these investments. Rehabilitating and equipping transcontinental configuration would require a very high investment commitment very quickly. Rehabilitating the configuration which I have selected would require considerably less.

ISHAM, LINCOLN & BEALE,
Chicago, Ill., June 29, 1979.

Senator RUSSELL B. LONG,
Chairman, Surface Transportation Subcommittee, Committee on Commerce, Science,
and Transportation, Washington, D.C.

DEAR SENATOR LONG: On behalf of the Trustee I submit the attached answers to your questions of June 13 with respect to the Milwaukee Railroad reorganization. We would be pleased to meet with you at any time to further discuss these matters and other issues which may affect legislation solutions to Milwaukee Railroad problems.

Yours very truly,

JOHN W. ROWE.

Attachments.

Question 1. In light of the nation's concern about energy, how does your plan to eliminate the Milwaukee Road's lines west of Miles City affect the ability of the railroads of the West to transport coal?

Answer. The elimination of Milwaukee Railroad's lines west of Miles City does not impair the ability of the railroads of the west to carry coal. Miles City is the westernmost point at which coal currently enters the Milwaukee system. This coal is carried east to a power plant in Wisconsin. As a result, the proposed Miles City subcore would maintain all of the actual coal movements on the existing railroad and would maintain the capability of the railroad to move coal east from Montana. We do not foresee near term opportunities to move coal to the West. There are no active mines along the Milwaukee and plans for the opening of new mines are most indefinite. In any event, there is more than adequate transportation capability on the two Burlington Northern main lines (formerly the Northern Pacific and Great Northern) and the Union Pacific main line to move coal from Wyoming and Montana to the States of Oregon and Washington. Accordingly the potential development of coal traffic does not provide a reason to maintain Milwaukee Railroad services west of Miles City. If, however, Congress believes that an existing railroad right-of-way may be an important national resource for the moving of coal in the distant future, consideration should be given to rail banking the Milwaukee Road's right-of-way, perhaps through purchase by the affected states. The catastrophic losses of the Milwaukee Railroad do not permit the continuation of its services for such services for such speculative objectives in the absence of large and continuous subsidies.

Question 2. There has been some suggestion that even with existing traffic, the western lines could be successfully reorganized on a profitable basis if sufficient capital is committed to rebuild the deteriorated track and equipment. Would you agree or disagree with this statement?

Answer. We do not believe that the western lines could be profitably reorganized with existing traffic even if sufficient rehabilitation capital were committed. The Booz, Allen & Hamilton analysis confirms this judgment in that 1977 pro forma results for a rehabilitated West End system were a loss of more than \$30 million, or more than \$21 million after taking advantage of market opportunities and operating improvements. The loss includes no debt service for financing rehabilitation beyond the normalized maintenance level and is exclusive of rehabilitation charges. The total rehabilitation commitment for track would be \$258 million in 1977 dollars. Moreover, the determination that a line is potentially viable is, in part, a risk analysis. The likelihood that a self-sustaining railroad can be developed must be balanced along with the risks of making the new investment.

Question 3. You state in your testimony that from 1975 to 1978, the Milwaukee lost approximately \$182 million and is projected to lose \$150 million or more if the entire system were to continue through 1979. Have you any indication of the percentage of these losses that is due directly or indirectly to deteriorating plant and reduced service?

Answer. We have no way to accurately compute an answer to that question. However, the Booz, Allen and Hamilton report suggests that 1977 pro forma losses

for the system without light density lines would have been about \$55 million or \$18 million after including market opportunities are considered. While not directly applicable, this suggests that between 60 and 70 percent of the losses are due directly or indirectly to deteriorating plant and equipment and reduced service, along with customer uncertainty. The total track rehabilitation commitment inherent in reversing this long term deterioration was about \$482 million in 1977 dollars. The equipment commitment is about \$600 million. The equipment commitment would have to be made before substantial reduction in losses could be achieved and this amount of equipment is not available in the short run.

Question 4. In addition to the railroad, what other businesses does the Milwaukee corporation own?

Answer. The Milwaukee Railroad owns the Milwaukee Land Company, the Milwaukee Motor Transportation Company, which operates motor carrier services closely integrated with the railroad's operations and owns various interests in connecting railroads and stations. The Chicago Milwaukee Corporation owns the stock of the railroad as well as several small companies. Orders of the Reorganization Court remove all power to manage the railroad from its parent corporation and vest those powers in an independent trustee.

Question 5. What are the Milwaukee Road's common carrier responsibilities?

How would you respond to the charge that the Milwaukee Road is operating unrelated businesses, while trying to rid itself of less profitable rail lines without accepting its common carrier responsibilities?

Answer. In essence the Milwaukee Railroad's common carrier responsibilities are to handle traffic offered to it to the best of its ability, within the constraints imposed by law, including the Bankruptcy Law, and by the availability of cash, equipment, supplies and materials. These responsibilities are not indefinite and the Railroad may be relieved of them by order of the Interstate Commerce Commission or a Court if continued losses compel such action.

The only unrelated business operated by the Milwaukee Railroad is the Land Company. In recent years the revenues of the Milwaukee Land Company have been used to assist the operations of the Railroad and to aid in meeting the Railroad's common carrier responsibilities. Between 1970 and 1979 the Railroad has received about \$71 million from this source. Of this amount approximately \$22 million has been received in 1978 and 1979. The Railroad has not financed the Land Company during this period.

Question 6. Please supply information regarding the percentage of revenues that was applied to maintenance and rehabilitation of track and equipment over the past decade as compared to other investments.

Answer. During the period 1969 through 1978, the Railroad expended a total of approximately \$1 billion on maintenance of way and structures and maintenance of equipment, exclusive of depreciation and retirement charges, and a total of approximately \$200 million on property additions, including the repayment of equipment loans, but excluding lease payment on equipment acquired by lease. The parent company of the Railroad, Chicago Milwaukee Corporation, which was formed in 1972, has not received any dividends or loans from the Railroad, nor has the Railroad invested in any of the acquisitions made by Chicago Milwaukee Corporation. The Milwaukee Land Company did loan \$1.7 million to Chicago Milwaukee Corporation in order to finance the start-up costs attributable to forming the holding company. In addition, in 1974 the Milwaukee Land Company acquired certain real estate interests for \$4 million in conjunction with one of Chicago Milwaukee Corporation's acquisitions. This property was leased back to the acquired company and the Land Company is being compensated for its investment. Contrary to the charges which are sometimes made, this railroad's operations have been sustained by a non-railroad affiliate.

Question 7. Please detail the efforts of the Milwaukee Railroad to market its services and secure new shipper traffic over the past decade.

Answer. The extensive efforts of the Milwaukee to attract new shippers up through 1976 are generally described in the testimonies of Vice Presidents Kronberg, Reynolds and Wiseman in the Interstate Commerce Commission's Docket No. 21478. These are attached. Attachments describe marketing activities during the period from 1976 to date.

MOTOR VEHICLES—CASSENS/MILW INTERMODAL

For many years prior to mid-1976, the Milwaukee Road, in conjunction with ConRail, had participated in an all rail movement of Chrysler produced vehicles (both passenger type and trucks) from their assembly plants in the Detroit, MI/

Windsor Ontario, Canada area to the Pacific Northwest over a Milwaukee Road unloading facility at Kent, WA as well as an unloading facility at Portland, OR.

In mid-1976, it became apparent that Chrysler Corporation could realize significant dollar savings in transportation costs by utilizing a combination of Canadian Agreed Freight Charges applicable from the Detroit/Windsor area to Vancouver, BC Canada thence over-the-road motor haul-away service from Vancouver direct to the dealers in the states of Washington and Oregon thereby diverting this long haul Transcontinental traffic from the Milwaukee Road.

To combat this competitive situation, we immediately negotiate a new intermodal type concept jointly with Chrysler Corp. and Cassens Transport Company (a motor carrier located in Edwardsville, IL) and established joint motor-rail intermodal rates from the Chrysler Detroit/Windsor Assembly Plants to the rail destinations at Kent, WA and Portland, OR.

This concept became effective in October, 1976 whereby Cassens Transport Co. loads Chrysler vehicles into their over-the-road trailers transporting same to the Milwaukee Road's facility in Chicago (Galewood, IL) at which point the vehicles are removed from the highway haulers equipment and reloaded into Milwaukee Road completely enclosed multi-level rack cars commonly referred to as "Bi-Levels" or "Tri-Levels." The Milwaukee Road then transports the enclosed cars to the rail unloading facilities at Kent and Portland where the vehicles are removed from the cars and reloaded into haul away carriers equipment for delivery to the dealers.

This concept resulted in the retention of this extremely attractive long haul business for the Milwaukee Road and offered Chrysler greater flexibility in their production and handling from assembly plants to ultimate dealers.

Associated with this Westbound concept of handling automotive traffic for Chrysler Corp., the Milwaukee Road was also successful in handling Chryslers Import compact vehicles manufactured in Japan which are handled through the port of Tacoma, WA to rail unloading facilities at Minneapolis, MN, Belvidere and Chicago, IL thereby utilizing the same enclosed rail cars that had handled the Westbound movements of domestic vehicles.

To further complement this round trip movement, the Milwaukee Road on July 4, 1977 established a provision whereby three bi-level enclosed cars could be substituted for two enclosed tri-level cars when in connection with the compact import vehicles. In other words, in lieu of returning empty bi-levels Eastbound and to alleviate a shortage of adequate tri-levels, the Milwaukee Road was innovative and offered the shipper the flexibility of using three bi-level cars of comparable capacity to transport the equivalent that would be handled in two larger tri-level cars.

AREAS INVOLVING AUTOMOTIVE TRAFFIC

(Supplement to Pages 27-28-29)

Since November of 1976, our purchase of multilevel railcars has increased from 1,000 units to 1,229. This growth was in fully enclosed cars. Our tri-level fleet currently totals 839 railcars of which 489 are fully enclosed and our bi-level fleet totals 390 railcars of which 225 are fully enclosed. Hence, our fully enclosed fleet totals 714 or 58 percent of our total fleet of 1,229 railcars.

Similarly, our carloadings and revenues showed increases.

Year	C/L's	MILW Revenue (millions)
1975	29,000	31
1976	31,325	35.6
1977	34,000	39.7

Auto parts boxcars

In addition to set-up motor vehicle traffic, the Milwaukee also handles substantial volumes of automotive parts. One of the primary components of our total parts traffic is the parts shipments destined to the Ford assembly plant located on our line at St. Paul, MN. This traffic is received primarily from eastern connections in Chicago and averages close to 8,100 carloads annually producing approximately \$8,500,000 in net revenue. To protect this traffic, the Milwaukee Road acquired in late 1977, 20 additional 86 foot hi-cube boxcars. Also, in early 1979, the Milwaukee took delivery of 20 new 60 foot auto parts boxcars in response to continuing traffic growth and shipper demand. This brings the Milwaukee Road's total parts equipment commitment for Ford to approximately 220 boxcars.

SUBSTITUTION RULE 4 TRAILERS IN LIEU OF ONE BOX CAR FROM CHICAGO, IL., TO
NORTH PACIFIC COAST

Under TCFB Rate Advice X-630, our company established a four (4) trailer for one (1) box car substitution rule for Sears Roebuck, Chicago, IL, in order to handle their movement of Catalogues from R. R. Donnelly, Chicago, IL, to Portland, OR, Seattle, Spokane, WA, under the 140,000 lb. carload rate of 243 cents cwt (X-343 level) minimum weight 140,000 lbs. published in Item 11545, TCFB Freight Tariff 1-Z. Publication of this unique tariff provision in Exception 2, Item 765, TC 1-Z became effective June 10, 1978, in Supplement 98 to said tariff. In addition, our Peoria Street-Chicago, IL, Satellite ramp facility tariff provision was expanded in Item 6695-series, WTL Freight Tariff 457-I in Supplement 57 becoming effective June 12, 1978, thus permitting Sears a faster turn-around time operation in that they can pick up empty loaded vans without the need to dray them from and to our Franklin Park facility near Bensenville, IL.

From June 1978 to June 1979, we handled this traffic for account Sears which returned approximately in excess of \$140,000 gross revenue to the Milwaukee Road. However, in view of the uncertainty at this time insofar as our west end operations is concerned, Sears has transferred this traffic to a competitor's mode with the understanding that in the future if the Milwaukee Road can continue its Transcontinental service on a permanent basis, the traffic will be returned to us.

PLAN II 1/2—FAK—MINNEAPOLIS, MN TO THE NORTH PACIFIC COAST

Under TCFB Emergency Application No. D-921, our Company filed an Independent Notice on May 24, 1977, to establish Plan II 1/2 TOFC rates on Freight, All Kinds, from Minneapolis, MN to the North Coast. This action was initiated for the account of Sears and Roebuck, Chicago, as they indicated that there would be available to our company a potential 200 trailerloads per month of this TOFC traffic. Publication for our account was made in Item 795 of Supplement 236 to TCFB Freight Tariff 22-F with an effective date of July 4, 1977.

On May 12, 1978, a similar publication was made by us from Davenport, IA to the North Pacific Coast to capture traffic that was presently moving via the highway.

We did not attract the Davenport business due to our poor Trans-Continental service. However, we did handle the Minneapolis traffic which was very substantial (100 trailers per month). The latter part of April 1979, we lost this attractive traffic due to our poor service.

We published 30M, 40M and 50M two-trailer rates. Preponderance originated in East and South and our rate was used primarily as a combined factor with the inbound Plan II 1/2 rates to Twin Cities.

MAYVILLE, WIS., ADDED AS A "PAPER RAMP" IN CONNECTION WITH PLAN II 1/2
SHIPMENTS BETWEEN MAYVILLE, WIS., AND ST. PAUL, MINN.

Under WTL 79-48, our company established Plan II 1/2 TOFC rates on freight, all kinds, between Mayville, WI and St. Paul, MN. This action was initiated as there would be available to our company a potential 200 trailer loads per year for account of Mayville Metal Corporation. Publication for our account was made in Item 8325 of Supplement 15 to WTL Freight Tariff 469-C with an effective date of December 1, 1977.

We've expanded this Plan II 1/2, Mayville, WI, "Paper Ramp," concept to include other destinations such as Denver and Longmont, CO (on the BN), and at the present time we are continuing to handle these shipments especially to the Denver area. On an average of \$2,600 gross revenue for the Milwaukee, our annual gross revenue amounts to approximately \$31,000.

DISTRIBUTION RATE MANKATO, MN. TO ST. PAUL, MN FOR ACCOUNT BROWN PRINTING

(Commerce of Minnesota) for Various Destinations

We were successful in securing new business from Brown Printing Company, Waseca, Minnesota, and Cotter at Mankato, Minnesota, to Chicago and Chicago gateway via "Sprint Train" service as well as to other points via Milwaukee Road line haul.

The Brown Printing Company movement was secured as a result of establishing a distribution rate between Mankato, MN and St. Paul, MN, in Item 955-C of Supplement 6 to Milw. Tariff 18742, effective September 21, 1977.

The shipments consist of magazines, inserts and catalogues.

This traffic moves as U.S. Mail under STCC No. 43 111 10.

Since establishment of our distribution rate we have handled approximately 180 trailers through April, 1979. We are still handling this business on a gradual upward trend.

PLAN II 1/4—MAGAZINES, PERIODICALS, ETC. FROM DES MOINES, IA TO NORTH PACIFIC
COAST

Under TCFB TOFC Application D-14671, our company filed independent notice December 31, 1976, establishing Plan II 1/4 (Full Service origin only) TOFC rates on Magazines, Periodicals, etc., from Des Moines, Iowa, to Portland, Oregon, Seattle, Spokane and Tacoma, Washington, in TCFB Freight Tariff 22-F. This action was the result of extensive discussions between our Sales people in Des Moines, Iowa and Traffic officers of Meredith Publishing Company headquartered at Des Moines, IA. These were shipper-negotiated rates and were to compete with existing truck rates. Included in these rates is a provision permitting stop-offs at various intermediate points in Montana (one-trailer of a two-trailer shipment).

From April, 1977 to March, 1979, we have handled 170 trailers which returned approximately \$230,000.00 gross revenue for our line and we are still handling this traffic.

LINE HAUL PLAN II 1/2 RATES FROM MASON CITY, IA TO CHICAGO, IL; AND
DISTRIBUTION RATE FROM ST. PAUL TO MASON CITY, IA

Recently (effective January 10, 1979) we established a Plan II 1/2 rate from Mason City, IA to Chicago, IL for account Commerce Consolidators of Iowa. We also established a distribution rate from St. Paul to Mason City in our Distribution Tariff (CMStP&P 7011) effective on January 10, 1979, which to create additional Plan IV and Plan II 1/2 FAK traffic for our line haul in connection with a new consolidator with headquarters in Charles City, IA.

Although we have not yet participated in this traffic the customer is organizing a plan to inaugurate the service and we anticipate that this potential business will be moving via the Milwaukee in the very near future.

Annual volume rate on merchandise from Racine, Wis. to Coffeyville, Kans.

The Milwaukee Railroad filed WTL TOFC Application X-F-256-52 dated June 20, 1977, proposing the establishment of an annual volume Plan II 1/2 TOFC rate on Merchandise from Racine, WI to Coffeyville, KS for the account of Western Publishing Company.

However, after extensive negotiations with the connecting lines, we were unsuccessful in implementing this rate into the tariff due to the connecting lines non-concurrence.

TEN-TRAILER PLAN II 1/2 TOFC RATE ON FREIGHT, ALL KINDS, FROM KANSAS CITY, MO
TO CHICAGO, IL

On February 4, 1977, the Milwaukee Railroad filed WTL TOFC Application X-F-79-17, proposing a Plan II 1/2 TOFC, Freight, All Kinds, rate from Kansas City, MO to Chicago, IL for the account of Trailer-Train, Inc. (the consolidator), Kansas City, MO.

This proposal was based on the same rules and tariff provisions as apply to comparable ten-trailer rates in the east.

In further support of this adjustment, we were advised that upon effective date of said rates, our company could expect a movement of 50 trailer loads per week, building to a volume of 100 trailers per week within 60 days, and, after six months, 1000 trailers per month. Of this volume, 90 percent to 95 percent of these shipments to Chicago would be for movement beyond. However, all trailers would be picked up at our Franklin Park, IL TOFC ramp by consignee for further handling.

We filed Independent Notice on April 1, 1977, but due to our poor service, we did not participate and the traffic was lost to a competing rail carrier.

EMPTY USED CONTAINERS—PACIFIC NORTH COAST TO TEXAS PORTS

In an endeavor to develop a transcontinental movement, CMStP&P RR, in conjunction with MKT RR, on May 1, 1977, established a rate of \$1,956 per flat car used, on empty used containers not exceeding 20 feet in length each, with total aggregate length loaded on a car not to exceed 80 feet, from Pacific North Coast Territory to Galveston and Houston, Texas. Traffic starting moving in March 1978 from Port of Tacoma to Galveston, Texas. The rate was \$2,053.80 per car, of which CMStP&P RR received \$1,495.17 per car for our handling to the Kansas City

interchange with MKT. To ensure our handling of this traffic, we assigned five 89-foot container flat cars for the movement until it was completed. The movement is now completed and we received total Milwaukee Road gross revenue of approximately \$50,000 for handling 34 shipments.

TRANS-LOADING FACILITY AT SEATTLE

On August 1, 1977, our subsidiary, Milwaukee Motor Transportation Company, established a trans-loading facility at Seattle to provide for the unloading of containers into rail equipment on import traffic and reloading of containers from rail equipment on export traffic at nominal charges.

This new concept provided a substantial savings to the shippers utilizing this new facility in lieu of port or steamship companies present container freight stations at Seattle. The advantage for the steamship company would also provide better utilization of their containers.

The benefit our company derived were as follows: (1) Utilization of empty trailers present at West Coast ports. (2) Produced empty return of steamship containers from Midwestern points to West Coast ports. (3) New traffic. This concept, since its inception, has generated new traffic for our company.

FREIGHT, ALL KINDS, TOFC/COFC EXPORT RATES

Effective November 12, 1977, Tariff 7013 (formerly 19002) was published providing for competitive export Plan II $\frac{1}{4}$, Freight, All Kinds, TOFC/COFC rates from Midwestern origins to North Pacific Coast ports.

This publication provided for a unique concept wherein consolidators could ship mixed shipments of Alaskan, Hawaiian and export traffic under one rate publication.

This publication, since its inception, has generated new export traffic and reduced the empty return movement of marine containers to Pacific North Coast ports. The reason for this publication was to establish a competitive rate via North Pacific Coast ports taking into consideration the total transportation costs via East and Gulf ports to Far East destinations when compared to total transportation costs via Pacific North Coast ports.

TRUCK COMPETITIVE TOFC RATES OR EASTBOUND LUMBER

The Milwaukee Road in connection with its motor carrier subsidiary undertook publication of a complete line of TOFC full service rates applying on lumber from several Montana, Idaho, Oregon and Washington origins to a large number of midwestern destinations.

Implementation of these rates in a specially produced Milwaukee Road tariff along with attendant service modifications made the railroad competitive for traffic which previously was strictly truck dominated. The thrust of this marketing effort was directed toward providing an appealing alternative to truck shipment for those small receivers whose volume requirements preclude rail carload participation. This approach has produced additional business for the Milwaukee Road.

SINGLE FACTOR THROUGH RAIL/BARGE RATE ON CORN AND SOYBEANS IOWA TO GULF

During the navigation season heavy volumes of grain move via truck from country elevators to the river for barging to the Gulf. This commodity is not regulated on either the trucks or barges. The transportation costs, therefore, fluctuate widely during the navigation season both for the truck as well as the barge portion of the haul. Large elevators which can load 25 or more cars at one time have the use of multiple car rail grain rates from Iowa to the Gulf and can depend on a fairly stable cost of transportation. The smaller shippers must rely on considerably higher single rail car rates to the Gulf or variable costs of truck to the river and barge beyond. In order to provide our smaller elevators with a stable pricing system during the navigation season, compete with the larger multiple car shippers, and still ship in lots smaller than 25 cars, our Profit Center devised a through rail/barge rate which permitted them to compete with the larger elevators and enter into long-term contracts directly with Gulf Grain interests. This innovative approach provided the following:

(1) Not more than 15 hopper cars of corn and soybeans can be loaded at one, or not more than three, interior Milwaukee Iowa elevators and will be moved in normal train service to Davenport, Ia. Upon arrival of the 15 car unit, the grain will be directly transferred to a barge for furtherance to an east side Gulf Port.

(2) The 15 car shipment will move under one bill of lading and the joint through rate to apply will include the total transportation charge from country elevator(s) to Gulf Port. A total of not less than 6 consecutive trips of a 15-car shipment must be made in order to qualify.

This Profit Center plan provided competitive rates, stable transportation costs, car supply necessary to move 90 cars of grain, direct contact with Gulf Port interests if desired, and a means to work with neighboring elevators if necessary to generate the required volume. It has been extremely successful for the Milwaukee Railroad.

IMPROVING THE IMBALANCE OF TRAFFIC BETWEEN ST. PAUL, MINN., AND CHICAGO, ILL., WITH MOVEMENT OF SOUTHBOUND TOFC SUGAR

The Milwaukee Railroad has historically had an oversupply of empty TOFC trailers at St. Paul because of an imbalance of traffic between St. Paul and Chicago. This imbalance necessitated heavy backhauling of empty trailers from St. Paul. In cooperation with our Field Sales Department, it was developed that a large volume of sugar was moving from St. Paul to Chicago via motor carrier. Current TOFC rates and terminal service would not permit this tonnage to move over our line. Our Profit Center in cooperation with the shipper, receiver, and our truck subsidiary which handles our deliveries, designed a Pricing/Marketing plan that made use of TOFC attractive to our customers and generated badly needed loads at St. Paul. Not only was it necessary to change our price, but special handling of shipper pallets and flexibility in distribution after arrival at Chicago were required. Our Profit Center plan accomplished these shipper/receiver needs and since its effectiveness in April, 1978, improvement has been noted in our St. Paul/Chicago imbalance of traffic.

SHORT-RUN RATE REDUCTION ON WHEAT FROM MONTANA TO NORTH COAST TO GENERATE LOADS FOR IDLE EQUIPMENT AND PROMOTE SALE OF WHEAT

In early 1977, Milwaukee Railroad had an excess supply of grain hoppers caused by a very depressed grain market. During the Profit Center's investigation, it was determined that a short-lived reduction in freight rates might very well be the necessary ingredient to create a market for Montana wheat on the North Coast and, thereby, generate loads for the idle hopper cars. On February 19, 1977, Milwaukee Railroad independently lowered the rates on wheat from Montana to the North Coast by 15¢ per hundredweight subject to an expiration date of 60 days from its effectiveness. This non-lasting reduction accomplished its goal of generating a market for Montana wheat to the extent that it was extended an additional 15 days so that shippers could finish shipping wheat which had been contracted during its effectiveness. At the end of that period, the grain market had advanced and orders for equipment were equal to our supply and the rate was permitted to expire. Without that reduction, our equipment would have remained idle and our shippers would not have had this added market.

GRAIN LOADING IN EMPTY RETURNING TOFC TRAILERS, MILES CITY, MONT., TO TWIN CITIES

Heavy unloading of TOFC shipments on the North Coast causes excessive backhauling of empty TOFC trailers eastbound. When we found this situation in the latter part of 1977, our Profit Center established TOFC rates on wheat from Miles City, Mont., to the Twin Cities. The equipment that had been returning empty was stopped at Miles City and, with the help of our trucking subsidiary, loaded with wheat destined St. Paul/Minneapolis, Minn. The rates established were truck competitive and provided our shippers with an alternative shipping method whenever we had TOFC trailers moving empty eastbound. The result to the Milwaukee Railroad was near maximum use of its TOFC equipment.

ANNUAL VOLUME CORN AND SOYBEAN RATES MONTEVIDEO AND WEGDAHL, MINN., TO ST. PAUL, MINN.

Large volumes of grain were moving via truck from Montevideo and Wegdahl, Minn., to St. Paul, Minn. Both origin points are served locally by the Milwaukee Railroad. Because this commodity is exempt from economic regulation prices charged the shippers varied greatly depending on the availability of motor carriage. In order to provide these shippers with consistent transportation cost and competitive service, the Profit Center initiated an annual volume rate on corn and soybeans from Montevideo and Wegdahl to St. Paul/Minneapolis, Minn. The rate required 10 car shipments and publishes rates based on 14,000; 28,000 and over 28,000 tons

annually. In order to improve service and equipment utilization, the Milwaukee Railroad also offers special mini-train service in connection with these rates. That service requires 20 cars to be shipped at one time and reloading of same equipment. In order to provide an incentive for the shipper to utilize his own equipment lower annual volume rates are provided when shipper equipment is furnished, with no change in the annual tonnage requirement. Since becoming effective in May, 1978, this program has been beneficial to both the shippers and the Milwaukee Railroad.

ESTABLISHMENT OF REDUCED RATES TO PREVENT SHIFT OF SOURCE OF SUPPLY TO
CANADIAN ORIGIN—DECEMBER 1977

We have just taken independent action under TCFB Application 13981, to which the Chessie System have agreed to establish rate of \$47.93 per gross ton, not subject to X-343, on Silicon Carbide, crude, to cover interplant movement for Carborundum Company from Vancouver, WA to Niagara Falls, NY. The present annual movement of 120 cars moves predominantly via BN-Chicago, IL-CR, with the exception of one car per month moving via MILW-Chicago, IL-CR, while the announced rate which reflects a reduction of \$5.46 per gross ton will enable a movement of 200,000 tons or 200 carload shipments. Carborundum has promised us 50 percent of this traffic or 100 carloads for a contribution of \$1,753 per car or total contribution of \$175,300 in Carborundum leased equipment and have also assured us that to the extent our line is able to furnish equipment, we will be included in the balance of the movement. If our ability to provide service and equipment is sufficient to satisfy the shippers' needs, our total contribution for this movement could approach \$350,000 per year.

ESTABLISHMENT OF RATES TO FOSTER MOVEMENT FROM NEW COAL MINE—SEPTEMBER
1978

During 1978 we worked with the operator of a new coal mine at Ashland, MT for movement via truck to our line at Forsythe, MT. To encourage this new business we established a new rate for a movement of 50,000 tons to Granite Falls, MN; which would also improve our profitability over existing moves. In addition, during the past couple of years, we have had sporadic limited participation in movements of Coal to two Northern States Power Company generating facilities at Red Wing and Mankato, MN. In the Spring of this year, we entered into negotiations with the Coal Creek Mining Company, who mine coal at Ashland, MT and truck it to our loading facilities at Forsythe, MT for single line through rates to these two NSP plants. We recently finalized our negotiations and announced a rate of \$14.50 with multiple car requirements applicable to both destinations. The combined anticipated tonnage to both destinations is from 150 to 300 cars per year which should produce a contribution of between \$75,000 and \$150,000 per year for our company (11-212).

ESTABLISHMENT OF RATES FOR MOVEMENT OF NEW PRODUCT IN SURPLUS EQUIPMENT
TYPES FROM MONTANA—JULY 1978

As a result of negotiations with A. E. Gogal & Associates in behalf of Black Diamond Graphite Company, a rate was announced by our line on Graphite Concentrates, Graphite Ore and a variety of similar products from Three Forks, Montana, to Chicago, IL of 3210 cents per net ton, not subject to X-343. Establishment of this rate will enable movement from Basin and Townsend, MT to Missoula via motor where shipments are to be transferred into MILW H140 open top hoppers as well as BA&P gondolas, both of which are considered surplus, thence movement to Chicago as a proportional rate for use in marketing throughout Official Territory. Volume projected by customer is 35,000 tons per year or approximately \$1,555,600 revenue which indicates a substantial contribution.

NEGOTIATION WITH CONNECTING RAILROADS TO PROTECT MILWAUKEE LINE HAUL—
SEPTEMBER 1978

We have recently completed a series of negotiations concerning routing with the BN for shipments of Liquid Oxygen and/or Liquid Nitrogen from Barberton, WA to the MHD facility near Butte, MT. While we tried to protect our longest haul via Seattle, the BN would not concur and we were finally able to work out a compromise routing of LT&N, Rye, WA, BN, Missoula, MT, MILW. This involves an anticipated movement for Airco Carbide Company estimated at 50 cars per month. Our portion of the revenue under the published rates will be over \$600 per unit with a contribution of about \$450. If movement reaches its full potential we should expect one quarter of a million dollars contribution per year.

ESTABLISHMENT OF RATES FOR COORDINATED BARGE—RAIL MOVE—JULY 1978

We recently took independent action to enable movement of cement clinkers from Canadian origins to the Lehigh Portland Cement Company at Mason City, IA via water carrier to Duluth, MN thence MILW direct. This will result in a one-shot movement of 20,000 tons and based on an X-343 rate of 920 cents per net ton and average loading of 134,000 pounds in MILW H-140 equipment, MILW revenue will be \$616.40 per car and contribution of \$229.40. Based on estimated 298 carloads the total MILW annual revenue will be \$183,687.20 and the total MILW contribution will be \$68,361.20.

ESTABLISHMENT OF MULTIPLE CAR RATES TO FOSTER MOVEMENT FROM NEW
PRODUCTION SOURCE TO SUPPLY THE WISCONSIN FOUNDRY MARKET—MAY 1977

Through negotiations with Inland Steel, Hurlbut Calcium and Chemical Company, and American Colloid Company we have announced a new rate on Crude Clay which will allow our participation in a movement from a new source at Rapid City to a new refiner on our line at Green Bay, WI. This new source will compete with tonnage currently moving from the Wyoming area via other rail line. We expect initial shipments of approximately 1,000 tons per month, producing an annual revenue of approximately \$180,000 with contribution in excess of \$80,000. If the new supplier and distributor are successful in penetrating this market, the total potential is in excess of two million tons per year.

AMENDMENTS IN RATES AND DIVISIONS TO ELIMINATE DEFICITS ON REPETITIVE COKE
TRAFFIC—JULY 1978

Our line was able to convert an out-of-pocket move to a positive contribution movement of coke from Koppers Company at St. Paul, MN to the White Farm Equipment at Charles City, IA on the Iowa Terminal. This increase in revenue was accomplished by the elimination of absorption of the BN switching charge at St. Paul; the increase in MILW division to 75 percent from 67.7 percent as result of renegotiation with the IaT; and the increase in the rate by use of rate to the next station beyond on the IaT. Based on X-343 rates of 1035 cents per net ton and minimum weight of 70,000 pounds, our revenue will now become \$271.69 and, when moving in CZ10 type cars, produces a contribution of \$106.39 per car as compared to a previous loss of \$43.34 per car. Our 1976 movement was 215 cars on this traffic which, at the new contribution, would total \$23,518.85 total contribution.

ESTABLISHMENT OF REDUCED RATES ON RECYCLABLE RESIDUES—JULY 1978

We have secured a new movement of 25 cars per month of Automobile Shredder Residue containing not exceeding 20 percent by weight of reclaimable metals in bulk from North Star Steel Company, St. Paul, MN served by the MILW to Pielat Brothers at Summit, IL, located in the Chicago Switching District on the IHB. The rate of 1701 cents per net ton, not subject to X-343, minimum weight 112,000 pounds, reflects the Scrap Iron Scale rate for involved distance and captures traffic formerly moving via the C&NW under rates containing not in excess of 40 percent with our new departure not affecting any other of our traffic. The rate is scheduled to become effective July 17, 1978 and is anticipated to produce monthly revenue of \$26,672 or \$320,100 per year in new revenue.

ESTABLISHMENT OF RATES TO ENABLE CUSTOMER TO DISPOSE OF BYPRODUCT—MAY
1979

A July 15, 1979 effective date is anticipated for the publication of through tank car rates on Sulfuric Acid from Anaconda, Montana to Cleveland, Ohio. We have previously established through rates to Detroit/River Rouge, MI effective May 15, 1979. We began to handle the traffic under existing combination rates in September of 1978 when negotiations for a rate adjustment were opened. From September 1978 through April of 1979, we have realized \$1,364,000 in revenue from this movement. Our revenue under the through rates will be over \$2,000 per car. The market for Acid in Detroit and Cleveland is uncertain. Canadian Acid was formerly used, but the supply from that source was interrupted by strikes.

TARIFF ROUTING ADJUSTMENT TO COMPENSATE FOR MAXIMUM WEIGHT RESTRICTION
ON BRANCH LINES—APRIL 1979

Effective April 7th, routing will be available via Twin Cities on Fertilizer/Urea rates from Alberta to midwestern destinations on our line. This arrangement pro-

vides an alternative to the Fairmont, Fargo, Madra, etc. junction routes which are no longer operationally sound due to weight limitations on the northern spur tracks. This will enable us to continue to participate in the traffic.

ADJUSTMENT OF MINIMUM WEIGHT PROVISIONS TO COMPENSATE FOR INABILITY TO FURNISH CARS OF SIZE REQUIRED—MAY 1977

The current rate on Copper Products from Montana to the Midwest carries minimum weight requirement of 190,000 lbs. per car, in order to cope with a lack of sufficient equipment of the size necessary to carry 19,000 lbs.

Our line effective May 1, 1977 has provided for the substitution of two cars for each 190,000 lb. capacity car requested in connectoin with movement of Copper from the Anaconda Company at Black Eagle, Mont. and ASARCO at Tacoma, Wash. to Western Electric at Chicago, Ill. in view of their requests of 20 cars per week and 15 cars per week of 190,000 lb. capacity in anticipation of possible Copper strike after June 30th when present contracts expire. Assuming that we furnish a total of 70 cars per week and participate in this traffic during the nine weeks of May and June our total revenue could reach \$941,141.25 based on \$104,571.25 per week most of which revenue would not have accrued to our line if this substitution publication had not been made due to our car shortage at these involved origins and the ability of the BN to meet such requests in the event we had no way of moving this traffic.

QUOTATION OF UNIT TRAIN RATES ON PIPE FOR ALASKAN NATURAL GAS PIPELINE

A complete program was designed to move pipe from mill to construction site. The SP and the MILW Railroads will provide what will amount to single line service from Baytown to Seattle, the Bay Area or Tacoma. Run through train operations with SP equipment. SP will act as service control center and single contact point in rate negotiations.

Options under consideration are:

(1) 4,800 mile rail-barge-rail route to operate as a single transportation system. Rail cars load at Baytown, TX for rail movement to Seattle via Southern Pacific—Portland—MILW Road with BN, UP or MILW switching the dock area. Then, rail cars loaded onto Crowley Maritime barges for ocean movement to Whittier, Alaska. Rail cars off loaded at Whittier and move by rail on the Alaska RR to Fairbanks where pipe will be unloaded.

(2) Secondary option for pipe transload for bulk barge movement: rail cars loaded at Baytown and move via SP direct to Bay Area or to Tacoma via SP—MILW. Then, pipe unloaded and staged at Benicia, Redwood City, or Port of Tacoma. Then, pipe loaded onto Crowley barges for transport to Seward. Pipe offloaded and staged on available Alaska RR property. Next, pipe reloaded onto rail cars for movement on Alaska RR to Fairbanks.

ESTABLISHMENT OF RATES ON NEW FUEL SUBSTITUTE "GASAHOL" TO ENCOURAGE NEW PRODUCTION ON OUR LINE—MAY 1979

Effective June 19th, a scale of 135,000 pound and 190,000 pound rates on "Gasahol" (Denatural Anhydrous Ethyl Alcohol) will be published for application within Illinois Rate Committee and Western Trunk Line Territory. The shipper is Archer-Daniels-Midland of Decatur, IL who will be utilizing our routing via Illinois Terminal RR—Peoria, IL—Toledo, Peoria & Western RR—Webster, IL—MILW as we are the only major midwestern line to publish the 190,000 pound rates. Archer-Daniels-Midland further advise that the majority of their leased car fleet are jumbo cars which will enable their utilizing the 190,000 pound rates via our line. In addition, these rates can be used by Solar Fuels, a company that is proposing several new gasahol plants on our line in South Dakota.

SPECIAL RATES ESTABLISHED FOR MOVEMENT RECYCLABLE MUNICIPAL WASTE—APRIL 1977

Through negotiations with the Vulcan Materials Company on behalf of the City of Great Falls, Montana we have arranged for the issuance of a Section 22 Quotation on Municipal Metal Waste Scrap, Viz: scrap tin plate, scrap tin can, etc. from Great Falls, Montana to Chicago, Illinois. This stockpile of 2,520,000 lbs. would not have moved to Chicago or would have moved adversely to our line to western areas had we not taken this action and based on average revenue of \$1,401.85 per car and average contribution of \$596.50 per car will produce total revenue of \$28,037 and contribution of \$11,930 to our line in the period of effectiveness of March 9th through May 9th, 1977.

ESTABLISHMENT OF MULTIPLE CAR RATES TO MEET INTERMODAL COMPETITION ON MOVEMENTS OF SCRAP IRON—DECEMBER 1976

In an endeavor to convert a movement of Iron or Steel Scrap from barge-rail handling to all-rail transportation, CMStP&P RR, in conjunction with Kansas City Southern Ry. and Texas and Northern Ry., independently announced establishment of a temporary multiple car rate of \$22.55 per gross ton, minimum weight 123,000 pounds per car, subject to a minimum tender of 616,000 pounds per shipment, in Iron or Steel Scrap, from Davenport, Iowa, to Lone Star, Texas. The rate is applicable via our line to Kansas City, thence connections, and since its inception on February 13 through the end of the month, CMStP&P RR handled some 2600 gross tons of this material, producing net revenues to our line of \$22,950.75. Prior to the establishment of this adjustment, the tonnage was tentatively scheduled to move via barge to Memphis, thence rail beyond to destinations. The adjustment is expected to generate additional tonnage for our handling in the months ahead.

ESTABLISHMENT OF ROUND TRIP INTERMODAL RATES—AUGUST 1977

As a result of negotiations with a motor carrier we were able to establish round trip charges on trailer loads of Iron or Steel products from Chicago, IL to Minneapolis, St. Paul, MN. The rates apply on the motor carrier's trailer and are subject to a minimum requirement of 300 trailers per month. During 1978 we handled 4,836 trailers producing revenues slightly less than \$800,000. Movement thus far in 1979 indicates an increase in volume. In addition we have just negotiated a 28 percent increase in freight charges to become effective July 1, 1979.

ESTABLISHMENT OF OFF PEAK SEASONAL RATE TO COMPETE WITH SUMMER BARGE MOVEMENT—JULY 1978

In cooperation with an Industrial Fuel Operator located in Milwaukee, WI it was noted that our inbound fuel oil shipments were seasonal in nature being replaced in summer months by barge movements from another producing origin. In order to compete with the barge transportation we independently announced a rate reduction of 15¢ from the otherwise applicable year-round rate to apply during the summer months from Sinclair, WY to Milwaukee, WI. The anticipated volume is in excess of 300 cars. The rate and contribution is as follows:

Rate.....	\$1.15
Weight.....	148,000
Gross.....	\$1,720
MILW:	
Percent.....	39
Revenue.....	\$663.78
Cost.....	\$392
CTO.....	\$271.78
Percent of CTO.....	69.3

This is the equivalent of \$38.82 contribution per car day.

QUOTATION OF MINI-TRAIN AND SPECIAL SERVICE RATES FOR MOVEMENT OF CONSTRUCTION PRODUCTS—1978

In a continuing effort to encourage the movement of various types of construction aggregates from sources on our line, we often study and quote rates on either multiple-car or mini-train service delivery rates. The major producer of these products on our line is the L. G. Everist Company, who ships out of Dell Rapids, SD and Ortonville, MN. An example of the potential movements quoted on during the last 12 months are as follows:

- (1) Crushed Stone from Dell Rapids to Sanborn, IA—45,000 tons annually.
- (2) Ballast from Ortonville, MN to Peever, SD—total tonnage 125,000 tons.
- (3) Crushed Stone from Ortonville, MN to Moreau Jct., SD—volume 36,000 tons.
- (4) Crushed Stone from Dell Rapids to Wolsey, SD—volume 31,000 tons.
- (5) Crushed Stone from Ortonville, MN to Selby, SD—volume 30,000 tons.
- (6) Crushed Stone from Ortonville, MN to Moberg, SD—volume 22,000 tons.
- (7) Rip-Rap from Dell Rapids, SD to Yankton, SD—volume 125,000 tons.
- (8) Ballast from Ortonville, MN to Fairmount, ND—volume 1,000 cars.

INCREASE IN CEMENT RATES TO ELIMINATE LOSSES ON A REPETITIVE MOVE—
DECEMBER 1978

We have a repetitive movement of Cement from Metalline Falls, Washington to Spokane, Washington and Missoula, Montana. System wide study of our profitability on Cement handling determined that these movements were in need of an increase. Cement rates to Spokane, Washington were increased to reflect all pending but not currently applicable general increases. Rates to Missoula, Montana were increased to a negotiated level from 46 cents per cwt. to 60 cents per cwt. This resulted in improved contribution on the movement to Spokane and the conversion from a deficit to contributing status on the movement to Missoula, Montana.

In June, 1977, the Milwaukee Road and Miller Brewing entered into a joint sublease agreement with the southern Railway on 250 RBL cars. With credit backing from Miller Brewing, the Milwaukee Road was able to obtain the cars at a substantial reduced monthly rate. The cars were required by Miller at their Milwaukee, Wisconsin, plant pending completion of their brewery at Eden, North Carolina, located on the southern Railway. The 250 cars generated approximately \$1.6 million in on-line annual revenues and approximately \$350,000 annually in per diem and mileage credits.

Commencing in 1977, the Milwaukee Road entered into a number of agreements with various shippers in which they have agreed to advance badly needed funds to our company for the repair of bad order special equipped freight cars that would otherwise remain out of service for an extended period of time. In return for the interest-free financing, our company has agreed to assign these cars to the shipper at points on our railroad for their exclusive use, until such time as the shipper has recovered his investment by prearranged terms. To date, 157 jumbo grain hoppers, 25 pneumatic covered hoppers, 51 small-cube 70-ton hoppers, 12 50-foot RBL cars, 22 small-cube airslides, and 8 jumbo airslides have been repaired at an expense of \$1,915,820.

In October, 1978, we commenced negotiations with CWS Trucking Company to handle their palletized loads of sheet and coil steel produced in the Chicago area to both Minneapolis and Louisville. This concept had been pioneered on the ICG, and they had been experimenting with the Chicago & North Western on the Minneapolis market. They desired a carrier who could serve the Twin Cities and Louisville, but more importantly, required a loading facility nearer the steel producing area in South Chicago and Indiana. We put together a package which required us leasing property on the IHB at Gibson and modifications to our property for terminals at the destinations and modifying bulkhead flat cars for affixing the palletized loads which would total an investment of around \$135,000 on our part. The benefit of such an investment will total an annual gross revenue of \$2 million, producing a contribution in excess of \$500,000. The Minneapolis movement started January 1, and we just this month worked out the details for the Louisville movement.

ENTRY FORM—THE 1979 GOLDEN FREIGHT CAR AWARD COMPETITION

(1) The Milwaukee Road, 516 W. Jackson Boulevard, Chicago, Illinois 60606 and Thomas E. Haben, Director, Intermodal Freight (312) 648-3218.

(2) On June 5, 1978, the Milwaukee Road began a new high-frequency piggyback freight service between Chicago and Minneapolis-St. Paul in a one-year demonstration designed to improve intercity freight service productivity and profitability.

The service is called "Sprint Trains." It is being provided under a subcontract awarded to the Milwaukee Road in an Intermodal Freight Program administered by the Association of American Railroads and funded in part by the Federal Railroad Administration. The Milwaukee Road is the first railroad awarded a contract in this program.

The purpose of the Intermodal Freight Program is to test whether significant volumes of intercity highway traffic will be attracted to rail piggyback service which provides frequent departures, quick schedules, and which offers competitive rates based on improved labor productivity and equipment utilization.

With two months remaining in the year demonstration, the Sprint Trains are already a success. As of mid-March 1979, average monthly TOFC loadings in the Chicago-St. Paul corridor are more than double what they were in the year before Sprint Train operations began last June. Of the new business carried on the Sprints, a minimum of 80 per cent had previously moved by truck over the highway.

The Milwaukee Road's Chicago-St. Paul main line is an ideal location to test the concepts of the AAR/FRA Intermodal Freight Program. Motor carriers operate at least 320,000 truck-trailer combinations yearly between Chicago and the Twin Cities over highways which in many locations are parallel to the Milwaukee's tracks.

Additionally, the Milwaukee's main line in this corridor has the physical capacity necessary to conduct the intermodal demonstration. The line is also the shortest of all rail lines between Chicago and the Twin Cities and has the most favorable grades and fewest curves.

To attract a significant volume of the highway traffic moving over this route, Sprint Train service was specifically designed to provide intermodal shippers with frequent, fast, and above all, reliable service.

The Sprint Trains are limited to no more than 25 flatcars to insure quicker operating times and faster turnaround at terminals. The trains operate with one locomotive and a caboose. Frequent departures are set to meet shipper distribution needs and to provide the options of day, evening or overnight delivery. Substantial track improvements were made at the railroad's Chicago (Franklin Park) and St. Paul intermodal terminals to further guarantee reliable Sprint Train performance.

The railroad's wholly owned trucking subsidiary, the Milwaukee Motor Transportation Company, played an integral role in the development and implementation of the Sprint Trains. Milwaukee Motor personnel operate the Chicago and St. Paul intermodal terminals. MMT also provides local cartage service in the terminal areas under the various piggyback plans available to shippers.

As the result of productivity agreements signed by the railroad and the United Transportation Union and the Brotherhood of Locomotive Engineers, the Sprint Trains operate nonstop with only a quick crew change at Milwaukee and with one, instead of two, brakemen.

Prior to the inauguration of the Sprint Trains, the Milwaukee Road operated one primarily all-piggyback train a day in each direction between Chicago and St. Paul. The initial Sprint schedule more than doubled this service by offering 32 all-piggyback trains a week. Increased business and the desire to provide even more frequent service led to the introduction of 10 additional trains a week in late August.

In operation, each Sprint Train makes the nearly 800-mile round trip between Chicago and St. Paul in 24 hours. Running time in each direction is 10 hours. Two hours are allotted at terminals to unload and reload the trains and to service train equipment.

The Sprint Trains have been very successful in maintaining this schedule. With the exception of some of the worst days of the severe winter of 1979, the Sprints have consistently achieved better than a 90 per cent of time performance level (under the terms of the demonstration contract "on time" means having trailers available for shippers within one hour after a train's scheduled arrival time).

This superior performance has resulted in a more than 100 percent increase in TOFC loadings in the corridor in less than a year. Loadings are expected to increase through the remainder of the demonstration.

(3)(a) The Sprints have attracted business from a competing transportation mode. A minimum of 80 percent of the new business handled by the Sprint Trains previously moved via truck over the highway between Chicago and Minneapolis-St. Paul. See question (3)(h) for additional traffic information.

(3)(b) Over a nearly two-year a period before the Sprint Train service began, Milwaukee Road marketing and intermodal specialists and representatives of the AAR's Intermodal Freight Program team conducted a thorough market study of motor carrier traffic on the interstate highway system in the Chicago-Twin Cities corridor.

Areas included in the study were total volume of traffic, who controlled it, which shippers owned their own equipment, directional balance of highway movements, and types of commodities moved by truck. The study also identified traffic that probably could not be attracted to rail piggyback service because of cost factors or type of commodity (for example, bulk liquids shipped in tank trailers).

(3)(c) Sprint Train service is being provided under existing TOFC rates and plans. The Milwaukee Road's TOFC rates encompass the full tariff range. The various piggyback plans offer shippers a wide variety of equipment and service options.

(3)(d) The Sprint Trains operate with conventional TOFC flatcars in dedicated service.

The railroad's Chicago (Franklin Park) intermodal facility is equipped with four mechanical lifting devices. Three mechanical lifting devices are in operation at the St. Paul intermodal terminal.

(3)(e) Train scheduling:

One of the key elements in designing Sprint Train service was the need to establish frequent and convenient departures for intermodal shippers.

The initial Sprint schedule of 32 weekly trains that went into effect on June 5, 1978, more than doubled the level of TOFC service the Milwaukee Road had been

providing in the Chicago-St. Paul route. Three Sprints operated in each direction Monday through Friday, and one train operated each way on Saturday.

On August 28, two trains were added to the daily schedule, raising to 42 the number of Sprint Trains operated each week. With this expanded schedule, the Milwaukee Road operated eight daily Sprints, four in each direction, Tuesday through Friday, with slight schedule variations on remaining days and holidays.

Operating techniques:

In preparation for the start of Sprint service, substantial modifications were made in the track configuration at the Chicago (Franklin Park) and St. Paul intermodal terminals to provide for run-through operations and the elimination of yard congestion.

These changes have helped the railroad to meet or better the two hour turn-around allotted at terminals to unload and reload trains and to service train equipment.

Work rules:

Labor organizations have been instrumental in the success of the Sprint Trains.

As a result of a productivity agreement signed by the Milwaukee Road and the United Transportation Union in early 1978, the Sprints operate with one instead of two brakemen and the trains are operated by their road crews within yard limits at intermodal terminals. Additionally, an agreement with the Brotherhood of Locomotive Engineers allows the Sprints to operate nonstop between Chicago and St. Paul with only a quick crew change at Milwaukee. Other through trains make two crew changes; at Milwaukee and Portage.

(3)(f) In addition to Marketing, the following departments were involved in the development of Sprint Train service: Sales and Service, Operating, Management Services (Labor Relations and Personnel), the Milwaukee Motor Transportation Company, and Law.

An Intermodal Freight Department was established within the Marketing Department prior to the inauguration of Sprint Train service. Headed by Tom Haben, Director-Intermodal Freight, and staffed by intermodal and marketing specialists, the group is responsible for supervising the entire Sprint Train operation. Among this group's functions are coordinating the service with all other departments on the Milwaukee Road and with representatives of the FRA and the AAR.

(3)(g) The railroad's trucking subsidiary, the Milwaukee Motor Transportation Company, has been closely involved in the development and implementation of Sprint Train service. Milwaukee Motor personnel operate the Chicago and St. Paul intermodal terminals. MMTTC also provides local pickup and delivery in the terminal areas under the various piggyback plans available to shippers.

(3)(h) In the year prior to the start of Sprint Train service, TOFC loadings in the Chicago-St. Paul corridor averaged 2,400 trailers a month. Loadings increased after the new service began, reaching a level of 3,800 trailers in September. TOFC volume followed a historic pattern and declined somewhat during the last three months of the year but then increased steadily during January and February.

The Sprints carried 1,407 loaded trailers during the week ending March 17. Projections for the full month of March are that loadings will be more than double the monthly average before Sprint service began last June.

Revenue and profit information is not available at this time.

(3)(i) A series of sales campaigns were conducted in the Chicago and Twin Cities metropolitan areas to acquaint intermodal shippers with Sprint Train service. Several thousand potential customers were contacted in each area. Off-line sales representatives also contacted possible Sprint Train users in conjunction with these campaigns.

Two direct-by-mail advertising campaigns were conducted involving the distribution of some 10,000 information brochures and Sprint Train schedules to intermodal shippers throughout the United States.

Publicity campaigns were conducted to announce both the beginning of Sprint Train service and the expansion of operations. These efforts resulted in wide media coverage, especially in the rail industry and traffic trade press and in Chicago and Twin Cities newspapers, and generated a sizeable number of inquiries from intermodal shippers.

Intermodal Freight Department representatives worked closely with connecting railroads to coordinate Sprint Train service with their intermodal operations.

Toll-free numbers were arranged to provide shippers with quick access to the Intermodal Freight Department.

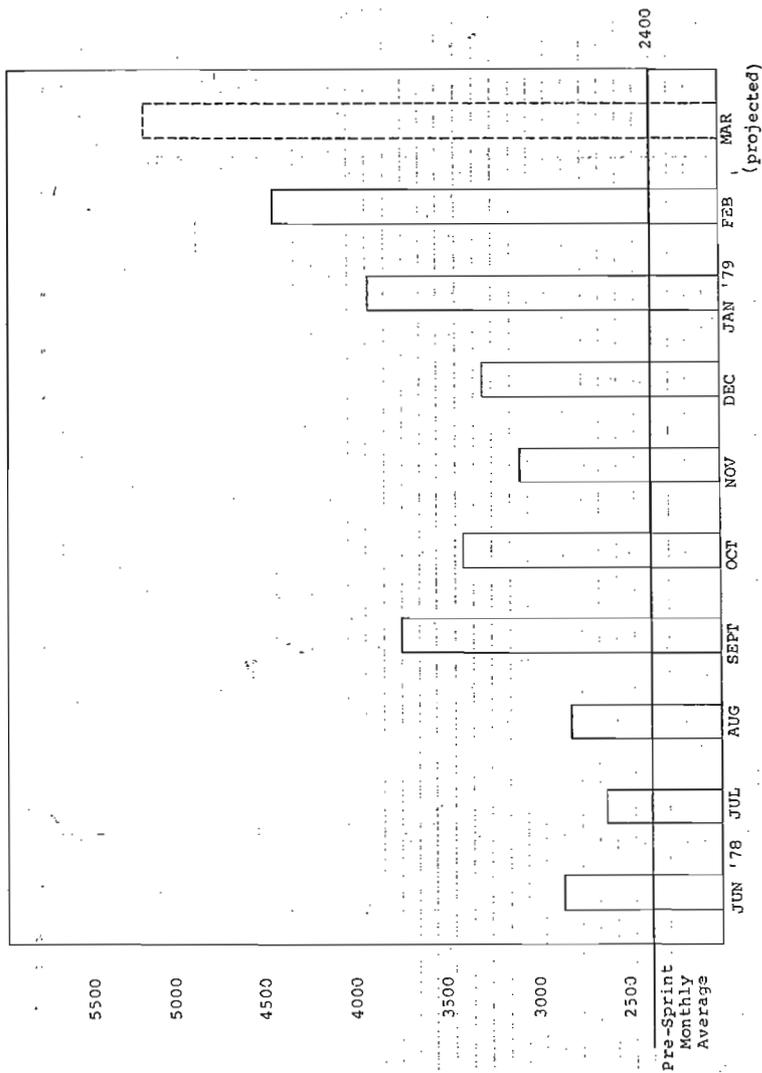
The Sprint Trains are operating over some 300 miles of main line track between Milwaukee and St. Paul that the railroad is rehabilitating with some \$33.6 million

in 4R Act funding. Track work began in 1977, continued during 1978, and is scheduled for completion by the end of the 1979 work season.

Two locomotives were initially assigned to each Sprint Train to insure service reliability. As they became available from the railroad's Milwaukee Shops, completely rehabilitated and upgraded SD40-2 locomotives were assigned to the Sprints. By December, each Sprint was powered by a single SD40-2 unit. The locomotives are part of a 4R-funded program to repair 111 Milwaukee Road locomotives.

The Milwaukee Road is working with the Department of Energy, the AAR and the FRA to monitor locomotive fuel consumption on the Sprint Trains to determine the extent that rail piggyback service is an energy-conserving alternative to motor transportation.

SPRINT TRAIN VOLUME GROWTH (Trailerloads By Month)



Question 8. Of the core system that the railroad proposes to maintain, which line segments are profitable routes?

Answer. Booz, Allen & Hamilton analyzed eight detailed configurations in assessing future viability for the Milwaukee Railroad. Their analysis was performed on an integrated system basis with profitability determined on each total configuration. Individual line segment profitability was not performed but line segments were included in a configuration if present or potential revenues appeared sufficient. Many segments without revenue generation potential are included in some configurations for operating linkage purposes i.e. a connection between two revenue generating segments in order to realize the revenue.

Some line segments can be incrementally measured for profitability. For example, at the long term market opportunity level, the adjusted annual NROI for the subscore is \$3.8 million, for the Miles City subcore the NROI is \$7.5 million. By deduction, the extensions of the subcore to Miles City added \$3.7 million annual NROI to the subcore system configuration. However, this same deductive process for the Miles City extension coupled to a different midwest system only realized an additional \$2.6 million annual NROI to the Core. The Miles City extension, if added to another configuration may yield yet another incremental effect.

Question 9. What percentage of your car fleet is bad ordered?

Note.—Bad ordered cars are cars awaiting repairs and ineligible for freight service.

I would appreciate your providing statistics on your bad orders by car classification—if you don't have the statistics available, please submit them for the record.

Further, provide information on the percentage of your locomotive fleet that is bad ordered.

Answer. The following percentages of our car fleet were bad ordered as of May 1, 1979:

Plain box 40 ft, ND	9.6
Plain box 40 ft, WD	26.7
Plain box 50 ft. but under 60 ft	10.4
Plain box 60 ft. or longer	8.7
Total plain box	12.9
All equipped box	23.7
Total all box	14.3
Covered hoppers under 4,000 cu. ft.	6.8
Covered hoppers 4,000 cu. ft. and over ..	4.0
Total covered hoppers	5.0
Plain and equipped refrigerators
Plain mechanical refrigerators	50.0
Equipped mechanical refrigerators	13.4
All other refrigerators	35.6
Total refrigerators	6.6
Gondolas under 61 ft.	11.6
Plain gondolas 61 ft. or longer	10.0
Equipped gondolas	12.6
Total gondolas	12.1
Hoppers (general service)	6.4
Hoppers (special service)	1.6
Total hoppers	6.2
Flats (general service)	6.4
Flats (multilevel)	1.3
Flats (TOFC-COFC)	6.0
Other flats (special service)	7.1
Total flats	5.1
Total tanks
All others	8.6
Grand total	10.2

In answer to the second part of Question No. 9, 22.1 percent of our locomotive fleet is bad ordered, as of June 26, 1979.

Question 10. Have the "end-of-the-month" cash balances on the Milwaukee Road remained relatively constant in the last few months?

Answer. A summary of the "end-of-the-month" book cash balance for the Railroad for the last few months follows. The summary shows actual month end balances which were only achieved through the substantial infusion of external funds (\$35.8 million during February through May) and pro forma figures assuming such funds

had not been received. It is quite apparent that the month end balances have not remained relatively constant.

(Dollars in thousands)

	Actual	Pro forma assuming external funding had not been received
December 1978.....	\$7,687	\$7,687
January 1979.....	479	479
February 1979.....	2,611	17,711
March 1979.....	2,678	17,778
April 1979.....	635	23,965
May 1979.....	3,839	31,961

1 Denotes deficit.

Question 11. What extent of your operating losses were attributable to the severe winter season at the beginning of this year?

Answer. It is quite difficult to estimate the extent to which the first quarter railroad operating losses of \$45 million were attributable to the extraordinary severity of the winter season, since such losses are attributable to several factors, including the continuation of the erosion of business. From a revenue standpoint, the reduction in carloadings during the first quarter of 1979 as compared with the first quarter of 1978 of 23,000 carloads represented an estimated reduction in net freight revenues of approximately \$12 million.

Question 12. It appears that the only increase in your carloading categories is attributable to "forwarder and shipper traffic" as opposed to your statistics for the same period in 1978. What accounts for the increase for this category?

Answer. The attached is Milwaukee's Form 32 report comparing the first five months of 1979 to the first five months of 1978. This report describes changes in carloading patterns. The increases in forwarder and shipper traffic amounted to about 24 percent and is primarily attributable to the Sprint Train operations which started on June 5, 1978. The Sprint Train is an intermodal "piggyback" project within the Milwaukee Railroad's subcore area from Chicago to Minneapolis-St. Paul. A more complete description of this project is found in the second attachment.

In addition, we had an 11.9 percent increase in coal reflecting a coal strike in the early part of 1978 and the addition of a new unit train in 1979 from Wyoming to a Wisconsin power plant known as Columbia II.

Other small increases of 5.4 percent in food products representing 194 cars and a 3 percent increase in wood and mill products representing 121 cars are attributed to a variety of small increases from various shippers.

Question 13. What would be your best guess estimate for the cost of a normalized maintenance schedule for the existing system; also how long would you estimate it would take to have the system where it would just require routine maintenance?

Note.—Normalized maintenance is right of way work needed to return it to industry standards and allow trains to operate at maximum speeds.

32 REPORT WEEKLY * 05/24/79-05/31/79 * YEAR TO DATE 32 REPORT SUMMARY FOR 05/31/79 VS 05/31/78

LINE NO	COMMODITIES	LD ON LI	RCVQ	TOTAL	THIS YR	LAST YR	CHANGE	REC FROM CONNECTIONS	WORKING DAYS	THIS YR	LAST YR	CHANGE	TOTAL	PERC
1	GRAIN + SOYBEANS	1,416	133	1,549	18,794	20,016	-1,222	2,585	1,900	685	21,379	21,916	537	-2.4
2	GRAIN MILL PROD	711	133	844	13,084	15,148	-2,064	3,084	3,843	-759	16,169	18,991	-2,822	-14.8
3	FARM PRODUCTS	6	17	23	664	419	-245	289	455	-305	1,013	1,013	-	-
4	PACKING HSE PROD	26	4	30	486	494	-8	256	244	12	742	930	-188	-25.2
5	CANNED + DAIRY PR	130	48	178	3,312	4,817	-1,505	1,084	1,714	-620	4,406	5,531	-1,125	-20.5
6	BEVERAGES + MALT	349	42	391	6,684	8,950	-2,266	695	776	-81	7,579	9,726	-2,147	-22.0
7	FOOD PRODUCTS	85	54	140	1,790	1,812	-22	1,940	1,724	216	3,730	3,536	1,944	5.4
8	PRF FOREST PROD	1,097	46	1,143	23,619	25,528	-1,909	1,010	1,560	-550	24,639	27,088	-2,449	-9.0
9	LUMBER + PLYWOOD	288	488	776	5,964	6,867	-903	9,693	13,474	-3,781	15,657	20,341	-4,684	-23.0
10	WOOD + MILL PROD	125	97	222	2,420	1,372	1,048	1,618	2,545	-927	4,038	3,917	1,21	3.0
11	PULP	57	99	156	1,086	1,577	-491	2,294	1,43	861	3,380	3,728	-348	-9.3
12	PAPER	619	205	824	10,909	11,957	-1,048	4,370	5,273	-903	15,279	17,240	-1,961	-11.3
13	PAPERBD + CONTRS	154	234	388	2,755	3,033	-278	3,987	4,814	-827	6,742	7,847	-1,105	-14.0
14	COAL	1,031	733	1,764	22,555	19,573	2,982	21,443	19,742	1,701	43,998	39,315	4,683	11.9
15	ORES + MINERALS	499	301	800	8,992	12,144	-3,152	5,073	6,748	-1,675	14,085	18,892	-4,807	-25.5
16	PETRO + COAL PR	77	86	163	1,371	1,549	-178	1,828	3,034	-1,206	3,199	4,583	-1,384	-30.1
17	CHEMICALS	148	479	627	3,363	3,629	-266	11,765	13,963	-2,258	15,068	17,592	-2,524	-14.3
18	METAL PRODUCTS	220	439	659	4,017	5,512	-1,495	7,291	8,952	-1,661	11,308	14,464	-3,156	-21.8
19	ORDINANCE	2	30	32	31	84	-53	37	47	-10	68	131	-63	-48.0
20	MACHINERY	233	80	313	3,643	4,372	-729	1,653	2,234	-581	5,296	6,606	-1,310	-19.8
21	MOTOR VEHICLES	130	418	548	2,426	3,219	-793	7,990	9,210	-1,220	10,416	12,429	-2,013	-16.1
22	AUTO PARTS	343	225	568	5,614	6,195	-581	4,508	4,743	-235	10,122	10,938	-816	-7.4
23	WASTE + SCRAP	379	133	512	7,335	8,317	-982	2,485	3,015	-530	9,820	11,332	-1,512	-13.3
24	FORWARDER SHPMT	1,285	86	1,385	30,164	23,821	6,343	2,112	2,189	-77	32,276	26,010	6,266	24.0
25	MANU + MISC PROD	403	235	638	8,019	10,729	-2,710	5,092	6,456	-1,364	13,111	17,185	-4,074	-23.7
26	TTL CARLOAD FGT	9,829	4,821	14,650	188,797	201,344	-12,547	104,134	120,946	-16,812	292,931	322,290	-29,359	-9.1
46	TOFC	1,773	47	1,820	39,114	34,733	4,381	1,458	1,858	-400	40,572	36,591	3,981	10.8
44	TTL N-REV FGT	461	10	471	4,647	3,109	1,538	97	2	95	4,744	3,111	1,633	52.4

LINE	COMMODITY	PERC GAIN	5 BIGGEST GAINERS	PERC LOSS	5 BIGGEST LOSERS	1 PER CENT CORRECTION FACTOR ADDED TO ALL THE ABOVE COUNTS
24	FORWARDER SHPMT	24.0	3 FARM PRODUCTS	-55.2		
14	COAL	11.9	19 ORDINANCE	-48.0		
7	FOOD PRODUCTS	5.4	5 CANNED + DAIRY PR	-32.5		
10	WOOD + MILL PROD	3.0	15 PETRO + COAL PR	-30.1		
			15 ORES + MINERALS	-25.5		

Answer. The Booz, Allen & Hamilton report estimated the cost of normalized maintenance on an annual basis for the entire Milwaukee system less light density branch lines as about \$100 million in 1977 dollars. This cost would probably be on the order of \$120 million in today's terms. We believe it would likely take 10 years to reach a normalized maintenance level on the entire system. The investment commitment for track rehabilitation to approach this level would be \$482 million.

Question 14. The Milwaukee recently filed in court supplemental testimony that analyzed the proposal to preserve the transcontinental mainline. Would you briefly summarize your analysis of the SORE proposal?

If SORE could obtain the necessary financing to take over the Pacific Coast extension, would you have any objections to their proposal?

Answer. The supplemental testimony and cross examination of SORE witnesses pointed out the following:

- (a) The SORE proposal lacks sufficient detail to constitute a credible analysis.
- (b) Revenue estimates were unrealistic—71.3 percent increase over 5 years or 14.4 percent year compounded growth rate. The magnitude of these increases have not been obtained by any railroad in the country over the last 5 years let alone by a railroad operating in an area where it is traditionally a weak competitor. Market share was assumed to be gained at the expense of two much stronger railroads, Union Pacific and Burlington Northern without competitive track or equipment. Substantial coal traffic from a nonproducing Montana mine to unknown midwest power plants was projected.
- (c) SORE's normalized track maintenance expenses estimates were grossly understated. Main Line track mile maintenance was understated by almost 30 percent. No specific funds were allocated for maintenance of yard and switching tracks.
- (d) The SORE proposal did not include any ownership in terminal facilities at Twin Cities, the main gateway for the traffic.
- (e) No rehabilitation costs were included for branch lines or yard tracks. A capital requirement of over \$150 million was completely ignored.
- (f) SORE's capital structure assumes a pro rata share, based on a 44 percent route-mile ratio, of the present Milwaukee debt. The proposal provides no compensation for about \$200 million in assets.

SORE estimates that the railroad can be in a profitable posture, after only three years of operation. It was shown that SORE's projected maintenance figures are too low, revenues are too high, and rehabilitation costs are understated. Their proposal is fraught with vagaries and unrealistic projections which certainly indicates that it has no possible hope of succeeding.

Even if SORE could obtain the financing necessary for its proposal, we would object because the assumption of 44 percent of the debt is inadequate compensation to the estate for the assets in question. In addition, the creditors of the Railroad would be injured by having their obligations assumed by an organization with such little prospect of success. If SORE were able to obtain the financing for a cash offer of adequate size we would not object, however.

Question 15. You have said on a number of occasions that the Milwaukee cannot successfully reorganize as a transcontinental carrier. Would you please explain the basis for these statements?

The Booz, Allen and Hamilton analysis states that the Milwaukee's transcontinental system could become viable after substantial rehabilitation and over a period of several years. If you were to place this line in the core system—and assuming that it was eligible for Title V assistance, what would be your objections to maintaining service on the Pacific Coast extension?

Answer. We do not believe that the Milwaukee can reorganize as a transcontinental carrier due to the massive amount of rehabilitation which would be required to place such a system in proper physical condition, the difficulty of obtaining the funds and meeting debt service requirements and the competition provided by the Burlington Northern and the Union Pacific. Even when the Milwaukee Railroad's transcontinental system was in good condition, it was not an effective competitor to the other transcontinental carriers. For example, the Milwaukee at its highest point only carried about 18 percent of the total rail market share in the Pacific Northwest.

With respect to the effect of Title V funds, we would, of course, reevaluate our position if an adequate amount of very low interest Section 505 funds were provided for track rehabilitation. We do not think the system could possibly serve more costly loans under Section 511 of the necessary magnitude. The total amount required at the front end to properly restore a transcontinental system would be from \$249 to \$482 million for track rehabilitation depending upon the size of the system. Even

with the availability of at least a quarter billion of Section 505 funds a reevaluation would have to take into account the serious risk that competition from the Union Pacific and Burlington Northern would prevent debt service or repayment.

Question 16. You have also stated your opposition to the development of an employee stock ownership plan for the Pacific Coast extension because the transcontinental revenue base has so severely eroded that it would not be successful. Would you please summarize the deterioration of the lines west?

What do you think the advantages would be of establishing an employee stock ownership plan for the Milwaukee core system? Do you personally favor an ESOP plan for the core system? How would the creditors react to such a proposal?

Answer. The annual carloadings on our lines west of Miles City are listed below for the period 1973 through 1977.

Year:	Total carloads
1973.....	198,100
1974.....	175,200
1975 ¹	156,700
1976.....	177,500
1977.....	167,900

¹ Recession year.

In May, 1978, the deterioration of our train service, which had been a prime of 55½ hours in the 1960's and dropping to over 100 hours, which has caused the loss of additional time sensitive traffic.

We would review a proposal to establish an employee stock ownership program with great care because such a proposal would have the potential benefit of placing the risks and rewards of the operation in the hands of those parties most interested in it. We would caution that such ownership does not naturally follow from traditional reorganization law which provides that either the existing shareholders or creditors would become the shareholders of a surviving railroad. However, we would favor a proposal from a shipper or employee group to buy the assets of the core railroad for cash which might be provided with government financing. The Milwaukee Railroad's creditors would almost certainly favor such a proposal if the cash were adequate in amount. Alternatively government rehabilitation loans might be converted to stock and assigned to employee or shipper groups in a reorganization plan if the government were prepared to forego repayment. This might be the most economical way to set up an ESOP. We do not know how the creditors would react to such a proposal. There are certainly other measures which might also be used but all require a substantial financial commitment since the assets of the Miles City subcore have a value of in excess of \$400 million including the Land Company, and significant rehabilitation funds are required. In any event, the Miles City subcore, which may be viable, is a far more reasonable structure to test the ESOP concept than is the west end of the Milwaukee.

BOOZ, ALLEN & HAMILTON, INC.,
Bethesda, Md., June 20, 1979.

Senator RUSSELL B. LONG,
Chairman, Surface Transportation Subcommittee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: In response to your letter of June 13, I am sending our answers to the questions that your subcommittee asked. I hope that our answers are useful to your committee in your deliberations on the Milwaukee Road.

In preparing our report to the Trustee, we attempted to present a balanced independent appraisal of the options available to the Trustee. In that regard we urge that these comments be taken in the context of our entire report and the Executive Summary which summarizes our report.

After spending several days in the Federal Court in Chicago listening to testimony and reading prepared statements by others, and after being cross-examined under oath on our report, I remain convinced that our report presents a fair assessment of the Milwaukee Road's situation. I believe that Special Master Gray and Judge McMillin concur with this view having heard and read all of the evidence presented.

I appreciate the opportunity to present our report to your committee as well as to respond to your questions. If we can be of further assistance, please have Bill Johnson contact me.

Very truly yours,

CHARLES W. HOPPE, Vice President.

Enclosure.

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question 1. In your opinion, could any of the transcontinental scenarios realize a return on investment?

A large amount of conjecture has been made about the necessity of retaining a transcontinental route to accommodate future coal needs in the West and Midwest. I would appreciate your comments on this aspect of a transcontinental route.

Answer 1. As indicated in Chapter VI of our study, both the Louisville Transcontinental System and the Twin Cities Transcontinental could possibly have a positive Net Railway Operating Income if the very optimistic long-term market opportunities were achieved, and if certain potential operating improvements were also achieved. The Net Railway Operating Income figure does not include provision for debt service, and our study did not examine this matter. I am thus not in a position to assess the chances of one of these systems achieving a return on investment. In making your own decision on this matter, you should note that the \$15 million NROI that might possibly be achieved by Louisville Transcontinental would have to cover a commitment of \$450 million for new plant and equipment as well as the capital that is already invested in existing facilities and equipment. The \$5 million NROI that might possibly be achieved by the Twin Cities Transcontinental would have to cover \$264 million in new plant in addition to capital already invested. These figures represent total rehabilitation requirements as well as capital project requirements and the value of equipment needs.

In regard to the question of retaining a transcontinental route to accommodate future coal needs, I am of the opinion that private railroads cannot be expected to maintain facilities that may not be needed for many years. There is presently no westbound coal traffic on the Milwaukee, and some time will pass before facilities could be constructed to produce or consume coal that would move over the Milwaukee's route. Capacity on other railroads may not be sufficient to handle future growth given present facilities, but investments to increase capacity will no doubt be made by these railroads when the traffic is at hand given compensatory rates.

If the government is concerned about rail transport needs in the distant future, it may wish to preserve the continuity of the Milwaukee's right-of-way in some sort of "rail bank." The line need not be maintained in operation, and if a need for it ever arises, track and signal facilities can be reconstructed on the right-of-way.

Question 2. The Committee has several copies of your study on the Milwaukee system prepared for the use of the trustee.

In your opinion what would be the most efficient Milwaukee system out of the several different scenarios that you prepared for the trustee. What would be the cost for the normalized maintenance of this particular system?

Does the Milwaukee have the equipment to adequately serve this particular system? If not, what would you suggest as an adequate capital figure to provide this equipment?

Answer 2. There are many ways to measure efficiency in railroad operations. If the ratio of operating expenses to revenues is used as a measure of efficiency, then the present Milwaukee System Without Light Density Lines is the most efficient, as it has the lowest such ratio at all traffic levels. If, however, you take capital requirements into account, the Miles City Subcore would appear to be more efficient, since the ratio of its capital needs to its potential NROI is the most favorable of any system. The cost of normalized maintenance-of-way for each system is contained in Appendix N of our report. For the System Without Light Density Lines that cost would be \$92.7 million at 1977 traffic levels and \$101.4 million at long term market opportunity traffic levels. For the Miles City Subcore the normalized maintenance of way expense would be \$36 million at 1977 traffic levels and \$38.7 million at long term market opportunity traffic levels.

As indicated in Exhibits VI-5 and VI-6 of our report, the Milwaukee does not presently have enough cars or locomotives to serve the System Without Light Density Lines at long term market opportunity traffic levels. We estimate in Exhibit VI-11 that additional equipment valued at \$600 million would be required to serve this system.

Exhibits VI-5 and VI-6 indicate that the Milwaukee presently has enough locomotives to serve the Miles City Subcore System, and would require only a small quantity of cars (estimated to be valued at \$25 million) to serve this system at the long-term market opportunity traffic level.

Question 3. Do you see any benefits to the development of an employee stock ownership plan as a means of preserving Milwaukee rail service, for either the core system or for the transcontinental service scenario?

Answer 3. In my opinion, the question of an employee stock ownership plan does not fully address the basic problem of preserving Milwaukee Rail service for either a core or transcontinental scenario. Employee motivation problems have been only a part of Milwaukee's problems, and I do not think that employee stock ownership will do enough to solve these problems. Experience in this country indicates that it is usually the upper level management people who invest in the stock of employee-owned railroads, and that most employees do not participate in these plans. Employee stock ownership is, however, a politically popular concept, and certainly will not be detrimental to Milwaukee's chances for reorganization if the needed capital can be raised in this manner.

Question 4. Your analysis of the viable core configurations of the Milwaukee indicate that the Milwaukee's transcontinental service could become profitable over a period of years, and if appropriate rehabilitation funds were invested. Would you please explain exactly what would be necessary to make transcontinental service profitable?

Answer 4. Our analysis indicated that the Louisville Transcontinental and the Twin Cities Transcontinental Systems could possibly have a positive Net Railway Operating Income. No conclusions were drawn as to profitability. In order for these transcontinental systems to achieve a positive NROI, traffic growth would have to occur at long term market opportunity levels (33.3 percent above 1977 levels for the Louisville Transcontinental and 17.9 percent for the Twin Cities Transcontinental System). In addition, the projected operating improvements would have to be achieved, and large commitments would be required for track rehabilitation and equipment acquisition. As we indicated in our report, there are many risks involved in achieving these projected results.

Question 5. Your report identifies one Milwaukee core system that you believe is more viable than all other core configurations studied. Assuming that the necessary rehabilitation funds were made available for the Pacific Coast extension, would such assistance significantly change your determination of what constitutes the most viable core of Milwaukee?

Answer 5. The systems analyzed in our study allow us to answer this question directly. The Subcore was identified as the most viable of the configurations studied. The addition of the Pacific Coast Extension to the Subcore system would produce the Louisville Transcontinental System. This system is projected to have a positive NROI of \$15 million at long term market opportunity traffic levels, and would require a commitment of \$255 million in plant rehabilitation and \$195 million in equipment. The funding of plant rehabilitation from outside sources would, of course, make this system more attractive, but in our opinion the risks of achieving the required traffic growth are much more substantial for this system than the Subcore because of the nature of the competitive railroads in the Pacific Northwest markets, and the lead times inherent in acquiring equipment, rehabilitating the plant and regaining traffic.

Question 6. Your report indicates that as part of the market analysis, you conducted a survey of 72 shippers who represent 63 percent of the traffic base. How did you conduct the remainder of the market analysis? How many shippers did you interview in total?

Your market analysis predicts a 35 percent increase for the Twin Cities transcontinental service scenario. What commodities make up this increase? Does this increase assume total rehabilitation of lines?

Answer 6. The customer survey was structured and designed jointly by Booz, Allen's Transportation Consulting Division and National Analysts Survey Division. The interviews themselves were carried out by members of the Transportation Consulting Division's Rail Group.

The interview sample was chosen in the following manner, as recommended by National Analysts; using the Milwaukee Road's 1977 Sales Department revenue records, we chose: Every one of the Milwaukee Road's 30 largest customers; every third customer of the next 70 customers (ranked 31 to 100); and every tenth customer of the next 200 customers (ranked 101-300).

This sample was supplemented by key customers that either the Milwaukee Road Planning Department or Traffic Department felt we should interview.

Only 72 of the 98 customers contacted by Booz, Allen chose to participate in the interviews. Many who declined to respond did so in accordance with their firm's policy of not responding to outside inquiries about the firm or companies with whom

they do business. The list of those who responded is provided in our report (Volume 2, Appendix D).

No other firms were contacted. However, the testimony of many Milwaukee Road customers before Senator McGovern's Subcommittee in Aberdeen, South Dakota, was forwarded to Booz, Allen by the Senator's staff for our review.

Our market analysis indicated that a 35 percent revenue increase was possibly achievable although quite difficult in the long term if all market opportunities were realized by the Twin Cities Transcontinental System.

As indicated in Chapter IV of our report, the market opportunities for the entire Milwaukee Road System were determined. Those opportunities were then adjusted on a geographic basis to determine those opportunities that were applicable to the Twin Cities Transcontinental System. The commodities producing the bulk of the additional revenues included Grain, Coal, Metal Products, Freight Forwarder Traffic, Lumber and Plywood, Paper, Chemicals, and Motor Vehicles. Appendix E of our report details the commodity breakdown of the system market opportunities. A similar commodity breakdown for the Twin Cities Transcontinental is not readily available, and its production would require some computer work.

The achievement of the market opportunities assumed (as mentioned on Page IV-7 of our report) that the Milwaukee's plant would be rehabilitated sufficiently to allow Milwaukee to provide freight service equivalent to that provided by its rail competitors.

Senator LONG. Senator David Durenberger from Minnesota is here and wishes to make a statement.

STATEMENT OF HON. DAVID F. DURENBERGER, U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER. Thank you very much, Mr. Chairman.

Few business developments have affected Minnesota as dramatically as the bankruptcy of Milwaukee Road. When trustee Hillman announced his original reorganization plan Minnesota faced two distinct problems, since the plan in effect abandoned two of our most important rail lines.

The so-called northern line which runs from Minnesota to Miles City, Mont., is my State's principal link with the coal producing regions of southwestern North Dakota. Loss of this line would have a serious impact on the energy needs of northwest Minnesota and nowhere is this more dramatically illustrated than in the problems confronting the Big Stone power generating plant.

Although the plant itself is just across the South Dakota line, it provides electrical power to more than 40,000 Minnesota homes and businesses. In addition, the plant is a principle employer in the Ortonville, Minn., area.

Big Stone runs entirely on coal power, and the northern Milwaukee Line is its only access to coal. Had the embargo taken effect as scheduled in early May, it would have required 500 trucks a day just to service the needs of this single plant. Our roadbeds couldn't sustain this traffic, and we lack the terminal facilities to handle it. Beyond this, it would inflict a serious financial burden on the families and businesses who rely on Big Stone for their energy needs.

In southern Minnesota, the problem has similar dimensions, but different details. By proposing to embargo the southern line, which runs from Rosemount south through Albert Lea and westward along the Minnesota-Iowa border, the reorganization severed the lifeline to one of Minnesota's richest agricultural regions.

This morning I am fortunate to be accompanied by Mark Seetin, Minnesota's commissioner of agriculture. Since the embargo was first imposed, Commissioner Seetin has been working to educate

the public on the problems a shutdown would inflict on Minnesota farmers. His testimony describes those problems in detail, and I will not attempt to preempt him.

In general, however, I can assure the committee that loss of the southern line would inflict a terrible toll on the economy of my State, and the lives of its farmers and businessmen. Added to this, of course, is the personal loss suffered by employees of the railroad itself.

As this committee is well aware, the States affected by this embargo have pursued a variety of options to address problems peculiar to their areas. Abandonment of the northern or Miles City line is a multistate problem, and Minnesota has joined its neighbors from North Dakota, South Dakota, and Montana in negotiating a tentative accommodation with the trustee that will permit service to continue on that route.

Utilizing funds available under the Local Rail Service Assistance Act of 1978—Public Law 95-607—Minnesota will make a substantial contribution toward restoration of the northern line roadbed. In return, the trustee has agreed to incorporate that line within his permanent core.

That agreement is now before the bankruptcy court and I am hopeful that it will receive approval within the coming week.

But, in contrast to this multistate arrangement, the problems of the southern line are Minnesota's problems. To resolve them, negotiations were commenced in April between Gov. Al Quie's office, Minnesota Departments of Transportation and Agriculture, and trustee Stanley Hillman.

In Washington, I've done everything I can to assist those negotiations by providing a focal point for information, and monitoring developments in similar negotiations between railroad officials and representatives of other States.

I am both pleased and relieved to inform the committee that these negotiations have been fruitful and have produced an arrangement that will retain service on most of the southern route throughout the remainder of this year.

Under the terms of that accord, Minnesota will invest approximately \$1 million in State rail service improvement program funds to provide necessary maintenance on the southern line roadbed. In return, the trustee will retain a majority of that line in his permanent core system through December 31, 1979.

At that point the status of that line will again be reviewed, and I am hopeful that its financial performance will be sufficient to justify permanent inclusion in the revised system.

I want to stress, however, that this is a tentative accord, and it will only take effect if approved by the bankruptcy court. Nevertheless, the accord is an encouraging development and Minnesota owes a debt of gratitude to the Minnesota commissioners of transportation and agriculture who worked so diligently to bring it about.

Of course, even if accepted by the court, these arrangements will only resolve a portion of the problem resulting from the Milwaukee bankruptcy. They leave many miles of embargoed track without the prospect of permanent service, and southern Minnesota farmers may be receiving no more than a 9-month reprieve.

These are short-term solutions and the process of evolving a long-term solution will challenge the limits of our commitment and integrity—excuse me, ingenuity.

Senator LONG. Both.

Senator DURENBERGER. But within the particulars of the Milwaukee's problem lies a more generalized message to all of us in the Congress, as well as the administration. For as demands on our transportation system increase, we continue to improvise, day by day, without a unified national transportation policy.

Development of that policy is essential to determine where the pieces of a particular problem, like a failing railroad, fit into the national transportation picture.

Certainly there is an overlap between transportation modes, and few would challenge the fact that our rail-freight system is over-extended. But where to trim back the system, and where to combine modalities, are complex questions that cannot be resolved in isolation.

Every time we address a problem like the Milwaukee bankruptcy on a piecemeal or emergency basis, we continue to further fragment the national transportation system.

Mr. Chairman, you and your committee are to be strongly commended for the work you've done in developing the basis for a national transportation policy. But, like the Milwaukee, we have miles to go, and I hope that the difficulties suffered by those of us who depended on this railroad will encourage Congress to pursue this national goal with renewed dedication.

Senator LONG. Thank you very much for your contribution. We are very much aware of your interest in this matter. I sat through two conferences with you already. I hope we can work out something to solve the problem. Thank you.

Next we will call Senator Baucus, who arrived while Senator Durenberger was testifying. We are pleased to have you.

STATEMENT OF HON. MAX BAUCUS, U.S. SENATOR FROM MONTANA

Senator BAUCUS. I appreciate this opportunity to discuss the Milwaukee Road and its financial problems. There are two points I especially want to stress.

First, railroad transportation is essential to the Northwest and to the Nation. Second, the Milwaukee Road is not a basket case. It could be profitable.

The importance of Milwaukee service is very obvious. First, railroads are the most energy-efficient means for transporting bulk commodities long distances. There absolutely is no other way to move grain and coal and forest products we produce in the Northwest.

Moreover, Milwaukee's Pacific Coast extension west of Minneapolis crosses rich coal deposits. Nearly half the Nation's strippable coal is in this area. When it is developed it will have to move by rail.

More and more U.S. grain is being shipped west for exportation. This trend will accelerate as trade with China develops. These exports are crucial to the U.S. balance of trade.

Finally, the Milwaukee Road supports jobs throughout the system and affects 10,000 employees. Many depend on the service. The economic effect of shutdown is far-reaching. Also, the railroad contributes to the tax base of every county and State it crosses.

The question to consider is how can we make the Milwaukee, which is in bankruptcy, a profitable operation providing vital transportation services?

I think the employee and shipper ownership proposals that have been discussed in recent weeks could be the solution. You know better than anyone else how employee ownership can increase efficiency. I want to point out one example of how it might help here.

Milwaukee officials have testified that coal has little potential for increasing the railroad's profits. This came out very strongly when I attended a hearing in Chicago where the trustee representatives were saying they didn't think the coal would be very profitable.

However, I want to point out an official of Western Energy Co. told me he has never been contacted by the Milwaukee sales force. His company operates the country's second largest strip mine in Colstrip, Mont. Western Energy is visited frequently by representatives of the Chicago-Northwestern Railroad, even though the Northwestern tracks don't come close to Colstrip.

The difference is that Chicago-Northwestern is employee-owned. It aggressively competes for new business.

Last week I discussed employee and shipper ownership with the State transportation officials in Chicago and met with Chairman Long and shippers and employee representatives here in Washington. The general consensus of these meetings was that the employee and shipper ownership may be the only way to save the Milwaukee.

We just don't have any alternatives left.

I don't think Congress can provide funds to rehabilitate the Milwaukee system without a solid financial commitment from employees and shippers.

The next question is how do we put employee and shipper stock ownership plans into effect; how do we continue the momentum developed in the last few days?

First we have to delay the trustee's proposed abandonment, the proposal to abandon service on three-quarters of the Milwaukee system.

Second, during the delay we have to have a solid plan to indicate how a shipper and employee ownership plan can be put together.

The trustees proposed abandonment would destroy chances of reorganizing the Milwaukee. If the bankruptcy judge approves the abandonment, the ICC will provide what it calls directed service. I would like to point out a few problems with that.

First, I don't think ICC can deal with the physical problems associated with it. Testimony at the hearing I attended in Chicago showed that, first, ICC doesn't know how they will physically keep track of the cars and the billing. Milwaukee has not promised to provide equipment for this. They probably will keep a portion and won't provide the rest to the other carriers. Other carriers don't have any to spare. That came out in the testimony.

No arrangements have been made to maintain track and equipment during this directed service. ICC has not decided which carriers will be directed to provide service.

Nobody knows how many employees will lose their jobs under this directed service.

ICC only directed service once before for 100 miles of track, not 7,000 miles. In my judgment, the ICC just doesn't have the expertise and manpower to handle this.

The second problem associated with directed service is that directed carriers will make every effort to divert the Milwaukee customers and upset established traffic patterns for their own benefit. After several months of directed service, we would find much of the traffic has disappeared.

Finally, directed service is enormously expensive to the Government. ICC must pay expenses. Estimates run to about \$25 million.

I have prepared a resolution which will require the Milwaukee to continue to provide service over its entire system for 45 days. That would give us the time needed to study employee and shipper stock ownership plans.

Along with several of my colleagues, I intended to introduce this resolution today.

During the 45 days of continued service, the Federal Government would provide necessary funds to keep the Milwaukee operating. These would come from the Emergency Rail Services Act Trust Fund.

Unlike directed service, the Federal outlay would not be a total loss under this resolution. Trustee certificates will be issued and require eventual payback by the railroad. Creditors of the Milwaukee have objected to the acceptance of ERSA funds on the grounds that, it undermines their financial position. My resolution would remove that objection.

Based upon the positive reaction to the concept we have been discussing these last few days, I am confident we can find a solution and I urge this committee to pass the resolution.

To move forward with an employee-shippers ownership plan, we need a comprehensive plan to show how this framework could be developed and operated. We don't know enough about the economics of the Milwaukee.

The Booz-Allen report indicates that in the long run all parts of the Milwaukee could return net operating income, but not enough for debt service. We must add that the report also states expressly on page 24 of the executive summary that this analysis does not address the public interest aspect.

The study is only directed toward the organizational—financial operations of the Milwaukee. It does not direct itself to the public interest.

Last October, in addition, Mr. Chairman, Senator Melcher sponsored an amendment requiring the Federal Railroad Administration to quickly produce a study of the Pacific Coast extension. Evidently that study started in March, but there haven't been results.

Independent analysis of the Pacific Coast extension by an employee group is also optimistic, showing a net profit within 5 years.

None of these studies consider the advantages of employee and shipper ownership such as high productivity and shipper loyalty.

We discussed the viability of this with Secretary Adams and Chairman O'Neal. The Department of Transportation could produce the necessary study within 45 days with the help of the ICC. The Department of Transportation has access to an enormous amount of railroad data. They have the expertise. They have done some of the work with the Milwaukee. Outside consultants with employee-shipper ownerships plans might have input.

In summary, I want to emphasize again the importance of the Milwaukee Road service and my belief the system can be made viable.

Our best chance for continuing at this time is through employee and shipper stock ownership plan. The benefits of shipper loyalty and employee productivity could drastically change the railroad's financial picture. To develop this, we need delay in abandonment and we need to develop a vehicle to put the plan together.

I want to thank you particularly, Mr. Chairman, for this opportunity to present my ideas. Everybody has an idea how to run a railroad. At this time I think if the various groups make solid commitments, I think that there is a good chance we can save the railroad. Thirty years from now when we look back upon this day I am hopeful that we will have decided wisely and gone that extra mile to continue rail service in the Northwest.

Thank you, Mr. Chairman.

Senator LONG. Thank you very much.

I had announced I would not ask any questions of the witnesses, but I won't cut off the chairman of the Appropriations Committee.

If you want to ask a question, go ahead.

Senator MAGNUSON. I have no questions. I do have a short statement I would like to make.

The recent surprise request by the trustee in bankruptcy asking for an embargo on the Milwaukee's western lines has added to the confusion and apprehension among the railroad's employees and customers in my State.

Hundreds of Milwaukee Road employees and their families need specific answers about their job futures.

A large number of shippers, now captive customers of the Milwaukee Road, need to know how service will be maintained, and what rates they can expect to be charged.

Mr. Chairman, it is ironic that at a time when we are studying various proposals to deregulate our railroad industry, we are also faced with the elimination of one of only three carriers now serving the Northwest and Northern Tier States.

I hope the committee will carefully consider the effect this proposed embargo will have on competition in the West.

I understand that the Interstate Commerce Commission has taken the position that an embargo on Milwaukee Road's western lines would be illegal. The ICC believes that such a proposal should come before the Commission as a petition for abandonment. This would allow affected parties an opportunity to be heard before a decision to eliminate service is made.

I support the ICC position in this regard.

While I understand the trustee's responsibility to protect the corporate creditors in the Milwaukee bankruptcy, I believe the Congress has a broader responsibility.

We must keep in mind the fact that a railroad exists to serve the public.

And it is the future of that service to the public, including employees and customers, that should be our primary concern.

I look forward to exploring this problem to determine what Congress can or should do to mitigate the hardship caused by the Milwaukee Road bankruptcy.

I must confess I don't know what we can do, but surely we ought to do something to avert this catastrophe that is going to happen, or at least think it out in long-range terms. More than just the ruling of the trustee in bankruptcy.

That came as somewhat of a surprise. I think we have a broader responsibility than that.

Otherwise, I have no questions to ask.

Senator BAUCUS. Mr. Chairman, I appreciate your comments. I think we are in agreement the Milwaukee is in a difficult financial position. Its roadbed is disastrous. I traveled over portions of their track in Montana. Its physical plant is very poor, compared with Burlington Northern, for example, also in Montana.

Railroads generally in the country are in financial difficulty. My feeling is that the direction of the railroads have to be changed.

The management has to change their direction, significantly.

My thought is through employee stock ownership plans the commitment of the employees and managerial commitment, along with shipper and managerial commitment, the efficiency of the railroad will be increased.

The Booz-Allen report shows that all of the eight alternatives the consultant group studied are profitable over the long run. All eight. Marginally profitable, but still profitable. But that does not assume greater efficiencies built in through employee and shipper ownership, which I think will improve profitability even more.

I think that is the direction to move.

Senator MAGNUSON. I didn't hear all your testimony; I was tied up, but I understand that you favor the proposal by S-O-R-E, called SORE, which is "Save our Railroad Employment." That group wants to explore the idea, if they can buy the railroad.

Senator BAUCUS. I favor that kind of proposal. I don't know that I necessarily agree with the specifics of the SORE proposal. That approach, that's right.

Senator MAGNUSON. That ought to be a—I was a long-time advocate of employees having a certain portion of the operation.

Senator LONG. If it will work at all, I think it will work that way; that is correct.

Senator BAUCUS. Thank you.

Senator MAGNUSON. I understand the Secretary, Mr. Adams, and the others, and Dan O'Neal, are looking at the figures. Maybe they will give us information whether or not it's feasible.

Senator BAUCUS. That is my hope. I spoke with Secretary Adams and Chairman O'Neal on this subject last Friday.

It's my understanding we could put something together here.

Senator LONG. Let me thank you for bringing a constructive suggestion there, Senator Baucus.

We are not looking for problems; we are looking for answers.

I do think you have made a very useful and constructive suggestion. We will be happy to consider it. As far as I am concerned, you can be sure it certainly will be given thoughtful consideration. I am not going to interrogate you about the proposal now but, as you know, I have attended a couple of meetings to hear your suggestions, and I think they have a great deal to recommend them, and we should explore them, and we will.

Senator BAUCUS. Thank you.

In addition, subsequent to the meetings we had, it's my understanding both the shippers groups and employees unions and other employee groups will make solid commitments.

I, like you, am anxiously awaiting to see what those commitments are and based upon those, I think we will be in a better position to know how expeditiously we can proceed.

Senator MAGNUSON. I want to express my thanks, along with others who have been interested in this route, for the chairman to take his time and hear this problem.

Senator LONG. Thank you very much, Senator Baucus.

Next we will hear from Mr. Robert E. Gallamore.

STATEMENT OF ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION; ACCOMPANIED BY RAYMOND JAMES, CHIEF COUNSEL

Mr. GALLAMORE. Thank you, Mr. Chairman.

I appreciate the opportunity to testify before you this morning. I am accompanied by Mr. Raymond James, who is chief counsel of the Federal Railroad Administration.

I am prepared to go through my statement in a summary fashion.

Senator LONG. I want you to present me the best of what you have in 10 minutes.

We can always read the statement.

Mr. GALLAMORE. All right.

The Milwaukee's problems and the proposed embargo have an impact on a large and important region of the United States. How we respond to the problem will have long-term implications for the national transportation system, especially the freight rail system. Clearly, the Department of Transportation has the responsibility to take a leading role in determining the appropriate Federal policy and then to carry out that policy.

In reacting to the immediate threat of loss of rail service and loss of rail jobs, we could choose to infuse massive amounts of Federal dollars and ignore our coordinated, efficient national transportation system which consists of many alternative elements—other railroads, trucks and barges—and shipper alternatives in production locations and markets.

Or we could simply walk away from the problem, saying that the Milwaukee has, by the test of the marketplace and a third bankruptcy in 60 years, finally proved itself not worth having around.

That, of course, would ignore, at least in the short run, the many people who are dependent on the railroad for their economic livelihood—shippers, employees, and consignees.

Neither extreme is desirable national transportation policy, and the Department of Transportation will follow neither path. What the Department will do is use the tools at our disposal—both public and private—to retain essential and economic services within the context of a self-sustaining national transportation system. These tools are, as described below, sufficient for this purpose, and no further congressional action is needed at this time, though we will be describing the Railroad Restructuring Assistance Act, which we have before the Congress, as well as our Rail Deregulation Act of 1979. Those two pieces, we hope, would go together as an important part of the solution.

The Milwaukee's performance over the past several years has been steadily downward. I have attached to my testimony copies of tables that show car loadings by major commodity groups for the Milwaukee, the Burlington Northern, and the Chicago & North Western. From 1973 through 1978, total Milwaukee Road car loadings were down almost 21 percent, while the North Western's were down 12.5 percent and the Burlington Northern's only 5.8 percent.

Like other commodities, grain loadings decreased precipitously—by a third from 1972 through 1978.

All of this was prior to the Milwaukee's December 19, 1977, filing for bankruptcy.

Because of declining traffic levels and reduced market shares, in recent years the Milwaukee has not been able to properly maintain its fleet of locomotives and cars, to acquire sufficient additional equipment to handle potential new sources of traffic or to maintain its right-of-way on a regular maintenance basis.

The problem of insufficient earnings to support even minimal equipment repair and track maintenance has accelerated during 1979 and will probably continue to do so.

Recognizing that the Milwaukee would not be able to turn itself around without capital to improve deteriorated track and equipment, the Department has, to date, provided the railroad with a total of \$55.2 million in financial assistance under title V of the 4R Act; \$9.3 million of this amount was in preference shares prior to the railroad's petition for reorganization and \$45.9 million in trustee's certificates after the bankruptcy.

Of the total, \$33.8 million has been made available under section 505 to finance a track rehabilitation project between Milwaukee and the Twin Cities, which is within the trustee's "core" system, and \$21.4 million has been made available under section 511 obligation guarantee financing for the repair of freight cars and locomotives and the installation of environmental control facilities at the railroad's shops in Milwaukee.

Actual expenditures under the agreements amount to \$41.9 million to date.

No applications by the trustee for further title V assistance are pending.

The title V assistance provides financing for particular projects and does not contribute directly to working capital.

Working capital assistance is available under the Emergency Rail Services Act of 1970. To date, we have provided the trustee with \$5.1 million under ERSA.

On May 4, 1979, we advised the Milwaukee's Reorganization Court that the Department of Transportation is prepared to meet its responsibilities under ERSA through additional funding to insure the continuation of essential transportation services on the Milwaukee's system and to permit necessary restructuring.

For 15 months DOT has been conducting an intensive campaign with railroad, shipper and State transportation officials to encourage them to use the tools of section 401 of the 4R Act to develop a healthier rail system through planned reductions in excess plant. Among the types of section 401 unification and coordination projects discussed to date have been coordinated abandonments, coordinations of mainlines through joint use agreements, and the acquisition and sale of assets.

While much of FRA's effort in section 401 restructuring during the past year has been of the missionary type, it is beginning to show some benefits.

One package, consisting of three coordinated abandonments and a trackage rights agreement between the Chicago & North Western and the Milwaukee Road, has been announced, and we are well along on restructuring projects involving several rail lines in several States. Passage of the administration's proposed Railroad Deregulation Act of 1979 will greatly assist this process.

On May 1, the Secretary held a meeting with the trustee and his key officers, Chairman O'Neal of the ICC, and the railroads being considered by the ICC for directed rail transportation on the embargoed lines.

The Secretary made a strong case for a private sector solution to the Milwaukee problem through permissive service orders and expeditious acquisitions of Milwaukee lines.

At the May 1 meeting, the Secretary discussed with the trustee the trustee's goal to shrink the Milwaukee's existing uneconomic system into a core railroad with the potential to be self-sustaining.

On May 3, the Secretary met with representatives of railroad labor organizations who, among other things, expressed their desire to insure that the trustee's embargo not become a substitute for the normal abandonment process in which the public interest and employees' rights would be protected.

We have recommended that the reorganization court order the trustee to file abandonment applications for all lines proposed to be embargoed.

Recognizing that the court would have no choice but to order an immediate embargo unless the trustee secured additional operating cash, DOT has supported the trustee's petition before the court for permission to borrow \$15 million from escrow accounts and the railroad's land company subsidiary.

I understand \$10 million has already been drawn down.

Our analysis of the Milwaukee's assets and liabilities convinces us that the United States still would be adequately protected should the Milwaukee be liquidated.

The court also found that the public interest required approval of the borrowing.

We have also offered to provide ERSA assistance to the trustee to insure the continuation of essential service and to permit necessary restructuring.

We anticipate that the trustee will file his application for ERSA funds on May 23, and we will then begin reviewing the application to determine whether the required findings can be made.

During the coming months FRA intends to use the powers granted to the Secretary under section 401 to assist in the orderly transfer of essential Milwaukee service to carriers that are better able to provide adequate transportation.

To a large degree, this activity will expand on the efforts the Milwaukee trustee has begun in attempting to negotiate sales to some carriers of portions of the Milwaukee.

While our primary role under section 401 is largely that of a catalyst, we are, in some cases, in a position to advise interested parties on an objective and quantitative basis, which railroad would be the best candidate to acquire portions of the Milwaukee.

The administration has submitted proposed legislation, the Rail Restructuring Assistance Act, as part of its railroad transportation legislative program, which also includes the proposed Railroad Deregulation Act of 1979.

The restructuring assistance bill would revise title V of the 4R Act and provide \$1.475 billion in assistance to the railroad industry as an additional incentive for restructuring.

By making funds available to all class I railroads and their subsidiaries, we feel the bill will encourage the larger, profitable railroads to participate in the restructuring of failing railroads.

The funds would be available at low cost, on favorable repayment terms, and would cover all or part of the costs associated with acquisition and rehabilitation of rail properties and any labor protection which may be associated with restructuring.

We must recognize that the existing tools at our disposal—trustee cash and other assets, ERSA, section 401, directed and permissive rail transportation, the Bankruptcy Act, and the cooperation of labor and industry—are sufficient to resolve the immediate problems created by the trustee's cash crisis.

The administration's deregulation and rail restructuring bills provide the best hope for a long-term solution to the Midwest rail crisis.

The Milwaukee situation we see today is the inevitable result of too much track and not enough traffic available for the Milwaukee Road.

It is the evidence of failure of past policies.

Second, we must avoid the extremes of massive subsidy or simply shrugging our shoulders.

There is a tremendous rehabilitative cost of upward of \$1 billion for trying to put the entire plant and equipment back in operation. As the trustee mentioned this morning, it is a large cost to be associated with continuing Milwaukee operations, if that were to be done. We believe the cash crisis is real.

We had hoped to be able to get to August 1 before the need for directed service, but now we must move more quickly.

The trustee's concept of restructuring, his general proposal, is the best hope we have of avoiding total liquidation of the Milwaukee Road.

We have said on many occasions publicly, if there is a "core" railroad, we should try to reach it, because it makes restructuring, sales and transfer of assets vastly more orderly, and the best job protection is a job itself.

We can provide jobs best with the "core" railroad concept.

The trustee has been candid about the situation and his plans.

He traveled widely to meet with affected parties.

He indicated the problem early, though doing so may have cost him much traffic loss. The Department has also done much to form and encourage alternative solutions.

Our policy is restructuring, because—

Senator LONG. I have to call time here.

We have the statement, and we will study the whole thing.

I want to submit some questions for you.

I would like you to prepare answers in writing as soon as you can, and we will interrogate you about that further.

Senator MAGNUSON. I want to ask you one question. You point out in the beginning of your statement two extremes. One, that you can walk away from the problem, though that "would ignore at least in the short run many people who are dependent on the railroad for their economic livelihood—shippers, employees, and consignees. Neither extreme is desirable national transportation policy.

"What the Department will do is use the tools at our disposal, both public and private, to retain essential economic service within the context of a self-sustaining national transportation system." These tools are described below. And you covered them.

Submission for this purpose and no further Congressional action is needed at this time. That's what you say.

Do you mean you don't need any more laws?

Mr. GALLAMORE. We need passage of the deregulation bill and the Railroad Restructuring Assistance Act, but we don't need specific emergency legislation to deal with this particular problem.

Senator MAGNUSON. What tools are currently available to reduce the hardship on the employees who lose their jobs as a result of bankruptcy? What tools are available?

Mr. GALLAMORE. ICC's directed service orders provide for the continuation of much traffic. We believe 99 percent of the traffic would be continued. There would be a substantial number of jobs available through the directed service funding.

The establishment of a core railroad by the trustee itself provides job opportunities for roughly half—

Senator MAGNUSON. When will the Department of Transportation complete its analysis on the SORE proposal?

Mr. GALLAMORE. Very soon.

Senator MAGNUSON. Will you make that available to the committee as soon as it is ready?

Mr. GALLAMORE. We certainly will.

Senator MAGNUSON. Now, is the ERSA money you talk about intended for only the core, or the whole system?

Mr. GALLAMORE. The ERSA money we have said should be available for the transition we are facing now. We believe it is necessary to restructure the Milwaukee Road system. We have not yet received the ERSA application. We expect to receive it later this week. Once we have the application in hand, we will have a better idea of exactly what the ERSA funds could be used for.

But we do believe the funds should be available for both purposes.

Senator MAGNUSON. The intent of Congress when we set up the funds was to take care of the bankrupt railroads, wasn't it?

Mr. GALLAMORE. It was an emergency assistance. It was not intended to be a continuing, long-term source of funding.

Senator MAGNUSON. It was intended for a bankrupt railroad. And you have some surplus in the fund.

Mr. GALLAMORE. By virtue of the Penn Central settlement.

Senator MAGNUSON. When you allocate the fund, you ought to allocate it not only to the core, but the whole system.

Mr. GALLAMORE. Our belief is the fund should be available to help us move the situation forward. We are prepared to make the funds available for whatever purpose the judge will approve in setting up his next steps. The funds could be available if the application were to be for the entire system or—

Senator MAGNUSON. When you used it for the Penn Central, you used it for the whole system. You didn't leave any part of it out, did you?

Mr. GALLAMORE. I believe it was for the full system. Assuming that the application is for that, and the judge approves it for that reason, we could use it for that.

Senator MAGNUSON. If you use it for Milwaukee, it should be used for the whole system. Not just the core.

Mr. GALLAMORE. One of the problems is—

Senator MAGNUSON. I don't care about the problems. The problems are in the whole system.

Mr. GALLAMORE. The ERSA funds come in at first lien status. That means that they are the first obligation that must be paid off in the bankruptcy reorganization. Therefore, they are objected to by the creditors.

The \$5.1 million we made available to Trustee Hillman, that we approved over a year ago, is still under challenge in the Federal courts due to the strong objections of the creditors of the Milwaukee estate to having new Federal loan funds come in on top of their existing obligations. That is the kind of situation we have.

Senator MAGNUSON. Well, do you need legislation to subordinate the Government's priority claim to that of creditors?

Mr. GALLAMORE. That would raise substantial questions about Federal lending policy. That would be tantamount to using Federal loan funds for continuation grants.

Senator MAGNUSON. You better use it for the whole system if you use it at all.

Mr. GALLAMORE. The question is how long should—

Senator MAGNUSON. What is the question about? You used it for the Penn Central for the whole system. They paid back.

Mr. GALLAMORE. Yes.

The ERSA guarantee of trustees' certificates for the Penn Central was on a first lien basis which was clearly repayable. A subordinate position would have made repayment much more remote. The guarantee did not restrict the use of the proceeds of the ERSA funding to any specific segment(s) of the railroad. As a condition to the making of the guarantee, however, the trustees were required to submit to the Secretary of Transportation a plan for the abandonment of lines of railroad of Penn Central which were uneconomical and, in their judgment, not required by the public interest. Further, the trustees were required to initiate and pursue such actions as would be required to carry out the abandonment plan submitted and any recommendations of the Secretary with respect thereto. In compliance with the terms of the guarantee, the trustees filed a plan involving 1,949 route miles of abandonments which the trustees pursued under ICC procedures.

Subsequently, in a report filed with the Reorganization Court, the trustees indicated that one of the major changes necessary for successful reorganization was the restructuring of the physical plant from the existing 20,000 mile Penn Central system to a smaller "core" system, with either abandonment or subsidized operation of the remaining lines. The Department, in a statement to the court, endorsed the trustees' position that the abandonment of unprofitable lines was necessary, unless States, local communities and shippers were prepared to underwrite Penn Central's losses in providing service on such lines. According to the trustees' studies, an 11,000-mile system would be operationally superior, but the earning potential of such a system was impaired by high labor protection costs. As a result, the trustees selected a 15,000 mile system as the basis for reorganization planning.

Senator MAGNUSON. Use it for the Milwaukee for the whole system, too. Not abandon part of it completely.

I have no further questions.

Senator LONG. Thank you very much.

[The statement follows:]

STATEMENT OF ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION

Mr. Chairman and Members of the Committee, I appreciate your asking me to be here today to discuss the unfortunate situation facing us in the Midwest because of the proposed embargo of a large part of the Milwaukee Road.

The Milwaukee's problems and the proposed embargo have an impact on a large and important region of the United States. How we respond to the problem will have long-term implications for the national transportation system, especially the freight rail system. Clearly, the Department of Transportation has the responsibility to take a leading role in determining the appropriate Federal policy and then to carry out that policy.

In reacting to the immediate threat of loss of rail service and loss of rail jobs, we could choose to infuse massive amounts of Federal dollars and ignore our coordinated, efficient national transportation system which consists of many alternative elements—other railroads, trucks and barges—and shipper alternatives in production locations and markets.

Or we could simply walk away from the problem, saying that the Milwaukee has, by the test of the marketplace and a third bankruptcy in sixty years, finally proven itself not worth having around. That, of course, would ignore at least in the short run the many people who are dependent on the railroad for their economic livelihood—shippers, employees and consignees.

Neither extreme is desirable national transportation policy, and the Department of Transportation will follow neither path. What the Department will do is use the

tools at our disposal—both public and private—to retain essential and economic services within the context of a self-sustaining national transportation system. These tools are, as described below, sufficient for this purpose, and no further Congressional action is needed at this time.

BACKGROUND

The Milwaukee Road was founded in 1850 and was originally chartered as a local railroad between Milwaukee and Elm Grove, Wisconsin. During the late 19th Century and the early 20th Century the Milwaukee gradually extended and expanded its network of lines as the Midwest was settled.

The Milwaukee participated in the last great expansion of the U.S. rail system by building its Pacific Coast extension in 1909. Many analysts feel that the Milwaukee's extension to the Pacific Northwest was never a viable operation and should not have been built. In fact, an independent analysis determined that in calendar 1977, the Pacific Coast extension contributed an excessively disproportionate share of the railroad's total loss.

The Milwaukee's performance over the past several years has been steadily downward. I have attached to my testimony copies of tables that show carloadings by major commodity groups for the Milwaukee, the Burlington Northern, and the Chicago and North Western. From 1973 through 1978, total Milwaukee Road car loadings were down almost 21% while the North Western's were down 12.5% and the Burlington Northern's only 5.8%. Like other commodities, grain loadings decreased precipitously—by a third from 1972 through 1978. All of this was prior to the Milwaukee's December 19, 1977 filing for bankruptcy.

Because of declining traffic levels and reduced market shares, in recent years the Milwaukee has not been able to properly maintain its fleet of locomotives and cars, to acquire sufficient additional equipment to handle potential new sources of traffic or to maintain its right of way on a regular maintenance basis. The problem of insufficient earnings to support even minimal equipment repair and track maintenance has accelerated during 1979 and will probably continue to do so.

WHAT WE'VE BEEN DOING

Recognizing that the Milwaukee would not be able to turn itself around without capital to improve deteriorated track and equipment, the department has, to date provided the railroad with a total of \$55.2 million in financial assistance under Title V of the 4R Act; \$9.3 million of this amount was in preference shares prior to the railroad's petition for reorganization and \$45.9 million in trustee's certificates after the bankruptcy. Of the total, \$33.8 million has been made available under section 505 to finance a track rehabilitation project between Milwaukee and the Twin Cities, which is within the Trustee's "core" system, and \$21.4 million has been made available under section 511 obligation guarantee financing for the repair of freight cars and locomotives and the installation of environmental control facilities at the railroad's shops in Milwaukee. Actual expenditures under the agreements amount to \$41.9 million to date. No applications by the Trustee for further Title V assistance are pending.

The Title V assistance provides financing for particular projects and does not contribute directly to working capital.

Working capital assistance is available under the Emergency Rail Services Act of 1970. To date, we have provided the Trustee with \$5.1 million under ERSA. On May 4, 1979 we advised the Milwaukee's Reorganization Court that the Department of Transportation is prepared to meet its responsibilities under ERSA through additional funding to ensure the continuation of essential transportation services on the Milwaukee's system and to permit necessary restructuring.

Two major causes of the deteriorating condition of the Milwaukee, and of other granger roads, are their failure to abandon excess trackage and to maintain compensatory rate structures. With today's system of hard surface farm to market roads and modern trucks, the current rail system, particularly in the granger areas of the Midwest, is far more extensive than it needs to be in order to service the available traffic. As presently constituted, the Midwest rail system has lost much of its economic reason for being, and too often acts only as a cash drain on healthier parts of the national rail system.

For fifteen months DOT has been conducting an intensive campaign with railroad, shipper and state transportation officials to encourage them to use the tools of section 401 of the 4R Act to develop a healthier rail system through planned reductions in excess plant. Among the types of section 401 unification and coordination projects discussed to date have been coordinated abandonments, coordinations of mainlines through joint use agreements, and the acquisition and sale of assets.

While much of FRA's effort in section 401 restructuring during the past year has been of the missionary type, it is beginning to show some benefits. One package, consisting of three coordinated abandonments and a trackage rights agreement between the Chicago and North Western and the Milwaukee Road, has been announced, and we are well along on restructuring projects involving several rail lines in several states. Passage of the Administration's proposed Railroad Deregulation Act of 1979 will greatly assist this process.

WHAT DOT HAS DONE SINCE THE TRUSTEE ANNOUNCED HE WOULD SEEK AN EMBARGO

Since the Milwaukee first declared bankruptcy, FRA has monitored the Trustee's cash position closely. This past winter when it became clear that the situation was very serious, we contacted the Trustee and encouraged him to consider applying for additional ERSA assistance.

On April 23, the Trustee announced that he would seek to embargo about 75 percent of the Milwaukee system with service continuing on a small "core" in the upper Midwest. The Trustee also stated that this action was based on a lack of cash and the report of his consultants, Booz, Allen, & Hamilton, that the Milwaukee could be reorganized into a profitable transportation company, but only if substantially reduced to a core system.

Upon learning of the Trustee's intention to discontinue service over a substantial portion of his system, DOT immediately took several actions.

Although the ICC has the primary responsibility to approve permissive service orders or direct other carriers to operate over the Milwaukee's lines, we have offered to work with the ICC to plan for the continuation of essential services. In this regard, on May 1, the Secretary held a meeting with the Trustee and his key officers, Chairman O'Neal of the ICC, and the railroads being considered by the ICC for directed rail transportation on the embargoed lines. The Secretary made a strong case for a private sector solution to the Milwaukee problem through permissive service orders and expeditious acquisitions of Milwaukee lines. At the May 1 meeting, the Secretary discussed with the Trustee the Trustee's goal to shrink the Milwaukee's existing uneconomic system into a core railroad with the potential to be self-sustaining.

On May 3, the Secretary met with representatives of railroad labor organizations who, among other things, expressed their desire to insure that the Trustee's embargo not become a substitute for the normal abandonment process in which the public interest and employees' rights would be protected. We have recommended that the Reorganization Court order the Trustee to file abandonment applications for all lines proposed to be embargoed.

In order to enable DOT and the public to study the consultant's report, which was not yet available, I asked the Justice Department to appear at the May 4 Reorganization Court hearing and recommend a postponement of the embargo decision until we could make a further filing based on an analysis of the report. At that hearing, the Trustee postponed his proposed embargo date until June 1, and the judge scheduled another hearing on the embargo issue for May 15. That hearing continued for the remainder of the week. Because the Booz, Allen report was not available to us until recently, we have not yet been able to do a detailed analysis of its methodology and conclusions. We are, in particular, not yet able to judge whether every line marked for embargo should, indeed, be embargoed.

Recognizing that the Court would have no choice but to order an immediate embargo unless the Trustee secured additional operating cash DOT has supported the Trustee's petition before the Court for permission to borrow \$15 million from escrow accounts and the railroad's land company subsidiary. Although these loans would reduce our security on the \$55 million in financial assistance which DOT has recently provided to the Milwaukee under Title V of the 4R Act, our analysis of the Milwaukee's assets and liabilities convinces us that the United States still would be adequately protected should the Milwaukee be liquidated. The Court also found that the public interest required approval of the borrowing. We have also offered to provide ERSA assistance to the Trustee to ensure essential service and permit necessary restructuring. We anticipate that the Trustee will file his application for ERSA funds on May 23, and we will then begin reviewing the application to determine whether the required findings can be made.

NEXT STEPS

During the coming month, FRA intends to use the powers granted to the Secretary under section 401 to assist in the orderly transfer of essential Milwaukee service to carriers that are better able to provide adequate transportation. To a large degree, this activity will expand on the efforts the Milwaukee Trustee has

begun in attempting to negotiate sales to some carriers of portions of the Milwaukee. While our primary role under section 401 is largely that of a catalyst, we are, in some cases, in a position to advise interested parties on an objective and quantitative basis which railroad would be the best candidate to acquire portions of the Milwaukee.

Given the possibility that lines that provide essential service but are uneconomic in the hands of the Milwaukee may come under directed rail transportation at considerable taxpayer expense, it is in the public interest to encourage interested parties to reach agreement through a prompt exchange of information and continuous discussion. In order to encourage this activity we intend to use all the tools available, including Title V of the 4R Act, the Emergency Rail Service Act of 1970, and local rail service assistance.

The Administration has submitted proposed legislation, the Rail Restructuring Assistance Act, as part of its railroad transportation legislative program, which also includes the proposed Railroad Deregulation Act of 1979. The restructuring assistance bill would revise Title V of the 4R Act and provide \$1.475 billion of assistance to the railroad industry as an additional incentive for restructuring. This restructuring would involve consolidation and reduction of duplicate tracks and facilities, discontinuance of uneconomic service, rationalization of routes and terminal facilities, and improvement in operating efficiencies. The elimination of excess capacity would enable railroads to reduce their maintenance and property tax expenditures and increase their liquidity by the sale of nonproductive property and facilities. By discontinuing uneconomic service and rationalizing routes and terminal facilities, railroads would improve cash flow.

The current financial assistance programs under Title V of the 4R Act have produced projects which involved substantial rehabilitation of facilities but only isolated restructuring. The restructuring assistance bill we are proposing will alter that situation.

By making funds available to all Class I railroads and their subsidiaries, the bill will encourage the larger, profitable railroads to participate in the restructuring of failing railroad. The funds would be available at low cost, on favorable repayment terms, and would cover all or part of the costs associated with acquisition and rehabilitation of rail properties and any labor protection which may be associated with restructuring. In addition, some funds would be available to encourage labor and management to undertake changes in work rules and operating practices which will not necessarily be associated with restructuring. Of the \$1.475 billion authorization requested, \$275 million would be available for labor protection and programs.

Under section 5 of the DOT Act, the Local Rail Service Assistance Program, States may receive Federal grant funds for a wide variety of rail assistance projects on light density freight lines. In response to the situation created by the Milwaukee crisis, States may apply for Federal funds to rehabilitate a light density line which an acquiring railroad agrees to continue in service.

Alternatively, a State or a local transportation district could purchase a line with or without Federal aid and could subsequently seek Federal rehabilitation assistance if the line carried under 3 million gross ton miles of freight per mile. It will also be possible for a State to seek Federal funds for rehabilitation of a line that Milwaukee petitioned to abandon if the Milwaukee agreed to withdraw the abandonment application and maintain the light density line at the level to which it was rehabilitated.

Federal funds are also available to States to subsidize the avoidable cost of providing service on a line for up to 3 years. Still another possibility is for a State to undertake a substitute service project, again using Federal assistance, to replace the service provided by the rail line being lost. Substitute service could include improvements to alternative highway facilities, construction of intermodal terminals or new rail connections to remaining rail lines which would then handle the traffic formerly handled by the replaced line.

The financial resource available to the States in FR 1979 total approximately \$88 million of which \$67 million was appropriated for FY 1979 and \$20 million was carried over from 1978. With respect to those States affected directly by the Milwaukee crises individual amounts in State entitlements for FY 1979 are in the range from about \$700,000 to \$5 million. I have attached a summary of the entitlement figures.

We must recognize that the existing tools at our disposal—Trustee cash and other assets, ERSA, section 401, directed and permissive rail transportation, the Bankruptcy Act, and the cooperation of labor and industry—are sufficient to resolve the immediate problems created by the Trustee's Cash crisis. The Administration's

deregulation and rail restructuring bills provide the best hope for a long-term solution to the Midwest rail crisis.

We will, within the limited time available, continue to analyze the Booz, Allen & Hamilton report to determine whether a smaller Milwaukee railroad can be financially self-sustaining. We are also taking a look at the proposals advanced by SORE and Mr. Louis Kelso for employee and/or shipper ownership of part or all of the Milwaukee.

CONCLUSION

I want to emphasize that, unless we are to start the Midwest down the path of nationalization, the financial viability of the lines which are continued either as part of a reorganized Milwaukee system or are transferred to other railroads, is essential. As Secretary Adams emphasized in this statement of April 24, the opportunities for self-sufficiency will be enhanced by, it not be dependent on, some Federal assistance to rehabilitate potentially profitable lines, and a freer and more equitable regulatory climate. Shippers are going to have to assist in the fight to keep essential service. They and the railroad must be able to come together to agree on the type of service needed and a fully compensatory price. The agreements must be enforceable on both sides, and the price must be one that allows the railroad to stay in business in the long run—a price that includes money to fix up track and equipment and keep it in shape. Freedom to negotiate such arrangements will be facilitated by swift passage of the Administration's proposed Railroad Deregulation Act of 1979 as well as the Rail Restructuring Assistance Act. Passage of this legislation will be important to the future of both the Milwaukee and all other railroads.

We will have to give much more thought to what should happen to the current Milwaukee system: how much of it is unlikely ever again to pay its way because traffic has already moved off it to other, more efficient, railroads or modes; how much of it will pay its way, but only after substantial rehabilitation of the lines and with better marketing of a better service; what the rehabilitation cost will be; from where will it be funded; how much of the system has the potential to be useful in the hands of other railroads.

And, we must reassure ourselves that the role we have outlined for the Federal Government is the proper one. The philosophy that propels us toward the marketplace and away from a nationalized system says that our roles should be two: to bring all parties together, especially other railroads in the region and labor, to work with them to develop programs that we and they can agree have the best chance of providing an efficient competitive transportation system in the long run, and to provide seed money to help make those programs work.

These actions will take time, but we believe that careful attention to the problem, cooperation of all parties, and increased flexibility in our ability to provide assistance and in the regulatory climate will enable us all to achieve this goal.

[The following information was subsequently received for the record.]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question: In your statement you stated that the Department will use title V, the Emergency Rail Service Act, and local rail assistance funds. Since the Trustee cannot take ERSA funds that erode the creditors security position, the local rail assistance does not apply to main lines, and FRA has indicated that title V is not available outside the core, what does the Department recommend be done until the long-term problem can be addressed?

Answer: Our projections indicate that the Trustee has sufficient funds available to continue service until mid-June. The Trustee has submitted an application for an ERSA guarantee and subject to our making the six statutory findings, we can make a guarantee available to continue service on the entire Milwaukee system as it moves toward a self-sustaining railroad approved by the Court. Since the Trustee has applied for ERSA funds to be used to continue service of the railroad in whatever form the Court orders, the Trustee has concluded that erosion of the creditors' interests, if any, is not prohibitive.

With ERSA funds available to the Trustee for the entire system in whatever form the Court orders, we intend to work with the several railroads and other concerns which have expressed interest in acquiring lines which Milwaukee proposes to embargo. I will use section 401 of the 4R Act to provide planning assistance to any one with constructive proposals.

Certain lower density lines (below 5 million and 3 million gross tons) are eligible for assistance under the Local Rail Service Assistance Program. Many of the non-core lines would fall into this category. In addition, section 511 is available for the acquisition or rehabilitation of "non-core" lines as well as "core" lines.

At this time, FRA does not know whether section 505 funds could be used outside the "core". Such a determination can only be made on the basis of an application. As I testified, we have provided title V assistance under both sections 505 and 511 to the Milwaukee Trustee for track rehabilitation, freight car repair and locomotive repairs. The track work is located on the Milwaukee mainline between Chicago and the Twin Cities. We have not received any application for lines outside the Trustee's "core".

Question. The branchline assistance program administered by the FRA was designed to assist states in the preservation of essential branchline services. Do you think the funding in this program is adequate to deal with the branchline crisis created by the Milwaukee's proposed reorganization and embargo of service? If it is not adequate, what do you plan to do to alleviate the crisis?

Answer. We believe that the \$67,000,000 appropriated for FY 1979 plus the \$21,000,000 carried over from the prior fiscal year should provide adequate support for the state rail program this year when considering the branchline crisis created by the Milwaukee's proposed reorganization and embargo of service. As of May 15, 1979, approximately \$63 million is unobligated and available for use by the states based on each state's share under the statutory formula.

The funding level of \$67 million which we have requested for FY 1980 should permit implementation of priority projects. The attached chart provides a rough estimate of the FY 1980 funding which would be available to the states under the formula in the existing law if the Administration's budget request of \$67 million were enacted. States will have to carefully evaluate eligible rail services and decide where to put the funds. If a state does not use its entire share of the 1979 funds, the balance will be available to the other states in FY 1980.

Further, to augment the Federal grant funds, a state may also request shippers on lines receiving assistance to contribute a portion of the project cost. States may also seek railroad contributions for projects to be retained as part of the core system or to be acquired by another railroad where the railroad as well as the state and local communities will benefit from the investment. Also, the states are aware that the Department of Agriculture has loan programs under its Farmers Home Administration which could be used for railroad projects.

At present several states are already developing programs to respond to the Milwaukee situation and other local freight problems using Section 5 resources. For example, South Dakota may be requesting Section 5 funds for a project to rehabilitate a portion of a Milwaukee line from Miles City, Montana to the Twin Cities. The neighboring States of Minnesota, North Dakota, and Montana may also use some of their FY 1979 Section 5 entitlement on this project which is estimated to cost \$2.3 million for an initial phase. Subsequently a loan guarantee may be sought under Title V of the Railroad Revitalization and Regulatory Reform Act for a second phase of work. Of course, we will not know whether this project will be eligible for Federal assistance until we receive applications. In another State, Iowa, the State may continue its program which uses a combination of State and shipper resources to upgrade selected lines. The "Iowa plan" assistance which is directed to pre-abandonment lines may now include the State's share of the Federal Section 5 funds for eligible projects. Funds are loaned to the railroad without interest and are repaid as the shipments on the line increase subsequent to a rehabilitation effort.

State	Miles	Percent		Distribution	Eligible ¹ mileage	ICC		Milwaukee Bankruptcy mileage ³
		Miles	Adjusted miles			Category 1	Category 2 ²	
Alabama	0	0.77	1.00	670,000.00	118.41	60.0	29.0	
Alaska	0	0	1.00	670,000.00	0	0	0	
Arizona	0	0.39	1.00	670,000.00	14.64	0	64.0	
Arkansas	0	0.80	1.00	670,000.00	104.66	76.0	23.0	
California	0	2.09	1.85	1,240,732.72	244.58	255.0	18.0	
Colorado	0	0.53	1.00	670,000.00	65.52	0	67.0	
Connecticut	0	0.52	1.00	670,000.00	84.80	3.0	55.0	
Delaware	0	0.32	1.00	670,000.00	56.30	1.0	32.0	
District of Columbia	0	0.07	1.00	670,000.00	0	0	12.0	
Florida	0	2.01	1.78	1,194,751.31	157.61	258.0	38.0	
Georgia	0	0.72	1.00	670,000.00	97.34	22.0	66.0	
Idaho	0	1.72	1.52	1,019,628.19	77.14	162.0	115.0	169
Illinois	0	4.23	3.75	2,511,788.14	877.81	296.5	93.5	346
Indiana	0	6.00	5.32	3,562,674.30	854.73	334.1	385.0	156
Iowa	0	6.53	5.79	3,879,195.58	582.48	794.0	137.0	1,053
Kansas	0	1.30	1.15	770,524.87	134.34	149.0	28.0	0
Kentucky	0	0.68	1.00	670,000.00	45.29	67.0	37.0	0
Louisiana	0	1.79	1.59	1,064,266.67	240.78	93.0	128.0	
Maine	0	0.90	1.00	670,000.00	99.91	64.0	56.0	
Maryland	0	1.44	1.28	854,612.87	349.70	40.0	71.0	
Massachusetts	0	2.08	1.84	1,234,840.36	125.10	91.0	231.0	
Michigan	0	6.59	5.84	3,910,747.70	1,371.92	386.0	219.0	143
Minnesota	0	4.88	4.33	2,898,990.17	502.70	475.3	191.8	741
Mississippi	0	1.89	1.68	1,123,520.16	146.69	279.0	0	
Missouri	0	3.78	3.35	2,244,728.60	109.18	635.6	0	140
Montana	0	1.40	1.24	831,522.87	146.65	190.3	0	1,028
Nebraska	0	1.79	1.58	1,061,666.10	276.56	154.0	51.0	0
Nevada	0	0.84	1.00	670,000.00	74.03	80.0	40.0	
New Hampshire	0	1.54	1.37	916,855.07	144.83	154.0	63.0	
New Jersey	0	2.52	2.24	1,497,464.67	190.48	0	374.0	
New Mexico	0	0.03	1.00	670,000.00	14.47	0	0	
New York	0	7.50	6.65	4,454,030.61	1,652.01	3.0	648.0	
North Carolina	0	1.36	1.20	805,788.97	67.80	105.0	111.0	
North Dakota	0	1.09	1.00	670,000.00	19.93	154.0	35.0	265
Ohio	0	6.24	5.53	3,705,050.05	1,194.32	141.0	477.0	
Oklahoma	0	2.38	2.11	1,410,562.62	227.17	250.0	82.0	
Oregon	0	0.72	1.00	670,000.00	108.92	38.0	45.0	0
Pennsylvania	0	6.09	5.40	3,616,687.04	1,399.34	43.0	461.0	
Rhode Island	0	0.22	1.00	670,000.00	20.90	0	31.0	
South Carolina	0	1.00	1.00	670,000.00	43.42	100.0	62.0	
South Dakota	0	3.52	3.12	2,087,987.42	447.17	344.6	99.7	
Tennessee	0	1.06	1.00	670,000.00	123.34	123.0	15.0	1194
Texas	0	2.38	2.11	1,412,643.71	299.23	184.0	118.0	
Utah	0	0.06	1.00	670,000.00	11.59	3.0	2.0	
Vermont	0	0.70	1.00	670,000.00	289.60	3.0	0	
Virginia	0	0.80	1.00	670,000.00	220.69	11.0	39.0	
Washington	0	1.62	1.44	962,089.99	156.93	202.5	23.1	800
West Virginia	0	0.88	1.00	670,000.00	241.08	1.0	56.0	
Wisconsin	0	2.22	1.97	1,316,649.25	303.78	254.9	16.0	615
Wyoming	0	0.02	1.00	670,000.00	9.11	0	0	
Total	14,144.98	100.00	100.00	67,000,000.00	14,144.98	7,080.8	4,944.3	7,100
					$\frac{1}{3}$	$\frac{1}{3}$	$\frac{1}{3}$	
						12,025.1	(%)	

¹ Eligible mileage is the total eligible under current law as of Oct. 1, 1978.

² The Milwaukee mileage in categories 1 and 2 has been subtracted from the States' total for each category to present the situation that would occur under present law if all Milwaukee category 1 and 2 mileage were to go into category 3. This Milwaukee mileage is less than the estimated 7,100 miles to be abandoned because the 7,100 total miles includes category 5 mileage as well.

³ Estimate.

Question. Prior to the release of the Booz, Allen & Hamilton core configuration studies FRA officials supported the Trustee's plan to eliminate transcontinental service at numerous public meetings.

Had the FRA conducted their own analysis of the Pacific Coast extension at that time?

Do you think it is appropriate to give official support for such a plan when no studies by either the railroad or the FRA had been completed?

Answer. At no time prior to the release of the Booz, Allen & Hamilton core report did FRA officials support the Trustee's plan to eliminate transcontinental service. What we did support was the approach that Trustee Hillman was taking toward a reorganized Milwaukee Road. As you know, the Department is on record in many instances stating that there is too much excess, duplicative, uneconomic railroad in the country.

Question. Secretary Adams called the Milwaukee's situation the "inevitable result of a railroad with too little traffic and too much track." He further indicated that the Department would work with other carriers for the eventual takeover of some of Milwaukee's non-core trackage, stating that the other carriers must participate in the takeover of Milwaukee service or we would be facing the possibility of nationalization.

Don't you think that there is some middle ground between a completely private sector solution, that could leave entire regions without reasonable rail service, and nationalization?

Answer. I don't believe that under a completely private sector solution any entire region of the Nation will be left without reasonable rail service. We know, for example, that the Union Pacific and Burlington Northern are interested in discussing the acquisition of portions of the Milwaukee Road in Washington, Idaho, and Montana. While transcontinental service by the Milwaukee would be lost, no entire region of the northern tier of states need be without "essential" rail service by reason of a private sector solution. If a State or States felt quite strongly that a portion of the Milwaukee not to be acquired by a solvent carrier should be operated in the public interest, we believe the mechanism to achieve that is through use of Federal funds from the present Local Rail Service Assistance Program under Section 5 of the DOT Act together with a contributing local share as required by that Act. Furthermore, should short line operations be contemplated for certain portions not to be acquired, Section 511 loan guarantees are available if a qualified applicant steps forward.

SENATOR LONG.

Next we will call the Honorable A. Daniel O'Neal, Chairman of the Interstate Commerce Commission.

STATEMENT OF HON. A. DANIEL O'NEAL, CHAIRMAN, INTERSTATE COMMERCE COMMISSION; ACCOMPANIED BY RICHARD H. SCHIEFELBEIN; JOHN MCCARTHY; AND JAMES B. THOMAS

Mr. O'NEAL. Good morning, Mr. Chairman. With me, to my right is Dick Schiefelbein, who headed up the staff effort to put together a directed service program in case it is needed for the Milwaukee.

On my far left is John McCarthy, who represented the Commission before the Court in Chicago on this matter.

On my immediate left is Jim Thomas, Director of the Bureau of accounts at the Commission.

We have a longer statement to submit for the record, and I will summarize it now.

The reorganization court held a hearing on the trustee's petition to embargo on May 4. At this hearing the Commission argued that under established principles of law the court lacked authority to grant the embargo unless it found that the trustee had in fact, run out of cash, to continue operation of the railroad or that no cash was available to the trustee which would prevent an unconstitutional erosion of the assets of the bankrupt through continued operations.

We also requested the court, should it authorize the embargo, to require the Milwaukee to file an appropriate application for authorization to discontinue and or to abandon service within the embargoed area.

At the hearing the court authorized issuance of the additional certificates, but did not otherwise rule.

On May 15 the Commission appeared again before the court and presented an outline of a plan for directed service and arguments concerning the proposed embargo. We expect the court to come to a decision before the end of May on this matter.

If the court orders the trustee to embargo portions of the system, the Commission will have to consider issuing directed service orders.

The Commission, although prepared to use directed service, approaches this as a last resort because of the expense it represents to the Federal Government and because it is only a short-term solution.

The other financial programs which are available involve loans to be eventually repaid to the Government.

Under directed service however, the directed carriers will be compensated by Federal grants for any losses incurred and will be paid a 6-percent profit based on revenues which they receive from this traffic.

Thus, it is the most expensive option for the Government to use and we believe it is preferable to develop other solutions such as ERSA funding to avoid cessation of operations.

We note, however, there are limited ERSA funds available and, in any event, the carrier must apply to use those funds before they can be made available under the act.

At any rate, we believe it essential to plan for directed service should the necessity arise for its use.

Shortly after the Milwaukee filed for reorganization, the Commission staff began contingency planning. We realized then there might be no time to lose since the time span between the announced decision to curtail service and the actual curtailment would be inadequate to compile the data necessary to develop a service order.

During this planning process we have constantly monitored the cash and financial situation of the Milwaukee to keep informed of the possibility and timing of an emergency situation.

As a result of the contingency planning, staff has presented the members with four general options which were considered by the Commission last week.

The first option, of course, was not to order directed service.

The second was to direct service over the entire railroad, including the core which the trustee is hopeful of being able to reorganize.

After reviewing this option, the staff recommended against it because it would be the most expensive for the Federal Government and, to the extent there is a viable core, this option would give the railroads that are competitive with the "CORE Milwaukee" access to core traffic. That could cause an erosion of revenue of such magnitude that the Milwaukee core system could never become successful.

Staff estimated the cost to the Federal Government of this option would run \$75-\$80 million.

The third option was to direct a single carrier to run all of the Milwaukee's lines outside the core. Under this option, transcontinental through-train service would continue to be operated.

There were disadvantages. For example, the track condition on many sections of the transcontinental lines is deteriorating rapidly and would require Federal grants under directed service to be rehabilitated although the lines may not be operated by anyone in the long run.

Also, we were concerned about the availability of locomotive power. There may not be sufficient numbers of operable locomotives to run both the core and transcontinental lines.

In spite of these disadvantages, this option had the advantage of preserving an alternative carrier for transcontinental service across the Northern Tier.

Implementation of this option would cost approximately \$40 to \$45 million without considering rehabilitation costs.

The fourth option, which was the one ultimately selected by the Commission, was to direct several different carriers to serve shippers outside the core system using the so-called "traffic pockets" approach. This would cost approximately \$25 to \$30 million as originally proposed.

The option finally approved by the Commission will cost, if implemented, about \$10 million for 60 days of service. This would involve a fairly complicated service order and much of our staff's time has been spent refining this option. The staff met individually with each potential directed carrier and outlined the areas which from its review the staff believes should be operated.

In those meetings, held immediately after the trustee filed his petition to the court, technical problems concerning each of the potential operators were raised. We addressed these problems in 2 days of workshops with representatives from the railroads.

The staff estimates that Option 4 would handle over 95 percent of Milwaukee's current traffic.

The goal of this approach is to provide a transition period for those who could lose rail service to make other arrangements to the extent possible.

It appears inevitable that unless some assistance or turn of events not now apparent occurs, major adjustments must be made by those who are served by the Milwaukee Railroad.

The planning for these adjustments must take place right now. The Commission can at best provide a short breather before the real problems must be faced.

Let me assure you of the full cooperation of the ICC in the difficult task of bringing order to the transportation system in the affected areas. We will process all applications for acquisitions, mergers, or abandonments as quickly as possible while giving due consideration to the affected parties and will be ready to direct service if that is unavoidable.

That is my brief statement. If I can answer questions, I will.

Senator LONG. I had two questions I would submit.

Senator Magnuson?

Senator MAGNUSON. Does the ICC continue to take the position that the court order and embargo is illegal?

Mr. O'NEAL. We take the position the court can't order an embargo unless the court finds there is no cash available to run that railroad and no likelihood of generating cash from the sources that now exist.

Senator MAGNUSON. Does it take the position that the Federal Court in Chicago should not set itself up as a mini-ICC? That deals with the court's opinion on your directed service plan, doesn't it?

Mr. O'NEAL. The legal mechanism involves line abandonments under the Interstate Commerce Act. We take the position that that is the proper approach that must be followed.

However, we have to recognize if the judge finds that there is inadequate cash to run the railroad that he may just let that railroad stop running sooner or later and at whatever point it stops running we have to be prepared to use directed service.

Senator MAGNUSON. Would you prefer to see ERSA funding or directed service as a short term answer? Not a long-term answer.

Mr. O'NEAL. We feel ERSA funding is the least expensive option available, and we would prefer it. However, if the trustee does not apply for funds, the way the act is written today, there is no way to force the trustee to use the funds. He has to make the application.

Senator MAGNUSON. I understand you would prefer to have the Federal emergency funds used for the whole line systemwide rather than just for the core.

Mr. O'NEAL. Well, I think the—if the desire is to preserve the—

Senator MAGNUSON. I am talking about a short-term answer, not a long term.

Mr. O'NEAL. I think personally I would feel that if there are possibilities of developing some answers—and I know there are various people working on resolutions—that there ought to be preservation of the transcontinental service. To do that, you need to provide service over the entire system.

Senator MAGNUSON. I have no further questions.

Senator LONG. Thank you very much.

[The statement follows:]

STATEMENT OF HON. A. DANIEL O'NEAL, CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. Chairman, Members of the Subcommittee, I appreciate the opportunity to be here today to discuss the Milwaukee Road System. I will first discuss the background of this problem and I will then cover recent developments, including the Milwaukee trustee's recent petition to the reorganization court to embargo most of its lines, and the Commission's response thus far. Finally I will give you the benefit of our views on what we believe may need to be done in the future.

The Milwaukee Road has been unable to generate sufficient cash flow from its operations to support its physical plant. Faced with ever-increasing costs, declining traffic volume, strong competition, severe weather, and other difficulties, this railroad has been in a state of decline for a number of years. Back in December 1974, the Early Warning Branch of the Commission's Bureau of Accounts reported that the Milwaukee was in a marginal condition, and that a continued decline in the Nation's economy would cause the carrier's performance to drop to poor. A series of later reports essentially confirmed that analysis.

In a report issued in November of 1977 by the Bureau of Accounts, it was once again concluded that the Milwaukee Road could not generate sufficient cash flow from its operations to support its plant, and that without greater financial aid or a major system rationalization through coordination of track with other competing

roads, the Milwaukee could soon be forced into reorganization. Unfortunately, that is exactly what came to pass in December 1977.

We have continued to monitor the financial situation of the Milwaukee. For example, last October our Bureau of Accounts forecast a cash loss of \$3.0 million in the fourth quarter of 1978 for the Milwaukee. In fact, a cash loss of \$2.3 million was experienced. For the first quarter of 1979, a cash loss of \$10.2 million was forecast followed by a cash loss forecast of \$6.9 million in the second quarter. With cash in excess of \$20 million in mid-October of 1978, we felt a cash crisis could occur at the beginning of the third quarter. Instead of a cash loss of \$10.2 million in the first quarter, however, a cash loss of \$29.1 million occurred with a further operating cash loss of \$4.1 million in April alone. This large increase in the cash loss was caused by an extremely severe winter which saw carloadings in the first quarter decline much farther than we had foreseen, from 183,000 carloads in the first quarter of 1978 (down almost 17 percent from 1977) to 162,000 carloads in the first quarter of 1979 (down a further 12 percent).

I would now like to discuss where the Milwaukee is in regard to the reorganization process. As mentioned, the Milwaukee filed a petition for reorganization in December of 1977. The trustee, while in the process of developing a reorganization plan, commissioned the consulting firm of Booz, Allen & Hamilton to make an overall system study which was recently completed. The Commission originally anticipated that a plan of reorganization would be filed by the summer of 1979, but we are now advised that it will be filed in September.

I would now like to turn to the petition recently filed by the trustee. In this petition, the trustee, based in part on the Booz, Allen & Hamilton study and on his own assessment of the Milwaukee's cash situation, petitioned the reorganization court on April 23, 1979, for an order requiring him to—

“Embargo on May 8 all freight services over most of the Milwaukee's lines not included in the 2,400 route-miles which stand some chance of becoming a self-supporting system;

“Furlough beginning May 8 all employes not required to operate the 2,400 route-miles or to continue the other necessary activities leading up to a reorganization plan;

“Notify the Interstate Commerce Commission of the possible need to direct service by other railroads over the essential portions of the embargoed lines.”

The trustee also requested authority to issue an additional \$15 million worth of trustee's certificates to enable the railroad to continue operations.

Subsequently, the trustee modified his petition so as to postpone the embargo date from May 8 to May 31, 1979. In addition, he proposed the retention of a core which would include the line to Miles City, Montana, while dropping the line from La-Crosse, Wisconsin, to Kansas City.

The reorganization court held a hearing on this petition on May 4, 1979. At this hearing, the Commission argued that, under established principles of law, the court lacked authority to grant the embargo unless it found: (1) that the trustee had in fact run out of cash to continue operations of the railroad, and (2) that no cash is available to the trustee which would prevent an unconstitutional erosion of the assets of the bankrupt through continued operations. Unless the court was prepared to make both of these findings, we argued, it would be necessary for the court to authorize the trustee to file applications for abandonments of lines with the Commission and successfully prosecute such abandonments before service could be terminated.

At the hearing, the court authorized issuance of the additional certificates. It did not rule on the request for cessation of service, but rather scheduled a hearing for May 15, 1979, to resolve that issue. At that time, the Commission was requested to provide a plan for directing service by other carriers in the areas in which the trustee desires to discontinue service.

Just last week, on May 15, the Commission presented testimony before the reorganization court with regard to our plan for directed service as well as suggested conditions to an embargo if the court should permit one. The conditions which we argued should apply in case of an embargo were that the Milwaukee should be required to provide sufficient locomotives and other equipment for directed carriers and that the trustee should be required to file appropriate applications to discontinue and/or abandon service within the embargoed territory. The court is expected to decide these issues before the end of May.

Since I brought up the subject of abandonment, this might be a convenient place to explain briefly the abandonment process. Under 49 U.S.C. §10903, a railroad must make application and receive the Commission's approval before it is allowed to discontinue all operations on a line or to abandon a line. The decision to grant a

certificate of abandonment is made after a proceeding in which all interested parties have been notified and have had an opportunity to participate. As a part of our regulations, each rail carrier is required to prepare a system diagram map indicating those lines which it anticipates will be subject of an abandonment proceeding within the next three years (Category I), and those lines which are under study for a possible future abandonment application (Category II). A line must be included in Category I for at least four months prior to the filing of an abandonment application, unless no opposition is anticipated. After this four-month period, application may be made to the Commission for a certificate of abandonment which would allow the railroad to terminate service and dispose of the line. Full notice is given and a hearing is normally held before an administrative law judge. Testimony from interested parties, including shippers and state and local governments, is welcomed at this stage of the proceeding. The administrative law judge will then make a decision which may be appealed to a Division of the Commission.

In the case of line abandonments by the Milwaukee, it is likely that there would be opposition, so a line would have to be included in Category I for four months before an abandonment application could be filed. Overall, the Milwaukee has listed 1,193 miles (27 lines) on its map in Category I, and over 2,000 miles in Category II (35 lines).¹ Since the Milwaukee filed for reorganization in late 1977, it has filed 45 abandonment applications. Nineteen of these applications, involving 660 miles, have been granted, while twenty-five of them, involving some 1,700 miles, are still pending (one application was withdrawn).

So far I have discussed in general terms where the Milwaukee is in the reorganization process, the abandonment process, and how the Milwaukee has designated some of its lines. I would now like to outline briefly the Federal financial assistance currently available to the Milwaukee.

First, assistance is available under the Emergency Rail Services Act of 1970 (ERSA) (49 U.S.C. 661 *et seq.*). This Act provides the Secretary of Transportation with authority to guarantee trustee certificates upon application by a railroad undergoing reorganization. These trustee certificates are a type of security or bond issued by the trustee in bankruptcy to the DOT, and have the highest priority of all claims for repayment. The Milwaukee has made application under this program and a \$5.1 million loan has been approved and drawn down by the carrier.² At the present time, there is a total of \$50 million in the ERSA fund which is potentially available to the Milwaukee or other bankrupt carriers. The Department of Transportation has recently stated that \$20 million in ERSA funds would be available to the Milwaukee. This matter will be reviewed by the reorganization court on the 29th of May. It is important to note that there is a limit to ERSA funds, and the carriers must make a request for the assistance.

Second, under Title V of the 4R Act, financial assistance is available for specific capital expenditures. Specifically, section 505 of the 4R Act provides that the Secretary of Transportation may directly purchase trustee certificates. Further, under section 511, the Secretary may guarantee loans to the railroad. In both instances these funds are to be used to rehabilitate and improve facilities or equipment. On July 31, 1978, the Federal Railroad Administration and the Milwaukee signed a contract through which the Milwaukee will receive \$24.5 million which will be used for upgrading the main line between Milwaukee and the Twin Cities. About \$16.9 million had been drawn down as of March 31, 1979. Under the contract the railroad will also receive \$21.4 million in loan guarantees for the repair of 111 locomotives and 950 freight cars. As of March 31, 1979, \$15.9 million of these funds had been drawn down.

As was mentioned, the reorganization court on May 4, authorized the trustee to issue certificates in the amount of \$15 million. Thus far the trustee has generated about \$10.7 million from issuing certificates. These funds have come from loans from the railroad's existing land sale escrow fund and from the Milwaukee Land Company. This leaves about \$4.3 million authorized and remaining to be received from the issuance of certificates.

¹ Our staff has been informally advised that the Milwaukee will file a supplemental system diagram map at the end of the month which will list in Category I all lines which would be covered by the proposed embargo.

² We should note that the Milwaukee's creditors attempted to block the carrier's receipt of these funds. The court ruled against these creditors, but the proceeding is presently under appeal. The creditors oppose this type of financing because the Federal government obtains a preferred lien against the railroad's assets.

These recent actions leave the Milwaukee with about a \$5.5 million cash balance as of May 15, 1979.³ The Milwaukee Land Company had a cash balance of approximately \$3.2 million on May 15. An additional \$4.6 million, generated from a property sale in Tacoma, has been placed in the railroad's land sale escrow account leaving a balance of about \$4.9 million in that account.

In spite of these funds, the Milwaukee remains in a very precarious financial position. In light of the trustee's petition to the court requesting an extensive embargo, we must face the possibility that the Milwaukee may not continue much of its day-to-day operations. Should this occur, the Commission has the authority under 49 U.S.C. § 11125 (formerly Section 1(16)(b) of the Interstate Commerce Act) to direct another carrier to operate the Milwaukee's lines for a limited period of time and compensate such a railroad for doing so.

I should mention that the Commission, although prepared to use directed service, approaches this as a last resort because of the expense it represents to the Federal government, and because it is only a short-term solution. The other financial programs which are available to provide funds to railroads involve loans which are subject to repayment to the government. Under directed service, however, the directed carriers will be compensated by Federal grants for any losses incurred, and will be paid a 6 percent profit based on the revenues which they receive for this traffic. Because this is grant money rather than loan money and includes full reimbursement of losses plus a profit, it is the most expensive option for the Federal government to pursue. We believe it is preferable to develop other solutions, such as ERSA funds to avoid a cessation of operations.

Shortly after the Milwaukee filed for reorganization, the Commission staff began contingency planning to enable us to respond quickly if a directed service order became necessary. It was essential that we begin this planning at an early date because we realized that the time span between any announced decision to curtail service and the actual curtailment would be insufficient to compile the data necessary to develop our service order. During this planning process our Bureau of Accounts constantly monitored the cash and financial situation of the Milwaukee in order to keep us informed of the possibility and timing of an emergency situation. This planning process has continued up to the present time.

As a result of this contingency planning, the Commission was presented with four general options, one of which has been chosen by the Commission for implementation in case directed service becomes necessary. The first option was obviously not to order any directed service. As I mentioned, the statutory authority in permissive—we are not required to direct service.

The second option was to direct service over the entire railroad, including the core which the trustee is hopeful of being able to reorganize. This option was viewed as undesirable from the viewpoint of expense. And, to the extent there is a viable core this option would have given the railroads who are competitive with the "core Milwaukee" access to the core traffic. That could cause an erosion of revenues and traffic of such magnitude that the core system could never become successful. Our staff estimated that the cost to the Federal government of implementing this option for the core system as originally proposed would be from \$75 million to \$80 million.

The third option available to the Commission was to direct a single carrier to run all of the Milwaukee's lines outside of the core. Under this option, transcontinental through train service would have continued to be operated. There are disadvantages to this choice, however. For example, the track condition on many sections of the transcontinental lines is deteriorating rapidly and would require Federal grants under directed service to be rehabilitated, although the lines may not be operated by anyone over the long run. In addition, we are concerned about the availability of locomotive power on the Milwaukee. It is possible that there are not sufficient numbers of operable locomotives on the Milwaukee to run both the core and the transcontinental lines. In spite of these disadvantages, this approach has the advantage of essentially preserving an alternative carrier for transcontinental service across the Northern Tier. Implementation of this option would cost approximately \$40 to \$45 million.

The fourth option, which was ultimately selected by the Commission to be used in the event of an embargo,⁴ was to direct several different carriers to serve shippers outside the core system. This approach is the least expensive directed service—it

³ This cash balance reflects the payment of about \$4-\$5 million in withheld vouchers. Since last February the Milwaukee has been withholding the payment of certain vouchers in order to conserve cash. The recent issuance of trustee certificates has allowed these vouchers to be paid.

⁴ Chairman O'Neal and Vice Chairman Brown voted to direct service over the entire Milwaukee system outside the core section for a 45-day period by one or more carriers.

would cost approximately \$25 to \$30 million.⁵ This would involve a fairly complicated service order, and much of our staff's time was spent refining this option. In this regard, the staff met individually with each of the potential directed carriers and outlined to those carriers the areas which, from its review of traffic data and other information, the staff believes should be operated. In those meetings, which were held immediately after the trustee filed his recent petition with the Court, technical problems concerning each of the potential directed operators were raised. Those problems, which are of substantial importance in making sure that any directed service actually in feasible, require swift resolution. To address them, the Commission scheduled two days of concurrent technical workshops with representatives from the railroads in an attempt to resolve them as far as possible. Those meetings were held at the Commission on May 3 and 4 and, in keeping with the Commission's attempt to keep this as open and public a process as possible, the meetings were announced (although on short notice) and the public was invited to observe.

In trying to determine where service should be directed under a multiple carrier approach, the Commission's staff focused on points where traffic originates and terminates. First, it became obvious that most of the trackage at the western extremity of the Milwaukee railroad was joint trackage with other railroads and that each of the railroads had full access to all of the shippers. Thus, it would not be necessary in such situations to direct anyone to continue service, since the other carriers already had rights to provide the service.

Directed service would have to be utilized on those lines having shippers that are exclusive to the Milwaukee road. On the transcontinental line, the nature of the Milwaukee's traffic is that it is clustered into small pockets. The Commission's staff has been determining where these pockets are, and which carriers have the best access to them.

In contrast, in the Midwestern area, and particularly in Iowa, the decision was more difficult to reach. In that area there are no distinct breaks between the level of traffic at one station and the next station. Thus, it is harder to determine where to direct service. One factor which is significant in shaping a service order in this area is the condition of the track. That is because we cannot, by law, direct service over track that is less than the Federal minimum safety standard. Thus, there is trackage over which the staff may not believe the Commission should direct service because of the track's poor condition, which would increase the amount of time and Federal money needed to rehabilitate the trackage to the minimum level required for direct service.

The fourth option was chosen by the Commission for two major reasons. First, it provides for maximum service at minimum cost. Also, this approach will require fewer locomotives than other options.

In choosing the fourth option, the Commission also decided that if service must be directed, then hearings should be held to determine the scope of any directed service ordered after the first order—which by law can be effective for no more than 60 days—expires. If the embargo should go into effect we would expect to hold hearings in mid-June. After public hearings and with the benefit of additional information, it is possible that we will make some changes in the structure of the directed service for the remaining 180-day period authorized by the statute.

Of course, even if the immediate cessation of operations can be avoided, it is quite possible that there will be numerous abandonments in the area served by the Milwaukee. While the Milwaukee would have to follow the abandonment procedures set forth above which would take a number of months and allow for contingency planning, the impact of a large number of abandonments could still be very serious. Of course, in appropriate cases Federal assistance may be available by way of funds provided under the Local Rail Service Assistance Act. Pursuant to this Act, each state is allocated limited Federal funds to be used in maintaining service over lines which would otherwise be abandoned. Also, funds can be used by the state for rehabilitation of certain lines prior to abandonment. Federal assistance for this program is limited to three years, and thus only provides a temporary solution.

⁵ The Commission in adopting this option voted to direct service for 60 days and to provide "protection" to Milwaukee rates for that period. This means that Milwaukee rate structure between various points will continue in effect. Thus, a shipper will pay the present Milwaukee rate even though the shipment may not go over present Milwaukee routes. At this time, the cost of directed service under this protection format is not susceptible to precise determination. However, our best judgment of the cost of directed service for 60 days with rate protection, is about \$10 million.

We should note that rate protection will probably cost more than no protection. This would be true of whatever option were chosen. This type of temporary protection was though desirable because a directed service order would otherwise guarantee service only and not a particular rate level.

In attempting to deal with the situation confronted by those areas of the country served by the Milwaukee, it is essential that serious planning take place. The states and all involved shippers, in coordination with the FRA, must be active in the effort to develop a more viable system of transportation. While some Federal assistance is available, it is limited, which makes it important that priorities be established and that coordination take place. Imagination and foresight must be used in formulating solutions to the problems which must be confronted.

In addition to other planning, state action could conceivably include encouraging shipper efforts to increase rail traffic, assisting shippers in efforts to form groups which could actually take over rail operations, encouraging other carriers to acquire lines within the state, consolidating grain elevators on certain lines, and examining the possibilities of having exempt motor carriers take over agricultural traffic.

I must emphasize that state and local action is necessary. The short-term solutions which I have outlined above are only that—short term. It appears inevitable that, unless some assistance or turn of events not now apparent occurs, major adjustments must be made by those people served by the Milwaukee, and the planning for these adjustments must take place now. The Commission can only provide a brief "breather" before the real problems are confronted. The planners in Washington can be of assistance, but only the people within the affected area can be aware of the full range of possible solutions.

Let me assure you of the full cooperation of the Interstate Commerce Commission in the difficult task of bringing order to the transportation system in the affected areas. In the short term we will be ready to direct service by other carriers to the large majority of shippers located outside the Milwaukee "core". Over the longer term we will process all applications for acquisitions, mergers, or abandonments as quickly as possible, while giving due consideration to all affected parties.

This concludes my prepared remarks. I will be glad to respond to any questions you may have.

QUESTIONS OF THE COMMITTEE AND THE ICC ANSWERS THERETO

Question 1. It is my understanding that much of the West which the Milwaukee serves is also served, or could be served, by the Burlington-Northern and the Union Pacific Railroad. It is also my understanding that less than 10 percent of the shippers within Montana depend on the Milwaukee's service. Now, in your opinion, what justification would there be for the Federal Government to put in hundreds of millions of dollars to perpetuate a transcontinental system that has a history of decreasing traffic, and services that are apparently non-essential to the national transportation network?

Answer. You are correct that much of the West that the Milwaukee serves could be served by the Union Pacific Railroad or the Burlington-Northern. You are also correct that less than 10 percent of the carloads originated or terminated in Montana are on Milwaukee lines. For your information, the relative rail market shares of the various carriers serving the States served by the Milwaukee are attached for the years 1966, 1969, and 1975-1977 (appendices A and B).¹ Also attached is a market share analysis for those States showing the numbers of carloadings by commodity group for the years 1975-1977 (Appendix C).¹

The chief justification for the perpetuation of the Milwaukee Railroad as a transcontinental carrier would be to provide intramodal competition for the Burlington Northern Railroad across the Northern tier of States, including Washington, Oregon, Idaho, Montana, and the Dakotas. The Union Pacific Railroad and the other transcontinental carriers do not provide the direct competition afforded by the Milwaukee's line. The weak condition of the Milwaukee at present limits its ability to provide vigorous competition, but the argument can be made that the investment of sufficient capital would produce more vigorous competition for rail service.

The presence of rail substitutes and truck competition in the West indicates that there is a serious question about an investment of "hundreds of millions of dollars" to continue the Milwaukee as a transcontinental carrier. As you know from my testimony on May 21, the Commission voted to direct service, if necessary, over the Milwaukee using a "traffic pocket" approach, rather than continuing the Milwaukee's transcontinental through trains. We estimated that the cost of this approach would be about \$10 million for a 60-day period. My testimony also noted that we feel the use of directed service is a last resort because of the expense to the Federal government, and because it is only a short-term solution.

Nonetheless, we believe that a limited expenditure of Federal funds is justified on a transitional basis in order to protect the shippers from an unanticipated cessation

of service, and to allow the shippers time to find alternative transportation options. We have reservations, however, about spending massive sums of Federal funds to preserve a corporate entity's present route structure. We believe that the preservation of essential services is the proper focus for federal involvement rather than the preservation of a specific railroad company. The most substantial impact of a restructuring in which other railroads would purchase portions of the Milwaukee would be on labor, not on the shippers. We believe that this is a serious issue, which must be addressed adequately to assure a smooth implementation of any restructuring of the Milwaukee Road.

Question 2. You have stated that the Milwaukee has suffered decreasing market shares over a number of years. In your opinion could a reorganized western rail line recapture sufficient traffic to be profitable? What would be the effect on competing carriers? In other words, is there only a relatively finite amount of traffic out there that is suitable to rail transportation so that any additional carriers would only result in both having only insufficient traffic?

Answer. We have doubts whether a reorganized Milwaukee Road could attract sufficient transcontinental traffic to become profitable. However, we believe that the "jury is still out" on the issue. The SORE (Save Our Railroad Employment) organization has presented the view that the western extension of the Milwaukee Road could be made viable. At the same time, the Trustee has presented the view that the midwestern "core" is the only portion of the Milwaukee that has a reasonable chance of a successful reorganization. We have initiated an internal review of the Booz, Allen & Hamilton report to the Trustee; the Federal Railroad Administration is also reviewing the Booz, Allen report. We believe that these reviews are essential inputs to any conclusion about the potential profitability of the Milwaukee's transcontinental line.

We would note that most of the Milwaukee's plant has deteriorated to the point that the railroad is unlikely to be competitive with other carriers unless there is a substantial infusion of external capital. Given sufficient capital, and given sufficiently capable management, the Milwaukee could become a viable operation. It is important to stress the word "could"; there are no guarantees that can be made as to the long term viability of the Milwaukee—or of any other enterprise, for that matter.

We do not believe that there is only a finite amount of traffic, so that growth of the Milwaukee, in the long run, would only occur at the expense of existing carriers. The demand for rail service is not inelastic; as service improves or price falls relative to competing modes, the demand for rail service can be expected to increase. Much of the decline in the fortunes of the railroad industry generally in recent years reflects a diversion of rail traffic to other modes, and presumably if service were improved sufficiently that could be recaptured, particularly given the relative energy efficiency of the rail mode. In addition, if the price/service offering of the Milwaukee (or the BN) improved, manufacturers in the Pacific Northwest may become more competitive in Midwestern markets with manufacturers located in the East and South, and vice versa. This is not to say that the growth of one carrier would not diminish the market share of its competitors, only that that need not happen.

Question 3. The ICC indicated by a recent press release that it would issue a 60 day directed service over the Milwaukee by neighboring carriers if the court allows the embargo of approximately 75 percent of the existing Milwaukee plant.

What is the ICC estimate for the cost of this directed service for 60 days? What would the cost for the same service be if the Government merely reimbursed the Milwaukee for its operating losses over that same period of time?

Finally, what amount of funds are in the ICC directed service account and presently available? Has the ICC revised its appropriations requested before Congress as a result of these recent developments on the Milwaukee?

Answer. The Commission staff has estimated that directed service outside of the "core" would cost somewhere in the range of \$10 million, exclusive of rehabilitation costs. This assumes that directed service would focus on the "traffic pockets" and would require that the Milwaukee's rates be honored by the directed carriers during the first 60 days. Directed service does not provide funds for rehabilitation expenses.

The cost to the Federal government of reimbursing the Milwaukee for its operating losses over this 60 day period for the "directed service" system would be in the magnitude of \$8.5 million. We should note that in addition some rehabilitation expenses in this period would probably be incurred, although we are unable to estimate the amount at this time. If the Federal government reimbursed the Milwaukee for its operating losses for the entire system for 60 days, the cost would be approximately \$15 million, exclusive of rehabilitation. The difference between the

¹ Appendices A-C are in the Committee files.

\$10 million and \$8.5 million figures basically reflects the 6 percent profit mandated by the directed service provisions.

Approximately \$14.3 million remains in the Commission's directed service appropriation. These funds were appropriated several years ago to remain available until expended. If we actually issue a directed service order on the Milwaukee, we will immediately submit an estimate of the total costs to the appropriate committees and will request the necessary supplemental appropriations.

Question 4. Your testimony advises that carloadings in the Milwaukee are down from 183,000 carloads for the first quarter of fiscal year 1978 to 162,000 carloads for the first quarter of fiscal year 1979. Which commodities suffered the greatest decrease in carloadings? What were the causes?

A great deal of conjecture has been made about the coal hauling capabilities of the Milwaukee road. What are the carloading statistics for that particular commodity for the first quarter of 1978 compared to the first quarter of 1979. What is your conclusion about the differences?

Answer. The following is a listing of the commodities which showed the greatest decreases in carloadings in comparing the first quarter of 1979 to the first quarter of 1978:

Commodity and percentage decrease in carloads

Farm products.....	64.3
Nonmetallic ores.....	64.1
Metallic ores.....	55.0
Petroleum.....	46.0
Food.....	30.2
Stone and clay.....	29.7
Coke.....	27.1
Metal products.....	22.7
Waste.....	20.9
Motor vehicles.....	19.4
Pulp and paper.....	18.5
Grain.....	18.4
Forest products.....	16.5

We believe that many factors contributed to the declines recorded in these commodities. The principal factors include the severe winter experienced in the Milwaukee's operating area in the first quarter of 1979 and the unavailability of sufficient operable locomotives. A number of less significant factors contributed to the reduction of movements of particular commodities. For example, reductions in coal traffic resulted from an extended shutdown at the Big Stone Power Plant and a reduction in coal demand from several power units in Indiana; another power unit in Wisconsin moved its stock pile from Milwaukee to the Northwestern Line. A decline in primary forest products traffic resulted in part from the shutdown of a chipping plant in Idaho.

Coal carloads for the first quarter of 1979 were 12,997 compared to 7,889 for the first quarter of 1978. Although this appears to be a substantial increase the first quarter of 1978 was an abnormally low period. The 1979 figure is below the 1976 and 1977 levels, but is comparable to the 1972-1975 levels. The following tables compare coal carloadings for the Milwaukee's first quarters and for each of the last six quarters:

Year:	<i>First quarter comparisons</i>	<i>Carloads</i>
1972.....		11,087
1973.....		10,575
1974.....		10,867
1975.....		11,642
1976.....		15,002
1977.....		15,113
1978.....		7,889
1979.....		12,997

Comparison of last 6 quarters

Quarter:	<i>Carloads</i>
4th, 1977.....	12,253
1st, 1978.....	7,889
2d, 1978.....	17,712
3d, 1978.....	15,401

Quarter:	<i>Carloads</i>
4th, 1978.....	14,426
1st, 1979.....	12,997

We believe, in light of the Administration's desire for the Nation to utilize greater amounts of coal as opposed to oil, that any railroad which transports coal will reap benefits. To the extent that the Milwaukee hauls coal in the future, it should share in the benefits of increased coal usage.

Question 5. In previous testimony on the Milwaukee, the ICC suggested that without "greater financial aid or a major system rationalization through coordination of track with other competing roads * * *" bankruptcy would be imminent. Bankruptcy is now a fact; however, does the ICC feel that a system rationalization through coordination of track with other competing modes would still be in order?

Has the ICC studied any possible market swaps that might be available to the Milwaukee?

Answer. We continued to believe that system rationalization through coordination with other railroads and greater utilization of assets, such as main lines, would be beneficial. However, the planning and developing of "market swaps" and coordination properly belongs with the individual railroad companies, with the assistance of the Federal Railroad Administration. As the eventual adjudicator of any such proposals, the Commission must be careful not to be in the conflicting positions of both proponent and judge on the same issue. Thus, although we have studied quite intensely such matters as directed service, we have not specifically addressed the question of potential market swaps for the Milwaukee.

Senator LONG. Next we will call a panel of Mr. Hagen, Mr. Meyers, Mr. Whiteside, Mr. Seetin and Mr. Kassel.

We will hear each member of the panel. Those not here, we will include their statements.

Proceed.

STATEMENTS OF BRUCE HAGEN, PUBLIC SERVICE COMMISSION, BISMARCK, N. DAK.; JAMES MEYERS, DIRECTOR DIVISION OF RAILROADS, PIERRE, S. DAK.; TERRY C. WHITESIDE, MANAGER, MONTANA DEPARTMENT OF AGRICULTURE, MARKETING AND TRANSPORTATION, HELENA, MONT.; MARK W. SEETIN, COMMISSIONER, MINNESOTA DEPARTMENT OF AGRICULTURE, ST. PAUL, MINN.; AND RAYMOND KASSEL, DIRECTOR, IOWA DEPARTMENT OF TRANSPORTATION

Mr. HAGEN. Thank you. Mr. Chairman, my name is Bruce Hagen and I am a public service commissioner from the State of North Dakota. I appear here today for the entire commission. North Dakota Gov. Arthur A. Link also supports all viable efforts to continue the Milwaukee Railroad. I am sure also that our congressional delegation will support all viable efforts to keep the Milwaukee Railroad operating.

The North Dakota Public Service Commission is the State agency designated to represent the State in surface transportation matters before most Federal agencies.

Thank you for holding this hearing, and thank you for the opportunity to appear.

We have already drawn a North Dakota State rail plan which has been submitted to the Federal Railroad Administration for approval and we are drawing a long-range State intermodal transportation plan.

The hearing today specifically involves the Milwaukee Road. The Milwaukee operates 366 miles of track in North Dakota, with slightly more than 100 miles being mainline track. This mainline serves the Knife River coal mine at Gascoyne, N. Dak., which, 6 days per week, ships 10,000 tons of lignite coal 360 miles one way

in 100-car unit trains to a 437 megawatt generating plant at Milbank, S. Dak., called the Big Stone plant. Revenue for this movement is \$30,000 per day. We approve the electric rates in North Dakota, so I am even more concerned.

The lignite is shipped in some 232 specially constructed, covered hopper cars, which were built for, and are owned by, the three electric utilities who own the Big Stone plant. These include Otter Tail Power Company, Montana-Dakota Utilities, and Northwestern Public Service. The Milwaukee provides the track, motive power, and crews.

Our commission has been most active in the Federal bankruptcy court proceedings involving the Milwaukee since it sought the protection of the courts on December 19, 1977. Just 2 weeks ago, the commission's director of traffic testified before the court in support of the plan of the trustee to obtain a \$15 million loan, and embargo all operations west of Miles City, Mont. Last week I testified before Representative Florio's subcommittee on the need for rail operations to serve the Big Stone plant.

As a commission, we favor a permanent, private-sector solution to the Milwaukee's problems. This is not to exclude other temporary assistance from Government sources which could help bridge the gap to a healthy railroad. We further realize that the Milwaukee's problems are endemic to the Midwest, and, in the long term, these problems must be addressed and solved if we are to guarantee rail service for future generations.

Essential to correction of Midwestern rail problems is more even-handed treatment of the railroads vis-a-vis competing modes. Motor carriers and domestic water carriers must pay their fair share for publicly provided and maintained rights-of-way and facilities. Rail management and labor must work together to modernize and become more efficient in every respect. The simple fact is, our rail carriers must become more competitive with the competing modes. Further the railroads must have greater flexibility to reorganize their systems.

The railroads' rate of return is insufficient to attract or retain capital. Captive commodities, our grain farmers and shippers, often now subsidize noncompensatory movements.

However, our rural rail systems are needed from an energy standpoint alone, and extreme caution and sensible planning is required for a long term rail system. Farmers, shippers, and our States must work together with the railroads and the Federal Government to accomplish this end.

I am testifying before the Senate Surface Transportation Subcommittee on May 22 in favor of a new national transportation plan to allow railroads the ability to compete with other modes. When the system is put back together, all rates must be fair and sufficiently compensatory to insure future successful operations.

Our farmers, have paid excessive freight rates for 100 years in North Dakota and elsewhere. Those rates should have brought an A-No. 1 rail system. Instead, the Milwaukee Railroad is bankrupt. Thousands of farmers are bankrupt as well, not just because of freight rates, but that is one significant reason why they've gone out of business.

The ICC should revise the grain rate structure. Dan O'Neal is doing a tremendous job. This is the best commission I have ever seen.

All railroads should, on all movements, recover the fully allocated costs. Instead, captive commodities, grain farmers, and shippers, pay the bill for other shippers. One-third of the commodities pay the bill for the other two-thirds.

On top of that, the railroads serving North Dakota have not provided adequate service. For the last 22 months, no cars. A continuing shortage exists. Millions of dollars have been lost by our farmers and shippers. The railroads have lost immense revenue. A real Catch-22 situation prevails.

I am a farmer in North Dakota. The other day in 23 miles on a highway in central North Dakota, I counted over 30 grain trucks going down the highway. The damage to the highways is immense. Who pays for that?

Our concern today, however, is with a short term solution to the Milwaukee's problems. It is in search of the shortrun solution that we support the plan of the Milwaukee's trustee to embargo all operations west of Miles City, Mont.

We support directed service if necessary. During that period, Congress, State, and local governments, affected shippers, and even solvent railroads can seek long term solutions. These include permanent subsidies, purchase agreements, trackage rights, and even abandonment, and better pricing for all freight rate movement. The important point is that under directed service there will be more time to seek an equitable solution, and the reorganization of the Milwaukee will not be hindered.

It appears that Federal Bankruptcy Judge McMillen is going to allow the Milwaukee to embargo all track west of Miles City, Mont., and the Interstate Commerce Commission has advised that it does have a directed service plan ready which will provide service to 99.4 percent of all shippers and consignees over the embargoed Milwaukee lines.

As for the 356-mile segment between the Big Stone powerplant and its lignite source in North Dakota, Trustee Hillman has indicated he wishes to continue to operate that segment as part of a core system, stretching from the Twin Cities, Minn., to Miles City, Mont.

South Dakota has already committed \$2.3 million to help make emergency repairs on the sector over which the unit coal trains move. We understand they will borrow some funds from the Federal Railroad Administration, under the section 803 provisions of the 4R Act, and seek subscriptions from shippers along the line to help with the necessary 20 percent contribution from the States.

I cannot say, at this time, whether North Dakota will be able to supply any section 803 funds to help South Dakota raise the total \$2.3 million. If approved by FRA, we have but \$700,000 available in the 803 program through September 30, and much of that is already committed to other projects. We are, however, reexamining our priorities.

However, the really big hurdle facing us is where an additional \$24 million is going to come from to make the necessary long-term repairs on that coal hauling segment to bring it to FRA class 4

standards. We are in the process of scheduling a meeting in Bismarck in mid-June between the various public service commissions in the Midwest, including South Dakota, Montana, Minnesota, and North Dakota, to discuss all possible avenues to assist the rehabilitation of this vital coal hauling segment of mainline track.

North Dakota considers operation of the mainline segment between Gascoyne and Milbank, 356 miles, to be essential service. The Big Stone plant has no other available rail service except the Milwaukee. The plant, as mentioned, is a 437-megawatt powerplant which serves 200,000 customers, or about 600,000 persons. The plant was built at a cost of \$169 million; to replace the plant would cost in excess of \$500 million today.

Otter Tail Power, which owns 47.5 percent of the plant, and Montana-Dakota utilities, which owns 20 percent of the plant, are major providers of electricity in North Dakota; 50 percent of all Otter Tail's customers are in North Dakota, and 50 percent of Montana-Dakota utilities' customers are in North Dakota.

Our legislature does not meet again until 1981. Our general fund does not have such dollars available now, and, as mentioned, North Dakota's entitlement under the 4R Act, for rehabilitation funds, is around \$700,000 for this year, and some of this is already committed to other projects. However, we will do our best with whatever resources we can utilize.

For this reason, we initially supported embargo of lines west of Renville, Minn., with support for directed operations between Renville and Miles City, Mont. However, when the South Dakota Governor committed the \$2.3 million, and the trustee sought to include the Renville to Miles City segment in the new core system, we supported the move, even though it was doubtful the Milwaukee could look to North Dakota for any financing. We did caution the bankruptcy judge that there should be the provision for an immediate embargo, with requested directed operations, at any time the trustee found the South Dakota funding insufficient to continue operations at a reasonable service level. Any directed operations must include the movement of grain and other products needed for agriculture. Nor should other shippers be ignored. Whichever railroad brings service should try to provide all essential services. Incidentally, the New England branch line is a potentially great grain shipping line.

The Big Stone plant was built at a cost of \$169 million. To reproduce that plant today, elsewhere, would cost in excess of \$500 million, and the debt service alone would exceed by two times the \$24 million needed to rehabilitate the line between Gascoyne and Big Stone.

Further, if the power companies had to close Big Stone and buy power elsewhere, the additional fuel surcharge involved would, most likely, exceed any cost to consumers if they accepted the surcharge to guarantee continued service on the existing line.

And, where is the power? It may not be available. We have a gas shortage. There could well be an electric shortage. For this reason we will examine the possibility and the options of our power companies, as well as other shippers, helping to fund the \$24 million in repairs on the line.

We have been told by the Federal Railroad Administration that there are section 511 funds under the 4R Act available for the power companies to borrow for this rehabilitation. Certainly we would want to explore the possibility of grain or other shippers along the line also sharing in the rehabilitation costs to insure future service.

We believe that the long-term solution on this mainline segment may involve purchase by other railroads, the Burlington Northern, Soo, or others. The BN's traffic between the Montana subbituminous mines and Eastern consuming centers is already straining the capacity of its mainline track which runs through southern-central North Dakota, and the addition of the Milwaukee mainline could be necessary to insure smooth flows of commerce in future years.

Even with rehabilitation, the Milwaukee may not be able to generate sufficient additional tonnages to keep the line maintained in future years. While it is apparent the Milwaukee has not provided sufficient cars to grain elevators on that line and its branches in recent years, the additional number of loadings available is not specifically known. However, with good service it would be substantial.

It is also true that other possibilities of coal mine and powerplant development may exist along the mainline, which would help make this segment of track viable. There are sufficient lignite reserves to build more generating units of Big Stone, and other energy plants could be built in South Dakota if the Milwaukee Railroad is not in question.

There are limits to mine-mouth plants due to air constraints, water, etc. If our new, budding nuclear plants are shut down or held up due to Three Mile Island, where do you go? Oil is short, gasoline supplies short, little natural gas. Where does the country go for energy for jobs, for the necessities of life?

They will not build plants along this area if the Milwaukee is not there. Where will you build energy plants if not in North Dakota? You can't move these companies too far from the mines. Lignite has a low Btu, so long distance transportation is out. South Dakota has some air. It's logical future plants possibly could be built there.

The alternative is to shut down the air-conditioning in Washington, D.C., and I wouldn't want that to happen. So we have a problem.

Several bills are currently pending in committee within Congress, relative to railroad problems. Many address specific Milwaukee road problems. I would hope that those bills will not be handled in a vacuum, but be considered together, with a single bill eventually coming out of committee which includes the salient points of each of the currently pending bills.

Some congressional help is certainly necessary in the short run, but any assistance should be with the intent of creating an eventual long-term, private-sector solution. We must return our midwestern railroads to financial health.

I would also say if this doesn't work, we must look at whatever can help for the future.

Thank you very much.

Senator LONG. Thank you very much.

How about Mr. Kassel?

Mr. KASSEL. Thank you very much for this opportunity to present our position here and the Milwaukee situation.

Our position is based on meeting with all the shippers on the Milwaukee and other shippers in Iowa.

The Iowa DOT is charged under the constitution to present the State's views on transportation issues.

Let me make it clear that Iowa DOT is interested only in retaining and supporting the continuance of rail service.

We don't support perpetuation of the Milwaukee Railroad as a corporate entity.

Quite contrary, we are convinced it should be liquidated as soon as practicable, so we can accomplish the inevitable restructure we need of railroads in the Midwest.

Trustee Hillman's proposal to embargo 7,000 miles was all he could do.

I support him. My concern is he didn't go far enough.

The proposed embargo includes all the Milwaukee trackage in Iowa.

That is 21 percent of the total rail service in our State.

Yet we support their proposal. We know the uncertainties we have to face, but recognize this adjustment must be made.

We are concerned that any congressional resolution and bailout philosophy would only delay the inevitable restructuring process.

We need legislation to expedite, not delay restructuring.

Our position is based on the fact that we have almost \$3 million in the Milwaukee Railroad to help them rebuild their lines.

Our shippers have another million and a half.

I heard other States talk about putting \$1 million in the Milwaukee tracks in their State.

We have put over \$9 million into the trackage of the Milwaukee Railroad through shippers, our own State money and through taxes that have been deferred.

Yet we know this restructuring has to take place.

During 1977 over 107,000 rail carloads of grain and corn and soybeans were originated in Iowa.

Of this total the Milwaukee carried 15 percent or almost 16,000 cars.

In addition to the grain movements, Iowa imports a considerable amount of fertilizer.

For example, over 2½ million tons were imported in 1977. Iowa contributed heavily toward a favorable balance-of-trade payments.

For example, Iowa corn and soybean shipments amounted to 10 percent of the total U.S. agricultural exports.

This helped offset the U.S. trade deficit created by foreign oil imports. Much of the Milwaukee lines in Iowa are economically viable. Three carriers have expressed serious interest in the north line across Iowa, the line from Spencer to Des Moines and Cedar Rapids to Ottumwa.

The 4R Legislation has helped, but now we are at a point where we need careful long-range planning. Subsidy should be accepted only in the short term to allow time to develop a rational long-term plan.

The only long-term solution is a viable rail system within the private sector and that we must struggle to have.

Keep it in the private sector.

This position has been expressed by the Secretary of Transportation, and Congress in the 4R Act.

The States have an important input into the system.

We are the most knowledgeable to effectively weigh many local impacts involved with rail service.

The level of detail possessed by many States can't be achieved unilaterally at the national level, therefore, we feel it's important the States be allowed to express their views and provide effective input into the decisionmaking in Congress and in the administration.

We urge the FRA and ICC continue to work with the States, so we can have some input.

As you may have heard about our branch line program, the program is flexible, effective and workable. Approximately one-third of the branch line upgrading is paid by the shippers, another third by the State and another third by the railroad.

Since 1974, we have negotiated contracts for upgrading 800 miles of branch line at a total cost of \$29 million in our State.

Since implementation of this, our shippers are getting their cars. We are providing the transportation service we need. We continue to improve rail service through another aspect of intermodality of transportation.

We have a rail-barge movement tariff. There is a single rate for the shipper to go from northern Iowa by train to the river, by the river to the gulf. One bill of lading. No contact with transfer points or anything else. This means 15 cars last summer did the work of 90 cars.

That makes for effective use of equipment. The Milwaukee also instituted another program, turning out very valuable. We are talking to other railroads in our State to continue with it.

That is the minitrain. They pick up five cars, haul it to the river and return the next day for loading again. That is another effective program that we have to have to provide for a transportation system. I urge we take the short-term decisions in the correct form, so they don't restrict competition and have adverse impact on long-term solution.

Among other things we should look at, is the potential east coast export markets rather than exporting through the gulf.

You reduce overall transportation mileage to Europe considerably by going to Norfolk or some of the other east coast ports.

You can save energy, and I think that is a thing we are striving to do.

In the Midwest, carriers operate financially marginal systems.

The restructuring process, along this line we feel there is enough grain for two railroads to make money.

Let's get to the point where we have two railroads that can be viable.

With the joint cooperation of Federal, State, local and private groups, only there can a long-term solution be found.

Congress provided the necessary tools to restructure the rail industry, but due to the changing environment, we have to ask Congress to continue to monitor the progress and continue to provide the States with the opportunity to present them both to you

and to the administration of our Government, so we can get those changes made that will keep the restructuring process in the private sector rather than drain resources from government at any level.

Thank you for the opportunity to make these comments.
[The statement follows:]

STATEMENT OF RAYMOND L. KASSEL, DIRECTOR, IOWA DEPARTMENT OF
TRANSPORTATION

INTRODUCTION

I am pleased to have the opportunity to present the comments of the Iowa Department of Transportation (DOT) on Milwaukee Trustee Hillman's embargo request and provide you with the position of the Iowa Transportation Commission.

IOWA'S POSITION ON THE MILWAUKEE TRUSTEE'S PROPOSAL

The Iowa DOT is interested only in retaining and supporting the continuance of essential rail services; we do not support the perpetuation of the Milwaukee Road as a corporate entity. Quite the contrary, the Iowa DOT is convinced that "the Milwaukee Road" should be liquidated as soon as is practicable so as to accomplish the inevitable restructuring.

Trustee Hillman has proposed to embargo over 7,200 miles (74 percent) of the entire Milwaukee Road system of slightly over 9,800 miles. The Iowa DOT has concluded that the embargo proposal is clearly illegal and that it is actually a de facto abandonment attempt. The proposed embargo includes all Milwaukee Road trackage in Iowa and consists of 1,475 miles; 20 percent of the total cited by the Trustee. At the present time, Milwaukee Road trackage represents 21 percent of all railroad mileage in this state.

Some of the lines proposed for embargo will require continued rail service by other carriers. Uncertainty of what the future holds for rail-oriented shippers and receivers is creating instability in the Midwest that cannot be tolerated. Trustee Hillman himself admits his proposed core system has no certainty of achieving a viable economic status. The Iowa DOT believes that there exists no rational logic to "experimenting" with a core system for eight more months while doubt, questions and apprehensions mount.

All of the above shows the need for a sound national transportation policy and legislation to allow a quick restructuring of railroad systems.

Congressional resolutions and "bail out" philosophies will only delay an inevitable restructuring process.

We need legislation to expedite, not delay, restructuring.

BASIS FOR IOWA POSITION

The Iowa DOT position is based on the following considerations:

1. Iowa has approximately \$2.7 million committed to various branch line assistance projects on Milwaukee lines.
2. Agriculture and industry have committed an additional \$1.4 million to the same track rehabilitation projects. Iowa shippers have also invested approximately a million dollars to rehabilitating rail cars.
3. In addition to the above financial commitments, various levels of government within the state are carrying over \$1 million of real estate taxes owed to them by the Milwaukee Road since 1977. Investments and taxes due total over \$9 million.
4. Implementation of the Trustee's proposal will have negative impacts on rail users, state and federal governments and others investing in assistance programs.
5. During 1977, over 107,000 rail car loads of grain (corn and soybeans) were originated in Iowa. Of this total the Milwaukee road originated almost 16,000 car loads (14.8 percent). Iowa corn and soybean originations accounted for 28 percent of the entire Milwaukee Road system's corn and soybean car loadings.
6. In addition to grain movements, Iowa imports considerable amounts of fertilizer. For example, 2.5 million tons were imported in 1977. (See Figure 1)
7. Iowa contributes heavily toward a favorable balance of payments. For example, Iowa's corn and soybean shipments amount to 10 percent of the total U.S. agricultural exports. This substantial contribution helps to offset the U.S. trade deficit created by foreign oil imports, since one-fourth of our foreign oil bill is made up by U.S. agricultural exports. (See Figure 2)
8. Much of the Milwaukee Road lines in Iowa are economically viable. For example, three separate carriers have expressed serious interest in the "North

Line" across Iowa, the line from Spencer to Des Moines, and the line from Cedar Rapids to Ottumwa.

FEDERAL LEGISLATION IN RAILROAD MATTERS

Legislation passed by Congress has begun to assist in the effort to revitalize the rail industry. The passage of the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) provided the necessary groundwork to improve the quality of rail service throughout the United States. In the statement of purpose in the 4R Act, Congress declared the following:

"It is the purpose of the Congress in this Act to provide the means to rehabilitate and maintain the physical facilities, improve the operations and structure, and restore the financial stability of the railway system of the United States, and to promote the revitalization of such railway system, so that this mode of transportation will remain viable in the private sector of the economy and will be able to provide energy-efficient, ecologically compatible transportation services with greater efficiency, effectiveness, and economy, through * * *. (2) the encouragement of efforts to restructure the system on a more economically justified basis, including planning authority in the Secretary of Transportation, an expedited procedure for determining whether merger and consolidation applications are in the public interest, and continuing reorganization authority * * *."

We must now work together to follow through with the intent and purpose of this legislation. While the groundwork has been laid, Congress should do whatever is necessary to speed up the process of restructuring and revitalizing the rail industry. Special procedures should be developed which will allow for an expeditious change-over and transition of service between rail carriers when faced with a massive discontinuance of service such as that proposed by the Milwaukee. Careful long-range planning must be utilized to avoid a "Conrail West". Subsidies could be acceptable only in the short-term to allow time to develop a sound rational long-term plan. The only long-term solution is a viable rail system within the private sector. This position has also been expressed by the Secretary of Transportation Adams and the Congress through the passage of the 4R Act and subsequent amendments.

IMPORTANCE OF STATE INPUT

States are in the most knowledgeable position to effectively weigh the many localized impacts involved with rail service. The sophisticated level of detail possessed by many states cannot be achieved unilaterally at the national level. Any national decisions based on aggregated data will be self-defeating when attempting to implement a restructuring plan on a state-by-state localized basis. For example, severe disruptions to individual communities may occur if only system-wide aggregation of statistics is employed in a national decision-making process. Consequently, it is necessary to allow states to express their viewpoints and provide effective input to the decision-making process.

RAIL PLANNING IN IOWA

Iowa has been directly involved in rail matters since 1974 when the Iowa Legislature appropriated \$3 million for branch line upgrading. Our unique Branch Line Assistance Program is a flexible, effective and workable program whereby the state, shippers, and rail carriers each provide approximately one-third of the cost for branch line upgrading work. Since 1974, contracts have been negotiated for the upgrading of 790 miles of branch lines at a total cost of \$28.9 million.

Since the implementation of our State Department of Transportation in 1975, the Iowa DOT has been actively involved in rail planning both at state and national levels. We assisted in directing the organization of the National Conference of State Railway Officials (NCSRO) in 1976 in order to provide a unified states' effort in rail planning, legislation and policy. The Iowa Rail Plan has received Federal Railroad Administration approval.

As part of our policy, the Iowa DOT supports a viable rail system which maximizes the benefits to the people of Iowa and yet reduces nonessential rail mileage which is a financial drain on the railroads. Our somewhat unique posture of supporting the abandonment of unnecessary or unprofitable rail lines is consistent with the U.S. DOT's position on rail rationalization.

In addition to our successful Branch Line Assistance Program, the Iowa DOT has worked toward improving rail services through the following innovative approaches: Iowa's consolidated rail/barge tariff, which ties rail/barge movements, under a single rate and a single bill of lading; a mini-train service available to shippers on the Milwaukee line traversing the northern part of Iowa; a fully certified Rail

Safety Program; and a track inspection vehicle which was the first in the nation to be owned and operated by a state. We have provided the railroads with our accumulated data which has assisted them in their maintenance programming efforts. In addition to the above-mentioned services and programs, the Iowa DOT has produced modal plans, transportation plans, special rail studies, including impacts of mergers, and is directing various consultant rail studies.

A number of our efforts are now in jeopardy due to the current Milwaukee situation. States must be afforded the time to assess alternatives and allowed to provide input toward solving the present Milwaukee problem.

CONCLUSIONS

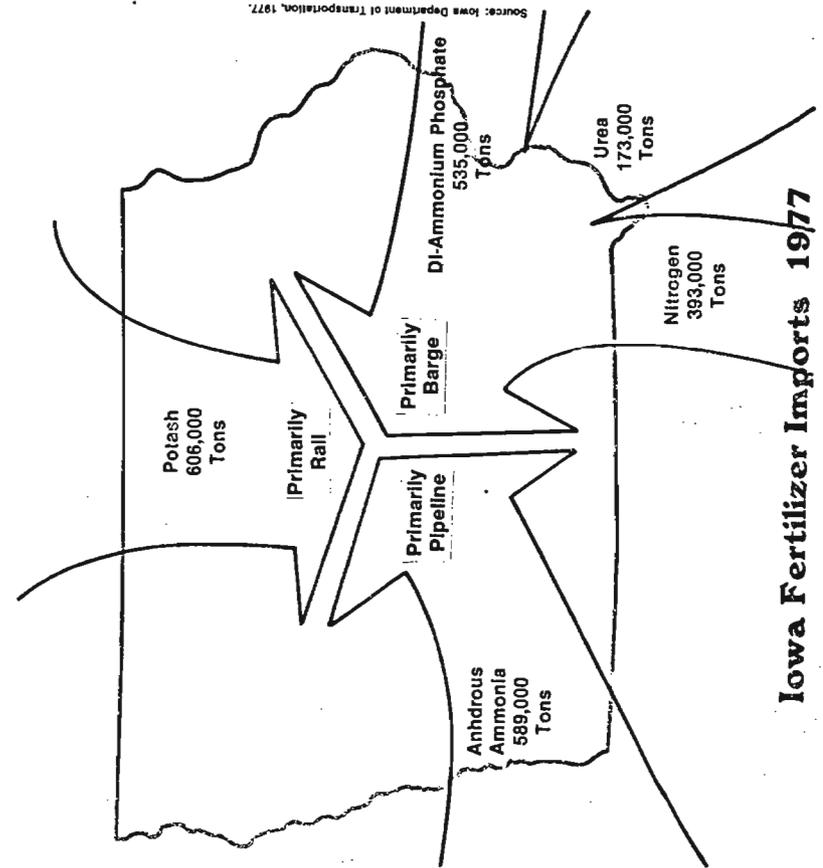
Iowa is concerned about the short-term decisions made in carrier selection and equipment allocation for directed service. These short-term decisions can restrict competition and impact long-term solutions. We must identify and investigate strategies in marketing, backhaul improvements, short line operation, and long-term future. For example, potential East Coast export markets could reduce overall transportation mileage to Europe and save energy. Active state participation in the planning and decision-making process is imperative.

In the Midwest, there are carriers operating financially marginal systems. In the restructuring process, there exists an environment in which to develop much needed efficiencies in the existing rail system. The federal loan programs under the 4R act must be available to all carriers that can identify potentially viable rail segments, allowing development of a profitable and efficient rail system.

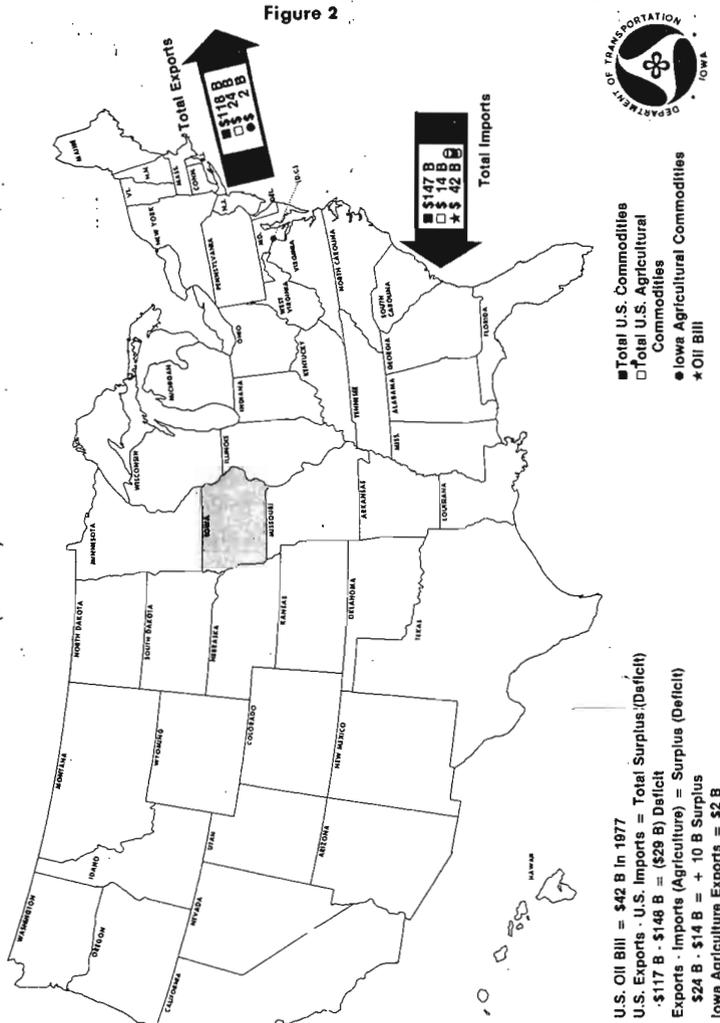
Iowa will continue its investigation and evaluation of solutions to our rail problems. Traditional concepts may not be effective in solving the present complex issues. Only through joint cooperation from federal, state, local and private groups can long-term solutions be identified, evaluated and implemented.

The Congress has provided the necessary tools to restructure the rail industry. But, due to the changing environment, we ask that Congress continue to closely monitor the progress and continue to provide the states with the opportunity to present testimony. We in the Iowa DOT sincerely appreciate the opportunity to testify before the Subcommittee on Surface Transportation. I would be happy to answer questions from the Subcommittee.

Figure 1



**ONE-FOURTH OF OUR OIL BILL MADE
UP BY U.S. AGRICULTURE
IOWA CONTRIBUTES 10% OF
TOTAL AGRICULTURAL EXPORTS**
(Billions)



Senator LONG. Thank you.

Mr. Seetin?

Mr. SEETIN. Mr. Chairman and members of the committee, I am Mark Seetin. I am the commissioner of agriculture for the State of Minnesota. I also am a farmer.

I am testifying on behalf of the State of Minnesota concerning the status of the Milwaukee Road embargo in Minnesota.

As you know, the Milwaukee Road petitioned the U.S. district court on April 23 to embargo service on over 7,000 miles of its system effective May 8, 1979, and asked the court for permission to borrow an additional \$15 million to pay current operating expenses. On May 4, 1979, the trustee asked the court to delay the pending embargo until May 31, 1979. Additional testimony was heard on this issue last week, with the court's decision expected this week.

The trustee's proposed embargo would have had a major disruptive effect on the economies of Minnesota and its western neighbors of North and South Dakota and Montana. The trustee proposed to cease operations on all rail lines in Minnesota except for its main line from Chicago to Minneapolis, to industrial sites in the Minneapolis area, and its main line west to Renville, Minn. It would also continue to operate over trackage rights to Duluth, Minn.

As has been pointed out by others, the Milwaukee's western main line services the Big Stone Power Plant located in eastern South Dakota. This facility is an important source of electricity for consumers in the States of North and South Dakota and Minnesota. Without service on the Milwaukee Road, the Big Stone facility would be unable to function since it is entirely dependent upon unit coal-train service from mines located in southwestern North Dakota.

In Minnesota alone, electricity to 43,000 customers would be jeopardized by supply interruptions to coal delivery. This line is also essential to allow rail users in Minnesota to move their products to the west coast making connection with the Burlington Northern at Miles City, Mont.

In addition to the embargoed service on its main line to Miles City, Mont. Milwaukee service would have been discontinued on an additional 628 miles of line within the State of Minnesota. Milwaukee's Minnesota lines traverse one of the most productive agricultural regions in the world. Indeed, according to the 1974 U. S. Farm Census, 48 of the top 100 counties in the Nation are located in this region. Approximately 82 percent of the State's gross farm income in 1978 was generated from producers in this area. Based on 1977-78 production estimates, this area accounts for 96 percent of the State's total corn production, 98 percent of its soybean production, 70 percent of the oat production, and 55 percent of the States' sunflower seed production. Approximately 75 percent of this total production is exported from the State to national and international markets. Of acute concern to the Minnesota Department of Agriculture was the proposed embargo on Milwaukee's line in southern Minnesota running from Rosemount to Ramsey and then west to Jackson. This line serves the "Bread Basket" of Minnesota.

Mr. Chairman, continued rail service is essential to this area to maintain the existing marketing system of onfarm storage, country elevators, subterminal type facilities—facilities with multiple-car loading capability—and terminal facilities. Within this marketing area, approximately 1 billion bushels of storage capacity exists. Approximately 220 million bushels of this capacity consists of country elevator and subterminal type storage facilities. The Milwaukee Road serves approximately 22 percent of this capacity. Of key significance is the location of the subterminal type facilities. Most of these are clustered in the southern three tiers of counties—the area of heaviest production of corn and soybeans. Approximately 70 to 75 percent of the commodities shipped from these facilities moves by rail directly to Gulf ports, Minneapolis/St. Paul for transfer to barge or processing, or to Duluth for shipment to international markets.

Milwaukee's Southern Minnesota Line is especially important in view of the rate of rail abandonment in this area. Eight railroad lines are proposed for abandonment or have been abandoned which abut or adjoin this line. In addition, 18 more lines are proposed for abandonment or have been abandoned in southern Minnesota in the last two years. Milwaukee's Southern Minnesota Line, however, stands as an exception to all parties concerned. Prior to the proposed embargo, the Milwaukee Road, State of Minnesota and shippers entered into an agreement and funded a rehabilitation program on the line from Alden west to Jackson. The fact that contracts have been signed among the State of Minnesota, shippers, and Milwaukee Road stands as testimony to the importance our producers and shippers place on maintaining and improving service on this critical line. Rail service is also essential to maintain a flow of input supplies such as fertilizer, agricultural chemicals and farm machinery. Long run needs also indicate that continued rail access to this area be maintained. Projected increases in crop production are clearly foreseen as well as the potential for coal-fired electrical generating sites requiring rail access.

Faced with the Milwaukee embargo, the alternatives of relying on other rail carriers and/or truck transportation to fill the void did not appear to be viable ones. Other existing rail carriers are not now able to fill current car orders to move grain out of Minnesota or other commodities in and have not been able to do so for some time. Faced with an expected shortfall in energy supplies, the shift of grain movement to less efficient truck transportation can only make matters worse. It requires 200 trucks to handle the volume of grain that one 50-car unit train is capable of moving. Our highway system could not handle such an additional burden, nor could our terminal facilities. Terminal capacity to unload trucks is overtaxed now with queues of up to 30 hours. The idling of trucks' engines an excessive amount of time so that the grain can be moved, which should have been moved by rail, is an unconscionable waste of dwindling petroleum reserves.

In Minnesota we face a 40-percent decrease in fuel inventories, compared to a year ago. My operation ran out of fuel on Saturday and was unable to locate additional diesel fuel. Truckers will be pulled off the road today because of shortages of diesel fuel. We face a real possibility within the week of farmers stopping tractors

in the field because of unavailability of diesel fuel. This is a problem that will stay with us. It's very important that we retain our most fuel efficient means of moving commodities.

Therefore, at the direction of Gov. Al Quie, the State of Minnesota has moved to join in cooperation with South Dakota, North Dakota, and Montana to maintain service on the Milwaukee's main line to Miles City, Mont., and has moved independently to maintain service on Milwaukee's southern Minnesota line. Through its Department of Transportation and Attorney General office, the State has made tentative arrangements with the trustee to retain these lines in its "core" system. These arrangements call for grants to the Trustee to maintain and rehabilitate these lines in exchange for continued service and the fulfillment of the existing rehabilitation contract.

Through its department of transportation, the State is cooperating with its western neighbors to retain the Miles City line utilizing Federal funds made available under the Local Rail Service Assistance Act of 1978—Public Law 95-607.

The State is utilizing funds from its rail service improvement program to retain service on the trustee's Southern Minnesota Line. Minnesota's Department of Transportation has also requested that the Interstate Commerce Commission direct service to all other lines in Minnesota which would not receive continued rail service by the Milwaukee. It is imperative to the State's economy that rail service be maintained with a minimum of interruption.

Mr. Chairman, these arrangements are of a short-run, stop-gap nature designed to continue rail service until the end of the year pending the Milwaukee's reorganization plan. Due to the complex interstate relationships and very heavy financial obligations, lasting solutions must be developed at the federal level so that this nation has a financially healthy railroad system. To that end we encourage this committee to continue to reevaluate the institutional structure of the Nation's rail lines. The "rules-of-the-road" need to be such that railroads have the flexibility to adjust their rate structures and size of plant and equipment to creatively and aggressively compete with other modes of transportation. The objective would be to have an intermodal transportation system whereby each mode is utilized over distances where each has a cost advantage. Such a system will benefit both consumers and producers, for they are the ones which ultimately pay for transportation services.

Mr. Chairman, this completes my statement. I would be happy to answer any questions you may have.

Senator LONG. Thank you very much. I am just going to ask each of you, as well as the members of the panel not here, to just prepare in writing and submit to the committee what additional contributions your states might be willing to make to a plan to continue the service of the Milwaukee in your State.

I won't ask you to respond to it here, but I would like you to provide that information in writing to us.

Do you have any questions?

Senator MAGNUSON. No, I have no questions, except I want to make an observation.

I sympathize with you people in the Midwest, your problem with the Milwaukee, but I hope you don't forget we have the same problems elsewhere and the same movement of grain, but it's going the other way, down to the seaports for import of grain. The situation in my State is practically the same as your situation. Therefore, I would think you people would agree with the ICC order of direct service for a short term period in order to see what we can do about the whole situation.

Mr. KASSEL. I would certainly agree with the directed service to buy the time we need, but it should be a relatively short time so we can proceed ahead.

Regardless of any additional commitments, our State will not make more financial commitments—

Senator LONG. Just give it to me in writing. It was clear from your statement what you have in mind. I am asking the panel to give me that.

Thank you very much.

Next is Mr. Fred Simpson.

Senator MAGNUSON. Mr. Simpson comes from my State. Welcome. We are glad to have you here.

STATEMENT OF FRED SIMPSON, PRESIDENT, SAVE OUR RAILROAD EMPLOYMENT, BAINBRIDGE ISLAND, WASH.; ACCOMPANIED BY BILL BRODSKY; AND JAMES WICKWIRE

Mr. SIMPSON. Thank you.

I have with me Mr. Bill Brodsky, formerly assistant vice president of planning for the Milwaukee Railroad in charge of business planning. He has been the individual who developed much of the data upon which my organization relies. Also with me is our attorney, Mr. James Wickwire of the Seattle law firm of Wickwire, Lewis, Goldmark & Schorr.

I am here on behalf of the association known as SORE, which is composed of approximately 600 Milwaukee employees in States of Washington, Idaho, Montana, North Dakota, and South Dakota.

I have submitted a prepared statement with attached affidavits.¹ If those might be incorporated in the record, I would limit my remarks today to three matters which I think have come up.

Viability of the western lines of the Milwaukee.

I would like to comment briefly on the Booz-Allen study the trustee offered as the only justification for his present action, and then comment briefly on the progress of the SORE proposal.

SORE has limited its activities to date to lines west of the Twin Cities due to the fact that the trustee's initial pronouncement in August was that under no circumstances would he include those lines when reorganizing the Milwaukee and he anticipated—

Senator MAGNUSON. A little louder, please.

Mr. SIMPSON. Better?

As I was saying, we limited our attention to the lines west of the Twin Cities. Consequently our data is all with regard to that area.

I don't want to imply by that that we feel the remainder of the system can't be reorganized. We just haven't concentrated on that portion of the system to date.

¹ Some of the submissions were not reproducible and are in the committee files.

The employees and myself personally are committed to a solution to Milwaukee's problems which results in a private, for profit corporation. We are not interested in grants or subsidies. Consequently, the first thing we undertook was a viability study.

We wanted to know if the revenues available would support the costs of the operation. This study was prepared from records kept by the company. Most of the work was done by Mr. Brodsky and myself working for the trustee with anticipation he would be interested in the material.

We never had an opportunity to present it, as it turned out.

The decision announced in August to abandon lines west of the Twin Cities is entirely contrary to the data we had generated.

What we found is that taking a very conservative approach, the revenue handled in 1977, adding to that the revenue that had been lost when time sensitive traffic had to use other modes due to the failure of the Milwaukee, and adding to that the revenue offered to the Milwaukee but not taken because equipment was not provided, plus 3 percent per year growth, shows—we took that for the revenue base and compared it with the cost of rehabilitating the lines from the Twin Cities to the west coast, the startup costs and working capital requirements of \$32 million plus \$20 million of losses incurred the first 2 years from the operation. We put in the necessary funds as a loan with 10 percent interest to be paid back.

What we found at the end of the fifth year, the company earns in the west \$16 million—

Senator LONG. Fifty years?

Mr. SIMPSON. Year five, end of the fifth year.

The proposal which was made available to the committee has pro forma income statements which show after the third year the company goes profitable and that by the 10th year the net profit after interest is \$42 million. Those are very conservative figures.

We have not added to that the tremendous growth the Port of Seattle is projecting and has experienced in the past. We have not added the coal traffic you heard testimony about. We haven't added to that the grain movements that witnesses testified about.

At the hearing in Chicago last week witnesses from the Port of Seattle and from GTA, the largest grain cooperative in Montana, a witness from the Western Energy Co., the second largest coal strip mine operator in the United States, all testified there was substantial additional traffic available to the Milwaukee. We haven't included that in our projections and still come out with a very positive situation.

This testimony was subject to cross-examination. There were no significant defects detected.

With regard to the Booz-Allen report, which is the justification for the trustee's work, we haven't had it very long, but it appears to be seriously flawed in at least two respects.

It starts out with the assumption the western lines are a drain on the Milwaukee. It goes from there to stating that the west coast extension was excluded from the core system after preliminary studies indicated this major segment was producing a negative contribution at 1977 traffic levels.

Mr. Brodsky testified as the manager of the budget for the company familiar with those figures for 1977 directly to the contrary and was not cross-examined on that on Friday.

Going from there to the market analysis, the conclusion is it should be noted from the preceding charts, the railroads and Milwaukee Road in particular didn't participate significantly in general market growth as represented by GNP and other indicators. Yet the following page shows the two principal competitors, the Burlington Northern with growth of 90 percent over 7 years, Union Pacific with growth of 40 percent over 7 years, and the real GNP during that period only grew by 25 percent.

To conclude from that there is no growth for western railroads is incredible. Not only is it inconsistent with their own facts, but there was a shipper survey which we were provided with a summary of to examine for a brief period and we could identify 22 shippers using Milwaukee lines west. Of these, 15 said there was significant additional traffic available to Milwaukee.

Milwaukee's own records don't support that conclusion.

There was prepared annual tonnage charts from 1920 up through the 1970's. Those showed on lines west—which is attached to my statement—between—

Senator LONG. What page were you quoting from on that statement?

Mr. SIMPSON. The statement in conclusion is IV-13.

Senator LONG. Thank you. Is this the chart you are looking at here?

Mr. SIMPSON. It is labeled exhibit IV-10.

Senator LONG. Just go over that again, if you would.

Mr. SIMPSON. On the preceding page you will find the conclusions I referred to. Then on the chart, if you take these indexes on the left, you will see the Burlington Northern increased to an index of 190, which would be a 90-percent increase over the 7 years.

The Union Pacific has grown by 40 percent over that same 7-year period.

You will see that the midwestern railroads, by contrast, where you have the short-haul problem, such as the Chicago-Rock Island at the bottom, dropped by about 30 percent. And you will see the Chicago Northwestern C. & W. only grew about 10 to 15 percent.

The real GNP is just above the point where the skew line is 25 percent.

Senator LONG. I have taken some of your time, so take a few more minutes to explain.

Mr. SIMPSON. Thank you. I did want to call your attention to this other chart in my testimony from the Milwaukee records. It shows the growth on the transcontinental line—107 percent between 1961 and 1973.

By contrast, the total system tonnage only grew by 42 percent.

Milwaukee had a similar experience in the west.

To conclude, I want to mention significant progress we have made in the last 2 weeks since the trustee's announcement. We had an opportunity to meet personally with Chairman O'Neal, an opportunity to meet personally with Secretary Adams, and he has assured us and, in fact, the Department of Transportation has begun an independent analysis of our proposal.

We have met with the Farmers Home Loan Administration, which has a substantial budget for branch line rehabilitation and has funded ESOP-type programs in the past. One of them in the past.

We met with the Economic Development Administration which had substantial experience and we are encouraged if we can get a short amount of time that the package can be put together and will be successful.

We have had excellent support from our employee members and are receiving very good responses from the organizations that represent them in labor matters.

Our employees believe in what they are talking about. They know the railroad. They know it can make money. We would like an opportunity to own it.

What we are asking is not for grants, not for subsidies. We just need the orderly legal process to be followed. We need 45 to 90 days. That is all we are asking for.

Senator LONG. Senator Magnuson?

Senator MAGNUSON. I am quite interested in your proposal. I am sure it will receive fair consideration here from the committee. But I guess from your testimony that you need to borrow some time; is that right?

Mr. SIMPSON. Yes, sir.

Senator MAGNUSON. The short-term program of the ICC might give us that.

Mr. SIMPSON. If the ERSA fund were made available.

Senator MAGNUSON. They should be made available, as I suggested, for the whole system and not just the core.

Mr. SIMPSON. I think the testimony here is that all the shippers have been caught by surprise as well as the employees. Two weeks isn't adequate to respond.

Senator MAGNUSON. Would SORE's proposal be hurt by directed service in segments?

Mr. SIMPSON. Yes, sir. That would have the effect of putting the competitors on the property. It is putting the fox in the chicken coop.

Senator MAGNUSON. I can see how that would happen.

I have no further questions. I think he presented an unusual and very definite proposal.

[The statement follows:]

STATEMENT OF J. FRED SIMPSON ON BEHALF OF THE ASSOCIATION TO SAVE OUR RAILROAD EMPLOYMENT

Mr. Chairman, distinguished members of the Subcommittee on Surface Transportation, my name is Fred Simpson. Bill Brodsky, James Wickwire of the Seattle law firm of Wickwire, Lewis, Goldmark & Schorr, and I are appearing today on behalf of the Association to Save Our Railroad Employment ("SORE"), an organization of present and former employees of the now bankrupt Milwaukee Railroad. Both Bill and I are former executives of the Milwaukee. Additional information concerning our background and experience appears in two affidavits filed by me in the Milwaukee Reorganization Proceedings in Federal District Court in Chicago, copies of which accompany this testimony. The Wickwire, Lewis law firm also represents the State of Montana in the reorganization proceedings although Mr. Wickwire is not today appearing on the State's behalf. Gentlemen, we are grateful for this opportunity to participate in your oversight hearings concerning the bankruptcy of the Milwaukee.

Mr. Chairman, you are to be congratulated for recognizing the critical importance to the nation and the western Northern Tier states in particular of the Milwaukee Road, the sixth largest rail system in the country. Although the recent proposal of the Milwaukee's Trustee in bankruptcy to "embargo" or terminate service on approximately 80% of that system, including all of the lines west of St. Paul, Minnesota,¹ has focused considerable public attention on the problem, your earlier and thorough interest in the bankrupt Milwaukee is greatly appreciated by the 600 members of SORE, the other 2,200 Milwaukee employees, thousands of shippers in western cities and towns and at least the states of Washington, Idaho, Montana and North and South Dakota, to whom continued operation of the Milwaukee is so desperately important.

Although we long have been certain and recent events have demonstrated that the Milwaukee's bankruptcy Trustee has been determined for virtually his entire 16-month tenure to abandon the Lines West, we will not take the Subcommittee's valuable time today in decrying the biased, destructive and callous attitude of the Trustee. The recent federal district court hearings on the Trustee's default abandonment recommendation, the record of which we will provide the Subcommittee once it becomes available, afforded ample opportunity for the affected states, their Congressional representatives and us to air our concerns about his closed-minded and harmful stewardship of this extremely valuable natural resource. Rather, our purpose here today is to reiterate for you the importance of retaining the Milwaukee as a functioning transcontinental rail system and to present at least one viable alternative to abandonment which clearly demonstrates that the Milwaukee's western lines can be reorganized into a competitive and ultimately profitable railroad.

In discussing the significance of the Milwaukee, it is also important to bear in mind that it provides the only rail service available or possible in substantial portions of the affected states. Furthermore, its abandonment would leave the Burlington Northern, its principal competitor, in essentially a monopoly position in the Northern Tier. The importance of competition in transportation should be abundantly clear in this area of impending rail deregulation. And, in any event, it is obvious that monopoly rail service would not be advantageous. In fact, the existence of a strong and competitive Milwaukee was the premise for the government's, and ultimately the Supreme Court's, approval of the merger which created the Burlington Northern. Had the Milwaukee than been in the precarious condition it is today, the Burlington Northern merger never would have been approved by the Interstate Commerce Commission or withstood Supreme Court review.

The western extension of the Milwaukee constitutes a great and possibly irreplaceable national asset which would cost on the order of \$4 billion dollars to rebuild once dismantled but which could be rehabilitated for less than \$200 million to provide the best line of railroad serving the Northern Tier and connecting the rapidly expanding north Pacific Coast and Columbia River ports with heartland population centers. The Milwaukee, completed in 1908, was the last railroad built west, and as consequence previously unavailable surveys were used for selecting a superior route through the mountain ranges in Montana, Idaho and Washington. The line constructed provided the shortest continental 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. The present condition of the Milwaukee track in the western states is deteriorated, due to two decades of perfunctory and half-hearted maintenance, but salvageable for a mere fraction of replacement cost. Generally, the rail is of heavy weight and in good condition, as are bridges and tunnels. The majority of rehabilitation work is limited to tie and ballast work, a relatively inexpensive undertaking.

Despite the existence of this resource, however tarnished and unrecognized, 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. In fact, what piecemeal work that has been done has tended to indicate that there would be additional traffic were adequate equipment available and service reliable. Even this limited work, which has relied on historical records reflecting the deteriorated condition of the railroad, demonstrates that actual demand for service far exceeded the Milwaukee's ability to provide it, whether through inadequate freight car supply, poor scheduling and marketing or unwillingness on the part of shippers to gamble on the Milwaukee's reliability. It is important to note, moreover, that of the six transcontinental lines,

¹Trustee Hillman's Apr. 23, 1979, announcement proposed embargo of the entire western lines, but following an unexplained interim shift to retain operations of the Kansas City line, has since dropped Kansas City and restored the St. Paul-Miles City, Mont., portion as part of a proposed mid-western core system not subject to the proposed embargo.

only the Milwaukee is in financial difficulty; the others are considered prosperous and successful railroads.

SORE's view that the Milwaukee's Lines West can be effectively reorganized is based on 1977 company traffic records and is therefore conservative given the abysmal quality of service then provided. SORE's conservative conclusion that reorganization is possible merely acknowledges but prudently does not rely upon reasonable expectations of new traffic. The Milwaukee's transcontinental line traverses nearly one-third of the nation's low-sulfur coal deposits, which are only now beginning to be tapped commercially. The national interest in exploiting this resource is clear given the darkening energy crisis and the dictates of the Clean Air Act. Larger quantities of Montana coal will be in demand if transportation is available.

The Milwaukee also serves exclusively a large portion of the grain producing regions of the Northern Tier, increased production from which can be expected for domestic and foreign consumption alike. And the Milwaukee provides critical service to the booming north Pacific Coast and Columbia River ports. These ports, lying a full day closer to the Orient than California ports and already exploiting just-normalized relations with the People's Republic of China, are concerned about their future growth because transcontinental rail capacity may be inadequate even if the Milwaukee survives. Many individual shippers have indicated a willingness to enter into long-term rail transportation contracts if the Milwaukee's transcontinental lines are rehabilitated. Additionally, relinquishment of U.S. control of the increasingly obsolete Panama Canal will tend to make transcontinental service transportation more attractive.

In fact, as we understand the Trustee's position before the Reorganization Court in Chicago, he acknowledges that even with existing traffic the western lines could probably be successfully reorganized on a profitable basis if sufficient capital is committed to rebuild the deteriorated track and equipment. The Trustee is simply not willing to undertake the risks associated with such a large capital program without the approval of the Milwaukee's creditors and shareholders. Because of the extremely conservative basis of the Trustee's traffic projections (i.e., 1977 data without any projection for future growth), we think his position and the underlying studies properly should be construed as support for our belief that the western lines can be reorganized as an independent and profitable railroad company.

The reason reorganization of the transcontinental line has not been considered by the management or the Trustee is fairly clear. As an article in the January 9, 1979, Wall Street Journal pointed out, Milwaukee shareholders would apparently realize a return on their investment in the range of 1600% if the entire railroad were liquidated. Holders of Milwaukee bonds similarly would be anxious for liquidation since interest rates on their rather long-term investments generally are below 5%. In recent speculative trading in Milwaukee stock indicates that new investors are banking on liquidation, a concept the Trustee has hardly discouraged.

Based on the results of a detailed viability study conducted during the last six months, a copy of which accompanies this testimony, SORE is confident that reorganization represents a financially viable alternative to abandonment of transcontinental service. Simply stated, the Milwaukee's western lines can be operated profitably by a properly-managed private company. A detailed presentation of the SORE plan has been submitted as an exhibit, but a summary discussion is warranted this afternoon.

A new company will be organized to acquire the assets of the Milwaukee west of St. Paul, including necessary cars, locomotives and supplies. The routes are shown on the system map and are listed at Appendix A, Page 1. The new company would also acquire the Milwaukee Land Company, a wholly-owned subsidiary of the railroad with extensive timber and approximately 150,000 acres of land in Washington, Idaho and Montana.

A. ACQUISITION OF ASSETS

The assets will be acquired in exchange for the agreement of the new company to assume a pro rata share of the Milwaukee's existing debt. This is essentially the same process as was followed in the case of the Chicago & Northwestern Railroad, which was acquired by its employees in 1971.

The new company would immediately resume payment of interest and principal on the bond and debenture debt assumed from the Milwaukee. Payments would continue in accordance with the terms of the various classes of bonds and debentures until maturity or earlier redemption. A non-cumulative 6% preferred stock would be issued to the balance of the unsecured creditors whose debt is assumed by the new company. Conservative projections show that dividends on that stock would be available as early as the fourth or fifth year of operation.

B. FUNDS FOR REHABILITATION AND WORKING CAPITAL

In addition to the physical properties, the new company will require cash. Cash requirements include, a loan of \$118 million to correct the effects of past deferred maintenance on the main line trackage, a loan of \$20.2 million to cover operating losses for the first two years, and equity capital of \$32.1 million to cover start-up costs and provide a fund of working capital.

This proposal limits its consideration to federal government loans and loan guarantees coupled with an employee Stock Ownership Plan. The proposal is cohesive and complete. There appears to be the possibility, as an alternative, of obtaining at least part of the necessary funding in the private sector. This could be done either through direct shipper investment in the debt or equity of the new company, or through loans based on long-term shipping contracts. Private participation would obviously reduce the requirements for federal loan guarantees or provide increased financial strength for the new company. SORE would endorse participation by the private sector but has not had an opportunity to develop such an alternative. On the other hand, whether or not such private investment is forthcoming, this proposal is a comprehensive and realistic alternative to the Trustee's plans to liquidate Lines West that can and should receive immediate consideration.

Present federal programs under the Rail Revitalization and Regulatory Reform Act of 1976 (the "4-R Act") and the Emergency Rail Services Act ("ERSA") are intended to provide sources of funding for rehabilitation and operating loss loans, of the type required. The necessary funds have already been appropriated and, based on present information, are available. There is some possibility that the regulations under which the programs are administered may need to be amended in order to make some of these funds available to the Milwaukee. This question is presently under review.

The 4-R rehabilitation loan payment would be deferred, pursuant to the terms of the statute, until the eleventh year of operations and would then continue through the thirtieth year.

The ERSA loan is scheduled in the plan for payment of interest only in years two and three and then for payment of principal and interest in the fourth through seventh year.

The \$32.1 million for working capital and start-up costs would come from the sale of the new company's stock to the employees through an Employee Stock Ownership Plan (or "ESOP").

C. EMPLOYEE STOCK OWNERSHIP PLAN

An ESOP is a program providing a means for employees to acquire an ownership interest in their company through the earnings of the company. Typically a loan is made to an ESOP Trust which uses the loan money to buy stock in the particular company. The company immediately receives the funds from the stock sale, and agrees to make regular payments to the trust sufficient to allow the trust to pay off the original loan. As the loan is paid off, the stock in the trust is assigned to the individual employees of the company, based on their period of service and rate of pay.

There have been notable successes with ESOP programs in situations involving financially distressed businesses as well as successful ones. The best known case of a financially distressed company purchased and revitalized by employees using an ESOP involved South Bend Lathe, Inc. An article from the August 16, 1976 Wall Street Journal describing how ESOP was applied in the South Bend situation is reprinted as Appendix B.

Under the SORE proposal, the federal government through the Economic Development Administration, or a similar agency, would guarantee a loan of \$32 million to an ESOP Trust which would, in turn, use the money to purchase all of the common stock of the new company. The new company would make annual tax deductible payments to the trust with which the trust would repay the loan. As the loan is repaid, the shares of stock would be credited to the accounts of individual employees. The ESOP loan would be repaid by company contributions over 15 years. If individual employees elected to purchase shares in addition to those purchased for them by the new company's annual payments, the loan would be paid at an earlier date.

A more detailed discussion of the SORE plan is attached.

The Milwaukee's western lines are of singular importance to the economic well-being of the states they serve as well as the nation generally. In just Washington, Idaho, Montana and North and South Dakota, the Milwaukee had in excess of 2,600 employees and a payroll of \$48.9 million in 1977. In addition to direct payroll, there are obviously many secondary jobs dependent upon Milwaukee employment. Hun-

dreds of small communities are totally dependent upon exclusive Milwaukee service. In Montana alone, there are 31 public warehouse and grain dealer facilities with a storage capacity of more than 4.3 million bushels which would be without rail service if the Milwaukee's lines are abandoned. In the west, where distances are vast and the commodities produced, such as grain, forest products and coal, heavy and bulky, railroads are the only economically practical means of shipment. In contrast, rail hauls tend to be relatively short in the midwest and east, where river and highway systems are highly developed and many commodities can move as economically and more expeditiously by truck or barge. The short-haul, congested and relatively high cost of eastern and mid-western railroads is easily and often supplanted by other modes. However, internodal competition hardly figures out west either as a viable alternative to rail service or as a rate limiting factor.

In addition to meeting a national responsibility to an entire region, rehabilitation of the Milwaukee serves notable national objectives as well. With the worsening energy crisis, it seems foolish at best to throw away a potentially viable rail system which consumes one-third the fuel which would be required by trucks. The movement of nationally significant quantities of forest products, wheat and other agricultural commodities would be imperiled. The development of vast reserves of extremely desirable low-sulfur coal would be retarded, if not precluded, and increasing valuable trade with the Pacific Rim may well be limited, negatively impacting our already bleak balance of trade. Furthermore, any action which results in reduced competition in a major transportation sector in any large region deserves very critical scrutiny.

Mr. Chairman, SORE believes that the interest you and your colleagues on this Subcommittee have shown in the Milwaukee has done much to focus public attention on the implications of abandonment of the transcontinental lines. Of course, we are grateful to you and other members of Congress who have recognized the importance of the bankruptcy proceedings.

As you are aware, Montana's Senator Melcher has successfully shepherded through the Senate legislation which calls for the Energy Secretary to conduct a rapid study of the coal producing potential of the area served by the Milwaukee with an eye toward demonstrating to the nation that it simply cannot afford to allow the Milwaukee to vanish as a functioning, independent transcontinental railroad. We also are encouraged and hope for the passage of Senate Resolution No. 69 calling for continued operation of the Milwaukee system for at least the next ninety days and federal support therefore in order to give Congress and the Trustee, assuming he would be so disposed, an opportunity to review rehabilitation alternatives such as the plan we presented to you today.

We ardently believe, Mr. Chairman, and we hope we have persuaded you that viable alternatives to abandonment exist. We remain extremely grateful to the Subcommittee for this opportunity to explain our proposal, about which we are increasingly enthusiastic. Given the opportunity, we are confident the Milwaukee not only can survive but can again become a successful transcontinental line. We intend to persist in presenting our proposal to the bankruptcy court, the Interstate Commerce Commission, appropriate federal administrative agencies and here in the Congress.

We are hopeful that the Milwaukee can be reorganized without additional federal legislation. However, should we find that during the next several weeks, that assistance necessary under either the Rail Revitalization and Regulatory Reform Act or the Emergency Rail Services Act may not be forthcoming, we would turn to you and our other friends in the Congress for help in clarifying what we feel was the clear legislative intent that these Acts reach situations like the bankruptcy of the Milwaukee. We ask only that you maintain your interest in the problem because we are confident that we can successfully appeal to you upon the merits of saving this great national transportation resource and clearly demonstrate that there is at least one viable plan for reconstituting the Milwaukee Road.

Again, thank you for your courtesy, Mr. Chairman.

Senator LONG. I will call you back when Mr. Snyder has testified, if I may. Perhaps I could interrogate the two of you at the same time.

If I may, I think I will call Mr. Snyder last—if I may, I will call Mr. Grutle.

STATEMENT OF R. O. M. GRUTLE, CONSULTANT TO THE PRESIDENT, OTTER TAIL POWER CO., FERGUS FALLS, MINN.

Mr. GRUTLE. Mr. Chairman and members of the committee, I would be surprised if you could pronounce my name. No one ever has. It's pronounced "Grut-le" up in northern Minnesota.

Senator MAGNUSON. What did you say about Norwegians?

Mr. GRUTLE. I have a summary of our testimony, but it's longer than the 10 minutes, so I will summarize the summary.

Senator LONG. All right, sir.

Mr. GRUTLE. The Big Stone plant has a capacity of 437 megawatts and that was mentioned. Its annual output is about 2.8 billion kilowatt hours.

Jointly owned by Otter Tail Power Co. 47½ percent, 20 percent owned by Montana-Dakota Utilities, 32½ percent by Northwestern Public Service. These three companies got together in the 1960's for the purpose of building a plant big enough to take advantage of the economies of scale not only in the plant but also in the ability to mine large quantities of coal and ship large quantities in unit train service. The location is a result of normal plant siting, available fuel, water, and load.

The tariff arrangements worked out with the Milwaukee Railroad were developed over a period of years, probably from the late 1960's to about 1975 when the plant started to operate. It included the possibility of a second unit in the late 1980's.

The plant burns about 2.8 million tons of coal per year and is shipped at the rate of 60,000 tons a week in six, 10,000-ton shipments. The shipments are made in plant-owned cars. The Knife River Coal Mining Co. has about 400 million tons of proven reserves in that mine. We expect this plant to use some 65 million to 75 million tons of that reserve.

Last year we used 2,860,000 tons and paid Milwaukee \$7,600,000 in freight. So we as well are vitally concerned with the continued service of the mainline.

The direct impact of shutting down the mainline between Gascoyne, North Dakota and Big Stone, South Dakota would be shutting off of fuel supply and therefore, shutting down the powerplant.

The first effect is that 62 full-time employees of the plant with an annual payroll of in excess \$1,600,000 would be terminated. We also pay \$2,100,000 in taxes to the various taxing entities in South Dakota, and the amount of \$2,100,000 for severance tax on the lignite coming from North Dakota. The coal mine has another 85 employees with a payroll in excess of \$1,500,000. All these jobs would be lost.

The original investment in the plant was \$169 million. Its depreciated value today is about \$150 million. If we assume that the plant is shut down and that investment is written off in the 8 years it requires to replace it, the 266,000 customers of these utilities would pay an additional \$15 million just to cover the amortization in the first year.

In addition, we would have to purchase the power these people require, our customers. While that looks possible next year, it would cost about \$32,500,000 more than if it had been generated by this plant.

The sum total of that is a 35 percent rate increase on the average for all our customers. There is no alternative way of delivering fuel. People talk about shipping by truck. The Highway Department of South Dakota made an analysis of that and their conclusion was it would require 358 loaded trucks and 358 empty trucks every day, 7 days a week.

My calculation says that would take about 22 million gallons of fuel oil. The railroad is probably using less than 2,500,000 gallons to haul the same amount of coal. I need say no more at this point in history.

We talk about slurry pipelines. There is no water anywhere in the vicinity of the mine. It's not practical. There are still technical questions as to whether you can slurry lignite. There are no other railroads within reasonable distances, and to reach such other railroads as do exist would require us to ship substantial distances by truck and there aren't any highways that would handle this kind of traffic. It has been suggested that perhaps we ought to buy the railroad. These three companies are already faced with doubling their capitalization in the next 5 years and finding more capital funds for this purpose looks very difficult.

The original investment in the mine of \$14,500,000 would also be wiped out. Worse than that, the large reserves of lignite coal that could not now be marketed.

It leads us to one conclusion. It's absolutely necessary that the Milwaukee railroad stay in service so we can continue to serve our area and preserve the economic wellbeing of that area.

There are many small businesses that are dependent on reasonable power costs—being a power man, I would say that first.

Second of course, economic transportation in the form of rail service is essential to all these agricultural-based industries.

I thank you for the opportunity to summarize my summary.

Senator LONG. Let me ask you this. I heard your statement, but if we could work out a plan where the workers and the shippers would be asked to put something into it, providing the Federal Government would put up most of the money to put this railroad back into efficient operation, would your company be willing to make a contribution?

I'm talking about putting something into it if it looked like a good business investment.

Mr. GRUTLE. I assumed that is what you meant.

Senator LONG. I wouldn't ask if I thought it was good money after bad.

Mr. GRUTLE. I have difficulty answering because I have to answer to four public service commissions first. One in Montana, North Dakota, South Dakota and Minnesota.

Frankly, I would have difficulty convincing myself that we could get the same answer from all four. Let me go one step further.

They, I am sure, would rightly point out, why should we allow you to charge your customers for this investment which is going to help a great many other customers of other services over whom we have no control?

I think they would turn us down.

Senator LONG. Thank you very much.

[The statement follows.]

SUMMARY OF TESTIMONY OF THE BIG STONE PARTNERS: MONTANA-DAKOTA UTILITIES CO., NORTHWESTERN PUBLIC SERVICE CO., OTTER TAIL POWER CO., AND KNIFE RIVER COAL MINING CO.

(Submitted by R. O. M. Grutle, Consultant to the President, Otter Tail Power Co.)

SUMMARY

The Big Stone Power Plant has a capacity of 437 MW and went into commercial operation in 1975. Its annual output approaches 2.8 billion kilowatt-hours per year. It is jointly owned, 47 1/2 percent by Otter Tail Power Company with headquarters in Fergus Falls, Minnesota; 20 percent by Montana-Dakota Utilities Co. headquartered in Bismarck, North Dakota; and 32 1/2 percent by Northwestern Public Service Co. headquartered in Huron, South Dakota. The combined companies provide electrical service in the area shown by Exhibit I. Otter Tail Power Company acted as agent for the owners during construction and now acts as the operating agent. The concept of the Big Stone Plant—size, etc.—evolved in the late 60's and early 70's. A joint effort was developed to allow the owners to build a station large enough to take advantage of the economies of scale, the economies that go with mining large quantities of coal and the economies associated with the use of unit trains for the movement of that coal to the power station. It was larger than any other North Dakota lignite-fired unit at that time.

The location, near Milbank, South Dakota, was the most advantageous to the needs of the three companies from the point of available fuel, water, and proximity to the load needed to be served by this plant. Tariff developments with the Milwaukee Railroad (the development of the rate)—the full requirements for this service, and all of the matters relating to it, which went into an ICC-approved tariff, were developed over a period of years, starting in late 1960's and continuing right through to the initial coal movement in early 1975. Those discussions, held with various officers of the Milwaukee Railroad, our consultant in these matters (Bechtel Power Corporation of San Francisco), and the owners were always on the most amiable basis.

Many meetings were held so that each of us would fully understand the requirements that must be met in order for this to be a successful tariff, from the point of view of the shipper, the receiver, and the railroad. We all felt that these things were accomplished. All matters were discussed that had any relationship to the tariff, and at no time were there any doubts created in our minds by anything presented to us by representatives of the railroad as to their ability to provide this service. The years of economic life that were to be expected from such a power plant were freely discussed, as was the strong possibility of the development of a second unit in the late 80's or early 90's. Our relationships and discussions were completely open.

The plant requires 2.7 million tons per year, or about 60,000 tons per week of lignite. It is supplied by Knife River Coal Mining Company from their Gascoyne Mine in southwestern North Dakota. Knife River has committed to supply the Big Stone partners with 55,000,000 tons of coal during the first 20 years of plant life. Last year the mine shipped 2,862,893 tons to Big Stone on which freight in the amount of \$7,615,287 was paid. Reserves of Knife River in the mine area are approximately 400,000,000 tons and the only means of transportation for this vast coal reserve is the Milwaukee Railroad. It is moved to the power plant through the use of two unit trains, resulting in six deliveries per week of 10,000 tons each. The 232 cars that make up the unit trains are owned by the power plant and were designed especially for this movement.

For this reason, the Big Stone partners and Knife River are vitally concerned with the possible discontinuance of Milwaukee Railroad service west of Minneapolis, or more specifically, between the South Dakota-Minnesota border and the North Dakota-Montana border. (See Exhibit II)

The direct impact of such a development would be the shutting off of fuel supply to the Big Stone Plant, which means that generation would terminate. This would result in many subsequent impacts.

The power plant has 62 full-time employees, with varying part-time numbers, plus contractors—particularly during the overhaul period. It is staffed by members of the International Brotherhood of Electrical Workers. The 1979 payroll will be approximately \$1,600,000. In addition, the plant pays \$2,100,000 in taxes to the various taxing entities in South Dakota, plus \$2,100,000 in severance taxes to the State of North Dakota. The coal mine employs an average of 85 people with an annual

payroll in excess of \$1,500,000. In the event of shutdown, these jobs and tax revenues would be lost.

The total investment in the plant was approximately \$169 million, the largest single private investment ever made in South Dakota. This includes the plant, its substation, the transmission lines, circulating water, cooling water systems, and the spare parts, etc. The amortization life varies among the three owners, but is on the order of thirty years. The unamortized investment balance December 31, 1978, was approximately \$150,000,000. If the owners had to recover this investment during the next eight years (the time necessary to build a replacement unit) instead of over the normal life of the plant, the extra cost to the 266,000 customers of the three owners would be \$15,250,000 in the first year of shutdown.

In addition, the utilities involved must still provide energy to their customers in spite of the loss of Big Stone. If this could be done and there are serious questions if it, in fact, can, the cost of purchased power would cause additional expense to the customer. It is estimated this additional cost would be \$32,700,000 in the first year alone. Therefore, the total effect on the customers of the three utilities would be an average increase in electric rates of 35 percent or \$158/customer in the first year.

Several alternative means of delivery of fuel have been mentioned. One is trucking. Attached is a report from the South Dakota Department of Transportation addressing that proposal. (See Exhibit III)

One point made in this exhibit is 358 loaded trucks would be required each day and, of course, 358 empties returning to the mine. In view of our national oil problems, we then must recognize this truck haul as most wasteful of oil resources. Trucking would require approximately 22,000,000 gallons of fuel oil annually, as opposed to 2,250,000 gallons of fuel oil if railroad movement is used, or a savings of nearly 90 percent to use the railroad.

Another is slurry pipelining. This requires a great deal of water—water that is not available in the area of the mine. It would have to be brought in from the Garrison or Oahe Reservoir. There are technical problems associated with the pipeline hauling of lignite. There is some question about the quantity of lignite that would go into colloidal suspension that would be impossible to remove from the water. Therefore, some of the fuel would be lost—but perhaps worse than that, the usefulness of the water would essentially be over.

One could look at the possibility of transporting coal via some branch of the Burlington Northern—the nearest one to the mine is at Mott, North Dakota. The Burlington Northern indicates that cars of even 60-ton to 70-ton capacity could not be moved over that line without complete rebuilding from the western end back toward Mandan. We still could not deliver to the plant without going over other branch lines that are in equally deplorable condition. Further, the highways between Gascoyne and Mott, North Dakota, are certainly not of the type that could handle heavy coal-hauling traffic.

The only other fuel possibility is oil, and that is contrary to national policy and probably not available.

It has been suggested that the partners purchase the Milwaukee Railroad. Cost estimates for the purchase of the trackage between Big Stone and Gascoyne, upgrading it, and necessary locomotives is \$65,000,000. The partners would be hard pressed to finance this acquisition as each is already projecting that they must nearly double their capitalization during the next five years. Attracting this amount of capital will be difficult enough without trying to acquire the additional capital needed to purchase a railroad.

The original investment in the mine was \$14,500,000. This would be lost to Knife River if transportation is no longer available for coal. But the real loss is the loss of the lignite coal to the nation. The abandonment of the Milwaukee will leave an area containing large reserves of lignite coal without rail service.

All this leads us to but one conclusion—the services of the mainline of the Milwaukee Railroad are absolutely necessary to the continued operation of the Big Stone Plant and the movement of the nation's lignite coal. Continued operation of the Big Stone Plant is essential to the economic well-being of the area it serves, and transportation of the coal is essential if it is to help meet the energy crisis.

EXHIBIT III.—AN ANALYSIS OF THE ADDED COST OF MAINTENANCE AND CONSTRUCTION IF THE COAL TO SUPPLY THE BIG STONE POWERPLANT WERE HAULED FROM GASCOYNE, N. DAK. OVER U.S. 12

(Prepared by the South Dakota Department of Transportation, Division of Policy Development and Evaluation, Office of Transportation Planning)

INTRODUCTION

This is an analysis of the added costs of maintenance and construction that would be made necessary to allow U.S. 12 to continue to serve if the coal to supply the Big Stone Power Plant were hauled from Gascoyne, North Dakota to the plant over U.S. 12. The cost of added maintenance and construction for the first five years of operation under coal traffic is discussed in the text of this analysis. In addition, the estimated cost of the year 2000 is shown in the appendices.

U.S. 12 is a principal arterial highway, primarily two-lane, that extends 316.5 miles through the northern tiers of counties. This highway follows in close proximity to the Milwaukee Railroad for its entire length through South Dakota from west of Lemmon to the Minnesota state line at Big Stone City. In serving this corridor, U.S. 12 is routed through the commercial districts of several cities. In the two larger cities, including the third largest city in South Dakota, there are signalized intersections which effects traffic flow and capacity.

ANALYSIS

The status of needed improvements and required maintenance along U.S. 12 is similar to those for other federal-aid primary highways. With all highways competing for highway revenues that are continually diminishing in purchasing power, a large portion of the needs will not be addressed in a timely fashion. The present backlog needs on South Dakota's primary system is \$76,000,000 and the backlog on U.S. 12 is \$3,400,000. There will be approximately \$28,000,000 available to improve the primary system in Fiscal Year 1980. U.S. 12 is 316.5 miles in length or 4.83 percent of that system so it might reasonably be expected to receive \$1,350,000 per year to correct deficiencies.

If the Milwaukee railroad discontinues service on the line adjacent to U.S. 12, it is reasonable to believe that the cargo hauled by rail will shift to the most direct highway facility. This would include the 3,000,000 tons of coal that is transported annually from the coal mines in North Dakota to the power plant at Big Stone City.

It requires 6 unit trains of 100 rail cars hauling 100 tons each to supply the Big Stone Power Plant for one week. This is equivalent to 125,000 truck loads each year or 358 loaded trucks and 358 empty trucks each day, assuming each loaded truck carries 48,000 pounds.

In South Dakota U.S. 12 passes through the communities of Lemmon, Morristown, Watauga, McIntosh, McLaughlin, Mobridge, Glenham, Selby, Bowdle, Roscoe, Ipswich, Aberdeen, Groton, Andover, Bristol, Webster, Waubay, Ortle, Summit, Milbank, and Big Stone City. This cost analysis provides for construction of a bypass around Aberdeen but does not address the impact on the other communities.

If coal were to be hauled by truck to Big Stone to supply the power plant it will take the equivalent of 1 loaded truck and 1 empty truck passing every point on U.S. 12 every 4 minutes. This assumes the hauling would be spread over 50 weeks of the year hauling 24 hours every day, 7 days of the weeks. If the trucking were not spread evenly, the frequency of trucks would increase during those hours of concentrated hauling.

Adding truck traffic of this frequency can be expected to have an impact on the parks, schools, churches and homes along the route. There will also be economic impacts on the communities. Motorists will be deterred from travel on U.S. 12 if they are aware of the frequency of the large trucks that would be on the route. No attempt has been made in this analysis to measure these social, environmental or economic impacts.

Safety could also be impacted by this frequency of heavy trucks. Even after making the first five years of improvements indicated in the analysis as necessary to accommodate the coal traffic, 58 miles would have a shoulder of 3 foot or less. Another 58 miles would have a shoulder of 6 foot or less. Thirty-seven percent of the route would have a shoulder of 6 foot or less. It takes a 10-foot shoulder to provide a relatively safe place to park a heavy truck. The shoulders along much of this route would be inadequate for a distressed motorist to use for parking. Whenever a vehicle was forced to park on the narrow shoulders a hazard would be created. The frequency alone of this truck traffic would be hazardous. No attempt has been made in this analysis to assess the impact on safety.

It would be extremely difficult to construct the improvements indicated in this report as needed during the first 5 years of coal hauling while carrying the traffic. No attempt has been made in this analysis to determine how to accomplish the improvements while carrying traffic nor to assess the added costs this might create over the cost of making the improvements under normal traffic.

If the coal traffic is diverted to U.S. 12, it will be carrying more truck traffic than Interstate 90 presently carries between Rapid City and Mitchell. The 1976 average daily truck traffic between Rapid City and Mitchell ranged from 355 south of Quinn to 735 just east of Rapid City. The average daily coal truck traffic would be 716. There is an existing truck traffic on U.S. 12 from 100 to 410. The impact of the increased loading on U.S. 12 would be similar but greater than the impact on S.D. 73 and U.S. 14 when I-90 traffic was diverted to these routes during 1973 and 1974. The resulting damage to the highway surfaces and the increased maintenance costs are documented in a report entitled "Evaluation of Structural Design of Existing Pavements Under Accelerated Heavy Loads." A copy of charts 17 and 18 of the report are attached as Appendix "A".

Charts 17 and 18 of the S.D. 73-U.S. 14 analysis report indicate the maintenance cost on the 29.293 miles of U.S. 14 rose from \$1,200 per mile per year to \$2,100 per mile per year under interstate traffic. The 14,775 miles of S.D. 73 rose from \$800 per mile per year to \$4,700 per mile per year of \$1,906 while under Interstate 90 traffic.

The maintenance costs, as shown, in the report "Evaluation of Structural Design of Existing Pavements Under Accelerated Heavy Loads" appear to have been calculated without considering inflation. The highway construction cost index for 1956 to 1972 averaged 88.34, for 1963 to 1972 averaged 97.09, for 1973 and 1974 averaged 149.70, and for 1978 averaged 223.2. Using these indexes to adjust for inflation, the added maintenance cost for U.S. 14 in 1973-74 dollars is \$250 and for S.D. 73 in 1974-74 dollars is \$3,345. The weighted average indicates an increased cost of \$1,288 per mile per year. In 1978 dollars, these figures become \$373, \$4,987, and \$1,920, respectively.

Some sections of U.S. 12 are currently in weaker condition than either U.S. 14 and S.D. 73 were in 1973 when the interstate traffic was diverted to them. For example, the stretches of U.S. 12 from Lemmon to Thunderhawk and from Watauga to McIntosh are much weaker. On the other hand, U.S. 12 west of Webster is now under contract for new surfacing and should be at or near a strength of 4.0. While the range of conditions on U.S. 12 are broader than those encountered on U.S. 14-S.D. 73, we feel the increased maintenance costs experienced on U.S. 14-S.D. 73 would be indicative of what might be expected on U.S. 12 under the coal traffic loading. Based on this assumption, added maintenance costs have been calculated and are contained in Appendix "A".

In addition to the increased cost of maintenance, the surface of the road was in much poorer condition after the I-90 traffic than it had been before. Before I-90 traffic diversion, it was serving the light traffic loads at relatively low maintenance costs and showed little cracking or distress. The report states that after the traffic returned to I-90, "The surfacing over the entire 44 miles of detour is now showing weakness in the form of rutting and incipient alligatoring." It will require a minimum of ½ inch laid seal in the town of Philip and up to 3-½ inches of overlay mat in other areas to carry the anticipated traffic. The impact of the I-90 traffic on S.D. 73 and U.S. 14 was to increase the maintenance cost and to greatly shorten the life of the surfacing so that overlays were needed much sooner than would normally have been needed. For the purpose of this analysis, we are assuming that the remaining life of the surfaces on U.S. 12 will be shortened by ⅓. The experience on U.S. 14 and S.D. 73 when I-90 traffic was diverted to it would indicate this is very conservative.

A detailed study of U.S. 12 has been made and is contained herein as Appendix "B". This report indicates the needs on U.S. 12 under current traffic. By shortening the remaining pavement lives shown in this report by ⅓, the anticipated date of need for an overlay or for reconstruction has been determined.

The depth of surfacing to be placed was based on that depth necessary to bring the average strength up to 4.0. Current design standards to meet today's truck loading creates a strength equivalent to 4.0. The average of tests on I-29 for the six projects north of mile post 158 test an average strength of 4.0. Several of the more recent projects on the primary system also test at or near 4.0. Some of these are the highway U.S. 18 bypass of Hot Springs, S.D. 44 west of Parker, U.S. 83 south of Mission, U.S. 212 west of Belle Fourche, and U.S. 212 from the Minnesota line west, (average 3.99).

¹ Cracks in the asphalt surface forming a pattern similar to alligator skin.

To determine the depth of overlay material needed to increase the strength to 4.0, a curve developed by the physical research program was used. A copy of this curve is shown in Appendix "C".

Where the needed depth of surfacing could be placed and a 24-foot roadway retained, the resurfacing costs were used. Where it would be necessary to narrow the surface to less than 24-foot to place sufficient surfacing, the cost of reconstruction was used. This again is very conservative since a 24-foot highway surface with no shoulders is a very minimal design for this traffic load.

Based on the detailed analysis of U.S. 12 contained in appendix "B" and the accelerated need for resurfacing or rebuilding caused by the added loading of coal traffic, and added construction cost have been calculated and are contained in Appendix "C". This calculation in Appendix "C" ignores the bridge problem.

The deterioration of bridges which is already a serious problem will be accelerated under coal traffic. The Bridge Program of the South Dakota Department of Transportation has estimated this added cost. Their estimate is contained in Appendix "D".

The cost of replacement of structures over the Milwaukee railroad was not part of the Bridge Program's estimate since the replacement of these structures if no railroads exist would not be logical. Instead, we have estimated the cost of removal of the structure and regarding and resurfacing the road. The cost of these replacements is based on the cost of a similar replacement of U.S. 77 at Altamont, South Dakota in 1966. Appendix "D" also contains this calculation.

The City of Aberdeen presents a serious problem if we are to attempt to add 716 trucks per day to the present traffic. There are currently 12 traffic lights on U.S. 12 in Aberdeen. The proposed developments in the airport area indicate the necessity of more traffic light installations in the near future. Current traffic counts range up to an average ADT of 26,164. It, therefore, seems probable the addition of this amount of added truck traffic in addition to the anticipated increases from developments already proposed would necessitate a bypass around the southern edge of Aberdeen. The cost of that bypass is estimated in Appendix "B".

CONCLUSION

The added costs of keeping U.S. 12 in service under coal traffic for the first 5 years in millions of dollars would be as follows:

	<i>Millions</i>
Added maintenance costs.....	\$3,749
Added resurfacing and rebuilding costs.....	37,578
Added bridge maintenance and replacement costs.....	24,658
Cost of removal of bridges over railroad.....	2,490
Cost of Aberdeen bypass.....	11,487
Total added costs.....	79,962

Normal traffic for roadway and bridge maintenance indicates a need for 20.209 million dollars and we can expect a need for an added 79.962 million dollars of work if the coal traffic is added for a total of 100.171 million dollars. U.S. 12 can be expected to receive $1.350 \times 5 = 6.75$ million dollars under present financing if available funds were allocated to the entire primary system on a per mile distribution formula.

It therefore, seems obvious that unless accompanied by a massive infusion of funds toward reconstruction and maintenance of U.S. 12, the diversion of the coal traffic to U.S. 12 would result in a total deterioration of portions of that route. Even with a massive infusion of funds, serious problems would remain. Construction of improvements under traffic would be difficult to accomplish. There would be serious social, economic, and environmental impacts on the communities along the route. The safety of motorists using the route would be negatively impacted.

Before any serious consideration is given towards the diversion of the freight traffic from the Milwaukee Railroad to U.S. 12, more study and commitment of resources are necessary. Unless there is detailed planning and the commitment of substantial resources to the mitigation of the problems, this diversion of traffic would create a calamitous situation.

STATEMENT OF JOHN MACFARLANE, VICE PRESIDENT, PLANNING AND CONTROL,
OTTER TAIL POWER CO.

Otter Tail Power Company is an investor-owned electric utility serving 115,000 customers in northeastern South Dakota, middle and eastern North Dakota and western Minnesota (refer to Attached Map). The company's total generating capac-

ity in 1979 will be 489 MW. All 376 MW of base load capacity—Big Stone, 208 MW, Hoot Lake, 148 MW and Ortonville, 21 MW—are fueled with North Dakota lignite. The remaining 113 MW of generation are used for peaking and include various diesels, three combustion turbines, and four MW of hydro.

Base load generating facilities provide the lowest cost energy, and are used the maximum time for providing the system's energy requirements. According to the 1979 forecast of Otter Tail's energy requirements, the Big Stone unit will provide 56 percent of the system's energy. This unit is the largest, most efficient, and produces the lowest cost energy on the Otter Tail System. The Big Stone unit is also the most recent addition—it went into commercial service in 1975. The last prior base load addition was the Hoot Lake No. 3 Unit, which went into commercial service in 1964.

The Ortonville unit, which provides 21 MW of base load capacity to the Otter Tail System, was placed in service in 1950. In 1975, equipment was added so the unit met all new environmental regulations. The use of coal supplied by unit train to Big Stone, lowered operating costs to the point that it was economically justified to increase the life of the Ortonville unit. The Milwaukee Railroad presently hauls lignite from the Knife River Mine near Gascogne, North Dakota to Big Stone. Fuel for the Ortonville Plant is trucked three miles from Big Stone to Ortonville. The proposed abandonment by the Milwaukee Railroad of lines in South Dakota would result in loss of fuel to these two units. This would cause a reduction in Otter Tail's base load generating capacity of 60 percent. There is no other way to transport coal to Big Stone other than the Milwaukee Railroad.

Otter Tail's system peak demand has historically occurred in the winter months and has grown at an annual rate of 7.9 percent for the years 1963 through 1977. Current forecasts of annual peak demand for the period 1980-1987 indicate growth at a rate of 5.2 percent annually. This reduction in growth results from the company's estimates of the effectiveness of its load management programs and conservation. Although load management is proposed to reduce the system peak demand growth rate it will result in an improved system load factor which will increase the need for dependable base load generating facilities.

Presently, Otter Tail is involved in construction of the Coyote Generating Station near Beulah, North Dakota. Coyote is essentially a duplicate of Big Stone. Otter Tail will own 35 percent or 144 MW of the facility scheduled for 1981 operation. This will only cover deficits in base load capacity until 1982 and could not cover capacity lost if Big Stone and Ortonville are forced out of service. Beyond 1981 studies indicate a need for 150 MW of base load capacity by 1986-87. Initially, there appeared to be opportunities for Otter Tail to share in joint facilities in Minnesota to provide the 150 MW. In the last year these alternatives have been delayed or canceled by the constructing utility because of new load forecasts, site application cancellation and regulatory delays. Currently, the most likely addition for 1986-87 would be by construction of a base load facility at either the Big Stone or Coyote sites. The loss of coal supply to the Big Stone site eliminates one of the two existing sites that Otter Tail and partners could use for a future 400 MW unit. The replacement of Big Stone capacity would have to be at the Coyote site and at three times the cost of the existing unit. This would necessitate development of a new site for the planned 150 MW addition and result in even more uncertainties for supplying the future base load generating requirements.

Replacement of the capacity and energy needed should Big Stone and Ortonville be lost would be through purchases from members of the Mid-Continent Area Power Pool (MAPP). Every effort would be made to replace the loss with base load surpluses. This could be accommodated through MAPP, should sufficient surpluses exist. Currently, estimates of available base load capacity surpluses for sale in the Pool indicate sufficient amounting to replace Otter Tail's output from the Big Stone and Ortonville units through 1983. Surpluses after 1983 available through the Pool would not provide the needed replacement capacity.

Otter Tail Power has interconnections with Manitoba Hydro, who currently is indicating surpluses through 1984. (Manitoba Hydro provides electrical service to the Canadian province of Manitoba.) There are limitations to Otter Tail's use of Manitoba Hydro's surpluses, however: 1) Otter Tail does not have sufficient transmission interconnection capacity with the Manitoba Hydro system for energy interchanges equaling the Big Stone and Ortonville capacity. In order to accommodate schedules of 200 MWs, Otter Tail would have to build new transmission facilities to increase the interchange capacity with the Manitoba Hydro system. It is estimated that these facilities could be in service no sooner than 1983. 2) The major portion of Manitoba Hydro's generating capacity is made up of hydro facilities. In an offer of sale of their surpluses, Manitoba Hydro restricts use of the sale to a 50 percent capacity factor. Otter Tail makes use of the Big Stone capacity at an 80 percent

capacity factor. Thus, some arrangements would have to be made to supply a significant deficit in energy or increase the capacity purchased from Manitoba Hydro in order to provide the required energy replacement.

Note must be taken that surpluses reported through the Pool and by Manitoba Hydro are based on current load forecasts. Also these surpluses are dependent on new generating facilities going into service according to their proposed schedule. Probabilities of units going into service as scheduled and accuracy of forecasts of future loads raise definite uncertainties of replacing existing capacity with these proposed surpluses. Ultimate replacement of the Big Stone unit as mentioned would require new construction.

Another question we must address is continuity of service. As indicated Otter Tail would likely be able to purchase sufficient energy to supply customer needs. However, the loss of a strategic unit like Big Stone would cause considerable reliability problems. Utility systems are designed and built to provide service in spite of the loss of a major unit or transmission line. However, the systems cannot be certain of providing service should a second contingency occur—loss of another major transmission line or generation. Despite the best efforts of Otter Tail and all MAPP members, there will be outages.

Provided replacement capacity and energy can be purchased and transmission is available, loss of the Big Stone and Ortonville facilities would still result in greatly increased rates for OTP's customers. Those increased rates, in addition to causing hardship for the direct customers of OTP, would have a negative impact on the economy of the entire service area of OTP.

The greatest increase in cost, and thus rates would be caused by the need to purchase capacity and energy to replace OPT's output from the Big Stone and Ortonville facilities. The net cost for this replacement power would be in excess of \$15 million in the first year alone. This would be an additional burden of \$125/customer and would increase the average residential customer's bill approximately 30-40 percent. Assuming replacement power will be available until a replacement facility can be placed in service in 1986-87, which is not at all certain, and cost escalated at no more than 6 percent/year, the total cost of replacement power until 1987 is \$148 million or approximately \$1,350/customer.

Another economic burden would result from the need to recover the approximately \$70 million of undepreciated investment OTP has in these facilities in a time frame considerably less than their normal remaining life. Assuming a net salvage value of zero (cost of removal equals salvageable value) the entire \$70 million must be recovered in extra depreciation charges. If the shortened time period is 8 years, the approximate time necessary to construct a replacement unit, the net additional cost to our customers in the first year alone would be approximately \$6.5 million or \$55/customer. Assuming a net salvage value greater than zero would reduce the impact. However, because of the specialized equipment involved and the percentage of labor and overhead costs associated with a power plant, maximum net salvage values would be in the range of 20 percent.

The third item adding to the increase in costs is the high cost of constructing a replacement facility. At the present time, the estimated cost to build a facility of equivalent size to Big Stone coming on line in 1987 is \$500 million. The added cost burden of this replacement facility, in addition to the facilities already planned for this period, will place a severe strain on OTP and its efforts to obtain financing. This would, in all likelihood, increase the cost of financing, if financing can be obtained. These increased costs would result in higher rates for our customers during the construction period and for many years to come. The exact impact or amount of this increased cost is not known at this time, but could very well amount to several million dollars per year.

These items indicate that increased costs in the range of \$200 to 250/customer/year could result if these facilities must be abandoned. This represents an increase of 50 percent to 60 percent on the average residential customer's bill.

As previously indicated, these two generating units provide 46 percent of the total generating capability and 60 percent of Otter Tail's energy requirements. It's been pointed out that surpluses do exist in the immediate future that could be purchased to replace their outputs. However, there are uncertainties in transmission capability and in replacement capacity beyond 1983. Thus, there are indications that our service area would be energy deficient at times of peak load. Voluntary curtailment of use of electric service would be required. If voluntary reduction of use was not satisfactory to maintain system integrity, non-voluntary load reduction would be required. An era of electrical rationing could arise should replacement sources and transmission not be successfully established.

The increased rates for electric service would most probably cause a reduction of electric use. Yet, electric service is essential to the user. There is a component of electrical need by the customer which has no price elasticity. Growth in industrial, commercial, and residential usage is certainly not encouraged by increased costs for electrical service. With these uncertainties, curtailment of new customers would be required which would further reduce the economic growth of the area.

The electric utility industry has established itself as a provider of dependable energy at relatively low costs particularly for lighting, rotating equipment and innumerable domestic and industrial uses. So dependent have people become on electricity that most do not have a backup energy source. In fact, there isn't a good example to point to and say, "This is what will happen if Big Stone is shut down," because there have simply not been similar experiences in the United States. Perhaps, short-term outage conditions would be similar to those which result from severe weather when people, at best, are inconvenienced and, at worst, suffer economic loss.

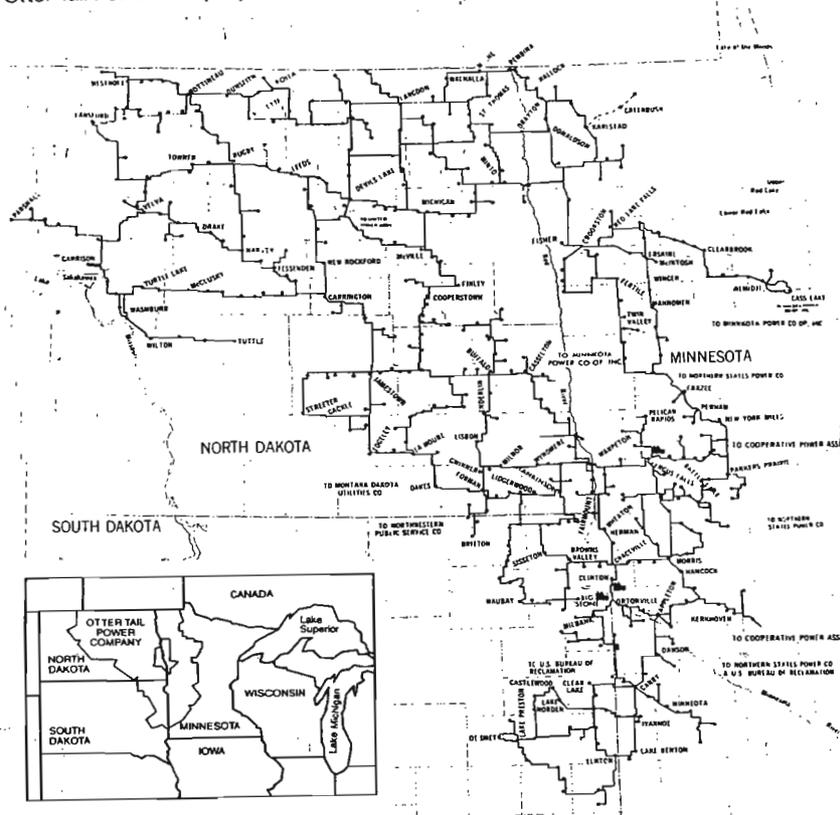
During the 1977-78 winter a coal strike caused considerable economic hardship in Ohio, Indiana, and surrounding states. Even though the affected utilities maintained at least a 30-day coal supply and there were few mandatory cutbacks (conservation took care of most of the problem) there were still layoffs, a slowdown in essential services, and schools and universities had to cut hours. The additional fuel and purchased power costs, in the case of Public Service of Indiana, increased customers billing 30 percent per month for the three months designated to recover these costs incurred during the two months of the strike. But again this was a short-term situation.

We can only imagine what would happen to the area if there was a severe shortage or if energy was available only at a much higher price for a long period of time. This coupled with the loss of direct and secondary jobs associated with the power plants with the loss of tax revenues, and with the loss in other economic sectors would cause severe problems. There would be economic stagnation, unemployment, deterioration of supporting facilities, such as retail outlets and services, and every individual would suffer their own particular economic hardship since a larger portion of their income must be dedicated to pay for electric service. Property values would perhaps decrease, tax-supported institutions would find it harder to operate, and more people would find their way to various types of welfare—it would be an unhealthy situation for the area. The inconvenience and downright suffering of many individuals even for the short-term is far too great to be borne when there is an opportunity to avert it.

Certainly, as in any other crisis it would be the people least equipped to suffer who will suffer the most. They are the real losers in a situation like this. Those with means will be able to afford the additional costs or relocate. The utilities involved will probably be able to secure energy to provide the needs and may, themselves, be able to survive, but the people who are already suffering will suffer even more.

It is certainly our concern that our customers, our employees, and our stockholders receive every consideration in this matter, and Otter Tail Power Company pledges it will do those things that it can to help avert this crisis. With that we appeal to you to lend the strength of your offices to the end that Railroad Service will continue to meet the needs of the citizens of the area.

Otter Tail Power Company Service Area



Otter Tail Power Company serves 115,000 customers located in 465 communities. The service area covers a 50,000-square mile area in northeastern South Dakota, western Minnesota, and middle and eastern North Dakota.

STATEMENT OF G. J. ENRIGHT, MANAGER, PUBLIC AFFAIRS, NORTHWESTERN PUBLIC SERVICE CO.

Northwestern Public Service Company ("Northwestern" or "Company") is an electric and gas utility engaged in generating, transmitting, distributing and selling electric energy in the east central portion of South Dakota. Northwestern furnishes electric service to more than 51,000 customers in 108 communities and adjacent rural areas. Northwestern's general service territory is a part of a 15,000 square miles area as shown on the attached Exhibit 1. The area is agriculture oriented and consequently encompasses very few large industrial loads. Approximately 43,000 of the 51,000 customers are residential and farm customers. These customers have an average annual family income which is 20-25 percent less than the national average family income. The remaining 8,000 customers are commercial and industrial customers, with all of these except approximately 300 being classified as small businesses and public agencies.

Northwestern also purchases, distributes and sells natural gas to more than 57,000 customers in twenty-four communities in east central South Dakota and in three communities in Nebraska.

Northwestern, Otter Tail Power Company and Montana-Dakota Utilities Co. jointly own and operate the Big Stone Power Plant, a lignite fueled electric generating plant with a capacity of 437,000 kilowatts ("KW"). Big Stone is located in the vicinity of Big Stone Lake in northeastern South Dakota. Northwestern owns 32.5 percent of Big Stone and is entitled to 142,000 KW of its generating capacity. Northwestern's undepreciated investment in the Big Stone Plant is \$52,000,000. In addition to its interest in the Big Stone Plant, the Company owns one steam generating plant, ten diesel plants, two combustion turbine plants, and a mobile unit. The aggregate nameplate capacity of all Company owned generating capacity is 224,516 KW. Northwestern relies on the Big Stone for baseload capacity, with the other generating stations serving as emergency, standby or peaking units.

The tremendous importance of the continued operation of the Milwaukee Railroad to the customers of Northwestern is apparent when considering the fuel supply of our Company. Fuels utilized in the generation of electric energy by Northwestern are lignite coal 94 percent, other coal 4 percent and oil 2 percent. Virtually all of our fuel supply is presently shipped over the Milwaukee Railroad.

Northwestern's electrical operations are centralized in seven divisions in South Dakota. Each division office is responsible for the operational and administrative aspects of providing electric service within the division. The main line of the Milwaukee Railroad runs directly through the Aberdeen and Webster divisions, where more than 30 percent of Northwestern's 51,000 electric customers are located.

Our Company's most significant utilization of the Milwaukee Railroad is for the delivery of coal to the Big Stone Generating Plant. The Big Stone Plant is fueled by lignite coal, a natural resource in abundant supply in western North Dakota. Our Company and the other Big Stone Plant owners through the purchase of a \$9 million unit train and through tariff negotiations with the Milwaukee Railroad have contracted for the delivery of North Dakota coal to the Big Stone Plant to be delivered over the Milwaukee Railroad line from Gascoyne, North Dakota, to the Big Stone Plant.

Northwestern further utilizes the Milwaukee Railroad for delivery of utility poles, substation transformers, miscellaneous supplies, and items of an extraordinary length or weight, such as the recent delivery of our Aberdeen combustion turbine. Many of these types of items cannot be shipped other than by rail due to load limit restrictions on our highways and restrictions on the overall length of transporting vehicles. In addition, we have used the Milwaukee Railroad for delivery of propane, fuel oil and coal supplies for our gas system peak shaving plant and our electric steam generating plant in Aberdeen.

Northwestern's future use of the Milwaukee Railroad consists of shipping potential in three different areas. The first and most obvious area is the continued shipment of North Dakota lignite coal to the Big Stone Plant. The plant owners have contracted for 50,000,000 tons of lignite coal for the Big Stone Plant. More than 2 million tons of lignite coal for the Big Stone Plant are shipped each year over the Milwaukee Railroad. Under negotiated tariffs with the Milwaukee Railroad, freight on these shipments in 1978 amounted to \$7,615,287. Delivery of this coal represents a large fixed shipping potential and substantial revenues on the Milwaukee rail line during the next 30-35 years.

The second area of shipping potential involves supplying the future power needs of our customers. If the economy of the communities we serve is to continue to grow, those communities must have a growing supply of energy. Fundamental to supplying electrical energy are four items, a demand, a fuel source, a water supply and a

fuel conversion facility, which ideally should be located between the demand and the fuel source. North Dakota has an abundant supply of lignite coal. The communities we serve have demonstrated an increasing demand for electrical energy. Adequate water supplies are available near the Missouri River and at the present Big Stone Plant site.

An energy conversion facility using coal as a fuel and located at the North Dakota source of coal must utilize transmission lines from the generating plant to the area of consumption.

Although these transmission lines do meet this need, recent transmission line siting problems experienced by utilities in our neighboring state of Minnesota have shown that the location and construction of a new major transmission line is costly and may be unacceptable to landowners whose property the lines must cross.

The message of such conflicts is loud and clear: "Use existing delivery facilities where possible rather than building facilities at a new location."

Utilizing the Milwaukee Railroad line for delivery of the coal to the generating plant is far more desirable. The railroad line is already in existence. Rights-of-way have already been obtained and inconvenience of their existence has long since disappeared.

The logical conclusion is that a high potential for future use of the Milwaukee Railroad exists in meeting the future energy needs of the communities in our service area.

Thirdly, Northwestern will continue to use the Milwaukee Railroad for delivery of large items (poles, substation transformers, etc.) into our Aberdeen and Webster service areas as well as for the delivery of propane fuels used in our Company's gas operations.

Should the Milwaukee Railroad abandon rail service on its main line, our Company would be forced to shut down the Big Stone Plant and seek replacement power for our customers. In the long term, we would be required to build a new power plant which under current estimates would cost from at least 3 times what it cost to build the Big Stone Plant. In addition, the delay from the planning stages to final construction of a new coal fueled power plant is a minimum of eight years. During the construction period, the added cost of the replacement facility in addition to the cost of facilities already planned for this period would place a severe strain on the Company's ability to finance its construction program and would likely increase the cost of the financing which could be obtained. These increased costs would result in dramatically higher rates for our customers during the construction period and for many years to come. The exact amount of this increased cost can only be estimated, but would be at least several million dollars a year.

Pending the planning and construction of any new power plant, Northwestern would be forced to buy short-term replacement power from members of the Midcontinent Area Power Pool (MAPP). The other owners of the Big Stone Plant would be in a situation similar to that facing Northwestern. Although the members of MAPP indicate a composite surplus of capacity sufficient to replace the loss of a unit the size of the Big Stone Plant through the winter season of 1983, most of this surplus would be from each member company's older, least efficient and most expensive generating units. After 1983 the Mapp Pool is deficient even if all units presently committed for construction would be completed on schedule, which at best, is a most unlikely assumption.

Perhaps a more helpful overview of power supply availability is provided by the National Electric Reliability Council's August, 1978 8th Annual Review which states:

"The outlook for reliability and adequacy of bulk electric power supply for the near term has improved over that projected in the 1977 assessment by . . . (NERC). However, the status of future power supply in the longer term—starting in the early 1980's has grown nationally worse.

"Based on the delays experienced with the licensing and construction of present nuclear and coal fired generating plants coupled with an assessment of future conditions it is expected that some of the generating units planned for service during the next decade will be delayed several years. This will result in deficiencies of generating capacity beginning in the early 1980's.

"In the face of the grim prospect that these endeavors are not successful, this nation will face shortages of electric power supply which initially will cause short-term curtailments of electric power and, ultimately, lead to some form of rationing of electricity, with serious economic consequences."

It is obvious that the loss of the Big Stone Plant would cripple the power supply to customers in this region. Any alternative power supply, if available, would be

extremely expensive and would place an undesirable additional financial burden upon our customers.

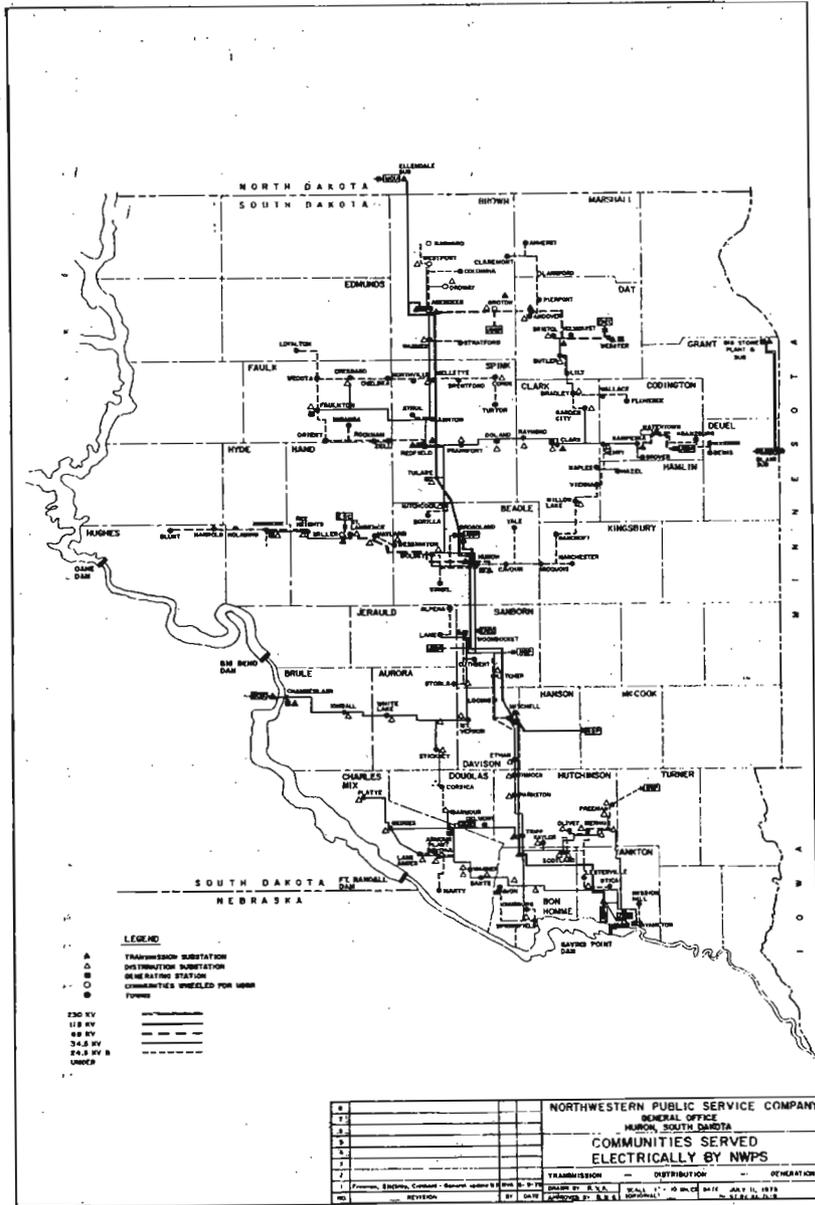
Substantial increases in electric rates brought on by inflation together with other increases in the cost of living over the recent years have resulted in a serious problem in basic economics for many of our electric customers, just as they have for electric users throughout the United States. Utility companies, regulatory agencies, government officials . . . all . . . have been working hard and long to minimize increases in the cost of electricity by promoting conservation, careful planning, and in many other ways. Attempts to minimize increases in electric rates would be severely impeded almost immediately, should the Milwaukee Road be abandoned and should we, as a result, be forced to find power sources alternative to our Big Stone Plant.

Our studies indicate that in the first year of the abandonment our 51,000 electric customers would have to pay an additional \$11½ million for electricity as a result of our necessity to purchase power from other sources (if such power would be available) and of generating electricity in our smaller, less efficient plants which use the more scarce and much more expensive oil as fuel for generation. This would be an additional \$225 per customer and would increase our average customer's bill by more than 30 percent. But that's not all! Our customers would also experience an additional increase in the cost of electricity of more than \$6 million just in that year and additional costs for years to come, to recover the undepreciated investment Northwestern has in the Big Stone facilities. This translates into yet an additional burden of \$117 per customer and would increase our average customer's bill by 17 percent. These two factors result in a 47 percent increase in the cost of electricity to our customers in the first year of shutdown. Such increases in customer rates would not only be distasteful to all of our customers, they would be disastrous to many.

In addition, should such a situation become a fact, the ability to serve our customers with the electricity they need, when they need it, would certainly become a matter of concern. The need for a continuous availability of substantial amounts of power could produce a rather helpless situation should other power suppliers have difficulties with breakdowns, peak periods, and other situations that would make it impossible to deliver power to us. The probable result: rationing . . . brownouts and blackouts . . . perhaps even curtailment of service in the most serious circumstances.

Beyond the disastrous effects the abandonment of the Milwaukee Railroad would have on our Company and our customers, are the serious problems it would create for the state of South Dakota. Transportation is critical to every area, to every economy. Transportation of South Dakota's agricultural products and manufactured products is absolutely essential, and the Milwaukee Railroad is a very necessary part of the transportation system in our state. The railroad delivers agriculture products from our state to many out-of-state markets, and in turn delivers farm machinery and other finished products to us. And it delivers electricity to our customers, in a sense, by providing the means of hauling lignite coal to our Big Stone Plant . . . the only feasible method of delivering that lignite, which is the lifeblood of the plant.

Loss of the Milwaukee Railroad would be a major step backward in the economic growth and stability of South Dakota agriculture and business.



STATEMENT OF W. W. KROEBER, VICE PRESIDENT, ELECTRIC, MONTANA-DAKOTA UTILITIES Co.

NEGATIVE IMPACTS OF MILWAUKEE ROAD ABANDONMENT

Montana-Dakota Utilities Co. (MDU) is a multiple energy utility serving nearly 155,000 gas customers and over 100,000 electric customers within the states of North Dakota, South Dakota, Montana, Wyoming and Minnesota.

While a relatively small portion of the MDU service area lies immediately adjacent to the trackage of the Milwaukee Road, its demise in our region would significantly affect in either a direct or indirect manner nearly all of the 243 communities served by the company.

GENERAL DESCRIPTION OF AREA'S ECONOMY

MDU serves an area of the Upper Midwest that ranges from the Red River Valley of eastern North Dakota westward to the foothills of the Rocky Mountains in Montana. Its depth extends from the Canadian border to the Black Hills of South Dakota.

This country, though not heavily populated, has considerable economic significance well beyond the confines of the area. It is primarily an agricultural environment, producing large quantities of wheat, durum, sunflowers, barley, sugar beets and potatoes. The vast grasslands produce a sizeable portion of the beef and lamb that graces the American dinner table.

While much of the land surface yields substantial agricultural produce, the inner depths are sources of extensive quantities of energy.

Huge lignite deposits are located in western North Dakota and eastern Montana and even larger deposits of subbituminous coal are found in other sections of Montana and Wyoming. Oil and natural gas have been produced in all three states for many years.

Some of this energy is consumed within the area either by homes, industry or conversion plants. But, much moves out of the region in its unaltered form to waiting markets to the east or south.

Coal is moved by unit train for direct industrial use or to be used as boiler fuel in the power plants of utilities. Oil and natural gas flows through underground pipelines to refineries or ultimate consumers.

The harvest of these vital natural resources whether through farming methods of mineral extraction provides a major employment for the area's citizens as does the refining, energy conversion, agri-business, processing and transportation.

All of these industries are largely dependent on power availability and reliability and would be seriously affected by deficient or abnormally high priced electricity.

MDU POWER SUPPLY

With the exception of those properties in the state of Wyoming, all communities served with MDU electricity are located on a network or interconnected transmission facility. The interconnected system is dependent upon power production from all generating stations owned fully or in part by the company.

The company's 20 percent interest in the Big Stone Plant is one of the integral components of MDU's electric generating and transmission system and as such represents 28 percent of the company's generating capacity. It is one of nine electric generating stations from which MDU supplies the power to satisfy the demands of its customers.

Active generating station

	Megawatt
Big Stone plant—(MDU's 20 percent)—Big Stone Citry, S. Dak	87.4
Heskett station—No. 's 1 and 2—Mandan, N. Dak	101.0

	Megawatt
Lewis and Clark station—Sidney, Mont.	50.9
Beulah station—Beulah, N. Dak.	14.9
Williston turbin (peaking)—Williston, N. Dak.	12.4
Glendive (peaking).....	7.3
Ellendale (peaking).....	2.8
Mobridge (peaking).....	2.6
Miles City turbin (peaking).....	29.4
Total	308.7
Total base load	254.2
Total peaking.....	54.5
Total capacity	308.7

The principal generating stations, Big Stone, Haskett, Lewis & Clark and Beulah, use lignite as a primary fuel while the peaking units utilize principally fuel oil.

The company will have sufficient capacity to meet peak load obligations through 1979 with its own generation and with purchased power from other Mid-Continent Area Power Pool (MAPP) members. An additional 30 megawatt peaking combustion turbin will begin operation in 1979.

To meet the capacity requirements of the near future, Coyote I, a 410-megawatt lignite-fired generating station, is under construction near Beulah, N.D., to be jointly owned by Otter Tail Power Co., Northwestern Public Service Co., Minnkota Power Cooperative, Inc., Minnesota Power & Light Co., and Montana-Dakota Utilities Co. The MDU share of ownership and capacity will be 20 percent.

LOSS OF BIG STONE—IMPACT ON MDU

A number of reassumptions must be made in assessing the impact on MDU and its customers faced with a loss of a major power source. Absent absolute cost data and the uncertainty of replacement power availability, generalities will have to be employed rather than specifics.

The critical nature of this situation indicates that it would be most difficult to overstate the negative impact which will be felt by all concerned. In fact, more than likely the reverse will be true.

Even if replacement power at comparable prices were available for the short-term, the eventual replacement of the Big Stone capacity would add to the investment capital burden the company presently faces.

The company is presently involved in the most massive program of capital formation in its 54-year history which is necessary to keep pace with the growing customer requirements for electric power and natural gas.

In the next six years, including 1979, the capital requirements will be about \$392 million. This will substantially tax the company's borrowing power just to finance the projects that have begun or are planned for the near future and to retire maturing debt.

The company's investment in utility plant accumulated over half a century is almost \$400 million. In just six years the company must add almost this amount to keep pace with customer demands.

MDU's share of the 410-megawatt electric generating station previously mentioned will require more than \$90 million by completion. And, the 30-megawatt combustion turbine scheduled for completion in 1979 will require \$5 million, just to name two critically important projects.

Financing a replacement plant equal to the 87 megawatts, which is the company's share of Big Stone, within a similar time frame at prices at least three times the original cost of that plant would present serious problems.

BIG STONE CLOSING—IMPACT ON CONSUMERS

If the Milwaukee Railroad were abandoned, this would force Big Stone to shut down. It should be noted, too, that the impact will be as great on customers 400 miles away from the Milwaukee Road as to those next door to the station. The additional cost to our customers in the next year to purchase power from the Mid-Continent Area Power Pool, if the power is available, would be approximately \$6.2 million. This would increase each customer's bill by approximately 12 percent.

There would also be additional costs to our customers to recover approximately \$30 million of investment that has not been depreciated. We would plan to recover this over an 8-year period. The net cost to our customers during this period would be approximately \$22 million, less salvage value, if any. The extra cost in the next

year would be approximately \$2.75 million. This would be an additional increase of approximately five percent.

While the impact on customer monthly bills would not in itself price electricity beyond the reach of most consumers, it must be recognized that during the same period other new plants will be added to MDU's investment. In 1979 a peaking plant will be added and in 1981 a large base load unit, Coyote I, will be on line. Most customers will probably survive those increases, too, though not without some problem. While financing a replacement plant for Big Stone would be impossible in the near term, it can be assumed that at some point a duplicate unit would be provided. However, the final blow would arrive within a short time when a replacement unit is constructed. Now instead of \$360 per kilowatt, the cost of construction would be approximately three times this amount.

By the time Big Stone would be replaced, our customers will be paying up to 50 percent more for their electric energy, taking into account that Coyote I and a new peaking plant would be in the rate base. With the Big Stone replacement added, our customers could be paying as much as twice the present rate.

The impact directly resulting from discontinuation of a vital transportation link between the energy conversion facility and its fuel supply would be devastating.

The bottom line is:

1. Business will be placed in a noncompetitive position creating a negative growth atmosphere;
2. Some will fall victim to bankruptcy;
3. Employment levels decline;
4. Economic stagnation of the area will be the final result; and
5. An even higher number of residential customers will have serious problems paying their electric bills.

There is a very real possibility that replacement capacity may not be available from other members of the power pool.

Since the Big Stone Plant provides MDU with slightly over 28 percent of its energy capacity, it is reasonable to assume that without it the company would not be capable of meeting the demands of customers, especially during the peaks.

Reliable electric service to consumers, be they residential, commercial, municipal or industrial, is essential. MDU customers depend on this sort of energy for warmth, convenience and to power the wheels of progress. The constant growth pattern of business has in the past been geared to the stability of electric power and the increasing supply available to meet the requirements of that growth.

A number of small manufacturing plants and processing facilities have been developed in recent years across the MDU service territory which have improved employment, increased the tax base and provide revenue for the large number of communities in which the company operates.

Electric home heating has increased substantially in areas where natural gas is not available, and electricity in ample supply has allowed consumers in the more rural areas to enjoy the same standard of living commonplace to their urban neighbors.

Curtailment of power caused by the reduction of generating capabilities of the company could result in a giant step backward.

It is not at all beyond the realm of possibility that rationing of electricity would occur, which would drastically reduce current life style and cause considerable hardship for most people.

Industry would periodically or perhaps regularly grind to a halt and be forced to cut back employment and output.

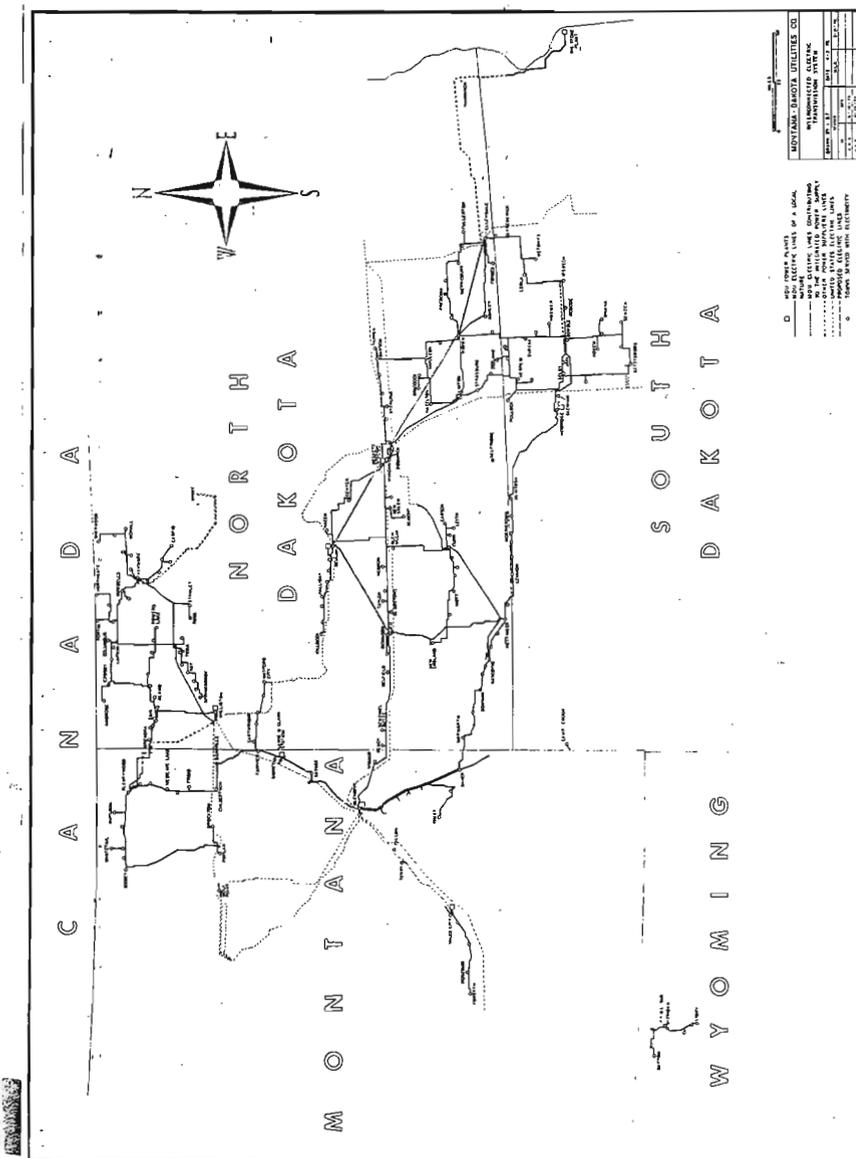
Agriculture with its harvest measured in millions of tons depends heavily on elevators, refineries and processors for marketing assistance. A constant supply of electric energy is vital. The farm economy may hang in the balance.

Oil which is pumped through pipelines 24 hours a day to distant refineries depend on a constant supply of power. What would be the effect of shutting down these vital operations?

Hospital and medical centers are year-round operations that must have dependable electricity, too. How would blackouts or curtailments affect them?

There is no equitable way to prioritize customers and no logical method to ration power, consequently, no way to accurately quantify economic deterioration. But, surely business and industrial regression and growth stagnation would be the eventual harvest.

If the power drought were of short duration, perhaps the fragile economy of this area could weather the storm, but generating capacity isn't built overnight. It takes eight to ten years from planning to on line capability these days and most customers couldn't survive that long. Property values would drop, schools, hospitals, community services and other vital institutions would wither for lack of commerce, revenue or normal funding. Every business, every service, every home would be



STATEMENT OF A. J. WITTMAYER, VICE PRESIDENT, KNIFE RIVER COAL MINING CO.

The Knife River Coal Mining Company operates lignite mines at Beulah and Gascoyne, North Dakota, and at Savage, Montana. The total production of these mines is approximately 5,000,000 a year, and all of the production of the Knife River Coal Mining Company is shipped by rail to the user, which consists, primarily, of electric utility power plants, which supply electrical energy to the Upper Midwest.

The mines at Beulah, North Dakota, and Savage, Montana, are served by the Burlington Northern, Inc., and so our concern rests with Knife River's mine at Gascoyne, North Dakota, which is served by the Milwaukee Road.

Gascoyne, North Dakota, is located in the southwest corner of North Dakota between Bowman, North Dakota, and Lemmon, South Dakota. The mine was put into operation in 1950 by the Knife River Coal Mining Company, primarily to supply coal to utility plants at Mobridge, South Dakota, and Ortonville, Minnesota.

On January 1, 1972, the Knife River Coal Mining Company entered into an agreement to supply coal to the Big Stone Power Plant, located at Big Stone, South Dakota, owned by Otter Tail Power Company, Montana-Dakota Utilities Co., and Northwestern Public Service Company. The contract became effective January 1, 1975, at which time Knife River started furnishing coal to this power station. Under the agreement Knife River is committed to supply 55,000,000 tons of coal to this power plant during the first twenty years of the contract, and under certain conditions could be obligated to supply an additional 20,000,000 tons of coal for a total commitment of 75,000,000 tons of lignite. The contract is based on an average annual output at the Gascoyne Mine of 2,400,000 tons, and during the early years of the power plant's life it is expected that the tonnage produced at the mine will average 2,700,000 tons a year. In the past twelve months the output of the mine at Gascoyne was approximately 3,000,000 tons of lignite, practically all of which was moved by rail.

The Knife River Coal Mining Company has reserves of approximately 400,000,000 tons of lignite in the Gascoyne Mine area, and in a recent hearing before the Public Service Commission in the State of Montana, Paul Weir and company, Consulting Mining Engineers, Chicago, Illinois, estimated that lignite reserves owned by the Knife River Coal mining company have a present value of sixteen cents a ton in the ground. The Knife River reserve is part of the Harmon Bed, as described in Geological Survey Bulletin 1015E, titled *Strippable Lignite Deposits, Slope and Bowman Counties, North Dakota*. This survey bulletin lists the reserves of 1.4 billion tons in the Harmon Lignite Bed as located in Bowman and Slope Counties, North Dakota. The Harmon Bed is only part of a large lignite reserve that extends from the northwestern corner of South Dakota to as far north as the Canada border and into eastern Montana.

The Knife River Coal Mining Company's operation at Gascoyne, North Dakota, employs on the average 85 people and has a present annual payroll of \$1,509,000. It is the one source of permanent, high-paying employment in an area bounded by Bismarck, North Dakota, to the Black Hills of South Dakota, west to Gillette, Wyoming, and Decker, Montana. The employment at Knife River's mine at Gascoyne, North Dakota, has a great impact on the towns of Hettinger, Reeder, Scranton, and Bowman, North Dakota, and the large payroll of this mine helps to lessen the vagaries of Main Street, caused by the fluctuating small grain prices and yields.

The primary consumer of lignite from Knife River's Gascoyne Mine is the Big Stone Plant, Big Stone, South Dakota. The coal movement is accomplished by unit trains with two trains in operation at all times, one taking coal to the plant and the other bringing empty railroad cars back to the mine for loading. Each train consists of one hundred 100-ton capacity cars, which are owned by Otter Tail Power Company, Montana-Dakota Utilities Co., and Northwestern Public Service Company, and six or seven loaded trains per week are shipped from the mine to the Big Stone Plant. This movement will, undoubtedly, continue through the life of the Big Stone Plant, which is estimated to be a minimum of 35 to 40 years.

The Knife River Coal Mining Company has made an original investment of approximately \$14,500,000 in that mine. The Big Stone Plant site is laid out for a second unit, which will be similar in size to the first unit, and Knife River is prepared to meet the coal requirements of the second unit at the time it is built, and is willing to make the additional mine investment in order to do so.

Abandonment of the Milwaukee main line west through South Dakota would leave a large area which contains large coal reserves unserved by any railroad. This area is roughly bounded by (designated by railroad stations) Mott, North Dakota, to Pollock, South Dakota, to Leola, South Dakota, to Redfield, South Dakota, to Gettysburg, South Dakota, to Pierre, South Dakota, to the Black Hills in South Dakota, to

New Castle, Wyoming, to Huntley, Montana, to Glendive, Montana, to Beach, North Dakota, to Mott, North Dakota, the starting point. This area contains approximately 51,100 square miles and contains the bulk of the lignite reserves in the United States, besides covering a large area underlain by subbituminous coal. (See Exhibit 1 from Environmental Impact Statement, Proposed Federal Coal Leasing Program, Volume 1).

It is inconceivable that our nation can willingly forfeit access to these large, essential, known coal reserves by allowing the abandonment of the Milwaukee Road, which in effect cuts through the very heart of the area described. Abandonment of the Milwaukee Road would be particularly hard on the northwest quarter of South Dakota, as well as the southwest quarter of North Dakota, as well as southeastern Montana, and would in all probability prohibit further development of the large coal reserves in those areas, besides causing forfeiture of investments made in the small towns and industry, such as that investment made by Knife River.

Upon abandonment of the Milwaukee main line in South Dakota, Knife River would have no choice but to cease operating its Gascoyne Mine, as there is no practical manner presently developed to move 60,000 tons of coal each week a distance of 350 miles other than by this railroad.

Tariffs paid by the shippers on the Milwaukee are set by the Interstate Commerce Commission and the various state commissions and are only set after rather lengthy and detailed hearings in which the railroad establishes the need for additional revenue. The need, as determined by the various regulatory authorities, is than embodied in published tariffs which are paid by the shipper. Thus, in fact, the public has paid what has been determined to be the proper tariff on all materials shipped on the Milwaukee Road, including the shipment of lignite from Knife River's Gascoyne Mine.

There has been constant and continuous publicity of the need for western coal to ease the crisis this nation faces in energy, and most studies agree that the volume of coal moving from the West to the East will involve massive movements by rail. There is contention in the press and in Congress that the railroads serving the western coal areas will be unable to meet the demands imposed on them by this movement of western coal. In fact, the federal government has authorized a study to determine the impact and possible remedies of the continually increasing movement of the unit trains through the cities and villages in the Upper Midwest.

Instead of attempting to abandon the main line of the Milwaukee Road west of Minneapolis, it would be much better to utilize this main line for the move of western coal. Utilization of this line for the movement of unit trains from the West, which will constantly increase, would help to dissipate the heavy magnitude of coal traffic which will continue to increase in the future. One of the larger producing areas of western coal is the Colstrip area in Montana, and the main line of the Milwaukee Road is ideally suited for the movement of coal from these mines to the East and would relieve the increasing traffic which is now occurring on the rail lines.

It is unconscionable that the same government, which is literally spending hundreds of millions of dollars on coal development, and byproducts from coal, so that the nation can eventually obtain some degree of independence from imported oil, would allow abandonment of a main line railroad which literally cuts through what is considered the largest coal reserve area in the United States, and it is inconceivable that this same government, which is formulating the energy policy based on coal, would allow abandonment of a railroad which would cause a company, such as Knife River, to literally lose an entire investment while at the same time the government, through regulatory authorities, is ordering existing plants and those being constructed to utilize coal.

PROBABLE OCCURRENCE OF COAL

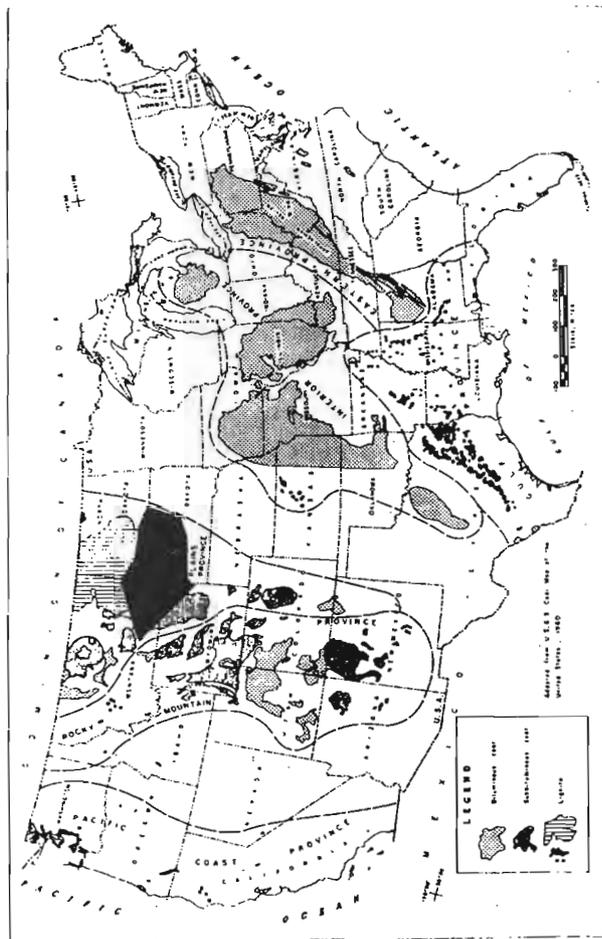


Exhibit 1.

Page I-47, United States Department of the Interior, DES 74-53, Draft, Environmental Impact Statement, Proposed Federal Coal Leasing Program Volume 1.

Coal Area, the interior of which would not have any rail service upon abandonment of the Milwaukee Road Main Line.

Senator LONG. I now want to call Jim Snyder.

STATEMENT OF J. R. SNYDER, NATIONAL LEGISLATIVE REPRESENTATIVE, UNITED TRANSPORTATION UNION, WASHINGTON, D.C.; ACCOMPANIED BY ED FRIEDMAN; AND WILLIAM MAHONEY

Mr. SNYDER. Good morning Mr. Chairman. It's a pleasure to be here this morning. I have submitted a prepared statement which I would like printed. Here I will limit myself to a short summary.

As stated in Senate Joint Resolution 69, Mr. Hillman's embargo extends over more than 7,000 miles of track in 13 States spread throughout the northern tier into the Midwest.

At least 5,000 families would suffer from the layoff of one of the principal, if not the only, wage earners. Loss of railroad retirement, health and welfare insurance, would be tragic for these people. Thousands of others whose earnings depend directly or indirectly on uninterrupted rail service would suffer hardship.

The effect of the embargo would ripple throughout the economy of every one of these States. The resolution would have serious, if not crippling impact. It's generally known that the end of the essential rail transportation in these States is today's way. The value of scrap iron is rising every day.

There is, of course, opposition to the trustee's proposal by the State, Federal Government and railroad labor organization. The plain fact is that Mr. Hillman's embargo poses what is an abandonment. An embargo can be used only as a short-term measure because of temporary conditions preventing full operation. There are no such factors here.

Mr. Hillman stated time and again he will not plan for the operation of these lines west in his reorganization. He has no intention of relaxing the embargo once he produces a sufficient cash flow. The creditors will not let him do so.

That Mr. Hillman followed a course of disengaging from service on lines west is clear from the record. The facts are that service on this segment of line was reduced by 70 percent as of the summer of 1978, with less than one train operating daily in this part of the region.

Mr. Hillman made no attempt to supply rail service to grain elevators in South Dakota. There appears to be a heavy demand for a large number of grain hopper cars, producing a revenue of about \$1,000 per car.

This past winter there was an enormous demand for grain movement to west coast ports. Mr. Hillman had an opportunity to take advantage of this since there was only mild snow in the area served by lines west.

The bankrupt railroad had an opportunity to move grain in record volume and yet Hillman didn't do so. These conditions have been self-induced. He encouraged shippers to seek alternate modes in the northern tier. He overlooked opportunities to concentrate on high revenue freight. He failed to make application to the Federal Government for loans under the various loan programs available to him.

Indeed, we have a report from one of our members that Milwaukee train crews worked 33 winters in subzero weather with severe

snow conditions in the lines west region, and that the railroad never failed to operate trains in any kind of weather.

Despite their opposition, we know rail service will end in a matter of days unless Congress moves rapidly on Senate Joint Resolution 69. Favorable committee action on Senate Joint Resolution 69 would provide breathing time to develop a plan to save this rail service.

It has been said that directed service by the ICC would be a sufficient response to this emergency. The economic impact from the radical dismembering of the Milwaukee Road, the loss of jobs, could not be reversed or repaired. The losses could never be recovered. Directed service is a radical proposal that must be rejected as a solution of any kind.

Mr. Mahoney will comment on this just briefly when I finish my statement.

Within the past few days a series of meetings have been held with the States, shippers, labor organization, Government agencies and others as to employee-shipper ownership. This proposal should be explored to determine whether the numbers are doable. This is a proposal based upon the experience of some 400 business enterprises in the United States and which we are told, is ideally suited for public utilities, including the Milwaukee Railroad.

All of the responses we received have established a solid interest in proceeding to explore the workability of this proposal.

We are told the study will take 30 days at least, once decided that the plan is workable. It will take another 6 months to set up the plan. Without prompt favorable action on Senate Joint Resolution 69 with some motions proposed in the past few days, the embargo will end rail service and it will be too late.

We must have a breathing spell, a moratorium laid on the embargo for even a short period of 45 days to provide at least time for the study of such plans.

I understand that a revision of the resolution was prepared and will be offered which will limit the period to 45 days and which will provide ERSA financing with subordination to creditors.

S. 1083 is designed to preserve the railroad pending purchase arrangements, using established financing machinery for the operation and rehabilitation of the railroad in that phase.

S. 1083 would amend section 5 of the Department of Transportation Act to include the Milwaukee Road.

The resolutions are desperately needed to maintain service. We join with the States involved, with all those whose livelihoods depend on continued service, to ask the committee to take immediate action on these bills to avoid a major economic disaster.

At this time, I would ask Mr. Mahoney to comment.

Mr. MAHONEY. I think it would be a terrible mistake if the Congress or anyone were lulled into thinking that directed service is some sort of stop-gap measure.

It's not.

What would happen would be a 240-day accomplished fact. Once these railroads take over this directed service, they would operate it for 60 to 240 days, at the end of which time they would either walk away from it with absolutely no obligation or some of them perhaps would purchase some of the lines.

In any event, the Congress would be unable to do anything at all about reforming or restructuring this railroad once that occurred.

You could have no ESOP or SSOP plan or anything, once you had directed service.

The fact would be there. The railroads would have those lines. It would do what they wanted to with them.

In answer to a question by Chairman Magnuson, Mr. Gallamore stated the employees would be protected—2,200 of them would be used in directed service.

We don't know if that number is correct.

That was a guesstimate on the part of the trustee on his directed service plan, which is different from the ICC's service plan.

ICC said they were basing their 2,000 employees on what the trustee had said. They had no idea how many employees would be used. At the end of 240 days all these people would be out of work. You would have at least 5,000 employees on Milwaukee out of work in 240 days, and you would have a railroad that would not resemble anything which Congress might decide it would want to see in the future.

One other thing, if I may add: The entire case in the court and here of the trustee is based upon this Booz-Allen report. As Senator Baucus mentioned, I would direct your attention to the bottom of page 24, first volume of that report, in which Booz-Allen says this analysis does not address the public interest, but rather deals with the additional business interests and opportunities involved in the eight options considered.

It does not address public interest and neither does the trustee.

I believe the trustee has a duty to address the public interest and, certainly, of course, the Congress does.

I am most disappointed that the Department of Transportation has bought lock, stock and barrel the position of the trustee in this, and so stated and supports that and supports directed service and doesn't even mention the feasibility studies they are supposed to be making, and ESOP and SSOP. And it might cast doubt on the validity of the studies when they come out.

They are apparently committed to the trustee plan.

Thank you.

[The statement follows:]

STATEMENT OF J. R. SNYDER ON BEHALF OF THE RAILWAY LABOR EXECUTIVES' ASSOCIATION

Mr. Chairman and members of the Committee, My name is J. R. Snyder. I am the National Legislative Representative of the United Transportation Union. I am appearing here today as the Chairman of the Legislative Committee of the Railway Labor Executives' Association acting on behalf of all Railway Labor organizations, to urge this Subcommittee to take immediate favorable action (1) on the proposed S.J. Res. 69, introduced by Senators McGovern, Baucus, Magnuson, Church, Culver, Burdick, Young, Boschwitz, Pressler, Durenberger, Jepsen and Jackson and (2) S. 1083 introduced by Senator Baucus. Edward D. Friedman, the attorney for the RLEA, is with me today to assist in the presentation of our views.

The RLEA is an association of twenty standard and international labor organizations, representing virtually all the organized work force employed by Class 1 railroads in this country. The RLEA's primary function is to promote the common interest and welfare of the hundreds of thousands of railroad workers and their families and it is with this purpose that we appear here today. I have listed the names of these twenty associated railway labor organizations, as required by the rules of the House.

A number of bills, including the proposed joint resolution offered in each of the Houses of Congress, addressing the problem of the Milwaukee Railroad, are now pending before each of the Houses of Congress. The theme which is common to all of these bills and resolutions is that the condition of the Milwaukee Road presents what in fact is becoming a crisis problem for the Northern tier of states and for the national economy.

There appears to be wide agreement with the point stated in S.J. Res. 69 that the embargo of freight operations of the Milwaukee Road sought by the Trustee in Reorganization, Mr. Stanley Hillman, in the states of Washington, Montana, Idaho, North Dakota, South Dakota, Illinois, Iowa, Missouri, Wisconsin, Kentucky, Minnesota, Michigan and Indiana would have severe, perhaps crippling, repercussions on the economy of these states.

At the heart of the problem appears to be a simple straight-forward fact that we are not dealing with prudent management on the Milwaukee Road. There has been no effort, so far as we know, to replace or to improve the management which presided over the deterioration of this railroad. It is our understanding that by and large this management has been disinclined to seek or to promote new sources for business and has been disinclined to seek new sources of revenue.

To the best of our knowledge and belief, the fact is that imprudent management began long ago, perhaps in the first few months of the trusteeship, when Mr. Hillman decided that he would not include the lines west of Minneapolis in his reorganization plan. He has been disengaging from the business of the railroad in that part of the system ever since.

The fact is that what we have seen taking place during this period is a methodical destruction of Lines West and that these bills, particularly S. 1083, will put a stop to this "let the public be damned attitude" of these imprudent managers.

The fact is that the creditors of the bankrupt estate are and have been doing all in their power to prevent access to federal sources for desperately needed financing because they want to liquidate the assets of the Milwaukee Road.

Yet we are told that the Milwaukee Road is an asset-rich railroad. Mr. Hillman reports that the scrap value of its properties is about more than 800 million dollars or twice the amount of the secured debt held by these creditors and is indeed ample to pay off debts.

The urgency requiring immediate consideration of S.J. 69 and of S. 1083 was heightened during the past few weeks by the unprecedented action taken by Mr. Hillman in proceeding on such short notice with his program to embargo freight on seventy-four hundred miles of this track. It was in fact a kind of blitzkrieg, unexpected and radical in thrust.

Mr. Hillman advised us a few weeks ago that he had commissioned Booz, Allen and Hamilton in early 1978 to analyze the operations of the Milwaukee Road to provide a viability study, indicating lines which might become self-supporting. On the night of April 19 of this year, we were told that the Booz-Allen report was ready and the views of this company would be unveiled at a meeting at the O'Hare Hilton Hotel in Chicago to be attended by the Milwaukee Road's general staff, various creditors, stockholders, and representatives of the Interstate Commerce Commission, the Federal Railroad Administration and the Department of Justice. We were invited to attend this meeting as representatives of labor. It was impossible at that late date and on such short notice to obtain reservations to get to Chicago. As a consequence, we were compelled to arrange with Chicago counsel to represent us at the meeting.

Seven configurations or segments of a rail system were explained by Booz-Allen, ranging from segment 1 with 1700 miles of line to segment 7 with 8000 miles of line. Mr. Hillman added a segment 8, 2400 miles in length representing a modification of the minimal segment 1 line.

On the following Monday, April 23, Mr. Hillman in what appears to be a pincers move, if we may again borrow from military language, filed his petition to "embargo" all freight on the Milwaukee except for his minimal segment 8, as of May 8. He filed with his petition a statement in support of his request.

As you know, the Court at that time set an April 30 date for an additional statement, perhaps less hurried, and for responses from interested parties, a May 4 date for the hearing and a May 8 target date for the embargo.

During the course of the May 4 hearing, Hillman admitted that he had decided months earlier to try the "embargo" approach on Lines West which he had earlier decided would not be included in his reorganization plan.

At the hearing he again surprised the interested parties by extending his proposed embargo from May 8 to May 31 and by modifying his minimal sub-core to include Miles City, Montana, and to exclude an equivalent number of route lines to

Kansas City. In reality, he switched from his segment 8 plan to the Booz-Allen segment 2 plan, twenty-five hundred miles in length, substituting the Miles City line for the Kansas City line.

Thus, in a period of 12 days, Hillman presented three different configurations, adding further confusion to the chaotic condition of the proceedings.

These tactics, particularly the timing of the broad embargo action and the selection of the retained minimal sub-core, appear to be political manipulations, hardly suitable for a crisis situation of this magnitude.

As stated in the preamble to S.J. Res. 69, Mr. Hillman's embargo extends over more than 7000 miles of track in thirteen States spreading throughout the northern tier into the Middle West. Six thousand railroad families would suffer from the permanent layoff of one of their principal, if not only, wage earner. The loss of job rights and expectations, including particularly railroad retirement and health and welfare insurance, would be incalculable. Thousands upon thousands of others whose earnings are dependent directly or indirectly upon uninterrupted rail service would suffer similar hardships. The effect of the embargo would ripple throughout the economy of everyone of these states and, in the words of S.J. 69, would have serious, if not crippling repercussions on our national economy.

It is generally recognized that the cessation of essential rail transportation in these states is imminent. The Continental Illinois Bank and the Murchinson interests are pressing hard for immediate action and liquidation. The value of the scrap iron is rising every day.

There is, of course, opposition to the trustees' proposal—opposition principally by the affected States, by the Federal Government and by the railroad labor organizations. The plain fact is that Mr. Hillman's proposed embargo cloaks what is actually a proposed abandonment. An embargo is available only as a short term expedient because of temporary conditions preventing full operation. There are no such factors here. Mr. Hillman has continuously stated that he cannot provide for the operation of these Lines West in his reorganization plan. He has no intention of relaxing the embargo once he produces a sufficient cash flow. He has no expectation—indeed has made no effort—to obtain the funds necessary for restoration of service of these "embargoed" lines.

The creditors will not let him do this.

That Mr. Hillman has followed a course of disengaging from service on Lines West is clear from the record.

The facts are that service on this segment of line was reduced by 70 percent as of the summer of 1978, with less than one train operating daily in this part of the region. Mr. Hillman has made no attempt to supply rail service to grain elevators in South Dakota. There appears to be a heavy demand for a large number of grain hopper cars, producing a revenue of about one thousand dollars per car. This past winter; there was an enormous demand for grain movement to west coast ports. Mr. Hillman had an opportunity to take advantage of this since there was only mild snow accumulation in the area served by Lines West. The bankrupt railroad was thus presented with an opportunity to move grain in record volume and yet Hillman did not elect to do so.

Hillman complains about lack of revenue to maintain track. He complains that he had to constrain severely the railroad's ability to keep in service its locomotive and car fleets which he admits are already too small to meet customer demands. He states that he has virtually eliminated the possibility that normally internally funded seasonal maintenance and rehabilitation of track will take place this summer. He admits that the maintenance of way work force is inadequate but complains that he lacks the funds to increase its size to perform necessary maintenance work. He complains that he has experienced greatly increased costs and significant revenue shortfalls by reason of an extraordinarily severe winter and because his administration of the bankrupt railroad has weakened customer confidence in the railroad and has resulted in the diversion of the business to other carriers.

These conditions of which Hillman complains have been self-induced. Hillman has in fact encouraged shippers to seek other alternative modes in the Northern tier of states. He has overlooked opportunities to concentrate on high revenue freight. He has failed to make application to the Federal government for loans under the various loan programs which are available to him.

Indeed, we have a report from one of our members that the Milwaukee train crews have worked 33 winters in sub-zero weather with severe snow conditions in the Lines West region and that the railroad has never before failed to operate trains in any kind of weather. The length of the train is adjusted to the conditions.

But despite this opposition, the predictions are that broad scale cessation of rail service in these states will take place within a matter of weeks unless the Congress moves rapidly on S.J. Res. 69. We would hope that favorable Committee action on S.J. Res. 69 would, at the least, provide some breathing time to develop a plan to save this important segment of rail service.

It has been said that directed service by the I.C.C. would be a sufficient response to this emergency. As Chairman O'Neal stated in his testimony a few days ago directed service would probably mean that several different carriers would be directed to serve shippers, involving a fairly complicated service order, creating problems of substantial importance. The Chairman of the I.C.C. emphasized that directed service is no more than a short-term bromide, if that.

More significantly, in this context directed service can be likened to radical surgery—an amputation of an ailing limb or two—and, should the operation have been unnecessary, as in too many radical surgical cases, there can be no recovery of the amputated parts.

In this application, the critical economic impact—from the radical dismembering of the Milwaukee Road—the loss of thousands upon thousands of railroad jobs and benefits—the loss of employment and livelihood for the additional thousands whose occupations depend on rail service—would be equally irreversible and irreparable. The losses could never be recovered.

Directed service is a radical proposal that must be rejected as a solution of any kind.

Within the past few days a series of conferences have been held with the states, the shippers, the labor organizations, the government agencies and others who are involved in the Milwaukee crisis to examine a program which offers promise. Upon the basis of the responses from the parties, this proposal will be thoroughly explored to determine, as one observer put it, whether the numbers are do-able. This is a proposal which is based upon the experience of some 400 business enterprises in the United States and which, we are told, is ideally suitable for public utilities, including the Milwaukee Road.

It would proceed through an employee-shipper stock ownership plan with full federal financing support. All of the responses which we have received so far have established a solid interest in proceeding to explore the workability of this proposal.

We are told that the feasibility study will take at least 30 days. Once feasibility is established, the employee-shipper stock ownership program will take, we are told, another six months.

Without prompt and deliberate favorable action and S.J. Res. 69 with some modifications proposed in the past few days, a point of no return will be passed with the imposition of the embargo.

It is essential that we have a breathing period—that a moratorium be imposed upon the embargo—for even a short period of 45 days—to provide, at the very least, time for the feasibility study of the ESOP and SSOP.

I understand that a revision of the resolution has been prepared and will be offered which will limit the period to 45 days and which will provide ERSA financing with subordination to creditors.

S. 1083 is designed to preserve the railroad, pending purchase arrangements, using established financing machinery for the operation and rehabilitation of the railroad in this phase. S. 1083 would amend Section 5 of the Department of Transportation Act to include the Milwaukee Road. It proposes a new subsection to provide for full Federal-State funding to maintain service, free from the restraints and conditions in Subsections (h)(i)(j) and (k) of Section 5. Financial assistance would be made to the states or to the Milwaukee road in the form of loan or loan guarantees drawn from the Rail Fund established by Title V of the 4R Act which has been established for rehabilitation of railroads. Under this bill these sources of financing would be available to cover the cost of rail service continuation payments or to cover the cost of rehabilitating and improving rail properties on the Milwaukee Road to the extent necessary to permit adequate and efficient rail service.

Under the plan of the bill the Secretary of Transportation would work with the affected states to determine the shape and form of the financial assistance program and to establish the basis upon which the states would share in the cost of the program.

It also would authorize the Secretary to defer or to waive the obligation of any state to contribute its share, pending action by the State legislature. This provision would be of great importance to the participation of states like Montana where there may be a time lag between the initiation of this program and the convening of the state legislature, providing needed flexibility to financing.

The bill, since it would amend the rail continuation bill, would contemplate Federal-State sharing in the same proportions as provided by Section 5 of the DOT Act.

Section 3 of the bill would provide for continuation of rail service pending the availability of financial assistance. This section would supersede any State or Federal law in conflict with it and would simply direct the Milwaukee Road to continue to maintain its existing level of service unless authorized to discontinue service by the Interstate Commerce Commission without objection from an affected state.

The bill also provides for an experimental corrective action program which has been successful in other contexts and which might be of particular significance on this railroad. Under its terms the Secretary of Transportation would be directed to establish a Task Force whose purpose would be to develop and stimulate programs to encourage cooperative self-help efforts by a combination of states, counties and municipalities, by the railroad, by shippers, suppliers, labor organizations and other interested groups. The Task Force to be named would consist of seven members drawn from all of the components of the railroad community. It would limit the number of programs to four in the coming year with an additional four for the following year. These programs are one year in duration but may be extended for an additional year.

A revised S.J. Res. 69 and its companion S. 1083 are desperately needed measures to maintain essential service on the Milwaukee road. We join with the States of Washington, Montana, Idaho, North Dakota, South Dakota, Illinois, Iowa, Missouri, Wisconsin, Kentucky, Minnesota, Michigan and Indiana and with all of those whose livelihoods depend on continued service to ask the Committee to take immediate action on these bills to avoid what otherwise will be a major economic disaster.

We thank the Committee for providing to us the privilege and opportunity to present these views.

Senator LONG. Let me just ask a few questions of you gentlemen sitting here. I will start asking my questions from this point forward, because I want to develop, if it can be developed, the case for what Senator Baucus has testified to.

As a predicate, let me make this point: Some years ago, the South Bend Co. was in the process of closing down, because the parent company concluded the operation was not profitable or not sufficiently profitable to justify investing any more money.

The workers tried to save their jobs by getting together and putting up some of their own money and asked anybody who would to help.

The city tried to help. I personally called Mr. Mizel and asked him to make EDA money available to give them a chance to save their jobs.

They went to work and took the company over. He did make the loan, by the way.

They took the company over and it made a profit.

They didn't have to cut their pay. They were able to get by without a pay cut. In fact, they made the company operate sufficiently well that within a few months they could raise their pay.

The company made a profit ever since that time.

I think mainly the fact was, they are working for themselves. This is a do or die proposition. Under those circumstances, they gave it everything they knew how to give and put all their enthusiasm into it and made it succeed.

That is the secret of free enterprise. Somebody working for themselves will try to make the business succeed.

I would think having done this type of thing, that this operation proved successfully, it would be worth trying it in regard to the Milwaukee Railroad.

I do think in fairness, if we ask Congress to put the taxpayers' money into this thing, the workers ought to put something in themselves.

Now they have about \$300 million worth of labor protection rights that would have to be paid, if this railroad was to be shut down.

I think it's fair to ask that they be willing to put some of that into it. If the average worker had about 6 years pay coming to him, if this shuts down, I think it would be fair to say: "If you would be willing to put up 1 year of that 6, that would be about \$50 million out of the \$300 million. We will try to get the Federal Government to go in with additional money."

I would like to see something that would indicate—for example, I personally could support a great deal more than \$50 million on the Federal side, if we think it's a viable proposition. None of us should go into it, if you don't think the railroad can succeed. I would be willing to recommend as much as \$200 or \$250 million of loan guarantees on the part of this Government, provided the workers put something of their own in it.

If anybody wants to be paid off and go home and say: "I don't think it's a good deal, and I don't think it's worth fooling around with, shut it down and give me my money now," I would be in favor of paying them off.

Have you discussed with their representatives and business agents what their attitude is to put some of their own money into it?

Mr. SNYDER. Mr. Chairman, we appear here today with one collective group in support of an alternative plan to continue the operation of the Milwaukee Railroad.

We appreciate the invitation by Senator Baucus and yourself, along with other representatives of labor to attend a meeting with Mr. Kelso last week.

Inasmuch as it was only a rough draft of a stock and employee ownership plan, we did respond to the request by the chairman and through telephone calls, and out of the 20 organizations, it's my pleasure to represent today, that belong to the Rail Executive Labor Organization, we have 15 organizations that responded in the affirmative, 4 with no reply, some companies that would not be affected here and 1 organization is in a convention at this time.

It would be their desire to work—they are receptive to such a plan that we had discussed on that day.

They have been receptive. In order to keep the Milwaukee operating, they would be receptive to make whatever could be worked out within these organizations when the plan is presented to them, to work out and respond, I think, in an affirmative way then, but we need time here.

Mr. Kelso said if that plan was to be put into effect, it would take at least 6 months. We understand that the study would be forthcoming from the DOT.

I don't know if we would be in a position to have a lot of faith in that, but we would—we do need a time to sit down with our groups—the railroad labor is willing to sit down with any group, Mr. Kelso, with you and your staff, or designated people, to get the show on the road, to get the ball rolling.

But we need some time.

Senator LONG. There is a story they tell in the Corps of Engineers about the difference between the way a contractor performs on a job, if he has the job by the day and the way he performs on it if he has it by the job.

They say if you had a piledriver operator on the job, if he is performing by the day, you can time the operations something like this: "by the day—by the day—by the day."

If he has it by the job, it goes like this: "by the job—by the job—by the job."

The record won't show that, but that will indicate the hammer is hitting five times as fast, if he has it by the job. If he has a certain amount of money to do the job, he will get it in a hurry. Paid by the time, he wouldn't do it as rapidly.

I don't think there is any substitute for motivation.

When people feel they are putting their own money into it and putting faith into it, and they have a chance to make a lot of money, if it succeeds, and if it doesn't they will lose their money, that type of innovation was what built this country.

I think workers interested in taking the railroad over ought to have the opportunity.

Sometime ago I protested against a situation with one of these railroads where the workers wanted to buy the railroad. Pittsburgh-Lake Erie. The workers wanted to buy the railroad. They would not permit the workers to buy the railroad. I protested about that. It seems at a minimum they should give the workers a chance to buy the railroad.

If it will change hands, why not give the workers a chance?

In this situation, I speak for the workers and feel that this thing need not be in this shape, and they think it could have been run better, that something could be done to make a success of this railroad.

I think so. I think if the workers want to take it over and make it more productive, I don't know whether they can make the whole system operate at a profit or not.

Some say they don't think this railroad can make money west of Miles City, but it seems to me if part of it can be made to operate successfully—maybe all of it—but the test is seeing whether the worker will put his own money into it. If so, we should give them the chance to prove it can operate successfully.

On that basis, I would be willing to support an effort to save this railroad on behalf of those who would put something into it.

I would hope that—the guys that want to put something into it ought to feel they have a job. The guys who don't well, we will pay you off; take your money and do what you want.

Mr. SNYDER. I would think it should be optional like that. We are very grateful for your interest in this, Mr. Chairman. That was music to our ears, when you made the statement you would put the Federal loan guarantee in there.

Just the other day this is really what triggered this, when you said you would meet us halfway. I think the railroad workers would meet you halfway in this.

The shippers have a lot at stake here.

It's my understanding maybe this might be the plan, the employees and the shippers.

We would support anything to keep the Milwaukee operating.

Senator LONG. If I were a business agent speaking for the workers, I would like to make those shippers a proposition and say: "Look, we want you in here, but if we could make this railroad make money, we would like an option to buy you out at a profit."

But I think that that railroad can be made to operate profitably if the employees had the kind of motivation that they would have. Those who want to stay with it to make that succeed.

Mr. SNYDER. Could that all be incorporated in such a plan that might be drawn up giving them that option?

Senator LONG. Up until now—all I am saying is up to now the railroad labor hadn't asked for it. If they asked for it, they just might get it.

If I were sitting where you are, I would be looking for the best deal I could get and say: "Well, if we can make this succeed, we would like the opportunity to buy the other guy out." They might be willing to do business on that basis.

Mr. SNYDER. We need legislation right away to begin on such a plan and see if we can't work it out.

Senator LONG. I would like to ask Mr. Simpson to come back up. Is he still in the room?

Mr. SIMPSON. Yes, sir.

Senator LONG. You heard our conversation about trying to work out a plan with the workers asking them to come up with equity, to the extent the workers want to participate, by saying how about putting up one-sixth of those benefits you have coming to you? Those who want to be in could be in. Those who don't could be out.

How does that appeal to you?

Mr. SIMPSON. I hesitate to comment as a representative of workers. We have taken the position with SORE that we are not a labor organization. We cut across a number of different crafts.

I think the other aspect to be considered is if the railroad keeps operating and provides jobs, of course there is a question of whether or not under the contracts any labor protection would be payable. I am not experienced enough to answer that.

I certainly concur with the sentiment expressed.

Senator LONG. My thought is people shouldn't be coming to Washington looking for us to help unless they will help themselves. If people are willing to put something into it, I believe we would find more appeal to those not involved.

As far as we are concerned, in my part of the country, we aren't involved in whether that railroad stays in business or not. If people are willing to put something into it themselves, it seems to me that's a basic point at which someone else can be asked to help.

Mr. SIMPSON. Let me speak for my members. They are willing to put in something. I don't want to talk about the contract unions. The members are willing to put in cash. To date, they have. They have supported Mr. Brodsky's study and my own efforts, and they are helping support this. We are willing.

Senator LONG. I can understand the attitude of the witness from Iowa who said as far as they are concerned Iowa feels they have gone the extra mile and shouldn't be asked to put up anything

more, and they won't. But there are other people who might feel differently about the matter. Those are the people we should be talking to to see what they are willing to do.

I don't find much appeal trying to help people solve a problem if they are not willing to try to help solve it themselves other than to say let nature take its course. Fine. That's it. But they didn't need to come here in the first place if that is what they had in mind.

If they are willing to join in an effort to make something succeed and they are willing to make a sacrifice and put something into it, I could recommend to my colleagues that we join forces.

If the Federal Government guarantees a loan, and that is what I was thinking of suggesting, that would mean if this doesn't succeed the Federal Government loses its money. That may be the answer to the problem.

I won't recommend we put anything into it unless it looks to us as though this had a chance to make money. For that matter, I won't recommend a working man or shipper put anything in if he would just lose his money.

If that is all there is to it, you ought to just call it quits.

Mr. SIMPSON. It was the feeling in our organization that that was the first issue to be addressed. That is why we did the viability study. We don't want a dead horse.

With regard to the other parties that might make a commitment to the program, our experience in dealing with shippers has been that they are very interested and they are willing to assist if there is some assurance there will be enough support to do the job.

Senator LONG. Thank you very much. I appreciate what you have told me.

I would like to call back the first witnesses we had today, Mr. Stanley Hillman, Trustee.

You may not be familiar before you came here today with the idea of workers and shippers making some money available to their railroad—workers out of what they are entitled to draw from labor protection arrangements and also the shippers out of something—out of money they would be asked to come forth with. Perhaps the State government might be willing to put something into it.

Recognizing the fact there tends to be higher employee motivation when the workers are working for themselves and have their own money in it, what is your reaction to the possibility that this railroad could be made to make money upon the entire system?

STATEMENT OF STANLEY E. G. HILLMAN—Resumed

Mr. HILLMAN. Mr. Chairman, I don't think that it is possible to operate the entire system without a very large infusion of funds. The Booz-Allen report indicates that the amount is something like \$1 billion. I don't think that it is in anybody's mind that that amount of money would be available.

On segments of the railroad, if a viable program is presented, I would say now and I have said consistently since the middle of last year: of course, I believe it might be possible to have the Milwaukee make money.

I think I should just take a little time to mention that I have had this problem on the table, so to speak, for quite some time. When I first became Trustee in February 1978, it was very apparent that

time was a more serious problem probably than was cash because there were government funds available in some areas for some purposes. Time is of the essence primarily because the condition of the track and equipment is absolutely deplorable. Really, little had been done for a period of 10 years.

There comes a point in time when equipment and track deteriorate so rapidly that you just can never catch up.

My first concern was: Where are we going to collapse physically before we can do something about it? The Milwaukee had received Federal 4R Act funds for its Chicago-Milwaukee-Twin Cities main line. An application was in process to continue that program.

At that time, that line was the only line that was eligible for those funds. It has been generally conceded, with the limited funds the FRA had, the FRA would not put money into any line that didn't show at least 20 million gross tons of traffic. This pretty well eliminated all our lines except that main line.

My greatest concern was for the transcontinental line because that line could collapse at any time within the next 2 years. That was February last year.

Given the time it takes to do something, to get money to do something on the line, you are talking probably 2 years.

My staff advised me at that time that they thought perhaps they could keep the line glued together for 2 years, so I had to do something reasonably quick. I couldn't do things in series; I had to do them in parallel.

At the same time I was having the Booz-Allen study done. I believe we have collected in this group at Booz-Allen probably the most experienced and knowledgeable people in the area of analysis available at this time.

Maybe you are thinking, what was the capability of the people who did the viability study for SORE?

A comparison of the capabilities of the staffs that did these jobs is worth looking into.

In view of the fact that I could not see my way—or I could not borrow money under the then existing regulations, I felt in order to preserve service in the public interest I should look towards those railroads who possibly would be interested or could be interested in purchasing parts of the line. So I started fairly early in the year to enter into confidential discussions to see if there was a possibility, just in case an emergency turned up.

This was being done, as I said, concurrently with the Booz-Allen evaluation as to whether there was any part of this railroad that could become viable. The results of the study show that none of it is viable in a true business sense. It can't sustain itself.

I think that is recognized generally of the industry as a whole. The industry makes less than 2 percent on its investment. That is not attractive.

Those railroads which continue to be successful have lots of other resources available which enable them to keep going. Density is the name of the game in the railroad business now. We didn't have the density on the transcontinental line.

There is lots of wishful thinking that we could increase density if we provided services comparable to the other railroads, but how do you do that?

You would have to spend \$100 million to put the track of the transcontinental line into shape and even that wouldn't make it comparable to the service the other railroads would give.

Let me give you an example. It takes us three times as long to move a train from Chicago to Seattle as the BN or UP. In the public interest, that is a disadvantage because a car or locomotive, where BN could use one, we would have to use three. As traffic and equipment deteriorates, that gets worse and worse. You are entering into a game you really can't win if you have no money to improve your equipment.

We were desperately short of locomotives in February last year. We had about 250 locomotives available and we need 450. Locomotives are in short supply throughout the industry. We were able to lease locomotives and I put as much money as was available to me into our own locomotives to try to build our fleet up.

We had been somewhat successful. But after the severe snows which tied up the Midwest very seriously this year, our rate of recovery was much slower than anticipated. That is what created our cash crisis.

If the heavy bad weather early this year hadn't come about, I would not be \$50 million short which I am today. It cost me \$50 million to clear up that problem. We have never recouped since then.

If I was a shipper, I am sure—shippers were beginning to leave us in 1977 when the situation was bad. When the bankruptcy petition was filed, it caused more shippers to leave. When we went through the first bad winter, even more shippers left us.

This year, still more shippers have left us. I made the statement 3 months ago that we would never survive another winter.

I had borrowed \$10 million in March and \$10 million in April. In May, I applied for another \$15 million part of which I received the other day.

We are losing money at the rate of one-half million dollars a working day. It is time that is of the utmost importance.

Last year in September I published for the ICC a map indicating what lines were potentially subject to abandonment.

Our entire system contains 9,800 miles or route. The core, which includes the coal line to Miles City, which is of utmost importance, totals 2,500 miles. There are 800 additional miles in the core area which are in process at the ICC for abandonment, which we would exclude from the embargo. That totals 3,300. That leaves for direct service 6,500 miles. Of that, only 1,500 were not previously indicated on the map which put shippers and everybody on notice that eventually many lines may have to be abandoned—a signal that they'd better start looking elsewhere. We can't profitably operate the 5,000 miles of line on that map which are included in the proposed embargo.

So we have in effect 1,500 miles which came as a surprise to everybody.

The area most severely affected is Iowa, which loses 1,000 miles. But you heard the testimony from them; they recognize there is not room for all the railroads there.

Senator LONG. How many miles?

Mr. HILLMAN. Over 3,000 miles, which is what we would continue to operate.

Since making the announcement of a probable embargo, we have had offers from some of the other railroads there to purchase lines from us. That State, in effect, will not be devoid of rail service.

Southern Minnesota has 300 miles which are of utmost importance to them. We are now trying to work out something with them similar to what South Dakota and North Dakota and Minnesota are doing to save the very important coal-carrying line to Miles City.

In Illinois, there are 200 miles involved in the proposed embargo.

The big issue is the sentiment, if you will, the idea that it is necessary to have three transcontinental lines across this country.

The BN has two very fine lines. The UP, with an interchange at Omaha connecting it with the Chicago & North Western, provides a third. There just is not enough traffic for four, and a weak fourth at that.

To put money up front, the kind of money we are talking about, hundreds of millions of dollars, as a risk to say we can make a go of it, when you are combating two strong railroads like BN and UP, in my pure business judgment I don't think it can be done.

Now, the SORE proposal indicates that in the next 5 years they can increase volume 70 percent, which is a compound growth rate of 14 percent.

No company grows that fast, let alone a railroad.

I think that the FRA's independent report will be the arbiter between what we see, and we think we have done a very detailed study, and what I think is a back-of-the-envelope study done by SORE. It needs to be looked at before anybody jumps off a cliff. That is looking at the thing in the broadest scope.

Losing \$500,000 a working day is \$10 million a month. If my embargo is not approved by the court or is delayed by the Court, that \$50 million left in ERSA disappears very quickly. Within 5 months it will be gone and we will be back where we started.

In the meantime, the plant is deteriorating further. The uncertainty among shippers will remain. They will be less inclined to go with us. Morale internally is shocking. It has been since bankruptcy was declared.

You are facing a very deteriorated railroad. The plant is going downhill so fast—in detailed testimony which I have submitted to this subcommittee, Mr. Chairman, shows many, many lines to be within months of literally going out of service.

The job a trustee has in balancing the public interest and the private interest was somewhat simpler when the bankruptcy laws were promulgated 40 years ago. Then, railroads had most of the transportation business. It was easy to recapitalize and keep on going.

Today, with the tremendous amount of cash the railroad requires, and nowhere to get it from, it is quite a different story. It is almost an untenable situation. You can't do both of the things a trustee must do, at least not fully.

So what I tried to do is to look half toward the creditors' interest and half towards the public interest. I can save part of this

railroad, I believe, and reorganize it. There will be hardships in many places, but I don't think there is any commercial hardship.

Most shippers will find all the means of transportation they need, mostly rail, if the sales we contemplate are made.

The hardship on the employees is the thing that concerns me more than anything else. If you close a plant in a normal business, you give 30 days' notice and the people don't have their jobs. That is normal business. Railroad labor is much better protected than that.

But what concerns me—and we will step up to the labor protection requirement, whatever it ends up to be—but what concerns me more is that the period between the layoffs and any settlement against the estate may be years off. What happens between now and that time to these individuals?

That really is the public interest item that concerns me and worries me more than anything.

The shipper concern: I think the railroad industry as a whole—you are well aware of it, the deregulation bill, et cetera—the day that every State has to have two railroads is gone. Other modes of transportation exist.

The Milwaukee has been a whipping post for ratemaking. During the hearings last week most of the shippers said, "We want the Milwaukee there. They are innovative." The result is we have been making good rates but we have lost money for the past 7 or 8 years.

Where do you go from here? I earnestly believe—I think you must recognize that eventually we run out of money. Initially when the SORE group came along, they advised me they had potential Japanese buyers. I couldn't wait. I wrote and said: "Let's see where it is." It never transpired.

SORE needs about \$170 million in Government funding. It needs it in order to get its program off the ground. Yet it ignores the equity interest.

I have reason to believe—Mr. Hoppe can talk to this—SORE has underestimated the rehabilitation requirements. More importantly, I think that area is wishful thinking.

All of a sudden we can become better and beat the strongest competition there is and increase revenues 14 percent per year? That would be magnificent if it could be done.

Senator LONG. You indicated you thought it would take billions of dollars to put this railroad in shape. How much would you estimate would go for rolling stock?

Mr. HILLMAN. About two-thirds.

Senator LONG. So with \$1 billion needed, about \$660 million of that \$1 billion would be for rolling stock?

Mr. HILLMAN. Yes.

Senator LONG. The thought occurs to me that the railroads will need rolling stock anyway. I would think that if you just set up a separate entity and the Government borrowed the money to buy a lot of rolling stock, assuming this railroad weren't a success, I would think you could sell that rolling stock for what you put into it.

You shouldn't lose much money on your rolling stock because I assume you would be buying the latest stuff off the production

lines. What you would be buying would be more than equipment. It wouldn't be a loss on your hands. It would improve the quality of the railroad industry in general that that rolling stock would be available; isn't that correct?

Mr. HILLMAN. Yes. It's about \$480 million for track rehabilitation.

Senator LONG. So you need about \$480 million for track rehabilitation. Out of that, how much of that is west of Miles City?

Mr. HILLMAN. 258 million.

Senator LONG. I don't think the railroad can make it west of Miles City.

Mr. HILLMAN. From the Twin Cities west, 258 million. I don't have the figure for west of Miles City.

Senator LONG. Then you would need about \$122 million east of Twin Cities; is that correct?

Mr. HILLMAN. \$200 million. Mr. Chairman, don't get me wrong. Nothing would make me happier than if ESOP could work. I think it's a great idea. But I think the financial analysis and the understanding of what the problem is is missing somewhere in an enthusiasm to continue the entire railroad.

The whole wouldn't work. In the SORE proposal, they intend to take or exchange for the assumption of debt, the Milwaukee Land Co., the stock of which has been pledged to the first mortgage since 1945.

The mortgage holders will fight for years before they will ever let the only earning asset of the total operation be transferred.

Senator LONG. What is that, you say?

Mr. HILLMAN. The Land Co. In SORE's program it states the acquisition of the Land Co. is essential, because it earns about \$12 to \$15 million a year which in the first several years would be applied against the railroad's losses. I myself had great trouble in getting the creditors to allow me to use any proceeds from the Land Co. I did that about a week after I first arrived, and they fought me through court until I came to a settlement just 6 or 7 weeks ago.

I think SORE made some assumptions without fully understanding the financial implications.

It will be burdened with a debt ratio of about 10 to 1, which is unheard of in business.

Senator LONG. Now have you thought about trying to make that railroad make a success? I know you thought about the idea of saying you start at some given point. If you are trying to make it work, trying to make what you could be viable, what would you take to make it succeed?

Mr. HILLMAN. In my proposal, the part that may work is primarily the main line from Montana to the Twin Cities, most of the States of Minnesota, Wisconsin, and Illinois, down to Kentucky. That is what the study shows has a potential.

The reason I selected it was that it was the core which required the least investment. In the public interest, we can't afford to run any more. The stretch from Miles City to the Big Stone power plant was of great concern, because there was no other railroad to operate that. Senator McGovern spent a lot of time in lots of meetings to try to find solutions; and initially, when I went down

to meet with the Commission and with the Secretary of Transportation on May 1, at that time South Dakota came through with the idea of making a grant to the Milwaukee sufficient to put the track in shape for the next year, so that something could be worked out in the interim.

Simultaneously the FRA had a meeting with the States involved in the process of trying to find a solution.

If that hadn't been done, that track would have been out before the end of this year, and we would not have been able to move coal to those power companies.

Senator LONG. How much track is that you are speaking of?

Mr. HILLMAN. About 700 miles. It's the most difficult area. There was no other railroad that could do the job, even under directed service.

I do think maybe the application of ESOP is feasible, if we can find a viable core, I think you will recall that ConRail looked at ESOP and it was finally discouraged, but I think if there is a viable core, on which we then can expand the capital strength of the railroad by employee interest, I think it has an application. But to burden an employee with something that may never get off the ground is a big mess.

Senator LONG. I don't think you want to see employees lose their money. I wouldn't urge the employees to put their money where they will just lose it. I will have to study this record and tell you all the details about it and perhaps get more before we can recommend this to the Senate.

I would certainly not recommend to an employee to put his money into something, if he doesn't have a reasonable chance to succeed.

Make it more efficient and make it operate more effectively and put a lot of dedication and zeal into it.

If they can't make it succeed, it could be sort of foolish to put them into it.

Just like I wouldn't advise a lot of friends I have known to go into a business and work hard, as they might if you are convinced that business can't succeed.

To the extent that it can succeed, I would be interested in helping them.

Do you think this segment you are speaking of would have a chance to succeed, or that you are talking about?

Mr. HILLMAN. In my opinion, it has the best chance of success of all of them.

Senator LONG. You don't think it's too good a chance of even that, I take it.

Mr. HILLMAN. No. Marginal, at best. Again, in the public interest, there would be fewer people laid off. If we come to the point where there is no more cash, and we exhaust the \$50 million of ERSA money—I was pleased to hear Senator Baucus indicate that the elimination of the priority of ERSA ahead of everybody else is being considered—I made that suggestion in testimony I gave last year and that would be very helpful.

In court I will not have as much problem as I have had up to date in getting approval of that ERSA money if the priority is eliminated.

But ERSA will be exhausted. In the meantime, what do we accomplish?

Senator LONG. Suppose we think in less ambitious terms of trying to see this railroad succeed with less miles and smaller operation, assuming it could succeed, it could do well.

Would there be anything at that point to keep the railroad from going back and laying ties and race back in to extend service out to an area where it previously served, which it had to abandon?

Mr. HILLMAN. Yes, Mr. Chairman. We have posed this at meetings we had with many of the States late last year.

I think the thrust of the Montana and SORE program is for the future. Rightfully so.

But we can only live from day to day. We can't live for the next 6 or 10 years. But if those lines are essential for the future expanding western trade, then they can be—the States, through the good offices of the FRA, can borrow money, railbank the track and leave the track the way it is, so when business does come back or expand, it's there.

I would recommend the States look seriously at that.

But in my opinion, currently, there is not the traffic. There is tremendous competition.

Any expansion that is contemplated there, the other railroads won't sit back and say: "Come and help yourself." They will fight and they have got many more weapons to fight with than we have.

Primarily, money.

Senator LONG. Thank you very much.

That concludes this hearing for the time being.

[Whereupon at 1 p.m., the hearing was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF HON. JOHN CULVER, U.S. SENATOR FROM IOWA

Mr. Chairman, I want to thank the members of the Surface Transportation Subcommittee for the opportunity to discuss the impact of a Milwaukee Railroad service embargo on the state of Iowa. Later this morning, the subcommittee will hear testimony from Mr. Raymond Kassel, Director of the Iowa Department of Transportation, on this important subject. IDOT has been holding a series of hearings with shippers, elevator operators and farmers who rely on the Milwaukee Railroad, and his testimony will be most useful to the subcommittee.

As a leading agricultural state, Iowa depends upon an economical and efficient rail transportation system. An integral part of that system is the 1,400 miles of Iowa track operated by the Milwaukee Railroad. It consists of two main lines—a northern route from Sheldon to Marquette and a more southerly route from Council Bluffs to the Mississippi River—and a number of local branch lines which provide critical services to smaller grain elevators. The Milwaukee carries about 50 million bushels of Iowa grain annually, approximately 15 percent of the total amount of grain shipped by rail in the state.

Mr. Chairman, it is not necessary to recount the Milwaukee's recent misfortunes at great length. Bankrupt since December 1977, the Milwaukee trustee has petitioned the federal court for permission to embargo service along three-fourths of its total 9800-mile system. The preliminary plan called for a suspension of operation along 1,000 miles of Iowa track, but the Milwaukee has amended this petition and now seeks to terminate all service in Iowa.

While there is general recognition that the Milwaukee cannot maintain track and equipment over its current system, I am, nevertheless, deeply concerned about the wholesale, "meat-axe" dismantling of the Milwaukee Railroad in my state. The short-term impact is particularly unsettling. Farmers and shippers have not had sufficient time to make plans for moving their grain by other railroads or alternative modes of transportation. Grain elevator operators are left with full bins and no way to ship them to eastern or southern markets, and the economic loss to operators and customers may be substantial.

The Interstate Commerce Commission (ICC) has developed a preliminary "directed services" proposal for Milwaukee users should the suspension be permitted to begin on May 31, 1979. I am pleased that the Commission's plan will continue about 75 percent of current Milwaukee service in Iowa, including both main lines, during the initial 60-day period. The Commission has worked diligently under difficult conditions to fashion a "directed services" plan, but has left unresolved several questions of critical importance to the citizens of Iowa. I would suggest, therefore, that an embargo by the railroad be delayed so that the ICC can consider these questions and assure Milwaukee users maximum service with minimum disruptions.

For example, the state of Iowa and private shippers have loaned the Milwaukee almost \$5 million to rehabilitate track under the state rail assistance program. If the Milwaukee is permitted to suspend operations along those portions of track that have been upgraded with private and state assistance, I urge that explicit provisions be developed to assure that shippers who have contributed to the track rehabilitation are promptly and fully compensated.

Second, the Milwaukee is part of an experimental rail-barge tariff program which guarantees shippers a supply of boxcars at a set tariff to transport grains to the Mississippi River and by barge to the Gulf of New Orleans. The "directed services" plan should specify whether the single tariff and boxcar contracts already in effect will be honored by alternative carriers.

Third, the Interstate Commerce Commission should prevent the Milwaukee Railroad from removing high-quality equipment from the embargoed areas to its proposed "core" system. Major portions of the Milwaukee line in Iowa are capable of providing efficient and profitable service if track and locomotives are maintained in good condition. Other railroads—including the Chicago and Northwestern and the

Rock Island—have indicated an interest in purchasing part of the Milwaukee track, and shippers must be able to demonstrate that there is a productive market for hauling grain along the current Milwaukee line. If existing equipment is used where possible, the necessary number of cars for users will be assured and the capacities of the other railroads will not be stretched.

Mr. Chairman, these issues should be resolved before a "directed services" order is effectuated. I was an original co-sponsor of S.J. Res. 69, which will delay any termination of operations for a period of 90 days while providing emergency funds to help maintain services during this period. This legislation is not designed as an open-ended, long-term, federal "bail-out" of the Milwaukee Railroad, but a prudent and interim effort to continue existing services pending a comprehensive solution to this problem. The Surface Transportation Subcommittee should approve legislation postponing the proposed Milwaukee action for the full 90 days in the near future.

Finally, Mr. Chairman, it is necessary to look beyond the ICC's plan and consider the long-term rail transportation needs of the people of Iowa. This, of course, consists of reliable and efficient rail service at reasonable cost. This can best be accomplished if there is a healthy and balanced competition among rail carriers. It would be in the best interests of the people of Iowa for several railroads to assume current Milwaukee services. I hope the Interstate Commerce Commission and the Surface Transportation Subcommittee will encourage other Midwestern carriers to expand their systems if the Milwaukee Railroad reduces its operations or is forced to liquidate entirely.

The Milwaukee Railroad's request is illustrative of the problems facing the Midwestern rail system, and a challenge to the private and public sector. It is imperative that both industry and state, local and federal governments continue to work together to develop a final solution that provides the citizens of Iowa, the Midwest and the nation the kind of efficient and sound railroad freight system they need and to which they are entitled.

Thank you, Mr. Chairman.

STATEMENT OF HON. JOHN MELCHER, U.S. SENATOR FROM MONTANA

I appreciate this opportunity to raise with this Subcommittee the importance of the Milwaukee Railroad to the nation, the northwestern and northern tier region, and my home state of Montana.

The Milwaukee tracks run across the Fort Union Deposit, the nation's and one of the world's largest deposits of coal. The Milwaukee is only one of two railroads serving this area. Over 50 percent of the deposit is easily accessible to the Milwaukee system.

But, just as there is a large deposit, there is and will be a large demand for this coal. During the next ten years, in the 19 states easily serviced by the Milwaukee either through rail interlining or intermodal interconnection, more than 190 coal fired electric power generating units have filed for permits to operate, and nearly 150 of these in the first years of the 1980's. This does not take into account the expanding industrial sector's demand for domestic coal. Nor does this take into account exportation of coal to the Far East, which is expected to increase through our northwest ports.

Add to the above components, the fact that rail service out of this deposit ran 10 million tons short during the past year and it becomes apparent why the loss of the Milwaukee is a disaster to the nation.

During the most recent session of the last Congress, we passed the Power Plant and Industrial Fuel Use Act of 1978, better known as the Coal Conversion Act. This law forces the shift of our industrial and electric generator power plants from other fuels to coal. Obviously, the intent of this law cannot be fulfilled if the coal cannot be delivered to the market place.

With this factual scenario as a background, I introduced S. 967. On May 1, 1979, the Senate Energy Committee held hearings on this legislation. On May 2, 1979, because of the great importance given this legislation as it related to the Milwaukee, the Senate Energy Committee by a 14-0 vote, passed out a substitute version of the original legislation. The following day, May 3rd, the legislation was passed unanimously by the Senate. During the bankruptcy proceedings that followed on May 4th, Judge McMillen was quite impressed with the interest and efforts of Congress embodied by these actions with respect to the Milwaukee.

Judge McMillen, Trustee Hillman and the creditors now have placed the Milwaukee bankruptcy proceedings at a critical juncture. They have placed the Congress in the unenviable position of having to "put-up or shut-up."

In addition to cosponsoring the resolution to be introduced by Senator Baucus, I intend to introduce legislation to assist the Milwaukee on a longer term basis. The legislation will be, I believe, acceptable to the Congress, the Court, the bankruptcy Trustee and the creditors.

The legislation will:

(1) Amend the 4-R Act to include a new revolving fund similar to the fund of the Emergency Rail Service Act which will provide seed money for employee stock option and shipper stock option plans.

(2) Amend the old Section 1(16)(b) of the Interstate Commerce Act to require carriers in bankruptcy to be the directed carrier for the first 60 days of directed service without the requirement for 6 percent profit, but with financial assistance assuring that the creditors base will not be eroded.

(3) Amend the Emergency Rail Service Act so that funds provided from it are not the highest lien on the railroads property and priority in payment under the Bankruptcy Act.

(4) Amend Title V of the 4-R Act providing a new assistance program for railroads providing assistance to areas where agricultural and natural resources are the commodities predominantly carried.

(5) Amends the Local Rail Assistance Act by extending the authorization date. The above bill when enacted, would provide the type of assistance acceptable and help the Milwaukee get back on its feet and become a profit tax paying railroad, which may, if not all, prognostications say it can be in the near term.

Mr. Chairman, I would like to close by re-emphasizing how important timely Congressional action is to the Milwaukee proceedings. The Judge is threatening in the next couple of days to grant the Trustee's requested embargo order. When that order is granted, directed service through the ICC becomes the rule of the day. I believe, and the ICC agrees, that directed service is expensive and does not provide the type of service from which a legislative solution can be accomplished. Therefore, any assistance you can provide it keep the Milwaukee from entering directed service phase would be greatly appreciated.

STATEMENT OF HON. LARRY PRESSLER, U.S. SENATOR FROM SOUTH DAKOTA

Mr. Chairman, Members of the Subcommittee, I deeply regret that I cannot attend today's hearing on the financial crisis of the Milwaukee Railroad. Because of a scheduling conflict, I will be en route to South Dakota and will not be able to participate in today's proceedings on this issue which is of vital concern to my state and to the whole midwestern region. Upon returning, I hope to have the opportunity to present my views personally when the Subcommittee next convenes.

Under the Milwaukee Railroad Trustee's proposal to halt all Milwaukee rail services west of Minnesota, South Dakota stands to suffer the heaviest losses in economic and social stability. Approximately 65 percent of rail trackage in the state is subject to abandonment. Not only will agricultural activity be enormously impaired, opportunity will be lost for industrial growth and new investment in the state.

In the short term, continuity of service must be assured to protect agricultural shippers dependent on the Railroad as the harvest and peak shipping season approach and to avert disruption of the fuel supply to the Big Stone City Power Plant. In the long run, dependable rail service is vital to the planning and development which will feed the state's economy. The challenge before us is to find alternatives which will preserve rail service in the midwest and great plains states while serving as a model to the entire rail industry.

I have long supported the concept of rail cooperatives to allow shippers the opportunity to retain service by purchasing the rail bed and track. On March 29, I introduced S. 839, the Rural Rail Cooperative Act of 1979, which would establish a Rural Transportation Office to offer assistance for cooperative ownership of rail bed and track. Based on the credit system of the Rural Electrification Administration which has shown so much success in serving the needs of rural areas, the measure would allow continuation of rail service through the participation of those who use it.

To increase the viability of many of the light density lines in the area, the efficiency of our marketing system for grain and other commodities must be improved. I endorse the concept of the regional grain subterminal to ensure the traffic needed to make lines more profitable.

In addition to planning for improvement of our transportation and marketing systems, it is vital that we offer assistance for rehabilitation of the severely deteriorated lines in the Milwaukee system. This assistance is essential to allow continued

operations and to encourage other carriers to purchase the lines to be abandoned. Although there is wide agreement that transportation needs will be best served by leaving the industry in the hands of the private sector, it will be necessary for us to provide assistance to encourage the Milwaukee and other carriers to undertake the enormous task of rehabilitating the lines in order to make operations profitable.

The task before us is great: we must develop a new plan to retain efficient, economical rail service for the shippers who currently rely on the Milwaukee Road lines.

Thank you.

STATEMENT OF HON. JIM LEACH, U.S. REPRESENTATIVE FROM IOWA

Mr. Chairman, I should like to comment briefly from the perspective of a Representative from Iowa on the future of rail service in Iowa and to suggest a framework for I.C.C. and Congressional action relating to assignment of Milwaukee Road trackage within my State.

As you know, the proposed embargo by the Milwaukee Road of a substantial part of its track service is unprecedented. The I.C.C. has responsibility for determining alternative service, and in this regard, I should like to urge the Commission to consider actions affecting Iowa within the following framework:

(1) Every conceivable effort should be made to maintain the most comprehensive possible service within the State. Over the past decade Iowa has moved prudently toward track shrinkage and we have today a very viable rail infrastructure with substantial usage by industrial as well as agricultural shippers.

(2) No one railroad should be allowed to dominate the State. Iowa shippers believe in the principle of competition and we are convinced that service will be better and more economical, particularly on branch lines, if competitive options are available.

(3) A premium should be placed on railroads willing to work innovatively on an intermodal basis with other forms of transportation. Grain, for instance, often moves most economically by truck or barge for a part of its route. The interest of commerce is best served by a railroad willing to stress service to customers, rather than maximization of miles shipped by rail. In this regard, Iowa cooperatives and corporations have a substantial investment in rail cars and loading and unloading facilities. If rail-barge cooperation is obtained, rail cars may be used far more efficiently than if cars are routed exclusively to port facilities. The importance of the rapid and flexible, as well as economical, movement of grain cannot be stressed enough. Iowa farmers produce for world markets. In recent years the capacity to produce grain has often outstripped the capacity to transport it on a timely basis, causing the loss of sales opportunities, and in some instances, serious hardship for potential buyers of grain.

(4) Attention should be given to working with railroads that have viable Eastern or Western route systems. On the whole, Iowa grain is shipped either by rail to Texas ports or to New Orleans ports by barge. Rail shipping from Iowa to the East and West Coasts appears to have real possibilities as alternatives for grain movement, particularly as Southern port facilities are sometimes congested. In addition, potential instability in the Panama Canal Zone makes Southern ports less attractive for shipments to the Far East, and almost 1,500 sea miles would be saved by East Coast rather than Gulf Coast shipments to Amsterdam.

(5) The I.C.C. should carefully avoid trapping itself in a situation where possession of short-term rights represents a valid claim to long-term service. Competitive interest from as many railroads as possible should be encouraged during the coming months. The unprecedented circumstances involved in the Milwaukee's decision has taken the industry somewhat by surprise, at least with regard to timing, and requires a strong interim response by the I.C.C. However, interim actions should not become the cement for final accommodations. The best long term solutions may not involve the same railroads which may be assigned interim rights to the Milwaukee trackage.

(6) The Commission should work as closely as possible with the Iowa Department of Transportation in developing transportation options for the State. I know of no more competent state transportation department in the country, and its people represent in the truest sense "honest brokers" for Iowa.

(7) The I.C.C. should give as much consideration as possible to the future of the approximately 1,000 employees of the Milwaukee Road in Iowa. It would be my hope that provision would be made that any proposed new rail carrier be required to give priority hiring rights to these employees. They have given their careers to a railroad which has been caught in a competitive bind.

(8) Finally, it is my strong belief that the best long-term solution in the restructuring process is a private rather than public sector one. Iowans don't want a Conrail West. Any subsidies considered by the I.C.C. should be short-term only. A commercial rail system in Iowa should be able to stand on its own internal resources.

STATEMENT OF ROBERT E. HEINE, VICE PRESIDENT AND DIRECTOR OF TRANSPORTATION AND DISTRIBUTION, ITT RAYONIER, INC.

Mr. Chairman, members of the Subcommittee,

My name is Robert E. Heine, Vice President and Director of Transportation and Distribution of ITT Rayonier Inc., located at 605 Third Ave., New York, N.Y. 10016. In this capacity, I am charged with the responsibility of planning, organizing, directing, and controlling the shipping and receiving activities of this corporation for both domestic and international markets.

ITT Rayonier Inc. is a wholly-owned subsidiary of International Telephone and Telegraph Corporation, organized and existing under the laws of the State of Delaware, with main offices in New York, N.Y., for the purpose of manufacturing and marketing woodpulp and related articles for markets in the Continental United States as well as in export markets throughout the world. It ships woodpulp in bales and in rolls, plywood, other forest products, and chemicals from mills in nine U.S. states, including Washington, and from three Canadian provinces to destinations in North America and to ports of exit therefrom. Our particular concern is with Milwaukee Road's branchline which runs 50.8 miles between Port Angeles and Port Townsend, Washington, connecting with a car ferry that operates between Port Townsend and Seattle—a vital link in interstate commerce.

On April 24, the Milwaukee Road's trustee, Stanley E. G. Hillman, requested permission from U.S. District Judge Thomas McMillen to cease rail service by May 8 over 7,400 miles of the line's 9,800 miles of track through issuance of an embargo. The proposed deadline has now been extended to May 31. The justification is based on the allegedly poor financial condition of carrier, and apparently the mechanism is a substitute for normal abandonment procedures.

Rayonier ships and receives 256,000 tons of chemicals, lumber, plywood, veneer, and woodpulp through the Port Angeles-Port Townsend branchline. On the outbound, furtherance is effected via barge to Seattle where shipments are routed via transcontinental carriers, primarily the Milwaukee Road. In this respect, we are extremely concerned about the severity of the impact should the embargo be implemented. In addition to Rayonier's traffic, there are about 225,000 tons of other commodities moving on account of several shippers in the community. All these movements are exclusive to the Milwaukee Road.

Our company, a key industry in the Port Angeles area, employs over 1,000 people at that location. Inasmuch as all of our commodities are transported efficiently and economically only via rail box car and tank car, curtailment of rail service at Port Angeles would place us in a noncompetitive situation.

The Port Angeles Mill produces approximately 175,000 net tons of woodpulp annually, requiring the loading of 1,200 40-foot box cars in domestic traffic. In turn, the production of woodpulp requires the inbound movement of 26,600 tons of chemicals for which 350 tank cars are used. Equally important is the inbound movement of 12,500 tons of veneer, an outbound shipment of 36,000 tons of plywood, and 6,300 tons of lumber for a total of 1,300 box cars, or an aggregate total of 2,850 cars per year.

For the last several years, ITT Rayonier has been forced to put up with inefficient rail service, sporadic shortages of cars and locomotives, extremely poor condition of track and equipment, unusually lengthy transit time, and a high number of derailments. Our pleas to the Milwaukee Road management have generally gone unheeded, while performance has been steadily downward.

On May 9, the Milwaukee's president, W. L. Smith, testified before the House Subcommittee on Transportation and Commerce that the only lines which would not receive service would be those branchlines already candidates for abandonment, and that affected shipments could be rerouted under the embargo.

On May 21, Trustee Hillman testified before the Subcommittee on Surface Transportation of the Senate Committee on Commerce, Science and Transportation in support of the embargo. He stated: "Many of the Milwaukee's services, many of its lines, are by no means unique, nor irreplaceable, nor even essential. In many respects the Milwaukee's services duplicate those of other rail carriers."

The implication of both statements is that the Milwaukee's trackage is joint trackage with other railroads which have full access to all shippers. Thus, it would

not be necessary to direct continued service since other carriers already had rights to provide the service.

The Port Angeles-Port Townsend branchline fits neither of these classifications. Continued service via the branchline is absolutely mandatory if cost-effective distribution of finished goods in interstate commerce is to be sustained. There is no other rail service. The operation is essential to the present and future economic needs of Rayonier and other captive shippers in the region, and is clearly in the public interest.

For these reasons, we respectfully request that the Subcommittee investigate all potential alternatives to cessation of three-quarters of the Milwaukee Road's operations, as a consequence of embargo or abandonment, and that the Subcommittee give special emphasis to the Port Angeles-Port Townsend branchline. Prompt action is required to ensure continuation of essential rail transportation for the operations of ITT Rayonier Inc., and other captive shippers in the community, taking cognizance of the unique geographical and economic characteristics of the area involved.

STATEMENT OF THE PORT OF SEATTLE

Mr. Chairman and Members of the Committee, the Port of Seattle appreciates the opportunity to present its views with respect to the important issues raised by the current financial situation of the Milwaukee Railroad. In this statement, we will identify the importance of the services provided by the Milwaukee, and will point out several reasons why those services will become even more important in the coming years.

The Port of Seattle, a municipal corporation organized under the laws of the State of Washington, is charged with the responsibility for the promotion and development of trade through the marine harbor facilities located in Seattle. The Port also owns and operates Seattle-Tacoma International Airport, and speaks for shippers and receivers who use the marine facilities in Seattle. The port is an active participant in regulatory, judicial and legislative proceedings which could have an effect on traffic moving through the Pacific Northwest.

THE GROWTH OF THE PORT OF SEATTLE

Because of its unique geographical advantages and a concentrated, integrated effort by the Port, Seattle is now one of the most important container cargo ports in the world. Based on 1977 cargo statistics, Seattle handled more containerized cargo than any other West Coast port and ranked second only to the Port of New York and New Jersey in the United States in the total number of containers handled:

Table 1.—Seattle ranks first among west coast ports in container traffic and second only to New York among all U.S. ports

Rank and port:	1977 traffic ¹
1. New York	1,610,000
2. Seattle	607,366
3. Oakland	605,803
4. Long Beach	558,318
5. Jacksonville	212,913
6. Honolulu	188,406
7. New Orleans	163,104
8. Houston	160,125
9. Anchorage	152,544
10. Savannah	99,422

¹ Expressed in 20-foot equivalents, or TEU's.

Source: Containerization International, Dec. 1978.

As of 1978, the Port had invested a total of over 150 million dollars in its marine container facilities as part of an integrated and planned effort to attract high-valued general cargo. Because the size of the local Pacific Northwest import-export market is not large enough to sustain efficient use of these modern facilities, a very significant proportion of the cargo flowing through Seattle must come from or be destined to the midwestern and eastern United States (so-called "overland common point of OCP traffic"). This kind of high value cargo was among the first to become containerized and today the vast majority of it moves in intermodal steamship containers on water, and by rail on land. Furthermore, in addition to the traffic growth figures cited above, additional growth has come from traffic which moves by

way of mini landbridge tariffs, for which figures are not available from ocean carriers.

THE IMPORTANCE OF COMPETITIVE RAIL SERVICE TO THE PORT OF SEATTLE

Because of the tremendous importance to the Pacific Northwest of traffic moving to and from inland destination points in the continental United States (virtually all of which can move only by rail), the Port of Seattle is especially dependent on quality rail services. As this Subcommittee knows, the quality of rail services are typically measured in three primary ways by shippers: speed, availability, and price:

Speed.—One of Seattle's biggest natural advantages as a port is its geographic proximity to Asia. Seattle is one to one-and-one half days closer to the ports of the Far East than competitive ports in California. Seattle effectively loses this important time advantage if rail carriers serving Seattle cannot effectively compete with movements across the southern tier of the United States. This has been an increasing problem for the Port as the physical plant of the Milwaukee has deteriorated, causing delays in transit time.

Availability.—Seattle's tremendous investment in container handling facilities enables it to process an enormous volume of containers on a rapid and efficient basis. Because the great preponderance of these containers will move either into or out of the port via railroads, rail car shortages means Seattle effectively becomes a bottleneck. In other words, Seattle's container capacity becomes effectively governed by the rail capacity of the carriers servicing it. If capacity is not available to handle the traffic tendered, the geographic advantages and the tremendous intermodal transfer facilities located in Seattle become irrelevant. Availability of COFC flat cars has been an increasing problem for the Port, and this is discussed further below.

Price.—Shippers making choices between competing ports will do so on service factors only when one routing or the other is not heavily affected by price considerations. Trans-oceanic rates across the Pacific are the same to all West Coast ports, and therefore inland transportation costs largely determine which route is the cheapest. Marketplace discipline requires shippers to look at the bottom line, which is the overall transportation cost of the delivered commodity. The competition afforded by the Milwaukee on Seattle Midwest traffic has helped to keep rail rates competitive with rates from competing ports, and the loss of that competition by the Milwaukee could make Seattle rail rates higher in comparison with rates to and from the Midwest and competing California ports, where there is active competition from a number of healthy and aggressive rail carriers. While this is important in the current context, when viewed from the point of view of the deregulation of railroads now proposed by the administration, it becomes much more important.

The Administration has proposed legislation (S. 796), which is currently pending before this Subcommittee and which would largely deregulate the nation's rail freight network. The current regulatory framework would largely be replaced by reliance on competitive factors to govern marketplace behavior. While recognizing the importance and desirability of taking legislative and regulatory action to permit the nation's rail freight network to earn a return adequate to attract sufficient capital to sustain itself, the Port of Seattle is very concerned over the possible effects of deregulation on its competitive position with major competitive ports if at the same time Seattle is going to lose its primary rail competition on service to important midwestern and eastern markets. Presently, only the Milwaukee and Burlington Northern provide single-line service between Seattle and Chicago (Seattle's biggest market). The Union Pacific, which also serves Seattle, provides service to Chicago only through interchanges in Nebraska or Kansas City. The importance of the Milwaukee's role is underscored by the fact that its yard in Seattle is closest to the harbor area and it has always carried disproportionately more maritime-related cargo than its size alone might suggest. Over the past three years, the Milwaukee has handled an average of approximately 47 percent of all of Seattle's overland commonpoint container traffic:

Table 2.—Percentage of OCP container traffic at Seattle handled by all rail carriers—Average 1976-78, by pounds

Carriers:	Percent
Milwaukee	47
Burlington-Northern	16
Union Pacific	36

Source: Port of Seattle Records.

While the Milwaukee has played an important role in providing transportation service for freight moving through the Port of Seattle over the past several years, this is not to suggest that there has not been severe problems already with rail service to and from Seattle. The most significant problem to date has been car shortages. It has not been uncommon to run out of COFC flat cars for periods of two to three days, and this problem has significantly worsened in the last two years. For example, there have been periods when chronic shortages have occurred for months at a time, and at one point the Port made daily reports to the ICC for over three full months because there were insufficient COFC flat cars. These shortages have at times resulted in 400-500 containers being stranded in Seattle yards awaiting adequate car supply. A cessation of service by the Milwaukee could significantly worsen this problem. The additional responsibilities would have to be borne largely by the Burlington Northern, which has not always been able to keep up with existing demands over the past several years. The second major problem with existing rail services stems from the deteriorating condition of the Milwaukee's physical plant. Rail service from Seattle to Chicago has been typically advertised to offer fourth morning delivery, but lately the Milwaukee has been providing that service in 11 or 12 days. Obviously, for the Milwaukee to remain an effective competitor for high valued container traffic, improvement of its physical plant or some arrangement to permit joint utilization of the Burlington Northern plant in some instances is an absolute requirement both from the point of view of shipper service and railroad operating costs.

FUTURE TRAFFIC GROWTH FOR THE MILWAUKEE FROM THE PORT OF SEATTLE

The Port of Seattle, through its Planning and Research Department, has made estimates of the growth of future container traffic of the type discussed above over the next five year period. The prospects for additional traffic which could travel over the Milwaukee were never better. The Port estimates that by 1983 Seattle's OCP traffic (virtually all of which will move by transcontinental rail) will increase dramatically:

Table 3—Estimate of Seattle OCP container traffic for the next 5 years

	TEU's
1979	73,000
1980	78,500
1981	85,000
1982	91,500
1983	100,000

Assuming that the Milwaukee Road attracts roughly only the same percentage of this traffic in the next five years as it averaged in the past three years, it could be expected to be tendered a total of approximately 694,000 short tons or 104,000 TEU's of container traffic over the next five years. Furthermore, as discussed below, there is a strong possibility that the Milwaukee's share of this traffic could even increase beyond the historic percentages it has carried.

While all estimates of future traffic growth—and therefore business opportunities for the Milwaukee's services—are necessarily sensitive to many factors which cannot be predicted with complete accuracy, there are a number of reasons to believe that the estimates of growth in traffic through the Port of Seattle may be conservative. In addition to a very strong regional economy, major new developments are now taking place with respect to Seattle's trading partners which may add significantly to the amount of traffic flowing through the Port of Seattle. For example, the first Chinese vessel to call at an American port since 1949 recently called in Seattle. Seattle is the closest U.S. port to China, and it is not unlikely that a significant China trade will develop over the foreseeable future. The most natural port to efficiently service that trade would be Seattle. Also, increases in trade resulting from successful completion of the Tokyo round of multilateral trade agreements and the reduction of non-tariff trade barriers could significantly stimulate international trade. These increases represent not just new opportunities for the Port of Seattle, but also new opportunities for the Milwaukee Railroad. It should be remembered, however, that in order to take advantage of these new opportunities, the steadily deteriorating service of the Milwaukee—a function of its deteriorating physical plant—will have to be improved.

The Port of Seattle is acutely dependent on the Milwaukee Railroad for service by direct connections to a number of important points which are significant sources of Seattle maritime traffic. For example, the Milwaukee is the only carrier offering

direct connections to Milwaukee, Madison, Green Bay, Louisville, Kentucky, and other numerous points in Wisconsin, Iowa, Minnesota, and Illinois.

THE NEED FOR COMPETITION IN A LESS REGULATED ENVIRONMENT

The Milwaukee represents an important and irreplaceable source of competition for the Burlington Northern on transcontinental traffic originating and terminating for these carriers in Seattle, and as the regulatory controls that have governed railroad marketplace behavior are replaced through deregulation by competition, the importance of the Milwaukee grows tremendously. Unfortunately, the Union Pacific is not able to provide single line service to the primary destination and origin point for this traffic—Chicago. While the Port enjoys a good relationship with the Burlington Northern, and Burlington Northern's services play a vital role for the Port, Seattle does not relish the prospect of a lack of competitive transcontinental rail service from the Burlington Northern or any other rail carrier. Competitive pressures between carriers help provide competitive rail rates, improved service, and innovative rail plans. As important as this has been in the past, it could become absolutely vital in the future in a deregulated environment for rail freight services. Furthermore, there is little intermodal competition for this type of traffic at present, and there will be less in the future with increasing fuel costs further emphasizing the advantages already enjoyed by railroads over trucks for this type of movement.

Without the Milwaukee, there will be no competitive forces governing market place behavior on transcontinental movements to and from the Port of Seattle. By way of contrast, Seattle's competition for significant import-export traffic (Oakland and Long Beach) enjoy competition between some of the nation's healthiest and most aggressive rail carriers. Reduced marketplace pressures will operate to introduce rate disparities for similar transcontinental movements between ports competing for the same traffic. The net result could be a steady increase in transportation costs to shippers and receivers using the facilities of the Port of Seattle in comparison to cost for use of competitive California ports. There is a distinct possibility that Seattle-Midwest rates and service will be coming increasingly noncompetitive with similar movements to and from California ports. The elimination of the Milwaukee Railroad could, therefore, have strong anticompetitive effects, to the long-range detriment of both the Port of Seattle and its customers. Continued competitive rail service currently provided by the Milwaukee is thus crucial to the shippers and receivers using the facilities of the Port of Seattle. The Milwaukee stands to gain substantial increases in import-export container traffic over the next five years, and the removal of the Milwaukee services would result in possible monopoly transportation conditions for Seattle-Chicago service. Serious impacts in the Pacific Northwest and on foreign trade is a distinct possibility.

A TEMPORARY CESSATION OF SERVICE WILL HAVE PERMANENT AND IRREVERSIBLE EFFECTS

Any cessation of Milwaukee service will likely have a permanent effect on Milwaukee customers and Port users. Containerized traffic is typically high valued general commodities, much of it imported for retail sale. This traffic has a high inventory value, it must be moved quickly, and its delivery must be timed to meet seasonal markets. For instance, import clothing from locations such as Hong Kong, Korea, and Japan is destined for special selling seasons, such as Christmas, Easter, summer and back to school. Purchase commitments and shipping instructions must be made months in advance. If import shippers learn that Milwaukee service is even temporarily suspended, they will demand that all future shipping arrangements be switched to an alternative rail carrier. Shippers cannot run the risk that their cargo will sit on the docks. Without question, shippers for whom the Port of Seattle serves as agent will request that we cease using the Milwaukee. In many cases, shippers will investigate other ports and routings and substantial traffic may be diverted from Seattle to California with better rail service. Once customers change allegiances, it is very difficult to get traffic back. There should be no misunderstanding on this point: If the Milwaukee stops service, the traffic will be gone for the foreseeable future, even if the Milwaukee were to resume its service shortly thereafter.

THE COMMITMENT OF THE PORT OF SEATTLE

Given the important role the Milwaukee already plays, and the more important role it will likely play in a deregulated future with increased traffic flowing through the Port of Seattle, it is vital that every viable option for the continued operation of the services provided by the Milwaukee be adequately explored. The proposal of the SORE group (and any other option for continued service) deserves a thorough

examination by the Department of Transportation, the Interstate Commerce Commission, and relevant shipper and other interests. This can occur only if services are continued while a determination of viability is made by responsible government officials. A Joint Resolution requiring continuation provides such an opportunity, and we urge its immediate passage in order to forestall what otherwise will be a complete closing off of all options. Particularly in view of the fact that financial resources are currently available from the Emergency Rail Services Act of 1970, it is incumbent on Congress to move as rapidly as possible in order to permit the determination of whether the Milwaukee services can be continued and improved with the participation of affected employees and shippers.

In this context, the Port of Seattle would be fully willing to help provide traffic figures and projections, and otherwise assist in whatever studies and negotiations occur following passage of the Joint Resolution. The Port, in order to help assure careful study of all reasonable alternatives for continuing the services of the Milwaukee, would be willing to work with shippers using Port facilities to explore the possibility of contract rates for guaranteed traffic levels and rates to be provided for specific services, subject to administrative or legislative approval of such arrangements. Certain guaranteed traffic levels for the Milwaukee could substantially aid its financial viability. Immediately after passage of the Joint Resolution, the Department of Transportation, pursuant to its authority and responsibility under Section 401 of the Railroad Revitalization and Regulatory Reform Act of 1976, should initiate discussions and studies among affected parties. Every alternative should be explored in these discussions, including the possibility of reducing the fixed costs of both the Milwaukee and the Burlington Northern by way of joint trackage agreements and facility sharing arrangements.

The Port appreciates the opportunity to present its views on these matters and looks forward to providing the Committee with any additional information or assistance it might require.

RICO INTERNATIONAL CO.,
TRANSPORTATION CONSULTANTS,
Kent, Wash., May 15, 1979.

Senator HOWARD CANNON,
Chairman, Senate Committee on Commerce, Science, and Transportation,
Washington, D.C.

DEAR SENATOR CANNON: I have a News Release that advises that the Surface Transportation Subcommittee under your Chairmanship will hold an oversight hearing on the current financial crisis of the Milwaukee Railroad in Washington on May 21st. I of course cannot attend this hearing as a witness, but would like to give a few ideas and facts that if utilized I am sure they will help considerably in arriving at a sound and practical solution to the Milwaukee Railroad situation.

I note that the firm of Booz, Allen & Hamilton that were commissioned by the Milwaukee Trustee have certain findings that of course can be helpful in this hearing. May I add this note, I myself have been on Transportation Special Studies with Daniel, Mann, Johnson & Mendenhall of Los Angeles, Brown Engineers International of New York, Ford, Bacon & Davis of New York; and Systan International, Inc. of Los Altos, Calif. I mention this to indicate the level of my professional status and past endeavors in Transportation and Railroad Special Studies.

The following I believe can serve as viable guidelines:

1. Place an Embargo on the Milwaukee Railroad of not allowing it to operate West of Minneapolis, Minn., and allow the Group who wish to take over the operations of all lines West of Minneapolis to assume control of these lines. To operate as they see fit without lessening any service on any line (Main or Branch) at the outset. Allow the Milwaukee Motor Transportation Company's permits and franchises along this new Rail Lines West of Minneapolis to be assumed by the new railroad operations.

2. Even though this will be an "Employee" owned railroad, be sure that a truly qualified railroad trained and experienced person can assume and be appointed to Manage this railroad during its first two years of operations, and to be re-appointed for additional two year terms if approved by the Group of Directors. The appointed Manager to be on the Board of Directors.

3. In the write up for the permission of the "Employee Group" to take over the Milwaukee Railroad lines west of Minneapolis, have it written in and allowed that it will be permissible to make contracts for Amtrak Passenger Train operations, if mutually agreed upon.

4. The sooner that the new railroad line operations west of Minneapolis to the Pacific Coast can shed itself of all past Milwaukee Railroad Management considerations, policies, thinking and doing the better off it will be. The Milwaukee RR with its long time policy of do nothing, system of defeatism and pessimism plus possible calculated demise schedules similar to the recent Penn-Central debacle—to have it end and out of the way will be a "blessing in disguise".

5. If the Group headed by Lawyer Simpson in Washington State can assume the ownership or responsible operations of the Milwaukee RR lines West of Minneapolis as an "Employee Owned and Operated" Facility it will then be a different and vastly improved railroad operation. It can be made into a paying entity if allowed to perform under a vital management.

6. From my own circle of responsible railroad oriented personnel, I can give you the nucleus of a very competent Management Staff immediately upon request none of which now work for the Milwaukee Railroad. One of Amtrak's problems is that it has some of the Milwaukee RR's "staff infections" and allergy problems.

For whatever the above may be worth I mean it to be helpful and not as a grim reminder of past mistakes. I stand ready to help and work with you if called upon.

Sincerely,

ETHAN C. ROBBINS.

BROTHERHOOD OF MAINTENANCE OF WAY EMPLOYEES,
OFFICE OF NATIONAL LEGISLATIVE REPRESENTATIVE,
Washington, D.C., May 21, 1979.

Mr. C. M. MCINTOSH,
Executive Secretary-Treasurer, Railway Labor Executives' Association, Washington, D.C.

DEAR SIR AND BROTHER: I am in receipt of your telegram dated May 18, 1979, in which you inquire as to whether the Brotherhood of Maintenance of Way Employees is agreeable to the institution of an Employee-Shipper Stock Option Plan on the Chicago, Milwaukee, St. Paul, and Pacific Railroad Company.

This is to advise you in connection with the foregoing, that subject to the following conditions, the Brotherhood of Maintenance of Way Employees would be agreeable to undertaking discussions for the purpose of instituting an Employee-Shipper Stock Option Plan on the Milwaukee Railroad:

(1) The Plan would be voluntary so far as participation by employees is concerned and would not result in any cost to employees.

(2) A complete review of the Milwaukee's management structure would be instituted as soon as possible and appropriate action taken to increase its effectiveness.

(3) Maintenance of Way work financed by Federal monies would be performed by the Milwaukee Railroad's Maintenance of Way Employees and not contracted to outside concerns.

The foregoing outline sets forth the basis upon which an Employee-Shipper Stock Option Plan would be acceptable to the Organization. In consideration of the foregoing conditions, the Brotherhood of Maintenance of Way Employees is willing to commit itself to assisting the Milwaukee in instituting changes that would enable it to operate more efficiently and further, that the Brotherhood would be agreeable to discussing subsequent monetary issues in light of the Milwaukee's economic conditions.

I trust that the foregoing is responsive to your inquiry and should you require any further information or have any questions concerning this matter, do not hesitate to contact me.

Sincerely and fraternally,

O. M. BERGE, *President.*

MEMORANDUM OF SAVE OUR RAILROAD EMPLOYMENT

MAY 21, 1979.

This memorandum responds to several points made by Trustee Hillman during the May 21 hearing before the senate Surface Transportation Subcommittee.

1. *The midwestern part of the Milwaukee has the greatest potential.*—In fact, the midwestern part of the railroad has the least potential for long term viability, particularly if the Twin Cities-Seattle transcontinental line is not retained as part of the system. There are no healthy midwestern railroads because the systems are overbuilt, rates are depressed and operating expenses are extremely high. Transcontinental rates remain fairly high because most of the commodities are bulk, move

over long distances and are not truck competitive. At present, only one railroad competes with the Milwaukee between the Twin Cities and the Pacific Northwest as opposed to 5 to 8 railroads competing in virtually all the midwestern markets. The Pacific Northwest is one of the fastest growing areas of the United States. Shippers have testified that considerable additional traffic is available to the railroad today in the west.

2. *The SORE proposal is unrealistic because it anticipates 70 percent growth over five years which equates to a 14 percent annual compounded rate of growth.*—The growth projected by SORE is comparable to the growth experienced by the Milwaukee's transcontinental line between 1961 and 1973. In 1973 the physical plant collapsed and growth was adversely affected by the recession of 1974-75. Growth experienced by the Burlington Northern and the Union Pacific, particularly in the northern tier states, substantiates SORE's position that traffic is available. Also, the testimony of numerous shippers clearly demonstrates the substantial amount of traffic available to the Milwaukee.

3. *SORE has underestimated rehabilitation costs.*—SORE's rehabilitation costs exceed those proposed by Booz, Allen & Hamilton for the main line between the Twin Cities and Tacoma, Washington. SORE estimates rehabilitation of the main line to be \$118 million versus \$101 million estimated by Booz, Allen & Hamilton. In addition, SORE proposes to spend fully normalized maintenance of \$10,000 per mile on the main line, \$6,500 per mile on secondary main line and \$3,500 per mile on branch lines. These expenditures will hold and in many cases improve the track conditions of nonrehabilitated territories while funding alternatives such as shipper assistance, Farmers Home Administration and 4R Title VIII are reviewed.

4. *The new company proposed by SORE would have a debt to equity ratio of 10 to 1 which is unheard of.*—The new company proposed by SORE will have a debt structure similar to the Chicago & Northwestern Transportation Company. The C & NW provided approximately \$2 million of equity while assuming several hundred million dollars of debt. The C & NW has made substantial progress in rebuilding its fixed plant and rolling stock since the employee ownership program was initiated.

5. *Bad weather killed the Milwaukee. The filing of bankruptcy and two successive bad winters have caused many shippers to lose confidence and abandon the railroad.*—The Milwaukee has suffered through winters since its inception. Bankruptcies have also happened before. The significant difference is the utter failure of Trustee Hillman to act to help himself. He removed equipment from the West at a time of unprecedented demand to move grain, and during the 1978-1979 winter when the western operation was not seriously hindered by snow. (There was some snow drifting in cuts, but this would not have been a problem if regular service had been run.) Last year's winter was severe in the midwest where most railroads were shut down or severely curtailed for weeks.

6. *Density is the "name of the game" in the railroad business.*—Contrary to Trustee Hillman's statement concerning traffic density, it should be noted that Conrail has traffic density that surpasses any railroad in the nation and yet it has lost \$600 million per year. Also, the Chicago and Northwestern Railroad operates approximately 50 million gross tons per mile between Chicago and Council Bluff, yet the railroad is extremely marginal.

Density is relevant to the extent that a revenue base is required to support the operation of the railroad. As traffic is added to the system, unit costs decrease until an optimum efficiency is achieved. Once that efficiency is accomplished, additional traffic tends to increase the unit costs of the system.

SORE's analysis indicates that sufficient traffic is available in transcontinental service to provide the necessary revenue base and that considerable additional traffic is available to direct the system toward an optimum efficiency.

7. *Rehabilitation of transcontinental line would require \$100 million up front, but would still not provide competitive routes. It takes the Milwaukee three times as long to move a train from the Twin Cities to the Pacific Coast as it takes the Burlington Northern.*—The Milwaukee introduced a 53 hour service between Chicago and Seattle during the early 1960's. This service can be re-established with an investment of \$118 million over five years between St. Paul and Tacoma. While Burlington Northern advertises a comparable schedule, the vast majority of its traffic moves over its system at speeds which are more comparable to Milwaukee's present service.

The Booz, Allen study prepared for the Trustee states that equipment reliability and cost are far greater concerns to the shippers than train speed. SORE addresses these items in the early years of its proposal.

8. *SORE has included the Milwaukee Land Company in its proposal and asserts that such inclusion is essential to the proposal. The creditors of the Railroad will never agree.*—The SORE proposal includes the Land Company and its earnings at

the rate of \$4 million per year. (Actual Land Company earnings have recently been determined to approximate \$10 to \$12 million per year.)

Certain Land Company assets are directly related to the operation of the railroad including property at Fife, Washington, which must be used for the construction of a new terminal facility, the Washington, Idaho, and Montana Railroad and financing paper on a significant amount of railroad rolling stock.

Whether the entire Land Company or just its rail related properties are included is a matter for negotiation between the creditors and the new company and for ultimate decision by the reorganization court and the ICC. The decision is not unilaterally controlled by the creditors.

9. *SORE's study is of the "back of an envelope" variety and SORE's capacity should be compared with Booz, Allen & Hamilton, recognized rail experts.*—The Trustee's criticism should have more appropriately dealt with facts instead of the credentials of the authors. SORE's proposal is based primarily on Milwaukee's data, developed by staff personnel (such as marketing, operating and engineering departments) who were not influenced by the bias of the railroad's executive management. In contrast, Booz, Allen & Hamilton approached the study with the initial assumption that the transcontinental line was a drain on the system, a position totally unsupported by the internal data available to the railroad.

The quality and conservatism of the SORE proposal is supported by the number of points on which Booz, Allen & Hamilton and SORE agree.

	B.A. & H.	SORE
Rehabilitation (millions of dollars).....	\$101	\$118
Locomotives (units).....	240	258
Normalized maintenance:		
Locomotives (appropriate per unit per year).....	\$70,000	\$70,000
Cars (per year).....	\$1,060	\$1,000
Track:		
Main line per year.....	\$12,500	\$10,000
Secondary main line per year.....	\$6,400	\$6,500
Branch line per year.....	\$5,400	\$3,500

The primary difference between the SORE proposal and Booz, Allen & Hamilton relates to traffic availability. Booz-Allen's conclusions are not supported by their own data.

MEMORANDUM OF MAY 28, 1979

Re Advantages of lines west as an ESOP demonstration program.

The Milwaukee Road is actually two railroads: a Midwestern railroad and a transcontinental railroad. While there are superficial similarities between the two portions, their economics are quite different. In the Midwest, average length of haul is short, competition between railroads and between railroads and trucks and barges is severe, and the rate level is depressed to the extent that it will not cover total long run costs.

Short haul rail transportation is relatively costly vis-a-vis trucks due to the high terminal costs of railroads and the inability to spread that cost over many miles. Trucks by contrast have low origination and termination costs, but relatively high over the road costs. The result is that trucks are very effective competitors for short haul traffic (up to 300 miles) being able to provide a rapid, more reliable service at a comparable price. By contrast, long haul traffic is moved efficiently and at a lower cost than can be provided by trucks.

The Milwaukee lines west of St. Paul combine the elements which have been clearly demonstrated in the railroad industry to be essential for ensuring economic viability. These elements include a strong market demand for the movement of bulk commodities over long distances under a rate structure that has not been unreasonably depressed. The necessary traffic has already been identified by the principal shippers as being currently available if equipment is provided and the plant is rehabilitated.

The Milwaukee Western Lines concentrate traffic at the endpoints thereby providing the opportunity to maximize length of haul and minimize operating expenses. This is analogous to the situation described by Union Pacific Chairman Evans in explaining the reasons for his company's outstanding success in the railroad indus-

try: (1) double the average length of haul for the railroad industry; (2) very few terminals which substantially reduce operating expenses and improves efficiency; and (3) lack of competition from other railroads and other modes.

The Milwaukee employees of Lines West have been fighting to preserve their jobs since August 3, 1978. They know that the railroad is operating in the West today only because of their strong determination to find an alternative to liquidation. The employees are also aware that to protect their jobs they must be prepared to assume an ownership role in a new company.

Likewise, the shippers on Lines West have also been battling liquidation since August 3, 1978. Traffic in the West is dominated by a few strategic shippers most of whom have already expressed an interest in joint participation with the employees. This is contrasted with the Midwest where in most cases shippers have several alternatives to the Milwaukee. The situations simply are not comparable.

Lines West employees are ready, willing and able to assume the necessary responsibilities of an employee stock ownership program. The Federal government can be the catalyst which combines these essential elements into a successfully reorganized transcontinental railroad company.

The following is a summary of S.O.R.E. and other oral responses in the bankruptcy proceeding to the supplemental testimony of Thomas Power, assistant to the Milwaukee Railroad's trustee, May 29, 1979.

(1) CORRECTIONS TO S.O.R.E. LINES WEST PROPOSAL, APRIL 20, 1979

The Revenue—Car Load Assumptions table, Appendix A, Page 6, should be revised to correct a transposition of data. The column under Car Loads should be as follows:

Commodity	Car Loads	
	Present	Corrected
Primary forest products.....	13,000	64,970
Lumber, plywood and related products.....	11,284	56,575
Grain.....	4,212	21,170
Automotive.....	1,508	7,665
TOFC—FAK.....	4,524	22,630
Paper and products.....	4,108	20,440
Coal.....	6,084	42,705
Perishable.....	676	3,285
Chemicals, petro products.....	520	2,555
All other.....	9,412	47,085
Total.....	57,772	289,080

All other columns on the Revenue-Car Load Assumptions chart remain unchanged.

The "Forecast of Net Revenue From Railway Operations", Appendix A—Page 12, under Operating Expenses, Taxes and Rents line entitled transportation should be changed from 47,100 to 49,600, "Total Expenses, Taxes and Rents" should be 217,800, and "Net Revenue Railway Operations" should be 22,000. As a result of these changes, the "Pro Forma Statement of Income", page 8 of the Proposal requires a correction in Net Revenue from Railway Operations Year 5, from 24,500 to 22,000 and in "Net Income (Loss) Before Taxes", year 5 from 18,588 to 16,088.

(2) REVENUE BASE

The substantial increase in freight revenue projected in the SORE Proposal can be achieved primarily by recapturing traffic formerly handled by Milwaukee Road. This traffic has eroded during the past four years as Milwaukee service reliability and car supply has deteriorated. Growth rates comparable to SORE's projected increases have been achieved during the past seven years by the only two competing railroads in the Pacific Northwest, the Burlington Northern and Union Pacific as verified in the final Booz, Allen and Hamilton Report, Exhibit IV-10. It should be understood that the projected revenue growth is traffic presently available. This is also supported by the Booz, Allen and Hamilton Confidential Shipper Survey Summary where 15 of 22 shippers who provide traffic on the transcontinental line responded that additional traffic was currently available.

Mr. Power's statement that a 60 m.p.h. railroad is required to penetrate the markets is totally unsupported. The primary considerations in selection of modes and in selection between competing railroads are cost, equipment and reliability. Speed is a secondary consideration and relates to a very small percentage of the shippers. This is also supported by Booz, Allen.

The Milwaukee historical participation in transcontinental traffic is of little relevance in today's economic and political environment. The Milwaukee had very limited gateways in the west prior to the Burlington Northern merger and therefore was deprived of the opportunity to maximize its length of haul. As late as 1967, the Milwaukee was soliciting west coast traffic via the central route utilizing Union Pacific west of Omaha in preference of its own transcontinental route. In spite of these severe restrictions, the Milwaukee experienced an increase in trailing ton miles of 107 percent between 1961 and 1973. Between 1970 and 1973, the trailing ton miles grew at a rate of 30 percent on the transcontinental line. During the comparable period, system ton miles increased only 43 percent and that figure includes the transcontinental line. It was only when the physical plant collapsed in 1974 that the growth rate receded.

Mr. Power is critical of SORE's projected traffic growth in coal. Western Energy Company testified in the bankruptcy court that they had traffic presently available and had not seen a Milwaukee marketing representative in four years. Evidence was presented to the bankruptcy court that a contract had already been let for exploration and development of Bull Mountain coal at Roundup, Montana. This coal is expected to move during the next five years if rail service is available in quantities of up to 2.0 million tons annually.

The coal projections used by SORE are extremely conservative. Coal can move to Milwaukee at Miles City, Roundup and possibly directly out of Coalstrip as a condition of the Burlington Northern merger.

Mr. Power's comments relative to shipper surveys are totally unfounded. Mr. Power should certainly be well aware that shipper input was utilized in the May 30, 1975 marketing study which demonstrated an additional \$64 million revenue available to Milwaukee on lines west if equipment were provided. In addition, SORE has talked to numerous shippers and shipper associations who have indicated substantially increased revenues would be available to a reorganized railroad west of St. Paul.

The Port of Seattle testified in the bankruptcy proceeding that unprecedented growth was taking place in the import traffic area and that substantial traffic increases would be available to the Milwaukee. Seattle is now the second largest container port in the United States, second only to New York.

The Milwaukee has historically handled approximately 15 percent of Montana grain traffic. Projections based on discussions with shippers and shipper associations indicate a potential for the railroad to expand its participation to 30 percent.

Mr. Power, in presenting his comparison with Burlington Northern and Union Pacific, conveniently picked the period between 1973, a peak year for all western railroads, and 1978, which included the recession period of 1974 and 1975. In looking at the trends over eight years from 1970 to 1978, the western railroads have experienced tremendous growth as demonstrated by Booz, Allen in their final report.

(3) COST PROJECTIONS

SORE's Proposal is consistently more conservative than Booz, Allen and Hamilton in terms of railroad expenses. Year 1 Locomotive requirements defined by SORE are 215 units as compared to 201 by Booz, Allen. In year 5, SORE projects 258 units as compared to Booz, Allen 240 units. SORE used an estimated 1978 locomotive price of \$700,000 with purchase over 15 years. Normalized maintenance of \$70,000 per unit on road locomotives and \$30,000 per unit for switch power has been included.

The ratio of Milwaukee total liquidation value (as defined by the Ford, Bacon & Davis appraisal for the Trustee) of \$832 million to \$370 million assets to be acquired by SORE represents the 44 percent figure proposed by SORE.

SORE has estimated freight car requirements of 8,000 cars in year 1 and 10,000 in year 5 with normalized car maintenance of \$1,000 per car annually.

The SORE Proposal includes money to fully rehabilitate the key lines which require class IV specifications for service and tonnage capability. It is SORE's opinion that the normalized maintenance-of-way budget is adequate to hold branch lines and yards in their present condition and, in fact, make a substantial improvement in many lines while economic evaluations and financing alternatives are progressed.

SORE's rail program is based on normalized 50 year cycle for main line rail that requires 40 miles of new No. 132 welded rail per year. Priorities for new rail were defined by projected operating tonnages per mile.

By the end of the five-year rehabilitation program, new welded rail will have been placed on most of the projected heavy tonnage line between Gascoyne, North Dakota and Aberdeen, South Dakota.

Cascading of secondhand rail will accommodate necessary changes of rail west of Miles City in the short term. An accelerated rail program is contemplated beyond year 5 when better determination of future coal movements can be properly defined.

SORE contends that proper subgrade, ties and ballast are of more concern than the welded rail referred to by Mr. Power. Coal trains can operate quite well on jointed rail that is properly maintained.

Most of Milwaukee's rail condition is actually quite respectable. Ties and ballast being the principal short-term consideration.

SORE feels quite strongly that when full rehabilitation of its main line is completed, it can be maintained with an expenditure level of \$10,000 per mile. A comparison with Burlington Northern, which has essentially rebuilt its plant over of earnings in recent years, shows that they spent only \$13,500 per mile on main line tracks. Mr. Power's quotes are unrealistic in terms of what is generally accepted practice in the industry.

The construction of a terminal facility at Tacoma was contemplated in SORE's plan; however, SORE did not contemplate having its western terminal sold. SORE's capital program for additions and betterments will concentrate on the proposed location at Fife with construction of the minimal terminal required to protect this operation at the end of year 5.

The operating plan includes joint facility revenue at St. Paul for operation to connecting line terminals.

SORE had no access to the details of the various budgets in the company. Therefore, estimates of existing budgets were made and where uncertainty existed, SORE assumed an extremely high pro rata share of the Milwaukee budgets.

It is certainly SORE's intent to computerize the equipment accounting and revenue accounting function to the maximum extent possible. Opportunities to do so are present in the restructuring process and will, in all likelihood, result in a smaller accounting function budget number than has been used here during the first five years of operation increasing to the budgeted amount by year 5.

The major rehabilitation of plant contemplated during the first five years of operations will significantly decrease the claims for personal injury and damaged freight. While the increase in revenue is substantial, the highly rated commodities of the west and minimal handling required as compared to midwest traffic make this assumption concerning freight claims realistic.

Mr. Power is incorrect in his analysis of the sources and applications. All funds are not consumed by the operating losses in year 1. The increase in working capital is \$20,808,000 which is required along with the ERSA draw-down to sustain operations in years 2 and 3.

PRELIMINARY ANALYSIS OF BOOZ-ALLEN MILWAUKEE STUDY BY ASSOCIATION TO
SAVE OUR RAILROAD EMPLOYMENT—SORE—MAY 29, 1979

I. INTRODUCTION

The crucial issue that must be resolved with regard to the Milwaukee Railroad is whether the freight revenues available to a rehabilitated railroad are sufficient to cover the costs of rehabilitation and operation. Two types of data are required—

1. A market analysis to define the traffic and revenues available to a rehabilitated railroad and;

2. Cost projections for rehabilitation and operation of a rail plant sufficient to serve the market identified in the market analysis.

Costs of rehabilitation and operation are relatively easily defined, particularly in a simple system such as the Milwaukee's lines west of St. Paul, which is essentially one long east-west main line crossed by a north-south line at each end, together with a few intermediate branch lines and terminals. The unit costs associated with material, labor, equipment and operations are well defined in Milwaukee data as well as published industry data. The amount of capacity that should be built into the system and the level of service desired, are the key questions to be answered on the market analysis. The market analysis is a more complex question requiring research beyond the existing records of the Milwaukee. Those records show only the business that the Milwaukee was able to attract with inadequate equipment and a

plant suffering from two decades of deferred maintenance. The real issue is the extent of the total rail transportation market in the various regional market areas, and then the market share that would be captured in each by a rehabilitated railroad. After existing traffic is identified, further projections required of the relative growth of the various regional economies and the major shippers.

II. THE MAJOR EMPHASIS OF THE BOOZ-ALLEN STUDY IS ON OPERATING REFINEMENTS

The Booz, Allen study's main emphasis is on the details of how various configurations of tracks, yards and equipment might be operated, with a great deal of attention expended on computer simulation of train operations. Such detail may be helpful in refining the mechanics of an operation but is of limited significance in determining the viability of a rail system. The cost of operating a given railroad with a particular volume and mix of traffic is narrowly defined by tonnage, terminals and distances between terminals. Any reasonable operation will require similar amounts of locomotive horsepower, equipment, track and equipment maintenance, terminal switching and clerical work. Improvements can always be made, but they are basically the fine tuning and polish that will hopefully shade total costs by one or two percent. Whether cars are blocked at Aberdeen or St. Paul may have some effect on efficiency, but the incremental cost difference between the two is minor in the context of total system costs, and certainly is not significant in determining whether a system is viable. If the margin is that close, the risk of the venture is unacceptably great.

In addition to being unnecessary in determining approximate costs, computer simulation of various operating refinements, as in the Booz, Allen study, implies a degree of accuracy and precision which is misleading. The accuracy of any method of cost projections depends upon the accuracy of underlying estimates of unit costs which, in turn, are estimates based on historic experience. In the railroad case an extended history gives relatively precise estimates that are probably within 5%. To assume accuracy of a higher level is unrealistic. No one can predict exactly how much snow service will be required in a given year, or what trend tax rates will follow, or how many derailments or personal injury claims will be experienced. Some items can be estimated with far more precision than others, but over all, it is unrealistic and would be unwise to claim precision better than $\pm 5\%$. Computer simulation is not required to achieve an acceptable level of accuracy.

III. THE MARKET ANALYSIS OF BOOZ-ALLEN IS INADEQUATE AND MISLEADING

The Booz, Allen market analysis purports to include an unbiased shipper survey, a traffic study and projections of future economic growth. In fact the analysis is based on biased and incorrect assumptions, outdated national economic and growth projections unrelated to any particular region, and reaches conclusions that can not be reconciled with either the data compiled by Booz, Allen or by the historic experience of the Milwaukee.

The following two examples are typical of the biased and incorrect assumptions and unsupportable conclusions:

"The west coast extension was excluded from the Core System after preliminary studies indicated that this major segment was producing a negative contribution at 1977 traffic levels, and would require more capital for rehabilitation than would be available from Milwaukee sources." At page III-1.

The preliminary analysis specifically included no market analysis. See page II-2. The decision to exclude Lines West from the Core System was based on a comparison of the Actual 1977 revenue with hypothetical costs based on fully normalized maintenance of plant and equipment. See page II-3. Obviously, if normalized maintenance and operation had been in effect, Milwaukee would have had substantial additional traffic and a larger market share. This is confirmed by Booz, Allen at page I-2, and then ignored. In fact, when actual 1977 costs are compared with actual 1977 revenues, Lines West made a positive contribution.

The Booz, Allen report goes on to state:

"It should be noted from the preceding chart that the railroads, Milwaukee Road in particular, did not participate significantly in general economic growth as represented by the GNP or other indicators." Page IV-13.

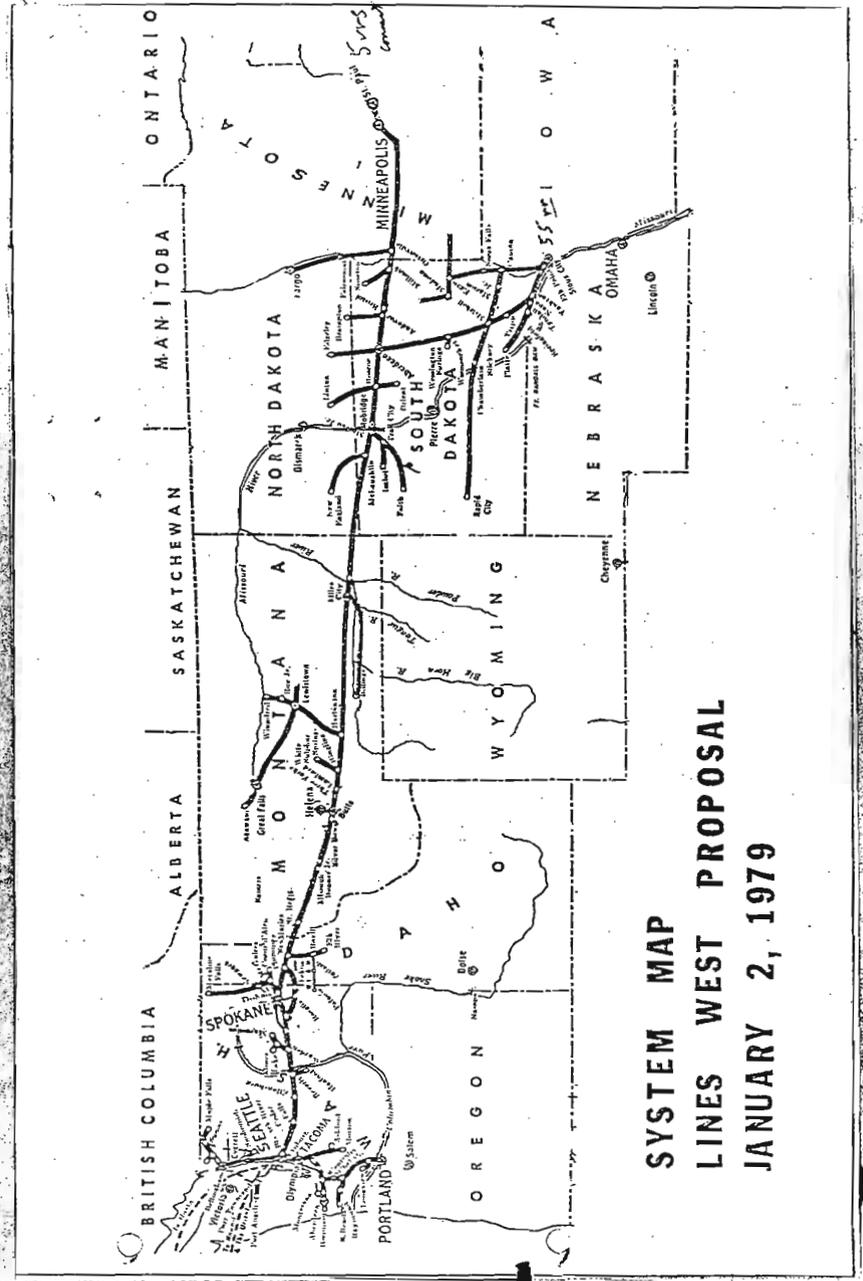
Contrary to all of the evidence, Booz, Allen fails to recognize that the Milwaukee system in fact includes two distinct rail systems: a long haul, transcontinental system west of St. Paul, and a short haul, mid-western system east of St. Paul. Booz, Allen also ignores the fact that the economic performance of railroads in the west has been one of phenomenal growth as contrasted with the dismal performance of mid-western and north-eastern railroads. The conclusion that railroads have done poorly and the implicit assumption that all railroads have performed equally badly

is directly contrary to the data reflected in the report exhibits. While Exhibit IV-8 shows that total U.S. rail tonnage has failed to follow GNP, Exhibit IV-10, shows that tonnage on the northern transcontinental railroads has not only out performed the growth in GNP, but has grown since 1970 at rates of double and quadruple GNP. In contrast, mid-western roads such as Chicago and Northwestern & Chicago, Rock Island & Pacific have grown either far slower than GNP or have actually lost ground. Milwaukee's own records show that between 1961 and 1973 the tonnage on the transcontinental line increased by 107% while total system tonnage increased by only 43%.

Booz, Allen completely misconstrues the market opportunities of the Milwaukee's transcontinental line by projecting performance based on national averages or averages including the weak mid-western carriers, rather than by using the performance of the Union Pacific or Burlington Northern who serve the transcontinental market in the northern tier.

When the proper basis for projection is used, the Booz, Allen conclusion of limited growth for a Milwaukee transcontinental line west of the twin cities is ludicrous.

Sore Proposal for Rehabilitation & Operation of Milwaukee Lines Between Twin Cities & West Coast, January 2, 1979



PROPOSED SYSTEM

MAIN LINE, SECONDARY MAIN LINE AND BRANCH LINE MILEAGES

MAIN LINE

St. Paul	-	E 14	23.1
E 14	-	Montevideo	119.4
Montevideo	-	Aberdeen	157.0
Aberdeen	-	Mobridge	98.0
Mobridge	-	Marmarth	190.1
Marmarth	-	Miles City	123.8
Miles City	-	Harlowton	216.7
Harlowton	-	Three Forks	113.9
Three Forks	-	Deer Lodge	111.7
Deer Lodge	-	Alberton	111.0
Alberton	-	St. Maries	145.7
St. Maries	-	Othello	166.8
Othello	-	Black River	179.4
Black River	-	Tacoma	28.1
			<hr/>
			1784.7 miles

SECONDARY MAIN LINE

Aberdeen	-	Mitchell	128.6
Mitchell	-	East Wye Switch	116.7
East Wye Switch	-	Sioux City	20.1
Plummer	-	Spokane	37.1
Sumas	-	Bellingham	25.1
Bellingham	-	Black River	107.3
Tacoma Jct.	-	Portland	160.1
			<hr/>
			595.0 miles

BRANCH LINES

Madison	-	Miloma	100.9
Napa	-	Platte	82.4
East Wye Switch	-	Sioux Falls Jct.	112.5
Canton	-	Mitchell	79.2
Mitchell	-	Mundo	142.4
Mundo	-	Rapid City	143.9
Ortonville	-	Fargo	117.0
McLaughlin	-	New England	133.9
Moreau Jct.	-	Isabell	55.4
Milbank	-	Sisseton	37.1
Garden City	-	Bristol	29.0
Andover	-	Brampton	43.0
Aberdeen	-	Edgeley	63.9
Roscoe	-	Linton	75.3

BRANCH LINES (cont'd)

Harlowton	-	Lewistown	61.0
Lewistown	-	Heath	9.2
Winifred Jct.	-	Winifred	42.7
Lewistown	-	Falls Yard	134.5
Falls Yard	-	Abawan	69.6
Sumas	-	Limestone Jct.	8.3
Hampton	-	Lynden	5.4
Fredrickson	-	Morton	54.3
Maytown	-	Hoquiam	56.6
Chehalis Jct.	-	Raymond	53.0
Beverly	-	Hanford	24.3
Royal City Jct.	-	Royal City	5.1
Warden	-	Moses Lake	21.6
Tiflis	-	Marcellus	38.7
Spokane	-	Metaline Falls	108.6
East Spokane	-	Coeur D'Alene	27.5
St. Maries	-	Bovill	51.7
Purdue	-	Palouse	50.0
			<hr/>
			2038.0 miles

SUMMARY

Trackage (Route Miles)

Main Line	1784.7
Secondary Main	595.0
Branch Line	2038.0
	<hr/>
	4417.7 miles

REHABILITATION PRIORITIES

1. Safety
2. Cash Drain
3. Benefits

YEAR 1.

Bitterroots

St. Regis - East Portal 8" rock 2000 ties/mi. (78,000) \$ 2.7 million
 East Portal - Avery Engineering, ties and ballest 1.5 million

Cascades

Cle Elum - Hyak 8" rock 1500 ties/mi. (72,000) 2.2 million
 Othello - Beverly 8" rock 1200 ties/mi. (65,000/mi.) 2.6 million
 Tacoma - Fredrickson 8" rock 1500 ties/mi. (72,000/mi.) 0.7 million
 - Gasgoyne 8" rock 1200 ties/mi. (65,000) 2.6 million

Necessary Funding for System Programs \$12.3 million
 Normalized maintenance in addition to forementioned programs. Normalized maintenance will hold other territories at present level.

REHABILITATION PRIORITIES

YEAR 2

McKenna - Western Jct. 8" rock 1500 ties (72,000) \$ 0.7 million
 Hyak - Maple Valley 4" rock 1200 ties (50,000) 1.5 million
 Ellensburg - Cle Elum 8" rock 1200 ties (65,000) 2.0 million
 Calder - Plummer 8" rock 1500 ties (72,000) 2.8 million
 Cobden - St. Regis 8" rock 2000 ties (78,000) 1.6 million
 Butte - Deer Lodge 8" rock 2000 ties (78,000) 3.1 million
 Grace - Butte 8" rock 1500 ties (72,000) 1.5 million
 Hamen - Lombard 8" rock 1500 ties (72,000) 3.6 million
 - 8" rock 1200 ties (65,000) 2.6 million
 - Gasgoyne 40 mi. N 132# 115# up 6.5 million

Necessary Funding for System Programs \$25.9 million

REHABILITATION PRIORITIES

YEAR 4

Hillsdale - Western Jct. 30 mi. 115# SH 85# & 90# up \$ 1.7 million
 Maytown - Chehalis 4" rock 1200 ties (65,000) 0.8 million

Marengo - Lind 8" rock 1500 ties (65,000) 1.3 million
 Paxton - Marengo 4" rock 1200 ties (50,000) 0.5 million
 Revenna - Missoula 8" rock 2000 ties (78,000) 3.1 million
 Alcazar - Piedmont 15 mi. 115 & 132 NNSH 100 & 131 up 1.6 million

Melstone - Lavina 8" rock 1200 ties (65,000) 4.2 million

Miles City - Terry 8" rock 1200 ties (65,000) 2.3 million

- 8" rock 1200 ties (65,000) 2.6 million
 - 40 mi. N 132# 115# up 6.5 million

Aberdeen - 8" rock 1200 ties (65,000) 2.6 million

Necessary Funding for System Programs \$27.2 million

REHABILITATION PRIORITIES

YEAR 3

Taunton - Beverly 25 mi. 115# SH 100# up \$ 1.4 million
 Beverly - Ellensburg 8" rock 1200 ties (65,000) 2.0 million
 Western Jct. - Maytown 8" rock 1500 ties (72,000) 0.6 million
 Bellingham - Sumas 8" rock 2000 ties (78,000) 2.2 million

Plummer - Pandora 8" rock 1500 ties (72,000) 1.8 million
 Pandora - Malden 4" rock 1200 ties (50,000) 0.8 million

Huson - Cobden 8" rock 2000 ties (78,000) 1.6 million
 Deer Lodge - Revenna 8" rock 2000 ties (78,000) 3.1 million
 Three Forks - Grace 8" rock 1200 ties (65,000) 2.3 million
 Hamen - Moyne 13 mi. 115# SH 100# up 0.7 million

Harlowton - Lavina 8" rock 1200 ties (65,000) 2.6 million

- 8" rock 1200 ties (65,000) 2.6 million
 - 40 mi. N 132# 115# up 6.5 million

Necessary Funding for System Programs \$28.2 million

REHABILITATION PRIORITIES

YEAR 5				
Chehalis	- Essex	8 mi. 115# SH down 85# up	\$ 0.4 million	
Lind	- Othello	8" rock 1200 ties (65,000)	2.0 million	
Malden	- Paxton	8" rock 1500 ties (72,000)	2.5 million	
Plummer	- Malden	30 mi. 115# down 100# up	1.7 million	
Missoula	- Huson	8" rock 1200 ties (65,000)	1.0 million	
Lombard	- Three Forks	8" rock 1200 ties (65,000)	1.6 million	
Baker	- Ferry	8" rock 1200 ties	3.3 million	
	-	8" rock 1200 ties (65,000)	2.6 million	
	- Aberdeen	8" rock 1200 ties (65,000)	2.6 million	
	-	40 mi. N 132# 115# up	6.5 million	
Necessary Funding for System Programs				\$24.2 million
Total to Date: \$117.8 million				

State and Shipper Programs

Priorities			
1. Northern Montana	Shippers & Title VIII	\$10.5 million	
2. Tacoma and Eastern	Shippers	4.2 million	
3. Metairie Falls	Title VIII		
4. Rapid City	Title VIII		
5. New England	Shippers		
6. Fargo	Title VIII		

REVENUE - CAR LOAD ASSUMPTIONS

YEAR 5

COMMODITY	CAR LOADS PER DAY		% CL	REVENUE	% REV
	5 DAY WK	365 DAYS			
Primary Forest Products	250	178	22%	\$ 7.8 mil.	3%
Lumber, Plywood & Related Prod.	217	155	20%	\$ 82.0 mil.	33%
Grain	81	58	7%	\$ 42.3 mil.	17%
Automotive	29	21	3%	\$ 14.6 mil.	6%
TOFC, FAK	87	62	8%	\$ 15.8 mil.	7%
Paper & Prod.	79	56	7%	\$ 13.3 mil.	5%
Coal	164	117	15%	\$ 24.3 mil.	10%
Perishable	13	9	1%	\$ 4.6 mil.	2%
Chemicals, Petroproducts	10	7	1%	\$ 2.6 mil.	1%
All Other	181	129	16%	\$ 37.6 mil.	16%
	1111	792		\$ 244.9 mil.	

PROJECTED MAIN LINE TRAFFIC DENSITIES

YEAR 5

Approximate Operating Tonnages Per Mile
Anticipated on Main Line at End of Year 5

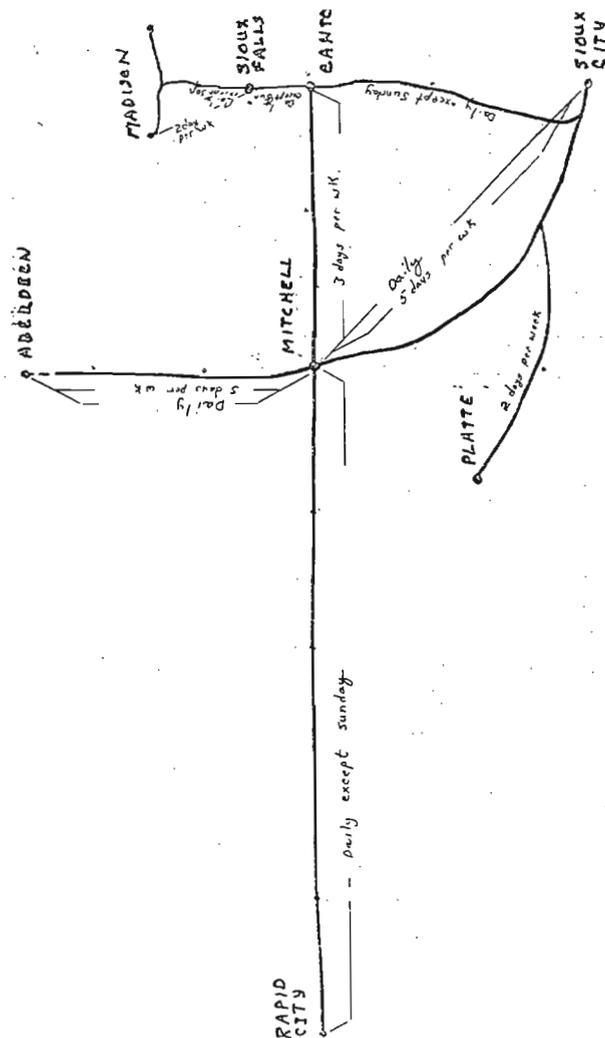
Black River	-	Othello	13.0	million tons/mile
Othello	-	Plummer Jct.	13.8	" " "
Plummer Jct.	-	St. Maries	14.3	" " "
St. Maries	-	Missoula	14.9	" " "
Missoula	-	Harlowton	16.0	" " "
Harlowton	-	Roundup	16.6	" " "
Roundup	-	Miles City	20.0	" " "
Miles City	-	Gasgoyne	22.5	" " "
Gasgoyne	-	Aberdeen	25.7	" " "
Aberdeen	-	Big Stone	21.4	" " "
Big Stone	-	St. Paul	18.2	" " "

Design criteria for Main Line operations to be Class IV 60 MPH timetable speed.

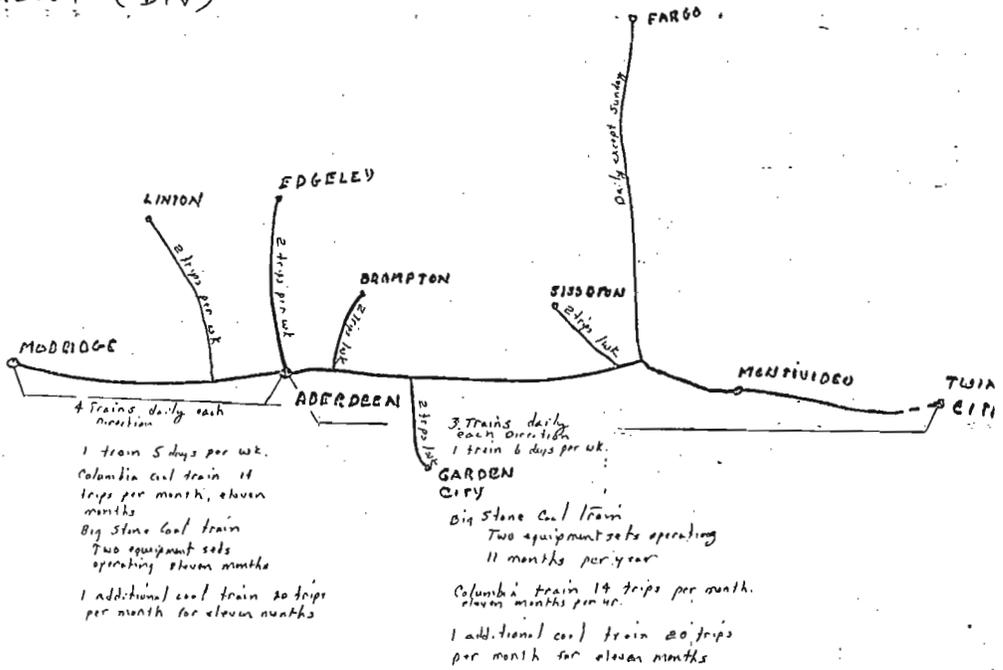
OPERATING PLAN

Following maps depict train operations for Year 5 based on a system composed of five operating divisions.

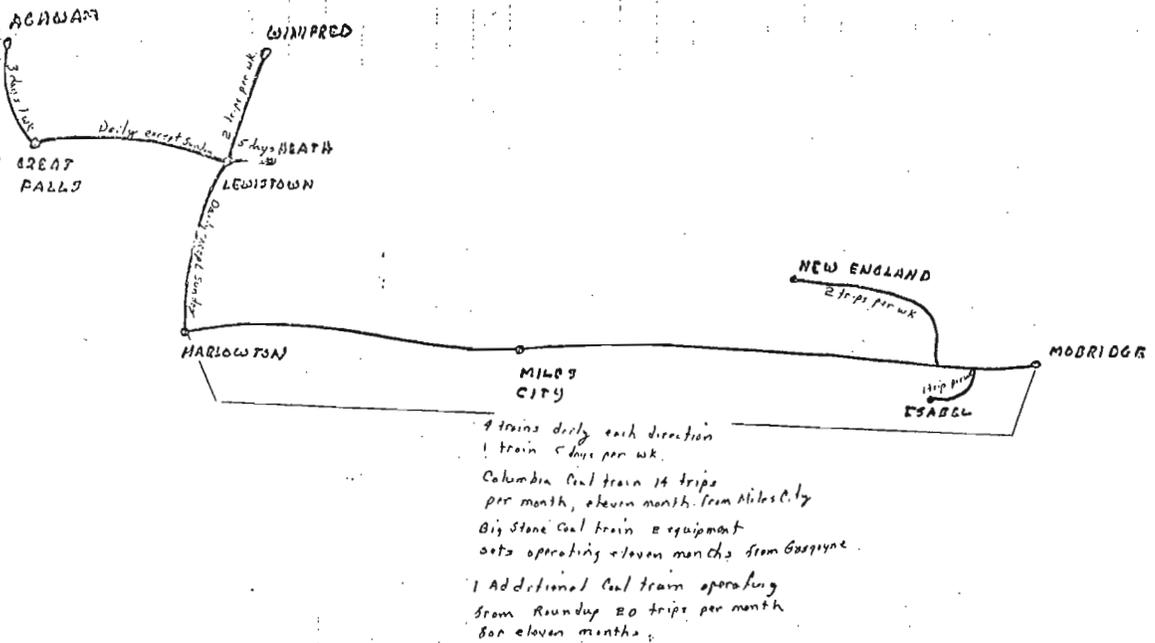
Train operations for Year 1 would include three transcontinental trains per day with branch line service essentially as shown.



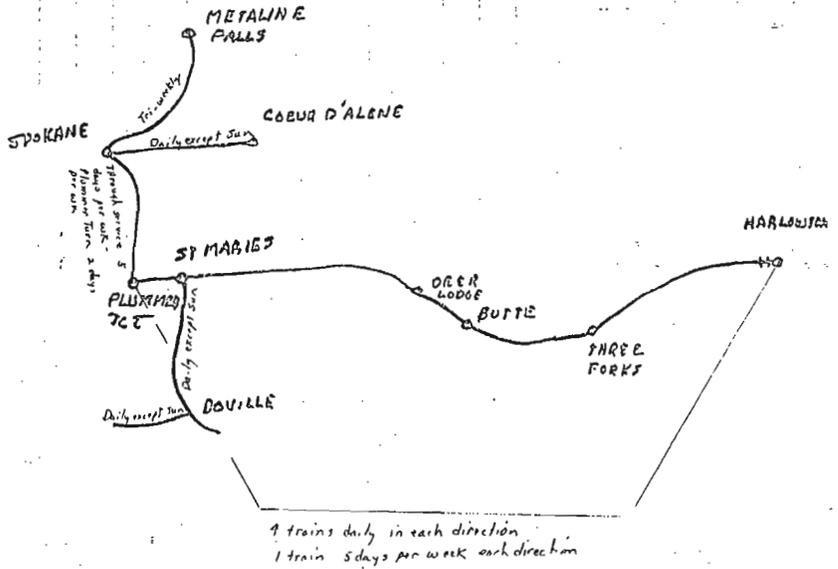
ARDREEN (DIV)



MILES CITY (DIV)

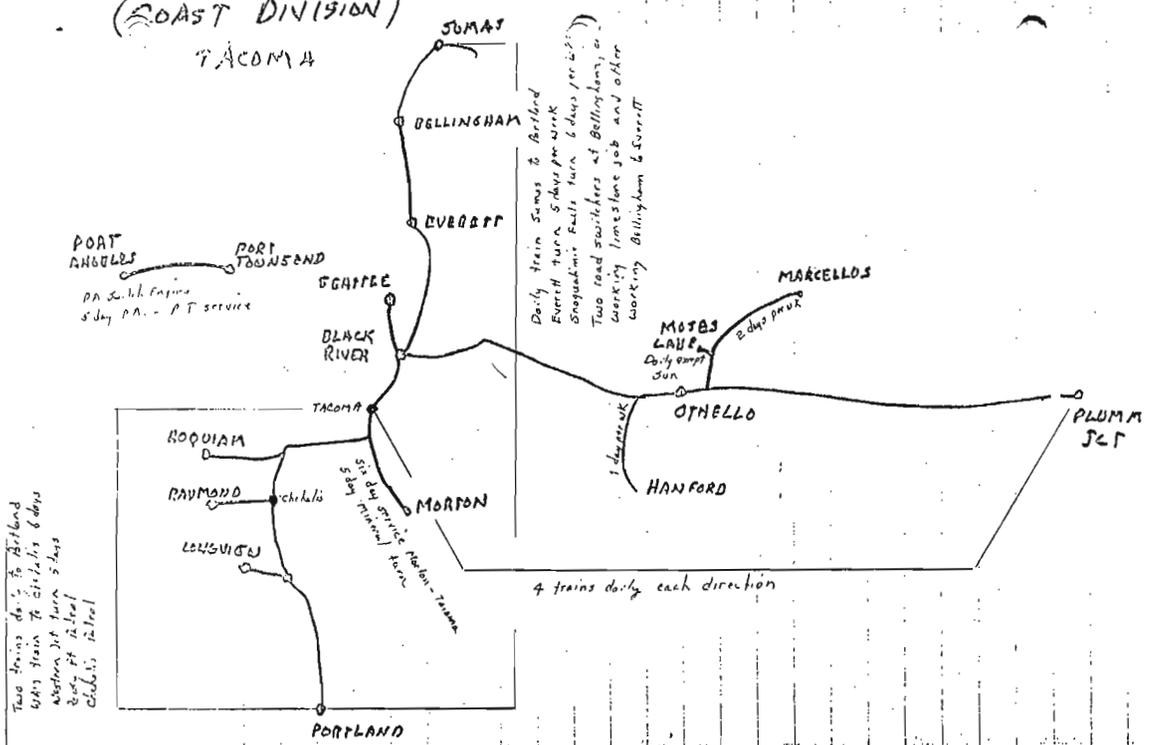


ROCKY MOUNTAIN (DEER LODGE)



156

(COAST DIVISION)
TACOMA



157

EQUIPMENT REQUIREMENTS

LOCOMOTIVES

SD 40 or equivalent	121 units
GP 38 or equivalent	66 units
MP 15 or equivalent	15 units
SW 1200 or equivalent	13 units

It is anticipated that most of the above units would be immediately available from the Milwaukee. There is a national shortage of SD 40 type units. It is proposed that 43 of this type unit would be purchased by the new company over the first five years, with purchases scheduled as early as possible. The annual purchase cost of 43 units will be approximately \$3.4 million.

FREIGHT CARS

It is assumed that the freight cars required for the first year will be Milwaukee cars presently in service. In addition, approximately 35% of the system loading will be handled in private and foreign railroad equipment. During the first five years of operating the company will acquire the following new cars:

<u>ITEM</u>	<u>QUANTITY</u>	<u>ANNUAL EXPENSE</u>
Covered Hopper Cars	700 @ \$40,000	\$3.6 million
Plain 50 Ft. Box Cars	1000 @ 36,000	4.1 million
Double-Door 50 Ft. Box Cars	750 @ 38,000	3.7 million
Open Top Hopper Cars	500 @ 33,000	2.1 million
Special Equip. Equip Box	700 @ 41,000	3.7 million

In addition, leases or obligations on 1,500 Milwaukee cars will be assumed at an anticipated annual cost of \$2.5 million.

FORECAST OF NET REVENUE FROM RAILWAY OPERATIONS
(Amounts Stated in Thousands)

YEAR 1

OPERATING REVENUES

Gross Freight Revenue	\$143,000
Less Adjustments and Absorptions	6,900
Net Freight Revenue	136,100
Switching	1,900
All Other	3,000
TOTAL OPERATING REVENUES	\$141,000

OPERATING EXPENSES, TAXES AND RENTS

Executive Department	\$ 600
Vice President, Law	7,200
Vice President, Administration	3,300
Vice President, Marketing	2,900
Vice President, Finance	10,500
Vice President, Operations	600
General Manager	81,000
Engineering	3,600
Mechanical	9,300
Transportation	38,500
Taxes Other Than Payroll	2,400
Retirement Charges	200
Depreciation Charges	1,500
TOTAL EXPENSES, TAXES AND RENTS	\$160,600
NET REVENUE FROM RAILWAY OPERATIONS	(20,600)

FORECAST OF NET REVENUE FROM RAILWAY OPERATIONS
(Amounts Stated in Thousands)

YEAR 5

OPERATING REVENUES

Gross Freight Revenue	\$244,900
Less Adjustments and Absorptions	11,800
Net Freight Revenue	233,100
Switching	2,200
All Other	4,500
TOTAL OPERATING REVENUES	\$239,800

OPERATING EXPENSES, TAXES AND RENTS

Executive Department	\$ 800
Vice President, Law	6,200
Vice President, Administration	4,000
Vice President, Marketing	3,100
Vice President, Finance	10,500
Vice President, Operations	600
General Manager	105,400
Engineering	7,400
Mechanical	25,800
Transportation	47,100
Taxes Other Than Payroll	2,200
Retirement Charges	200
Depreciation Charges	2,000
TOTAL EXPENSES, TAXES AND RENTS	\$215,300
NET REVENUE RAILWAY OPERATIONS	\$ 24,500

IMPACT OF TRAFFIC GROWTH

MONTANA COAL WEST

Assume one train, ninety cars, five days per week, fifty-two weeks per year. (2.3 million tons annual volume.)

Retained Earnings \$1200 per car load

Incremental Cost:

Cycle Time: 56 hours west bound load
51 hours east bound empty
4 hours loading
16 hours unload, makeup, dept.
127 hours total

5 sets equipment requires: 480 cars
46 locomotives

14 road crews and 2 helper crews

Cars	\$ 1.8 million
Locomotives	3.6 million
Fuel	5.7 million
Crews	3.7 million
Car Maint.	0.8 million (\$1,600 per car)
Loco. Maint.	3.2 million (\$70,000 per unit)
Track Maint.	3.4 million (\$3,000 per mile)
	\$22.2 million

Incremental Revenue \$27.6 million

Net Incremental Revenue \$ 5.4 million

IMPACT OF TRAFFIC GROWTH

OREGON LUMBER EAST

Assume one train of sixty loads, five days per week, fifty-two weeks per year.

Retained Earnings	\$1800 per car load
Incremental Cost	\$ 650 per car load
Net Incremental Revenue	\$1150 per car load

15600 Loads Per Year
 \$28,080,000 Incremental Revenue
 \$17,940,000 Net Incremental Revenue

COMPARISON:

	SORE PROPOSAL LINES WEST	ESTIMATED MILWAUKEE 1978 TOTAL SYSTEM
Maintenance of Way	\$36,000,000	\$35,000,000
Maintenance of Equipment	\$33,000,000	\$31,000,000

SCOPE OF WORK

Pursuant to the Resolution of the Governors of the Old West Regional Commission adopted December 6, 1978, the following items will be undertaken to develop a feasible reorganization plan for that part of the Milwaukee Railroad that serves the Region:

- I. Verify Present Situation.
- II. Outline Plan of Reorganization.
- III. Work With and Present Findings to ICC, FRA, Reorganization Court, Trustee and Other State and Federal Agencies.
- IV. Present Report to Old West Regional Commission Outlining Results Developed and Make Recommendations for Future Plans and Actions.

The sequence of the items in the outline does not indicate the timing of the actual work, it being anticipated that work on the various topics will be undertaken simultaneously. The following outline describes the specific material to be developed and the actions to be taken under each topic.

I. VERIFY PRESENT SITUATION.

- A. Prepare a brief review of the Milwaukee's activities over the past ten years leading to bankruptcy, including:
 - (1) Merger proposals;
 - (2) Maintenance and operations; and
 - (3) Marketing philosophy.
- B. Verify present status of that portion of the Milwaukee Railroad serving the Old West Region, including:
 - (1) Limited physical inspection of plant to extent weather permits;
 - (2) Review of Railroad and ICC engineering and mechanical status reports;

- (3) Review Railroad and shipper traffic records;
- (4) Interview shippers, officials of government regulatory agencies, and company officers; and
- (5) Review relevant Railroad and government financial and statistical data, including budgets, plans, personnel records, etc.

II. OUTLINE PLAN OF REORGANIZATION FOR LINES SERVING OLD WEST REGION.

A. Reorganization plan: Provide a general description of a five-year plan of reorganization which encompasses the following:

(1) Marketing:

(a) Assess the revenue potential of traffic presently available to a reorganized railroad serving the Old West Region:

- 1. Shipper interviews;
- 2. Milwaukee traffic tapes;
- 3. Milwaukee traffic studies;
- 4. Connections, divisions and solicitation arrangements with connecting railroads.

(d) Assess anticipated market shifts and undeveloped potentials.

(e) Explore possibility of long-term traffic commitments from shippers.

(2) Operating:

Develop a plan of operation for a reorganized company, including a definition of the service level to be provided, the equipment required, and the necessary personnel.

(3) Financial:

Develop annual income statements and cash flow analysis to coincide with five-year reorganization plan.

(4) Rehabilitation:

Develop a statement of work required to provide level of service for viable operation, including description of work, work schedules and cost.

B. Organization of proposed company:

(1) Definition of assets and valuation, including right of way, cars, engines, tools and track maintenance equipment.

(2) Review of alternative sources of financing, including debt deferral, shipper assistance, traditional lending institutions, formation of a cooperative, and government programs administered by DOT and EDA.

(3) Review of ESOP and other profit-sharing arrangements.

(4) Explore alternative corporate structures, including representation of labor organizations, shippers, public agencies, as well as stockholders on Board of Directors.

III. WORK WITH AND PRESENT FINDINGS TO ICC, FRA, REORGANIZATION COURT, TRUSTEE, AND OTHER STATE AND FEDERAL AGENCIES.

A. Establish liaison with other parties to Milwaukee reorganization proceeding and with appropriate federal and state offices and agencies and make all formal appearances on behalf of the Commission that are necessary to the formulation and presentation of a reorganization plan for the western lines.

B. Confirm present status of reorganization proceeding:

(1) Review bankruptcy proceeding to date.

(2) Review statutes governing railroad reorganization.

(3) Review precedent established in other railroad reorganizations.

C. Seek assistance of ICC, FRA, Reorganization Court, Trustee and other appropriate state and federal agencies in minimizing and avoiding actions, circumstances, and conditions that would make reorganization less feasible, giving particular attention to the following items:

- (1) Protection of revenue base;
- (2) Preservation of physical assets necessary to a reorganized company, including yards and branch lines;
- (3) Participation by the Trustee in reopened or pending merger cases between competing or connecting railroads;
- (4) Use of ERSA funds to preserve estate during period of reorganization; and
- (5) Activities of state rail planners under Title 8 of 4-R Act.

D. Present findings developed under Parts I and II to appropriate parties and agencies.

IV. PRESENT REPORT TO OLD WEST REGIONAL COMMISSION OUTLINING RESULTS DEVELOPED AND MAKING RECOMMENDATIONS FOR FUTURE PLANS AND ACTIONS.

REASONS FOR IMMEDIATE ACTION BY OLD WEST REGIONAL COMMISSION

1. The Trustee plans to open traffic gateways with Burlington Northern and Union Pacific at Great Falls and Portland. This will cause an irreversible loss of the Milwaukee's revenue base if not strictly limited. Present indications are that these gateways may be opened as soon as winter weather interferes with Milwaukee's operations.
2. An announcement is expected during the week of December 18 of a Union Pacific/Milwaukee agreement for sale to Union Pacific of small but critical segments of Milwaukee main and branch lines. Such an agreement, if consummated, would render reorganization impossible.
3. Many branch line abandonment proceedings have been initiated by the Trustee. The loss of revenue base that would accompany abandonment could well render reorganization impossible. Each branch line has a different impact, but the revenue base now available to a reorganized company should not be diminished at all if the reorganization is to have the greatest potential for success.
4. The Burlington Northern/Frisco merger case is moving ahead rapidly, and it is imperative that certain conditions be imposed to protect the competitive position of reorganized Milwaukee lines serving the Old West Region. It is particularly important to preserve access to southeastern markets.
5. Emergency Rail Services Act (ERSA) funds are presently available to the Trustee to preserve operation pending reorganization. The Trustee has indicated an intention not to draw on these funds. If lines serving the Old West Region are to be reorganized, the ERSA funds should be utilized to protect the operation through the present winter.
6. The Trustee has indicated that he has not decided if he will follow up on the October decision of the United States Court of Appeals for the Seventh Circuit ordering the ICC to reconsider Milwaukee's

petition to reopen the Burlington Northern merger case. Reopening of that case provides an important opportunity for the Milwaukee to obtain access to Colstrip, Montana, thereby greatly strengthening the Milwaukee's revenue base in the Old West Region.

7. The Trustee has repeatedly reduced the number of locomotives, serving the territory west of Minneapolis. The fleet has now been reduced to the point where traffic is accumulating in terminals and cannot be moved. At the same time the number of available trainmen and enginemen has been reduced to a point where it has been necessary for the Trustee to cancel vacations of enginemen in Montana. The deterioration of service caused by failure to provide locomotives and crews will force shippers to abandon the Milwaukee to the extent they have any alternative and thereby make self-fulfilling the Trustee's prophesy that there is not sufficient business to support the system.

LINES OF THE MILWAUKEE RAILROAD FROM THE TWIN CITIES
TO THE WEST COAST CONSTITUTE AN
ECONOMICALLY VIABLE UNIT

As summarized below the portion of the Milwaukee line that the trustee plans to abandon could be reorganized with minimal capital investment as a profitable railroad company.

1977 revenues net to Milwaukee generated on lines west of the Twin Cities were in excess of \$130 million. A study done in 1978 by the Milwaukee Traffic Department showed that additional traffic that would have generated another \$64 million was offered to Milwaukee in 1977 but was not accepted due to lack of serviceable cars and power.

Annual costs of owning and operating lines west of the Twin Cities are less than \$200 million, even with present uneconomical conditions.

Substantial cost savings would be produced by a rationalized operation combined with a capital investment of \$50 million over two years that would eliminate deferred track maintenance, allowing increased operating speeds, thereby providing savings from:

- (1) Improved car and locomotive utilization due to faster turnaround;
- (2) Decreased derailment expense; and
- (3) Decreased crew costs and "dog catching."

Repair of inoperative system cars would allow:

- (1) Reduction in foreign car hire; and
- (2) Increased revenues during period of car shortage.

Substitution of the existing "Run to Failure" locomotive program with normalized maintenance would allow:

- (1) Reliable operation;
- (2) Reduced delay due to failure; and
- (3) Repair cost of 28¢ per unit mile versus present cost of 73¢ per unit mile.

An additional important result of the foregoing program would be increased revenue to a reorganized Milwaukee from traffic that was handled previously but has been lost to other railroads due to service deterioration.

IMPACT ON OLD WEST REGION OF ABANDONMENT
OF MILWAUKEE RAIL LINES

There will be a direct loss of Milwaukee employment as follows:

	<u>Employees</u>	<u>Payroll</u>
Montana	829	\$15,517,683
South Dakota	505	9,221,934
North Dakota	32	565,892
TOTAL	1,366	\$25,305,509

Perhaps even more critical will be the loss of rail capacity at a time when coal and grain movements are taxing current capacity of both car supply and rail plant. The capacity problem has reached such proportions that the State of North Dakota, through its Public Service Commission, is studying the feasibility of acquiring its own covered hopper rail fleet. Montana and Wyoming are faced not only with problems of capacity to move grain, but also coal. The serious consideration being given to a coal slurry pipeline to increase capacity to move coal, emphasizes the potential importance of Milwaukee rail lines.

Abandonment of the Milwaukee rail lines in the region will end rail competition which has held rates at a level lower than would otherwise have prevailed. While this influence is difficult to quantify, it definitely involves millions of dollars per year in savings to rail shippers and the region's economy. As an example, there is good reason to believe that the Milwaukee caused the Burlington Northern to forego a 15 percent grain rate increase in the past year. The total rail freight bill for grain shipments from Montana is \$80,000,000. Fifteen percent amounts to an annual saving of \$12,000,000.

Recognizing the economic importance of competition within the nation's transportation system, Congress and the administration are actively pursuing deregulation of the airline and trucking industry in order to foster competition. To simultaneously eliminate rail competition in the Old West Region through liquidation of the Milwaukee's western lines would be highly deleterious to the nation's economy as well as to the economy of the region.

Attachment D

500 WAINWARD BUILDING
119 FIRST AVENUE SOUTH
SEATTLE, WASHINGTON 98104

Telephone
(206) 622-9503

MEMBERS OF FIRM

James Wickwire, born Wenatchee, Washington, June 8, 1940; admitted to bar, 1957, Washington. Preparatory education, Gonzaga University (B.A., 1955); legal education, Gonzaga University (J.D., cum laude, 1957). Editor in Chief, Gonzaga Law Review, 1956-1957. Legislative Assistant to U.S. Senator Henry M. Jackson, 1957-1958. *Members:* Seattle-King County, Washington State and American Bar Associations.

O. Yale Lewis, Jr., born West Point, Georgia, July 19, 1940; admitted to bar, 1969, Oregon; 1970, Washington. Preparatory education, Harvard College (A.B., cum laude, 1962); legal education, University of Virginia (LL.B., 1969). Law Clerk to Hon. Alfred T. Goodwin, U.S. Court of Appeals, Ninth Circuit, 1969-1970. *Members:* Seattle-King County, Washington State and American Bar Associations; Oregon State Bar. [Lieut., U.S. Navy, Submarine Corps, 1962-1966]

Charles A. Goldmark, born Washington, D. C., January 23, 1944; admitted to bar, 1973, Washington. Preparatory education, Reed College (B.A., 1965); legal education, Yale University (J.D., 1973). Editor, 1972; Note and Comment Editor, 1972-1973, Yale Law Journal. Author, Note, "Sell More Ads About Dirty Books," 81 Yale Law Journal 359, 1971. *Members:* Seattle-King County, Washington State and American Bar Associations.

John Jay Dystal, born Chicago, Illinois, November 6, 1949; admitted to bar, 1973, Washington. Preparatory education, Brown University (A.B., 1955); legal education, Yale University (J.D.,

1971). *Fraternity:* Phi Beta Kappa. Member, Board of Editors, Yale Law Journal, 1959-1971. Author, Note, "Conspiracy and the First Amendment," Yale Law Journal, 1970. Co-Author (with Nicholas Johnson) of Article, "A Day in the Life: The Federal Communications Commission," 82 Yale Law Journal 1575, 1973. Law Clerk to Hon. Alfred T. Goodwin, U.S. Court of Appeals, Ninth Circuit, 1971-1972. *Members:* Seattle-King County, Washington State and American Bar Associations.

Jon M. Schorr, born Columbus, Ohio, May 15, 1940; admitted to bar, 1959, Washington. Preparatory education, The Ohio State University (B.S., 1957); legal education, The Ohio State University (J.D., cum laude, 1958). Certified Public Accountant, Washington, 1972. *Members:* Seattle-King County, Washington State and American Bar Associations; Washington Society of Certified Public Accountants. [Capt., U.S. Marine Corps, 1952-1955]

Kevin F. Kelly, born New Orleans, Louisiana, April 27, 1949; admitted to bar, 1973, Washington. Preparatory education, Gonzaga University (A.B., summa cum laude, 1970); legal education, Boalt Hall School of Law, University of California (J.D., 1973). *Fraternity:* Order of the Coif. Head Note and Comment Editor, California Law Review, 1972-1973. Author, Comment, "Attorneys' Fees in Individual and Class Action Antitrust Litigation," 61 California Law Review 1656, 1972. Law Clerk to Hon. Eugene A. Wright, U.S. Court of Appeals, Ninth Circuit, 1973-1974. *Members:* Washington State and American Bar Associations.

WICKWIRE, LEWIS, GOLDMARK, DYSTAL & SCHORR (Continued)

ASSOCIATES

David C. Crosby, born Winchester, Massachusetts, February 5, 1945; admitted to bar, 1970, California; 1971, Alaska; 1973, Maine; 1975, U.S. Court of Claims; 1976, U.S. Court of Customs and Patent Appeals; 1977, Washington. Preparatory education, Yale University (A.B., 1967); legal education, University of Southern California (J.D., 1970). Editor-in-Chief, Southern California Law Review, 1959-1970. Law Clerk to Hon. Raymond Plummer, U.S. District Court, District of Alaska, 1970-1971. *Members:* Alaska and Washington State Bar Associations; State Bar of California.

William H. Block, born Chicago, Illinois, June 15, 1949; admitted to bar, 1975, District of Columbia; 1977, Washington. Preparatory education, Pomona College (B.A., cum laude, 1971); legal education, University of Chicago (J.D., cum laude, 1974). *Fraternity:* Order of the Coif. Editor-in-Chief, University of Chicago Law Review, 1973-1974. Law Clerk to: Hon. Carl McGowan, U.S. Court of Appeals, District of Columbia Circuit, 1974-1975; Hon. Harry A. Blackmun, U.S. Supreme Court, 1975-1977. *Members:* Washington State Bar Association; The District of Columbia Bar.

Thomas J. Brewer, born Greenville, Illinois, November 2, 1946, admitted to bar, 1975, California, 1978, Washington. Preparatory education, Dartmouth College (A.B. magna cum laude, 1968); legal education, Oxford University (B.A., 1973), Harvard Law School (J.D. magna cum laude, 1975). *Fraternity:* Phi Beta Kappa. Harvard Law Review 1974-1975.

Associate, not listed in Martindale-Hubbell. Joined Wickwire, Lewis, Goldmark, Dystal & Schorr in February, 1978.

Attachment E

RESUMES FOR SIMPSON AND BRODSKY

J. FRED SIMPSON

Address: P.O. Box 10629
Bainbridge Island, Washington, 98110
Telephone: (206) 842-4301

- 1963 Degree in Economics, Stanford University.
- 1966 Degree in Law, Harvard University.
- 1966-1968 Private practice of law, Seattle.
- 1968-1978 Employed by Milwaukee Railroad as General Attorney representing the company in Washington, Idaho and Montana and then as Assistant Vice President, Planning-Financial Assistance, at Chicago.

William H. BRODSKY

Address: 427 So. Princeton
Itasca, Illinois 60143
Telephone: (312) 773-2180

- 1968 Degree in Mechanical Engineering, South Dakota School of Mines & Technology
- 1968-1970 U.S. Army, Viet Nam.
- 1970-1978 Employed by Milwaukee Railroad in following positions:
 - Engineer, Electrified Territory, Marlowton, Montana, to Tacoma, Washington.
 - Assistant to General Manager, Special Projects, Seattle.
 - Train Master, Tacoma.
 - Manager, Operations Planning, Chicago.
 - Superintendent, Bensonville Yard, Chicago.
 - Assistant Vice President, Planning-Budget, Chicago.

Attachment F

Rehabilitation and Operation of Milwaukee Lines Between Twin Cities and West Coast

System

The proposed system includes the transcontinental line of the Milwaukee Road from St. Paul, Minnesota to Tacoma, Washington, secondary mainlines from Aberdeen, South Dakota to Sioux City, Iowa and from Sumas, Washington on the Canadian border to Portland, Oregon. With the single exception of the line from Faith to Trail City, S.D., all present branch lines in the associated territory are to be rehabilitated and operated as part of the proposed system. Total route mileage of the proposed system is 4,417.7 miles including 1,784.7 mainline miles; 595.0 secondary mainline miles and 2,038.0 branch line miles. This compares to Milwaukee's present total system mileage 10,074.

The eastern terminus of the proposed system, Minneapolis and St. Paul, Minnesota will provide connections with five class I railroads: Soo Line, Chicago and North Western, Milwaukee, Rock Island and Burlington Northern. In addition, connections will be established with the Minneapolis Northfield and Southern and various switching and transfer operations to be negotiated. These connections will expand the existing potential for westbound traffic from all mid-western carriers as the proposed system is no longer a principal competitor in the midwest.

Connections at Sioux City, Iowa will provide additional traffic opportunities to the South and East. The Illinois Central Gulf, Chicago and North Western, Burlington Northern and Milwaukee Road all provide connections at Sioux City affording an excellent opportunity to establish service routes to Kansas City and the Gulf states.

Sumas, Washington is the Canadian gateway for the proposed system and when utilized in conjunction with the Portland gateway and connections with the Southern Pacific, the system provides a North South service route for the movement of raw materials from Canada to principal population centers on the West Coast and also provides a service route for the movement of manufactured products to Canada.

In total, the proposed system provides the opportunity to maximize length of haul and minimize operating expense thus resulting in a viable operating entity.

Rehabilitation

The most important issue facing the reorganized company will be rehabilitation of the proposed system. Our figures indicate a requirement over five years of approximately \$118 million to rehabilitate the main line from the Twin Cities to the Coast to provide a Class IV, 60 m.p.h. time table speed railroad capable of providing the fastest rail service between the Pacific Northwest ports and the Midwest.

The rehabilitation program has been designed around three basic priorities: Safety, elimination of cash drain and net service benefits. The first year of the program will require an expenditure of approximately \$12.3 million. The work effort will be concentrated in mountain territories where safety and reliability of the operation is the principal concern. At the end of year 1 the operation will be slow but safe and reliable. Year two of the rehabilitation program requires an expenditure of approximately \$25.9 million with emphasis on safety and also on those areas where excessive crew expenses are incurred as a result of slow running time between terminals. These expenses represent an avoidable cash drain that will be eliminated to provide a safe efficient operation at the end of year two. The expenditure requirement for year three will be approximately \$28.2 million. The service provided at end of year three will show a significant reduction in transit time and should again establish the proposed system as a truly competitive carrier in the Northern tier of states. Year four will require an expenditure of \$27.2 million and year five \$24.2 million. During the two latter years service capability will continue to improve as the overall objective of Class IV, 60 m.p.h. railroad is achieved.

Branch line rehabilitation projects will be progressed over the five-year period with most lines qualifying under Title VIII of the 4-R Act for financial assistance. Shippers have also expressed an interest in participating financially in the rehabilitation of branch lines.

In addition to the rehabilitation program fully normalized maintenance of \$10,000 per mile mainline, \$6,500 per mile secondary mainline and \$3,500 per mile branch lines, will be accomplished during the five-year period. Beginning in year one, the normalized maintenance of way budget will provide a rate of expenditure that exceeds the budget for the entire Milwaukee System in 1978.

While the entire rehabilitation program will require an expenditure of approximately \$118 million, it is anticipated that only 70 million will be required from outside funding sources. This is essentially the first three years of the program. Years four and five can be financed internally. Possible funding sources are Title V and Title VIII of the 4-R Act of 1976, the National Energy Act of 1978, shipper financial assistance, the public market, or trustee borrowing against the 432 million dollar equity of the estate.

Traffic

The principal data sources for projected revenues available to a reorganized railroad are two documents: 1) Chicago, Milwaukee, St. Paul and Pacific Railroad Revenue flows by line segment maps, sheets 1 and 2, 1977, 2) Milwaukee Railroad traffic studies by principal shippers 5/30/78.

These documents show that approximately \$166 million revenue is available to the proposed system less \$34 million for the division east of St. Paul and Sioux City. An additional \$50 million revenue is available by meeting present equipment shortages. Year five the service route is fully established and an additional \$26 million time sensitive traffic is included. Also year five includes additional coal traffic of \$17 million. A 3 per cent growth rate was used during the five year period. Total revenues at end of year five are \$244,900,000.

The revenue car load assumptions define the \$244.9 million revenue figure in terms of revenue car loads based on commodity mixes consistent with historical trends. Where known changes are expected to occur, i.e., coal traffic, such changes have been incorporated. The car load statistics are then used to define level of train service, equipment requirements and budget impacts.

The projected mainline traffic chart densities is a summary of anticipated traffic densities between principal mainline locations. The tonnages are used to plan anticipated track maintenance requirements and relate to the car loads previously defined.

Operating Plan

The operating plan is comprised of five operating divisions approximately equal in physical size, headed by a Division Manager.

The division territories have been designed to facilitate optimum control of activities on the local level, thereby allowing the Division Manager the opportunity to truly manage his entire operation. The emphasis in personnel will be on the Division level as opposed to overhead function, thereby making the divisions as self-sufficient as possible.

Service provided in year one is essentially a three transcontinental train per day operation with slightly expanded activity on some branch lines. Equipment requirements, both locomotive and freight car, will be met primarily with present Milwaukee Road equipment during year one. Assumption of lease costs for high horsepower locomotives has been included in the budget. Also freight car leases have been budgeted at \$4.5 million and trailer train rental at \$4.3 million. Orders for new locomotives and freight cars would be placed as soon as practicable with anticipated lead times for delivery of twelve to twenty-four months. In addition to present Milwaukee Road equipment, utilization of private and foreign cars are budgeted to handle 35% of system loading year 1.

The core of the proposed operation is the scheduled service operated between Tacoma, Washington and Aberdeen, South Dakota. These two locations will be principal switching yards for the system. At Aberdeen, South Dakota, eastbound traffic would be blocked for connecting lines at St. Paul, Minnesota and Sioux City, Iowa. Traffic received from connections will be blocked for western destinations at Aberdeen. Tacoma, Washington will function in a similar manner on the west end of the proposed system with major emphasis on blocking traffic for the Southern Pacific at Portland, Oregon.

The proposed system combines the advantages of long haul traffic and minimal terminal congestion to maximize revenue potential and minimize operating expenses.

The operation in year five expands to four transcontinental trains per day and a fifth train operating from Spokane, Washington to Aberdeen, South Dakota five days per week. Branch line service remains basically the same with increased service for the movement of logs for Weyerhaeuser Company anticipated on the Morton, Washington branch line.

Equipment Requirements

The locomotive requirements for year one will be met with existing Milwaukee Road units. An additional 88 units will be required as part of the five-year reorganization plan to handle the projected increases in tonnage during that period. String line charts and individual yard and branch line analysis were used to project the locomotive requirements.

The proposed system will require a freight car ownership of approximately 10,000 freight cars. Acquisition of approximately 3,650 new cars has been budgeted with approximately 6,000 cars to be acquired from Milwaukee Road as part of the initial acquisition of property.

Forecast of Net Revenue from Railway Operations

Year One

Gross Freight Revenue	-	as defined by Chicago, Milwaukee, St. Paul and Pacific Railroad revenue flows by line segment map 1977, less \$35 million for lines East division.
Adjustments and Absorptions	-	Settlements between railroads or between railroad and shipper on revenue payments. Figure is derived as a percentage of gross based on historical data (4.85%).
Switching	-	Revenue derived from switching charges paid by foreign lines to switch cars to and from industries located on line. Estimated figure based on knowledge of the system and historical data.
All Other	-	Other operating revenues not accounted for in gross freight revenue, i.e., operating leases, rentals of equipment, etc. Estimated 1.8% of gross freight revenue.
Operating Expenses, Taxes and Rents		

Executive Department	-	Includes positions of president, five vice presidents and president's support staff. President's salary budgeted at \$80,000 and vice presidents at \$60,000.
Vice President Law	-	Pro rated at approximately 30% of existing law department budget.
Vice President Administration	-	Includes personnel-labor relations, computer services, purchasing and materials, planning and corporate communications functions. Approximately 27% of existing budget.
Vice President Marketing	-	Include sales and marketing function at approximately 27.5% of the present budget.
Vice President Finance	-	Estimated to be 50.2% of existing budget.
Vice President Operations	-	Includes 4 AVP positions, staff support and business expenses.
General Manager	-	Includes entire operating budget for five operating divisions, including normalized track maintenance of \$10,000 per mile mainline, \$6,500 per mile secondary mainline and \$3,500 per mile branch line. Car and locomotive maintenance force are increased but not to fully normalized level in year one.
Engineering	-	Includes staff support and system program work excluding that which comprises the five-year rehabilitation program. The budget is 29.8% of the present system budget.
Transportation	-	The transportation budget includes \$19.4 million for foreign and private freight car rental. \$10.1 million for locomotive rental and \$10.0 million for fuel costs. The budget

		represents approximately 35% of the present system budget.
Taxes Other Than Payroll	-	Pro rated and adjusted for the area the proposed system will serve. The budget is approximately 32.6% of the present system budget.
Retirement Charges	-	Estimated based on very minimal retirement program.
Depreciation Charges	-	Minimal depreciation budget as major plant renovation and investment will be occurring. Budget number has been estimated.

Forecast of Net Revenue from Railway Operations

Year Five

Gross Freight Revenue	-	Includes base revenue of \$166 million year one less \$35 million Lines East Division, with 3% growth rate throughout the five year program. Also included is \$50 million of additional traffic defined in "Traffic Statistics by Principal Shipper" which is related to present equipment shortages and \$26 million of additional time sensitive traffic. Additional coal traffic of \$17 million is also included.
Adjustments and Absorptions	-	Approximately 4.8% of gross freight revenue
Switching	-	Estimated
All Other	-	Estimated
Operating Expenses, Taxes and Rents		
Executive		

Department	-	Includes added staff support and administrative costs. Increased budget of \$200,000.
Vice President Law	-	Reduced freight claims and personal injuries due to rehabilitated plant. Reduced budget of \$1 million.
Vice President Administration	-	Budget increased \$700,000 in personnel-labor relations as number of employees are significantly increased. Also included is an increase in inventory of materials.
Vice President Marketing	-	Budget increased \$200,000, primarily in off line sales area.
Vice President Finance	-	Same
Vice President Operations	-	Same
General Manager	-	Budget increased \$24.4 million to accommodate increased traffic and fully normalized car and locomotive maintenance.
Engineering	-	Budget increased \$3.8 million to include expanded system programs in normalized maintenance budget.
Mechanical	-	Budget increased \$16.5 million to include additional shop activities necessary to maintain system bad order car and locomotive levels at 5% and 16% respectively.
Transportation	-	Budget increased \$8.6 million to include additional fuel costs and equipment leases. Anticipated fuel costs in year five are \$20 million, car and locomotive lease purchase costs of \$20.6 million and trailer train rental of \$4.5 million.

Taxes, Retirement Charges and Depreciation charges show only very minor changes between year one and year 5.

All revenue and expense figures shown in the Proposal for Reorganization are in constant dollars. It is assumed that inflated expense dollars will be off set by exparte freight rate increases over the five-year period. The actual impact of inflation will be taken into account when the detail of the plan is developed.

Booz Allen Study

The study of the Milwaukee Road System contracted with the firm of Booz, Allen & Hamilton by the trustee is essentially an operational feasibility study of existing traffic, handled in accordance with various operating scenarios intended to optimize rail car movement across the system.

The basic question regarding reorganization is availability of revenue Booz, Allen has attempted to answer what is a marketing question with an operational feasibility study. The viability of Lines West as defined by Booz, Allen & Hamilton included present revenues, fully normalized maintenance charges and excessive avoidable costs in transportation expenses, the latter of which were challenged by the railroads transportation department and lack credibility. Through the manipulation of transportation costs Booz, Allen & Hamilton proposed that Lines West was creating a drain on the Milwaukee System of approximately \$30 million. These expenses related to car hire, locomotive costs, lease expenses and fuel costs.

The midwestern railroad proposed by Booz Allen & Hamilton as related to Brodsky by Mr. P.C. White, Vice President Planning, would lose \$30 million to \$40 million annually. Booz, Allen & Hamilton then proposed to undertake a marketing study in the midwest to determine if additional traffic were available to meet the shortfall. No detailed marketing analysis has been prepared to access the potentials of Lines West by Booz Allen & Hamilton.

FORECAST OF NET REVENUE FROM RAILWAY OPERATIONS
(Amounts Stated in Thousands)

YEAR 5

OPERATING REVENUES

Gross Freight Revenue	\$244,900
Less Adjustments and Absorptions	11,800
Net Freight Revenue	233,100
Switching	2,200
All Other	4,500
TOTAL OPERATING REVENUES	\$239,800

OPERATING EXPENSES, TAXES AND RENTS

Executive Department	\$ 800
Vice President, Law	6,200
Vice President, Administration	4,000
Vice President, Marketing	3,100
Vice President, Finance	10,500
Vice President, Operations	600
General Manager	105,400
Engineering	7,400
Mechanical	25,800
Transportation	47,100
Taxes Other Than Payroll	2,200
Retirement Charges	200
Depreciation Charges	2,000
TOTAL EXPENSES, TAXES AND RENTS	\$215,300
NET REVENUE RAILWAY OPERATIONS	\$ 24,500

FORECAST OF NET REVENUE FROM RAILWAY OPERATIONS
(Amounts Stated in Thousands)

YEAR 1

OPERATING REVENUES

Gross Freight Revenue	\$143,000
Less Adjustments and Absorptions	6,900
Net Freight Revenue	136,100
Switching	1,900
All Other	3,000
TOTAL OPERATING REVENUES	\$141,000

OPERATING EXPENSES, TAXES AND RENTS

Executive Department	\$ 600
Vice President, Law	7,200
Vice President, Administration	3,300
Vice President, Marketing	2,900
Vice President, Finance	10,500
Vice President, Operations	600
General Manager	81,000
Engineering	3,600
Mechanical	9,300
Transportation	38,500
Taxes Other Than Payroll	2,400
Retirement Charges	200
Depreciation Charges	1,500
TOTAL EXPENSES, TAXES AND RENTS	\$160,600
NET REVENUE FROM RAILWAY OPERATIONS	(20,600)

FREIGHT CARS

It is assumed that the freight cars required for the first year will be Milwaukee cars presently in service. In addition, approximately 35% of the system loading will be handled in private and foreign railroad equipment. During the first five years of operating the company will acquire the following new cars:

<u>ITEM</u>	<u>QUANTITY</u>	<u>ANNUAL EXPENSE</u>
Covered Hopper Cars	700 @ \$40,000	\$3.6 million
Plain 50 Ft. Box Cars	1000 @ 36,000	4.1 million
Double-Door 50 Ft. Box Cars	750 @ 38,000	3.7 million
Open Top Hopper Cars	500 @ 33,000	2.1 million
Special Equip. Equip Box	700 @ 41,000	3.7 million

In addition, leases or obligations on 1,500 Milwaukee cars will be assumed at an anticipated annual cost of \$2.5 million.

EQUIPMENT REQUIREMENTSLOCOMOTIVES

SD 40 or equivalent	121 units
GP 38 or equivalent	66 units
MP 15 or equivalent	15 units
SW 1200 or equivalent	13 units

It is anticipated that most of the above units would be immediately available from the Milwaukee. There is a national shortage of SD 40 type units. It is proposed that 43 of this type unit would be purchased by the new company over the first five years, with purchases scheduled as early as possible. The annual purchase cost of 43 units will be approximately \$3.4 million.

REVENUE - CAR LOAD ASSUMPTIONS

YEAR 5

<u>COMMODITY</u>	<u>CAR LOADS PER DAY</u>		<u>% CL</u>	<u>REVENUE</u>	<u>% REV</u>
	<u>5 DAY WK</u>	<u>365 DAYS</u>			
Primary Forest Products	250	178	22%	\$ 7.8 mil.	3%
Lumber, Plywood & Related Prod.	217	155	20%	\$ 82.0 mil.	33%
Grain	81	58	7%	\$ 42.3 mil.	17%
Automotive	29	21	3%	\$ 14.6 mil.	6%
TOFC, FAK	87	62	8%	\$ 15.8 mil.	7%
Paper & Prod.	79	56	7%	\$ 13.3 mil.	5%
Coal	164	117	15%	\$ 24.3 mil.	10%
Perishable	13	9	1%	\$ 4.6 mil.	2%
Chemicals, Petroproducts	10	7	1%	\$ 2.6 mil.	1%
All Other	181	129	16%	\$ 37.6 mil.	16%
	1111	792		\$ 244.9 mil.	

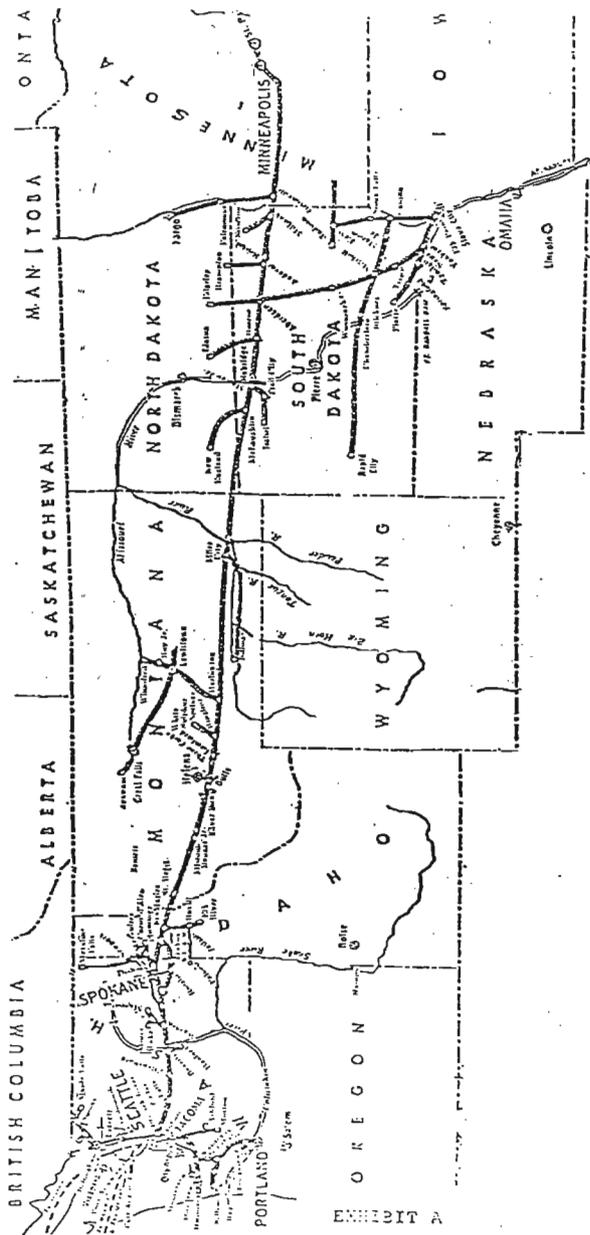


EXHIBIT A

S.O.R.E.

Lines West Proposal

APRIL 28, 1979

I. INTRODUCTION.

The Chicago, Milwaukee, St. Paul and Pacific Railroad Company under the direction of court-appointed Trustee Stanley E. G. Hillman, has determined that it no longer wishes to operate its transcontinental main line between St. Paul, Minnesota and the Pacific Northwest.

The Milwaukee's transcontinental line is a vital national asset that traverses nearly one-third of the nation's low sulphur coal deposits and provides rail transportation service to a large portion of the grain producing region in the Northern Tier of the western states. This main line route provides the shortest, most direct line between the rapidly growing Pacific Northwest ports and the population centers of the midwest and east. The line presently is in a deteriorated condition, the result of twenty years of deferred maintenance.

Based upon the results of a detailed viability study prepared during the past six months, we believe that there is a financially viable alternative to the Trustee's intended abandonment of transcontinental service: The Milwaukee's western lines can be operated profitably by a properly-managed private company.

The Milwaukee's transcontinental line is the only transcontinental line that is in financial difficulty at the present time. The five other railroads that participate in the transcontinental market are all considered extremely prosperous and successful railroad companies.

This proposal addresses itself to the process by which a new company would be formed to acquire and operate the Milwaukee's transcontinental line and associated operations west of St. Paul, Minnesota. The method of acquisition, structure of ownership, asset requirements, federal participation and financial evaluations are presented for review and consideration as a realistic alternative to the abandonment of service proposed by the railroad's Trustee.

II. DETAILS OF SORE's ACQUISITION PROPOSAL.

A. Assets to be Acquired.

The assets to be acquired by the new company have a total liquidation value of approximately \$370 million. This figure may be slightly over-stated with regard to the Milwaukee Land Company as the Trustee has recently arranged for loans from the Land Company to cover his cash short-fall. Final valuation will be negotiated.

A listing of the assets to be acquired is as follows:

LIQUIDATION VALUE OF ASSETS TO BE ACQUIRED

(000)

I. REAL PROPERTY OF RAILROAD:

Idaho	4029 acres	\$2,075
Minnesota	1768	5,000
Montana	26745	6,080
North Dakota	7218	1,500
South Dakota	30941	7,650
Washington	<u>17504</u>	<u>43,057</u>
	88205	\$65,362

II. ROADWAY PROPERTY:

Track	\$112,752
Signals & Communications	<u>1,188</u>
	\$113,940

III. MILWAUKEE MOTOR TRANSPORTATION COMPANY:

Liquidation Value \$1,330	44%	\$585
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IV. OTHER INVESTMENTS:

Longview Switching Company	\$ 11
Delta Alaska Terminal, Ltd.	1
Minneapolis Eastern Ry. Co. 40%	10
Minnesota Transfer Ry. Co. 40%	114
Trailer Train	<u>247</u>
	\$383

V. MILWAUKEE LAND COMPANY:

\$110,203

VI. OWNED EQUIPMENT:

Freight Train Cars	44%	\$50,568
Locomotives	44%	13,050
Work Equipment	44%	3,673
Motor Vehicles, Shop & Power Plant Machinery	40%	<u>981</u>
		\$68,272

VII. INVENTORY (Materials & Supplies):

\$11,717

TOTAL ASSETS

\$370,462

B. Method of Acquisition.

The proposed process by which the new company shall seek to acquire the necessary assets of the Milwaukee Road is through an assumption of debt.

The value of the assets to be acquired, as defined in the study prepared by the firm of Ford, Bacon & Davis for Trustee Hillman, is approximately \$370 million. This represents 44% of the value of the Milwaukee's \$832 million of total assets. SORE proposes that the new company assume with specific exceptions the same pro rata share of the Milwaukee's total debt as it takes of the assets (44%). There does not appear to be any reason for the new company to assume any of the debt recently incurred to rehabilitate the Chicago to Twin Cities line, as that line which is not in this SORE proposal will directly reap the benefits of the investment.

C. Federal Participation.

The proposal for acquisition and operation of Milwaukee Road lines west of St. Paul, Minnesota, by employees of the company can only be successful if three specific funding requirements can be met:

1. Approximately \$118 million must be made available under a deferred repayment schedule for the rehabilitation of the main line between St. Paul, Minnesota and Tacoma, Washington to Class IV standards.
2. An Emergency Rail Services Act loan must be made to the company to cover an operating cash short-fall during the first two years of operation of \$20.2 million.
3. A loan guarantee of \$32.1 million must be made available to the employees of the railroad in order to establish the necessary employee owned trust to acquire the stock ownership of the new railroad company.

PRO FORMA STATEMENT OF INCOME
YEARS 1 - 5 & 10

(Amounts Stated in Thousands)

	Years					
	1	2	3	4	5	10
Net Revenue from Railway Operations	(19600)	(8600)	2450	13475	24500	45219
Fixed Charges	(1695)	(6608)	(7955)	(10417)	(9912)	(8397)
Income Before Taxes	(21295)	(15208)	(5515)	3058	14588	36822
Subsidiary Earnings	4000	4000	4000	4000	4000	6000
Net Income (Loss) Before Taxes	(17295)	(11208)	(1515)	7058	18588	42822

The Railroad income is based on conservative traffic estimates, which do not take account of much of the growth in coal traffic projected by coal companies, nor possible penetration of markets held by competing railroads. If coal traffic handled by the new company grows more rapidly than the traffic projections used, then earnings are significantly understated. By the same token, extensive penetration into the market shares of competing railroads would also increase profits. If, on the other hand, the new company is unable to attract more traffic than is presently being carried, the venture will not be profitable. The best estimates available have been used, but in questionable areas a conservative decision has been made.

A conservative approach has also been used with regard to railroad operating costs. Fully normalized maintenance of track and equipment has been budgeted. When there were judgments required for particular cost items a higher figure was normally used.

The following table shows the anticipated sources and application of funds for the first year of operation.

While the government's role in financing the rehabilitation and acquisition of these railroad properties is quite substantial, the proposed company can clearly demonstrate the ability to meet all incurred debt obligations and produce significant income over the long range. The conservative nature of the figures used in the viability study summarized in Appendix A, minimize the risks associated with this proposal. Loans and loan guarantees, not a continuing subsidy, are the only form of government assistance required. Aside from this one-time, front-end assistance, SORE proposes a private solution to the reorganization of the Milwaukee's Lines West.

D. Inclusion of Milwaukee Land Company

The proposal includes acquisition of Milwaukee Land Company, as a wholly-owned and controlled subsidiary of the new company. While the new company's long run profitability will depend on the earnings of the railroad, in the early years income from land company timber harvest will be important to cover debt service requirements. In later years land company timber sales will provide a cushion during economic slow downs that temporarily adversely affect rail income.

The land company also owns lands and rail properties which are essential to the long run viability of Lines West. These properties include the proposed Fife Yard site for the new western terminus at Tacoma, the Washington, Idaho and Montana Railroad, and industrial lands which have potential for feeding substantial traffic over the lines of the new company.

Even though acquisition of the land company means the assumption of substantial additional debt, it is felt that the financial contribution it will make coupled with the key properties it owns more than off-set the cost, and are essential to the new company.

III. PROFITABILITY

Based on the viability study prepared for SORE by Bill Brodsky, the new company is expected to lose money for the first three years of operation and to make rapidly increasing profits thereafter. The early losses which are covered by the ERSA loan and equity capital, occur while the plant is rebuilt, operations are gradually restored to a rational basis, and equipment is secured to meet the demands of shippers.

SOURCES AND APPLICATION OF
FUNDS YEAR 1

Sources of Funds:

From Operations		
Net earnings	(15,600)	
Depreciation and retirement charges	<u>1,700</u>	
Working Capital from Operations	(13,900)	
Borrowing		
Employee Stock Ownership Plan	32,108	
Emergency Rail Services Act	15,600	
Railroad Revitalization and Regulatory Reform Act	<u>12,300</u>	
	TOTAL	<u>46,108</u>
Application of Funds		
Property Additions & Betterments	1,500	
Mainline Rehabilitation	12,300	
Debt Retirement	--	
Start up Expense	11,500	
Increase (Decrease) in Working Capital	<u>20,808</u>	
	TOTAL	<u>46,108</u>

IV. CONCLUSION

If the SORE proposal is implemented, all of the requirements of the existing law would be met, significant economic and social benefits would result to the communities served, as well as the nation, and the employees, through ESOP, would gain control of the new company.

Chapter 77 of the Bankruptcy Act requires that any plan of reorganization provide for the convenience and necessity of the shipping public, the well being of employees, and the protection of creditors. The SORE proposal will result in rehabilitation to Class IV standards (60 mile per hour time table speed) of a

transcontinental railroad with the shortest route between Puget Sound and the Midwest as well as the least grade and curvature.

Competitive service will be offered to shippers with the concomitant favorable impact on car supply and level of rates. The competitive benefits which are important today assume greater significance in light of current proposals for deregulation of railroads.

The new company will not only retain all of the existing employees, it will hire a substantial number of new employees to carry out the normalized maintenance programs and expanded train service anticipated.

Creditors will be protected by being paid either in accordance with their existing debt instruments or by receipt of preferred stock in the new company.

The national interest in providing transportation capacity to move low sulphur western coal will be protected. This is of particular importance when the increasing demands for Montana coal generated by the energy crisis and the Clean Air Act are contrasted with the inability of the Burlington Northern to meet present demands for coal service.

The agricultural community of Montana and the Dakotas, presently unable to move sufficient volumes of grain to western ports for export will be served. The rapidly expanding Puget Sound ports of Seattle and Tacoma, as well as Columbia River ports will have rail capacity to move import-export traffic in the volumes presently projected.

The employee owners of the new company will have a modern profitable railroad 4400 miles in length serving rapidly expanding markets and owning a valuable subsidiary with assets including 150,000 acres of timber land.

V. NOTES AND ASSUMPTIONS

This proposal is based on a detailed viability study prepared by Bill Brodsky. The railroad revenue and cost projections are thought to be conservative. It should be noted however, that revenue figures were based on 1977 Milwaukee Traffic Records. Since that date the Trustee has significantly reduced service on the transcontinental lines of the Milwaukee and traffic volumes have fallen sharply. It is assumed that the traffic will return as service is restored.

Costs are based on existing labor agreements and figures are in constant dollars.

The debt assumption calculations were based on a net identifiable Milwaukee debt of \$345 million with \$152 million or 44% assumed by the new company. Details of equipment and other debt obligations were not available for use in preparing the proposal. As the details of specific obligations of the Milwaukee and of those to be assumed by the new company are negotiated, the dollar amount of debt and debt service requirements will be affected, but it is not anticipated that there will be any material change in the basic outline of the proposal.

Milwaukee Land Company earning projections were not available, but the projected \$4 million annual earning on assets valued at \$110 million appear to be attainable in the first five years with an increase to \$6 million per year sustainable thereafter.

In order to properly protect the revenue base and ensure that opportunities for growth are available to the proposed operating company, it will be necessary that appropriate conditions be sought in the Burlington Northern Inclusion Case, which is now pending before the ICC. These conditions will significantly improve the new company's competitive position in the Northern Tier of states and are particularly important with regard to potential coal traffic.

APPENDIX A

SUMMARY OF FIVE-YEAR VIABILITY
STUDY AND REHABILITATION PLAN

The following is a summary of data concerning railroad operations used in preparing SORE's acquisition plan.

PROPOSED SYSTEM

MAIN LINE, SECONDARY MAIN LINE AND BRANCH LINE MILEAGES

MAIN LINE

St. Paul	-	E 14	23.1
E 14	-	Montevideo	119.4
Montevideo	-	Aberdeen	157.0
Aberdeen	-	Mobridge	98.0
Mobridge	-	Marmarth	190.1
Marmarth	-	Miles City	123.8
Miles City	-	Harlowton	216.7
Harlowton	-	Three Forks	113.9
Three Forks	-	Deer Lodge	111.7
Deer Lodge	-	Alberton	111.0
Alberton	-	St. Maries	145.7
St. Maries	-	Othello	166.8
Othello	-	Black River	179.4
Black River	-	Tacoma	28.1

1,784.7 miles

SECONDARY MAIN LINE

Aberdeen	-	Mitchell	128.6
Mitchell	-	East Wye Switch	116.7
East Wye Switch	-	Sioux City	20.1
Plummer	-	Spokane	37.1
Sumas	-	Bellingham	25.1
Bellingham	-	Black River	107.3
Tacoma Jct.	-	Portland	160.1

595.0 miles

BRANCH LINES

Madison	-	Miloma	100.9
Napa	-	Platte	82.4
East Wye Switch	-	Sioux Falls Jct.	112.5
Canton	-	Mitchell	79.2
Mitchell	-	Mundo	142.4
Mundo	-	Rapid City	143.9
Ortonville	-	Fargo	117.0
McLaughlin	-	New England	133.9
Moreau Jct.	-	Isabell	55.4
Milbank	-	Sisseton	37.1
Garden City	-	Bristol	29.0
Andover	-	Brampton	43.0
Aberdeen	-	Edgeley	63.9
Roscoe	-	Linton	75.3
Harlowton	-	Lewistown	61.0
Lewistown	-	Heath	9.2
Winifred Jct.	-	Winifred	42.7
Lewistown	-	Falls Yard	134.5
Falls Yard	-	Abawan	69.6
Sumas	-	Limestone Jct.	8.3
Hampton	-	Lynden	5.4
Fredrickson	-	Morton	54.3
Maytown	-	Hoquiam	56.6
Chehalis Jct.	-	Raymond	53.0
Beverly	-	Hanford	24.3
Royal City Jct.	-	Royal City	5.1
Warden	-	Moses Lake	21.6
Tiflis	-	Marcellus	38.7
Spokane	-	Metaline Falls	108.6
East Spokane	-	Coeur d'Alene	27.5
St. Maries	-	Bovill	51.7
Purdue	-	Palouse	50.0
			2038.0 miles

SUMMARY

Trackage (Route Miles)	
Main Line	1784.7
Secondary Main	595.0
Branch Line	2038.0
	4417.7 miles

REHABILITATION PLAN

A five year program for rehabilitation of the system main lines has been designed to allow rational upgrading of the plant without the excessive cost which would be incurred if it were attempted to repair the results of twenty years deferred maintenance in one year.

REHABILITATION PRIORITIES

1. Safety
2. Cash Drain
3. Benefits

YEAR 1

<u>Bitterroots</u>				
St. Regis	- East Portal	8" rock 2000 ties/mi. (78,000)		\$ 2.7 mil.
East Portal	- Avery	Engineering, ties and ballast		1.5 mil.

<u>Cascades</u>				
Cle Elum	- Hyak	8" rock 1500 ties/mi. (72,000)		2.2 mil.
Othello	- Beverly	8" rock 1200 ties/mi. (65,000/mi.)		2.6 mil.
Tacoma	- Fredrickson	8" rock 1500 ties/mi. (72,000/mi.)		0.7 mil.
	- Gasgoyne	8" rock 1200 ties/mi. (65,000)		2.6 mil.

Necessary Funding for System Programs \$12.3 mil.

YEAR 2

McKenna	- Western Jct.	8" rock 1500 ties (72,000)		\$ 0.7 mil.
Hyak	- Maple Valley	4" rock 1200 ties (50,000)		1.5 mil.
Ellensburg	- Cle Elum	8" rock 1200 ties (65,000)		2.0 mil.
Calder	- Plummer	8" rock 1500 ties (72,000)		2.8 mil.
Cobden	- St. Regis	8" rock 2000 ties (78,000)		1.6 mil.
Butte	- Deer Lodge	8" rock 2000 ties (78,000)		3.1 mil.
Grace	- Butte	8" rock 1500 ties (72,000)		1.5 mil.
Hamen	- Lombard	8" rock 1500 ties (72,000)		3.6 mil.
	-	8" rock 1200 ties (65,000)		2.6 mil.
	- Gasgoyne	40 mi. N 132# 115# up		6.5 mil.

Necessary Funding for System Programs \$25.9 mil.

YEAR 3

Taunton	- Beverly	25 mi. 115# SH 100# up	\$ 1.4 million
Beverly	- Ellensburg	8" rock 1200 ties (65,000)	2.0 million
Western Jct.	- Maytown	8" rock 1500 ties (72,000)	0.6 million
Bellingham	- Sumas	8" rock 2000 ties (78,000)	2.2 million
Plummer	- Pandora	8" rock 1500 ties (72,000)	1.8 million
Pandora	- Malden	4" rock 1200 ties (50,000)	0.8 million
Huson	- Cobden	8" rock 2000 ties (78,000)	1.6 million
Deer Lodge	- Revenna	8" rock 2000 ties (78,000)	3.1 million
Three Forks	- Grace	8" rock 1200 ties (65,000)	2.3 million
Hamen	- Moyne	13 mi. 115# SH 100# up	0.7 million
Harlowton	- Lavina	8" rock 1200 ties (65,000)	2.6 million
"	-	8" rock 1200 ties (65,000)	2.6 million
"	-	40 mi. N 132# 115# up	6.5 million
Necessary Funding for System Programs			\$28.2 million

YEAR 4

Hillsdale	- Western Jct.	30 mi. 115# SH 85# & 90# up	\$ 1.7 million
Maytown	- Chehalis	4" rock 1200 ties (65,000)	0.8 million
Marengo	- Lind	8" rock 1500 ties (65,000)	1.3 million
Paxton	- Marengo	4" rock 1200 ties (50,000)	0.5 million
Revenna	- Missoula	8" rock 2000 ties (78,000)	3.1 million
Alcazar	- Piedmont	15 mi. 115 & 132 NNSH 100 & 131 up	1.6 million
Melstone	- Lavina	8" rock 1200 ties (65,000)	4.2 million
Miles City	- Terry	8" rock 1200 ties (65,000)	2.3 million
"	-	8" rock 1200 ties (65,000)	2.6 million
"	-	40 mi. N 132# 115# up	6.5 million
Aberdeen	-	8" rock 1200 ties (65,000)	2.6 million
Necessary Funding for System Programs			\$27.2 million

YEAR 5

Chehalis	- Essex	8 mi. 115# SH down 85# up	\$ 0.4 mil.
Lind	- Othello	8" rock 1200 ties (65,000)	2.0 mil.
Malden	- Paxton	8" rock 1500 ties (72,000)	2.5 mil.
Plummer	- Malden	30 mi. 115# down 100# up	1.7 mil.
Missoula	- Huson	8" rock 1200 ties (65,000)	1.0 mil.
Lombard	- Three Forks	8" rock 1200 ties (65,000)	1.6 mil.
Baker	- Terry	8" rock 1200 ties	3.3 mil.
"	-	8" rock 1200 ties (65,000)	2.6 mil.
"	- Aberdeen	8" rock 1200 ties (65,000)	2.6 mil.
"	-	40 mi. N 132# 115# up	6.5 mil.
Necessary Funding for System Programs			\$24.4 mil.
Total Over Five Years: \$117.8 million			

State and Shipper Assisted Programs for Branch Lines To Be Carried Out As Funding Becomes Available:

Priorities		
1.	Northern Montana Shippers & Title VIII	\$10.5 million
2.	Tacoma and Eastern Shippers	
3.	Metalline Falls Title VIII	
4.	Rapid City Title VIII	
5.	New England Shippers	
6.	Fargo Title VIII	

Normalized Maintenance

In addition to the system rehabilitation program described above, normalized annual maintenance at the following rates is incorporated in the projected budgets for the new company.

Mainlines	\$10,000 per mile
Secondary Mainlines	\$6,500 per mile
Branch lines	\$3,500 per mile

The normalized maintenance will hold or gradually improve territories not immediately scheduled for major rehabilitation.

REVENUE - CAR LOAD ASSUMPTIONS

YEAR 5

COMMODITY	REV/CL	CAR LOADS	% CL	REVENUE	% REV
Primary Forest Products	\$120	13,000	22%	\$ 7.8 mil.	3%
Lumber, Plywood & Related Products	\$1450	11,284	20%	\$ 82.0 mil.	33%
Grain	\$2000	4,212	7%	\$ 42.3 mil.	17%
Automotive	\$1900	1,508	3%	\$ 14.6 mil.	6%
TOFC, FAK	\$700	4,524	8%	\$ 15.8 mil.	7%
Paper & Prod.	\$650	4,108	7%	\$ 13.3 mil.	5%
Coal	\$570	6,084	15%	\$ 24.3 mil.	10%
Perishable	\$1400	676	1%	\$ 4.6 mil.	2%
Chemicals, Petroproducts	\$1000	520	1%	\$ 2.6 mil.	1%
All Other	\$800	9,412	16%	\$ 37.6 mil.	16%
		57,772		\$244.9 mil.	

PROJECTED MAIN LINE TRAFFIC DENSITIES

YEAR 5

Approximate Operating Tonnages Per Mile
Anticipated on Main Line at End of Year 5

Black River	-	Othello	13.0 million tons/mile
Othello	-	Plummer Jct.	13.8 " " "
Plummer Jct.	-	St. Maries	14.3 " " "
St. Maries	-	Missoula	14.9 " " "
Missoula	-	Harlowton	16.0 " " "
Harlowton	-	Roundup	16.6 " " "
Roundup	-	Miles City	20.0 " " "
Miles City	-	Gasgoyne	22.5 " " "
Gasgoyne	-	Aberdeen	25.7 " " "
Aberdeen	-	Big Stone	21.4 " " "
Big Stone	-	St. Paul	18.2 " " "

Design criteria for Main Line operations to be Class IV 60 MPH timetable speed.

OPERATING PLAN

Following maps depict train operations for Year 5 based on a system composed of five operating divisions.

Train operations for Year 1 would include three transcontinental trains per day with branch line service essentially as shown.

IN THE U.S. DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 77 B 8999

IN PROCEEDINGS FOR THE REORGANIZATION OF A RAILROAD

IN THE MATTER OF CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, DEBTOR

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,
County of King, ss:

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 competently 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 interest 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 or 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 follow: The shareholders apparently would realize a return on their investment in the range of 1600 percent 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 percent 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 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 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 had 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 mention 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 midwest 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 carload of transcontinental freight results in a relatively high contribution to overhead, often approaching or exceeding \$1,000. By contrast, the contribution produced by a carload 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 experienced. 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 accruing 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 impossible 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 occurrence. 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 continue 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 noticeable 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 identity 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 productivity. 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 branch line 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 dispensable, 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 visibility 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 Bitterroot 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.

Subscribed and sworn to before me this 4th day of March, 1979.

D. YALE LEWIS, Jr.,

[NOTARY PUBLIC]

THE MILWAUKEE ROAD STRATEGIC PLANNING STUDIES, EXECUTIVE SUMMARY, MAY 1979

(Prepared by Booz-Allen & Hamilton, Inc., Transportation Consulting Division)

BOOZ · ALLEN & HAMILTON Inc

Transportation Consulting Division

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May 11, 1979

Mr. Stanley E.G. Hillman
Trustee
Chicago, Milwaukee, St. Paul and
Pacific Railroad Company
516 W. Jackson Boulevard
Chicago, Illinois 60609

Dear Mr. Hillman:

We enclose herewith the first volume of our report on the Milwaukee Road Strategic Planning Studies. The full report is contained in three separately bound volumes:

- The first volume contains the Executive Summary presenting in a condensed format the substance of our studies and findings.
- The second volume contains a detailed presentation of the background, processes and findings of our studies including all exhibits and appendices, except the confidential appendices contained in the third volume. The latter are identified as to title by a page in the appropriate section of the second volume.
- The third volume contains the Confidential Appendices on Competitive Information presenting marketing and other data, which by its nature is proprietary to the Company.

We will make distribution of this volume in accordance with the instructions received from Mr. John W. Rowe.

Very truly yours,

Booz Allen & Hamilton
BOOZ · ALLEN & HAMILTON Inc.

Enclosure

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INTRODUCTION

This Executive Summary, the first volume of the report to the Trustee of the Milwaukee Road dated May 11, 1979, presents a condensation of the substance of our work on the Milwaukee Road Strategic Planning Studies. The purpose of the Executive Summary is to highlight the major topics of the report in order to provide for a concise overview of the study. The full study results are contained in the second volume of the report, with certain proprietary data contained in a third confidential volume.

The report presents the analyses and findings on eight alternative system configurations of the Milwaukee System. The analyses have been conducted to assist the Trustee in determining whether, within the network of the bankrupt railroad system, there exists the potential for a reorganizable railroad and the nature of the risks attendant with each of the several options considered.

The Executive Summary is organized into chapters similar to the second volume of the report, which presents the details of the background, processes and findings of our studies. This organization should facilitate relating points in this summary with the supporting details found in the second volume and the related appendices. We have also included in this volume certain key exhibits from the report, which are supportive of the narrative presented in this summary. The exhibits have been renumbered for presentation in this summary. The complete list of report exhibits is located in the second volume after the Table of Contents and List of Appendices pages.

I. BACKGROUND

The Chicago, Milwaukee, St. Paul and Pacific Railroad Company filed a petition for reorganization under Section 77 of the Federal Bankruptcy Act on December 19, 1977. Shortly thereafter, Mr. S.E.G. Hillman was appointed Trustee by the Federal District Court for the Northern District of Illinois.

1. THE TRUSTEE IS REQUIRED TO EVALUATE THE POTENTIAL OF THE RAILROAD

The Trustee is required to determine whether he can develop a workable reorganization plan for submission to the Federal Court overseeing the reorganization of the Milwaukee Road. Prior to developing such a reorganization plan to deal with the interests of the Milwaukee Road's creditors, employees, and the public, the Trustee was faced with the need to evaluate the long-term potential viability of the entire railroad and of various smaller configurations of the property.

2. BOOZ, ALLEN WAS ASKED TO CARRY OUT STRATEGIC PLANNING TO ASSIST THE TRUSTEE

Booz, Allen & Hamilton was asked to aid the Trustee by carrying out strategic planning studies and evaluating rehabilitation requirements. The planning studies would be used to determine whether all or part of the Milwaukee Road might become viable. Specifically, Booz, Allen was asked to determine:

Availability of traffic for various network configurations

- . Operational requirements for the configurations
- . Facilities and equipment required for operations
- . Financial impact of each system configuration
- . Capital investments required to rehabilitate the plant and equipment
- . Employment impact of each system.

The results of Booz, Allen's analysis would assist the Trustee in determining if there is a long-term viable railroad configuration within the Milwaukee Road. Following that determination (and beyond the scope of this study) is the question of whether the Milwaukee has the resources necessary to get from its present situation to long-term viability.

3. ASSISTANCE WAS PROVIDED BY SUBCONTRACTORS
IN SPECIALIZED AREAS

Booz, Allen & Hamilton performed the bulk of the work on this project with members of its own professional staff. In areas where particular specialized expertise was required, other firms were called upon to provide aid.

- . Thomas K. Dyer, Inc.—Normalized maintenance of way, and rehabilitation
- . The Consulting Center, Inc.—Economic projections
- . Transport Consulting Ltd.—Market opportunities
- . Harry Williamson, Professional Engineer—Rehabilitation requirements.

II. PRELIMINARY SYSTEM ANALYSIS

This chapter addresses the preliminary system analyses carried out in the early stages of this project.

1. "TOP DOWN" PRELIMINARY STUDIES WERE CONDUCTED AT 1977
TRAFFIC LEVELS ON THIRTY-THREE SYSTEM CONFIGURATIONS

A number of preliminary studies were performed in order to narrow the field of alternative systems that would be subject to thorough simulation and detailed analysis. At the time that this preliminary work was being performed, some of the complex computer programs and methods used in the detailed analyses had yet to be developed, and available data was not as detailed in many areas. The Trustee desired some preliminary guidance to aid him in directing the ongoing operation of the railroad, and could not await full development of the methodology that would be utilized in the detailed studies.

In order to meet these requirements within a reasonable period of time, a "top down" analytical method was developed which utilized detailed data and systems that were available in certain areas at that time, but which relied on abbreviated methods of analysis in other areas. Data reported for 1977 was the basis for these studies. No adjustments were made for traffic growth or inflation.

The thirty-three systems subjected to the preliminary analysis were constructed by dividing the Milwaukee Road into segments representing major gateways or traffic producing areas, and putting these segments and their traffic together in various combinations.

During the course of the preliminary studies, the Trustee asked Booz, Allen & Hamilton to perform an analysis of eight alternative configurations involving a possible sale of parts of the Milwaukee Road to the Union Pacific (UP) Railroad.

2. PRELIMINARY ANALYSIS RESULTS WERE USED TO FOCUS DETAILED STUDY AREAS

As a result of a review of the preliminary analyses of the various configurations resulted in the following recommendations made to the Trustee:

- . Detailed analysis using more refined methodology should be carried out on a Midwest Core System which would include the Council Bluffs, Duluth, Louisville, and Green Bay lines.
- . A Base System consisting of the present routes without Light Density Lines should be analyzed.
- . The west coast extension appeared to be a drain on Milwaukee's resources and should not be included in the Core System, but would be included in the Base System.
- . A market analysis should be performed to determine the effect of future changes in traffic on the Core System. The Kansas City line was later added to the Core System when it appeared that it could make a contribution when market opportunities were taken into account.

III. SYSTEM CONFIGURATIONS STUDIED

Detailed Studies were made of eight alternative system configurations, in addition to the study of the full system, which was operated by the Milwaukee Road in 1977 (Base Case). The study of the Base Case was made to calibrate the analytical models to the 1977 Annual R-1 Report to the Interstate Commerce Commission. This chapter describes the selection process for the Core System that would initially studied, the extension of the study to the additional alternative systems and the assumptions resulting from the deletion of light density lines. The chapter concludes with a brief description of each of the systems studied and the systems maps for each configuration.

1. THE PRELIMINARY STUDIES SERVED AS A BASIS FOR THE CORE SYSTEM DEVELOPMENT

The preliminary studies described in Chapter II gave an indication of the relative desirability of certain gateways and geographic areas served by the Milwaukee Road. A Core System was then subjected to detailed analysis using computer models and the methodology developed for the project.

2. ADDITIONAL SYSTEM CONFIGURATIONS WERE LATER IDENTIFIED FOR DETAILED STUDIES

Initial detailed analysis of the Core System indicated that an even smaller system configuration might have greater potential for viability. The resulting Sub Core System was designed to reduce rehabilitation requirements to a minimum. A number of other alternative system configurations were

designed so the Trustee could examine specific questions that had been raised during the course of the analysis and have quantitative information to use in the decision process.

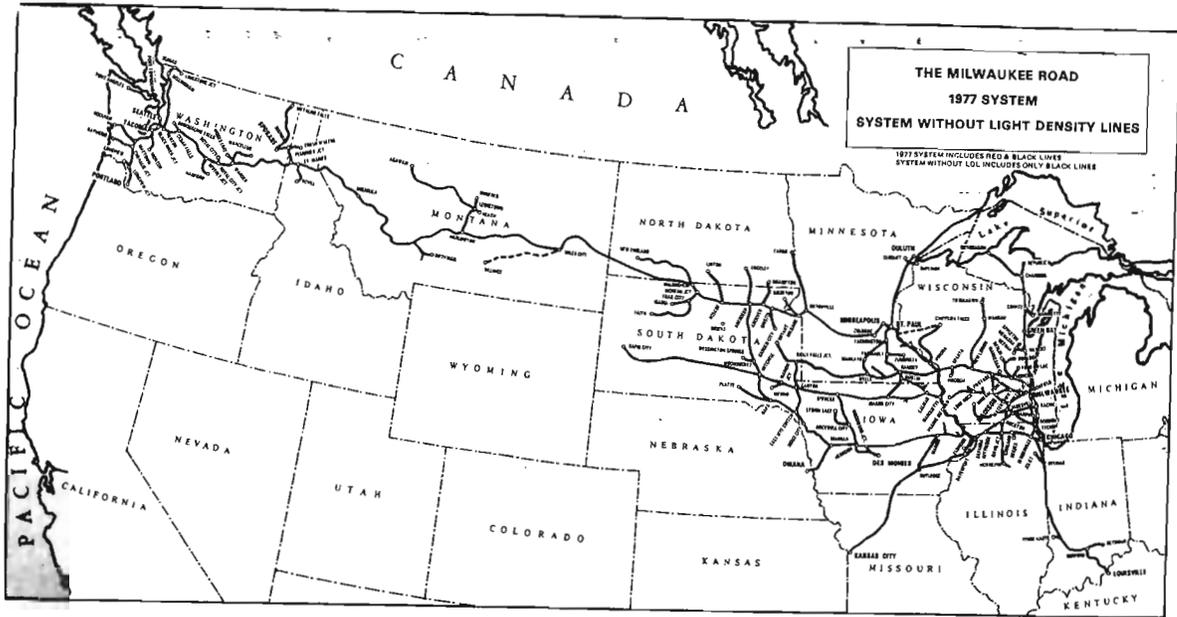
3. A TOTAL OF EIGHT OPTIONS WERE STUDIED IN DETAIL

The following alternative system configurations were studied in detail:

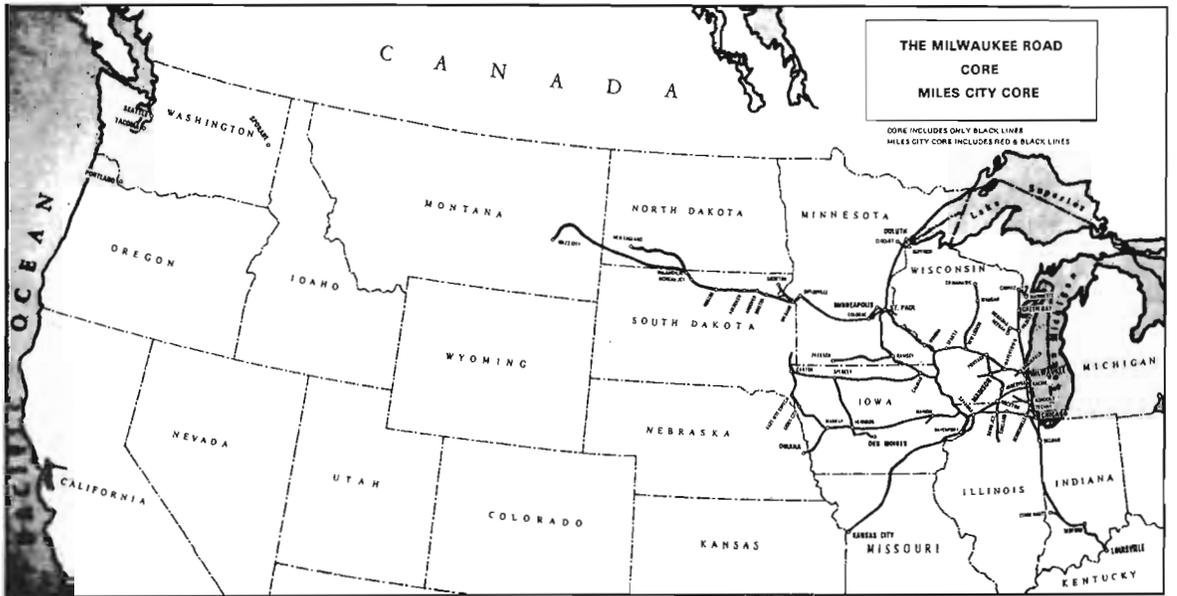
- . System Without Light Density Lines—this option excludes all light density lines that were identified on the Milwaukee Road ICC System Diagram Map dated March 31, 1978, as pending or likely to be abandoned within three years. (7,965 route miles)
 - . Core—this options includes main lines between Louisville and Duluth, Chicago and Omaha, and Milwaukee and Kansas City, as well as secondary lines to the Green Bay, Wausau, Sioux City, Sioux Falls, Des Moines, and Madison areas, and a number of feeder lines. (3,894 route miles)
 - . Miles City Core—this option includes all lines in the Core System, plus the Renville-Miles City Line, the New England branch and the Sisseton Branch. (4,661 route miles)
 - . Sub Core—this option is a reduced Core System designed to minimize rehabilitation requirements, and consists of main lines between Louisville, Duluth, Green Bay and Madison, as well as certain feeder lines. (1,722 route miles)
- Miles City Sub Core—this option includes all lines in the Sub Core, plus the Renville-Miles City Line, the New England branch and the Sisseton branch. (2,488 route miles)
- Kansas City Sub Core—this option includes all lines in the Sub Core, with the addition of the River Junction-Kansas City Line, the Davis Junction-Sabula Line, the Burlington-Beloit Junction segment and the East Moline-Albany and Eldridge branches. (2,393 route miles)

- . Louisville-Transcontinental—this option includes all lines in the Sub Core, plus the transcontinental main line from Renville to Portland, as well as the New England, Sisseton, Bonner, Spokane, Coeur D'Alene, Snoqualmie Falls, and Everett branches. (3,861 route miles)
- . Twin Cities Transcontinental—this option includes the main line from St. Paul to Portland, as well as branches in the Sioux City-Mitchell area and most branches along the transcontinental main line. (4,467 route miles)

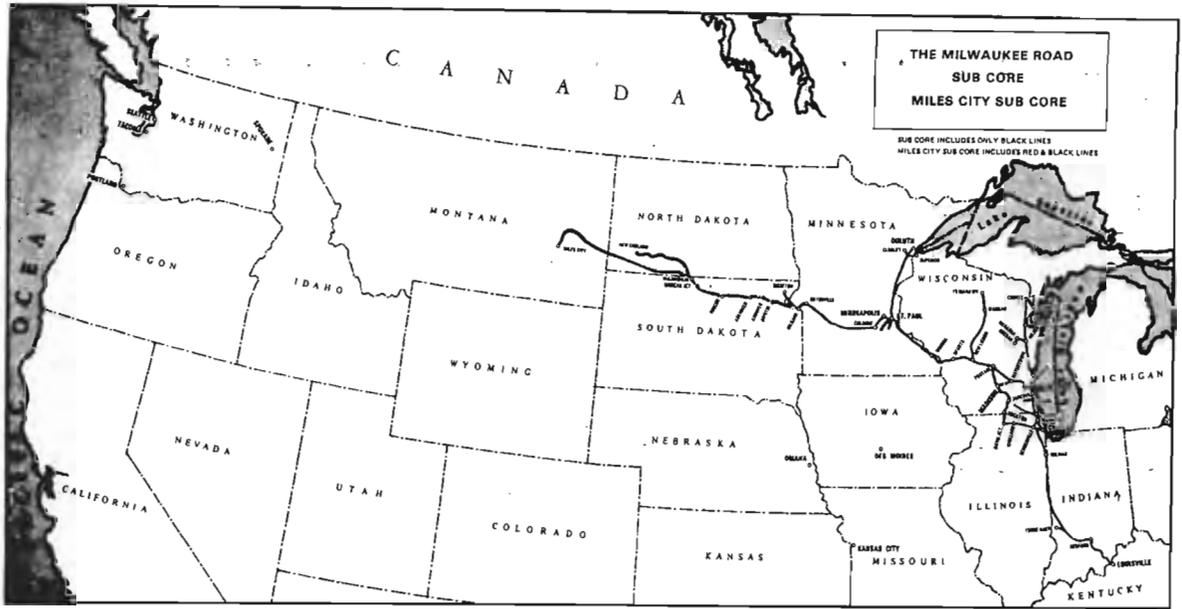
Maps of the various system configurations which were studied in detail follow.



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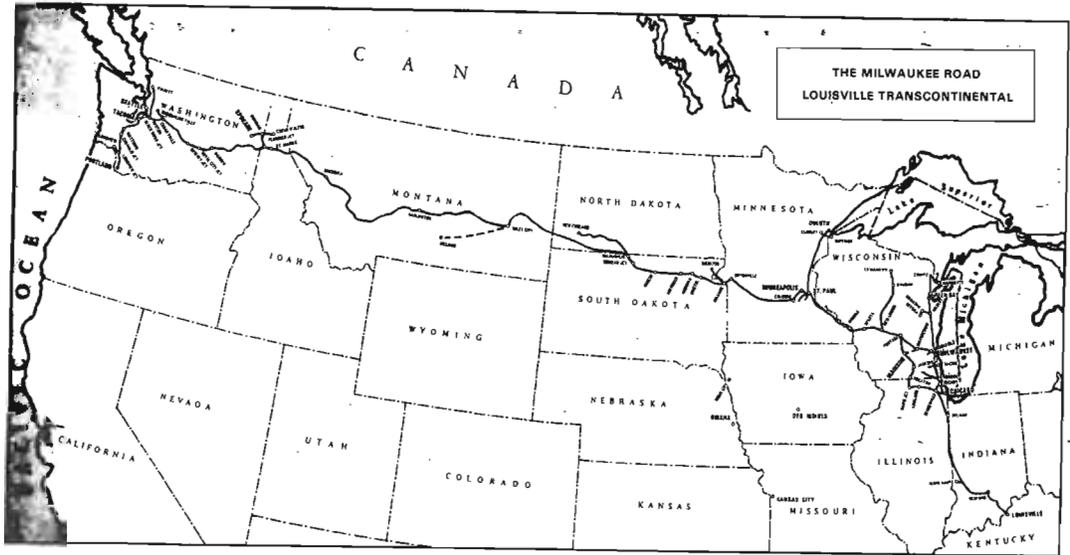
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IV. MARKET ANALYSIS

During the course of this project, it was recognized that relationships between the options might vary with the market served. Further, it was observed that the options involving reduced plant should have ample equipment and reduced rehabilitation requirements to meet customer service requirements and thus recapture lost traffic.

To assist in the projection of future traffic levels for the various options, several market analysis tasks were undertaken.

1. THE CUSTOMER SURVEY REVEALED MARKET OPPORTUNITIES AND PROBLEMS

As part of the market analysis undertaken for the Milwaukee Road, a cross-section of the railroad's current and potential customers was interviewed to determine the following:

- Whether opportunities exist for additional traffic for the railroad
- What level of service and equipment would be required to secure additional traffic
- How the Milwaukee Road has performed in the past and how it currently compares to its rail, truck, and barge competitors
- How the customers feel about specific steps the Milwaukee Road has taken or is contemplating as part of its reorganization efforts.

The survey plan, developed with the assistance of Booz, Allen's National Analysts Division, selected 98 customers

in a stratified sample. Seventy-two of the 98 customers selected to be interviewed actually participated in the survey. The remainder declined to participate on policy grounds. The respondents were representative of the wide range of industries that railroads traditionally serve, and together account for 63 percent of the Milwaukee Road's present traffic. Noncustomers were also included in a few significant instances.

The overall findings of the customer survey indicate that market opportunities exist for the Milwaukee Road providing it can supply needed equipment on a timely basis and provided the railroad's plant is rehabilitated and it can provide satisfactory service. On the other hand, this would be a long-term effort requiring that the railroad demonstrate over time that it can match other carriers. Realistically, some traffic has been permanently lost because of market shifts and changing marketing practices.

2. SUCCESS PROBABILITIES WERE ESTIMATED ON MARKET OPPORTUNITIES IDENTIFIED BY MILWAUKEE ROAD TRAFFIC OFFICERS

With the rehabilitation expenditures assumed, and with normalized equipment and track maintenance, the respondents to the survey indicated that Milwaukee Road could recover some lost business as well as gain some new traffic. With this in mind, Milwaukee Road's marketing and sales departments were asked to project a series of "new business" opportunities based on the assumption that added traffic and revenues could be obtained given a rehabilitated plant and adequate equipment availability.

With participation by both field and headquarters officials and staff, the market opportunity projections were developed for 25 specific commodity groups. Each line item was reviewed and success probabilities were assessed by the consultants based on the findings of the survey, existing traffic flows, and the consultant's extensive railroad marketing experience.

In their final form, the forecasts reflect 411 individual new traffic movements over a Milwaukee Road System Less Light Density Lines of 7,965 miles. As originally submitted by Milwaukee's marketing and sales staff, the "new business" opportunities included 276,869 carloads producing an estimated \$205.5 million of additional Milwaukee Road revenue. The consultants estimated success probabilities on a line-by-line basis. After adjustment to reflect the success probabilities, the market opportunities were reduced to 211,384 carloads producing \$145.6 million of additional revenue.

The list of 411 individual new traffic movements identified as possible for the Milwaukee System Without Light Density Lines was modified to represent market opportunities for the other system configurations being studied by use of the diversion process described in detail in Chapter V of this report. Traffic flows and divisions were modified to reflect the various route patterns, and changes in the Milwaukee Road's relationship with other carriers were also taken into account.

If Milwaukee Road can achieve the freight service and equipment fleet revitalization indicated above as the basic assumption underlying the market opportunity projections,

the results should be individually attainable for any of the 25 discrete commodity groups. The market survey indicates the importance of having equipment available for loading and competitive service in capturing new traffic. Producing those improvements simultaneously for the entire traffic base, however, poses a management challenge of major proportions.

3. CHASE ECONOMETRIC FORECASTS WERE USED IN PROJECTING TRAFFIC GROWTH

The projections for short-term and long-term growth were developed by The Consulting Center, Inc. and were based on the March 1979 macro-economic forecast of production indices made by Chase Econometrics. This Chase economic scenario included a high probability of a recession or period slow real growth during 1979 and 1980. Estimates for the growth in Milwaukee Road's traffic were then developed.

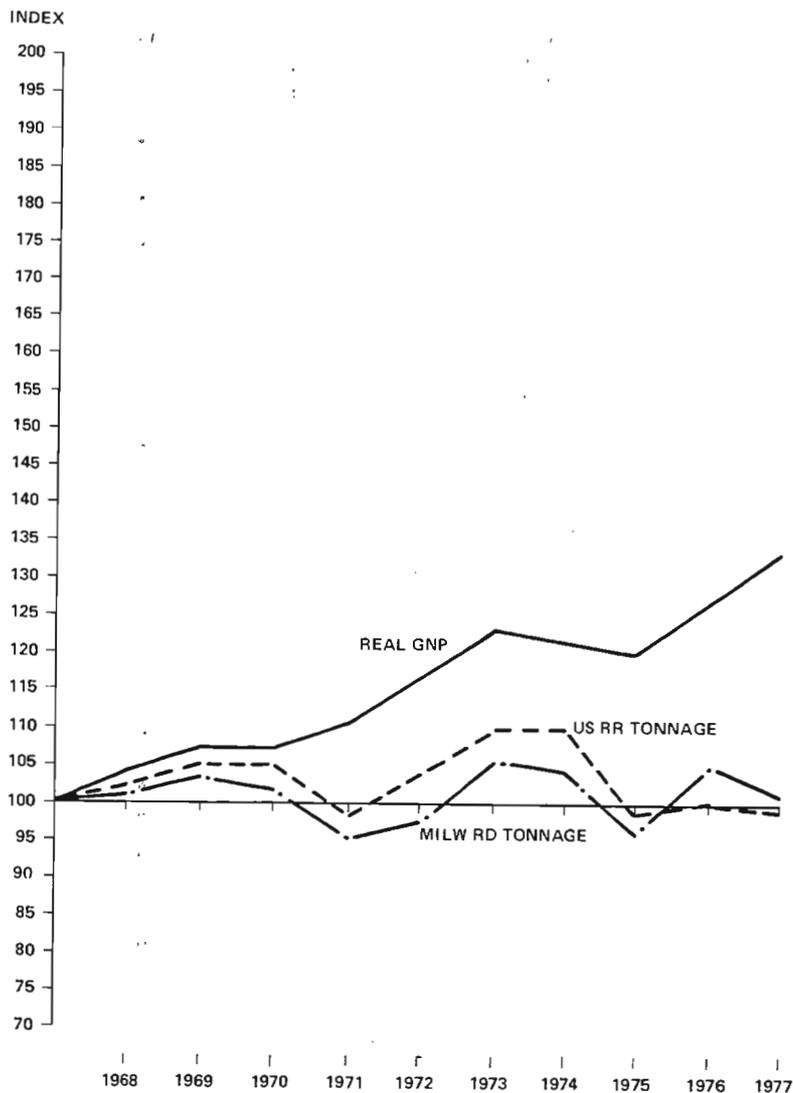
4. PAST TRENDS WERE REVIEWED FOR RAILROAD PARTICIPATION IN ECONOMIC GROWTH

Traffic statistics selected to establish past trends of railroad participation in economic growth were reviewed for the years 1968 to 1977 for all U.S. railroads.

Exhibit I plots U.S. railroad tonnage and Milwaukee Road tonnage against real gross national product (GNP). This exhibit indicates that in recent years neither the Milwaukee Road nor the U.S. railroad industry as a whole has participated in the growth of the economy in terms of tonnage carried.

The impact of increased coal haulage on the Milwaukee Road and Burlington Northern is shown in Exhibit II. The

EXHIBIT I
Gross Tonnage
Vs.
Real GNP

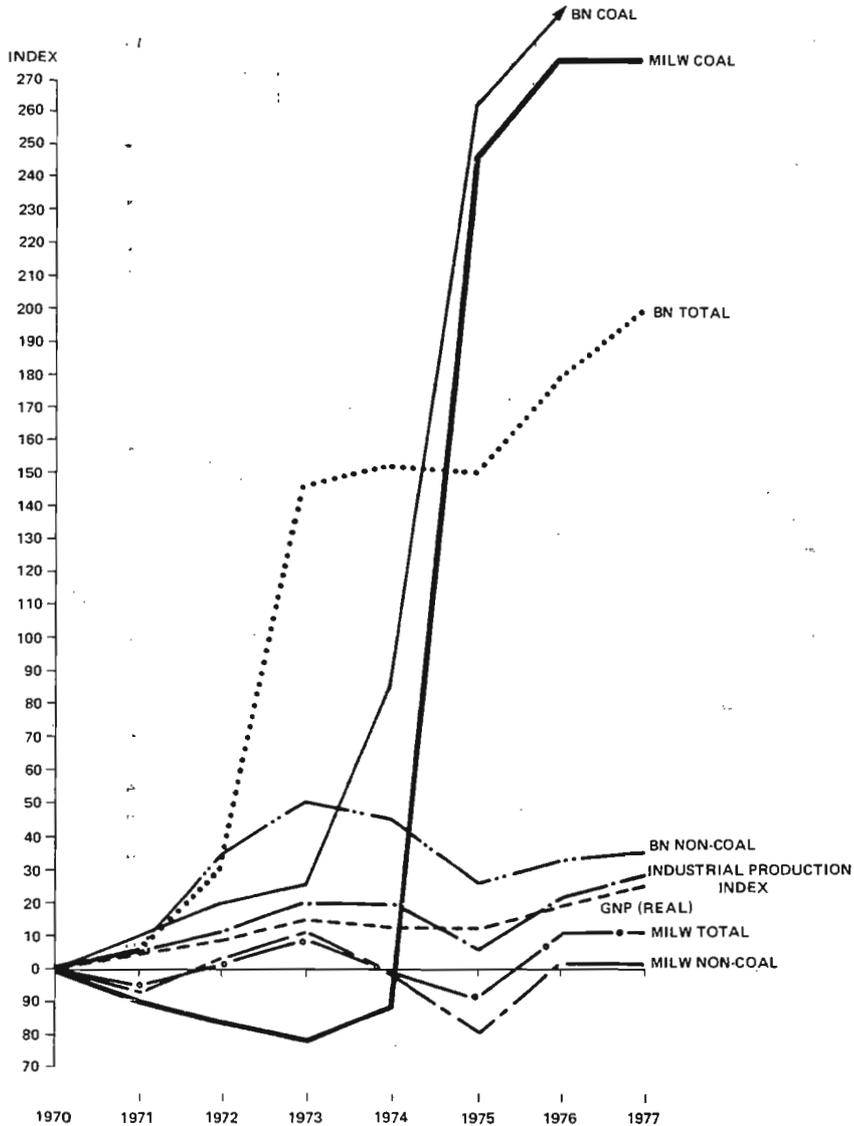


hart suggests that the Milwaukee Road and Burlington Northern have had little success in attracting additional ton-miles of non-coal commodities since 1973. Thus, the Milwaukee Road's task of securing the market opportunities largely by diversion from Burlington Northern will be difficult since both roads have experienced a decline in non-coal traffic over the past five years and the growing segment of the market—coal—is not as susceptible to normal solicitation. Exhibit II appears to indicate that in the early 1970's the recently merged Burlington Northern's growth in non-coal traffic may have been at the expense of the Milwaukee in part.

5. PAST TRENDS AND SEVERE COMPETITION MUST BE OVERCOME BY RELOCATION OF EQUIPMENT AND IMPROVED SERVICE

The preceding charts indicate that the Milwaukee Road did not participate significantly in general economic growth as represented by the GNP or other indicators. While the review of Milwaukee Road's market opportunities resulted in an assessment of the probabilities of achieving the individual flows, recent history would suggest that taken as a whole, the market opportunities may be optimistic. On the other hand, much of the new traffic is projected to be recaptured from other carriers as Milwaukee focuses its equipment on key markets and rehabilitates its plant—a difficult, but not unreasonable task. A favorable factor, is the strong desire expressed by many shippers to keep Milwaukee in the region as a viable competitor.

EXHIBIT II
Milwaukee Road Vs. Burlington
Northern Ton Mile Trends
1970 to 1977



V. DATA, METHODOLOGY, AND ASSUMPTIONS

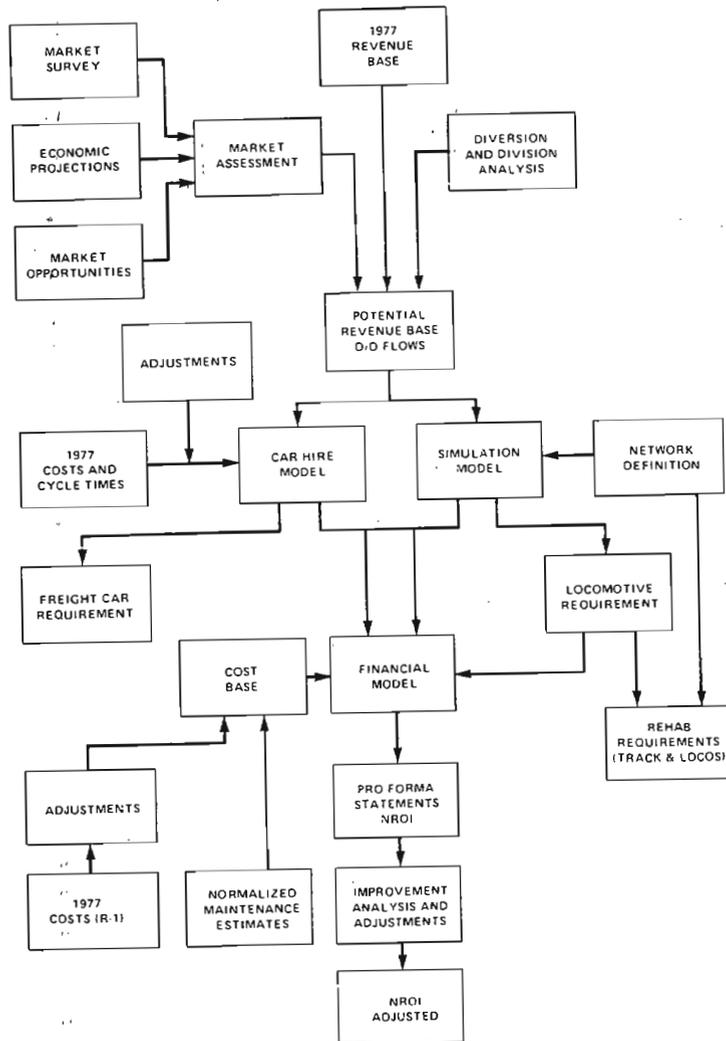
This chapter describes the data and approaches used for detailed analysis of the system configurations described in Chapter III. The assumptions employed are described in the appropriate sections.

Data used in this study were obtained primarily from the Milwaukee Road and from published sources such as the Association of American Railroads and the Interstate Commerce Commission. An overview of the analytical process employed is presented in Exhibit III.

1. DATA GATHERING FOCUSED ON 1977 OPERATIONS

The data gathering focused on 1977 operations of the Milwaukee Road. This was the latest full year available when the study began. Additionally, data from 1978 reflects post bankruptcy abnormalities. Where possible materials provided by the railroad were checked through several sources and calibrated as necessary. Traffic data and revenues were based on a four-month origin-destination traffic file on which the revenues were settled in the months of February, June, August and October 1977. The "settlement files"—significantly more accurate than car movement records—provided both volume and revenue information. The resulting four-month data base was annualized and provided a best-available representation of the pattern of 1977 traffic flows by origin-destination, car type, and car ownership.

EXHIBIT III
Analytical Process
System Overview



Two major sources were utilized for financial data:

- . The 1977 Annual R-1 Report filed by the railroad with the Interstate Commerce Commission
- . The Milwaukee Road's responsibility accounting system which provides details of charges by activity and by geographic location.

In addition, details of leasing arrangements, property accounts and other materials supporting the annual R-1 Reports were provided.

Details were provided on the physical plant, operating plant, timetables and schedules, equipment rosters and administrative and staffing data. In addition, detailed physical inspection of the operating facilities of the Milwaukee Road was made by the consultants who carried out the analytical work.

2. ALL EIGHT OPTIONS WERE SIMULATED AT FOUR TRAFFIC LEVELS

To demonstrate both short-term and long-term potential of the alternative system configurations, the various options were simulated with four different traffic levels. Growth projections were developed and applied to both the existing traffic base and the projected market opportunities. To project traffic availability to each of the systems under study, a diversion analysis was also performed, utilizing a standard set of diversion rules.

3. A NETWORK MODEL WAS UTILIZED TO SIMULATE OPERATIONS

To provide an efficient and accurate means of analyzing operations over the various systems being studied, Booz, Allen &

Hamilton utilized a family of computer models. Some of these models are derived from simulation models originally developed by the United States Railway Association (USRA) for use in preparing the Final System Plan for Conrail. Other models have been developed specifically to deal with the wide range of options considered in this study.

Availability of the network model made it feasible to simulate the operations of the various Milwaukee Road systems under study in detail, and to measure the effects of changes in operations. The simulation output provided measures of various activity levels for a design day. A "post processor model" was next developed to convert these output statistics into a form usable by the financial model.

4. CAR HIRE AND EQUIPMENT REQUIREMENTS WERE DEVELOPED FOR EACH OPTION AND TRAFFIC LEVEL

Car hire estimates for each traffic scenario and system configuration were developed in a specially designed model. This model is used to project the per diem and mileage receivables and payables, as well as the lease costs related to freight cars, racks and trailers. The model also was used to develop the freight car fleet requirements. The development of car requirements was done on the basis of 21 general car types and four classes of ownership (system, foreign, private and Trailer-Train). This level of detail allowed for accuracy and flexibility in testing the sensitivity of the estimates.

Locomotive requirements for each option and traffic level were determined by formulating a basic fleet designed for the four types of service to which locomotives would be assigned.

Output from the Network Model was utilized in determining these requirements.

5. NORMALIZED MAINTENANCE OF WAY EXPENDITURES WERE ASSUMED

The Pro Forma Net Railway Operating Income (NROI) Statement for each system configuration included maintenance-of-way expenses on a normalized basis. The long-term economics of any system are determined by the average annual long-term maintenance-of-way cost to maintain the fixed plant. This is referred to as normalized maintenance.

Normalized maintenance-of-way expense is defined as the average annual cost over the long term to maintain the fixed plant in a condition adequate to support an efficient transportation service. In general, the annual work function and material replacement costs for normalized maintenance will be the cost to perform the work function or material replacement divided by the life of the work function or material in years. A 50 percent remaining life would be the result of the long-term installation of the annual requirement of track materials based on usable life and is referred to as a normalized condition.

Most maintenance functions are performed on a cyclical basis. In any year on a given mile of road or specific line, costs can vary greatly, as bridge repairs may be performed every ten years, programmed rail replacement every twenty years, tie replacement every six years, etc. Over a total system, the cyclical nature of maintenance work should tend to even out.

The upkeep of track represents about 75 percent of the fixed plant maintenance cost (less depreciation), while replacement of track materials is normally about two-thirds of the total track and right-of-way maintenance expense. Therefore, when replacement of track materials is averaging above or below normal, the impact on the maintenance-of-way budget and net income can be significant.

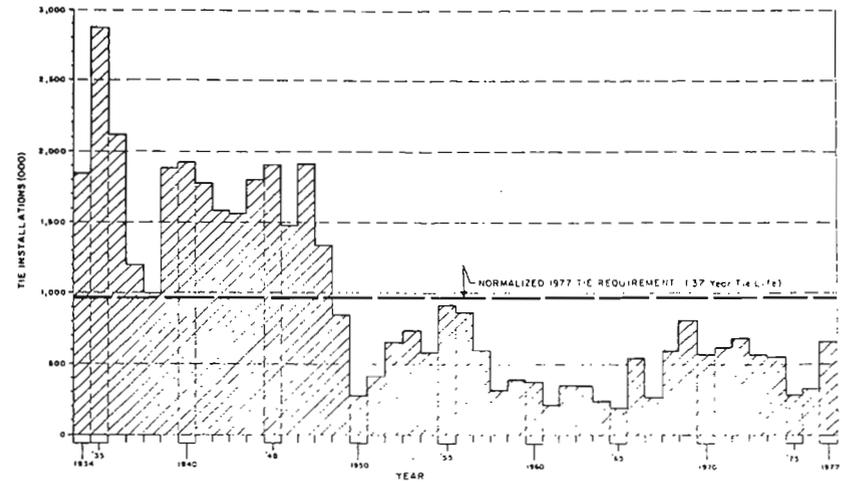
Requirements above or below normalized maintenance in any given period can also be due to the past history of material installations. If expenditures are appreciably below normalized requirements for an extended period of time, reduction in operating speeds and reliability will result, and maintenance expenditures above normalized levels will be required in the future if operations are to continue.

Normalized maintenance levels only apply to plants which would be operated over the long term. Plants which would not be replaced over the long term, such as an uneconomic light density branch line, can be maintained considerably below normalized cost by using up available track material life until the line is abandoned.

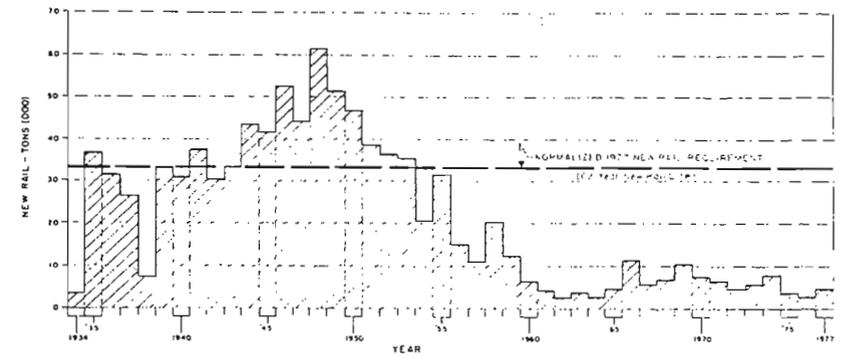
6. MILWAUKEE'S TIE AND RAIL REPLACEMENT HAVE BEEN BELOW NORMALIZED LEVELS FOR OVER TWENTY YEARS

The Milwaukee Road's installation of ties and rails each year from 1934 to 1977 is shown in Exhibit IV. As can be seen on these charts, track materials were installed above current normalized levels until 1950, after which installations were below the normalized level based upon a 37-year life for ties and 62 years for rail on the Milwaukee Road. While it might be expected that tie and rail replacement

EXHIBIT IV
Milwaukee Road Rail
and Tie Installations



MILWAUKEE RAILROAD
TIE INSTALLATIONS
1934-1977



MILWAUKEE RAILROAD
NEW RAIL INSTALLED
1934-1977

TABLE 4. OVERVIEW

would be minimal for a few years following the surge of installation during the period of World War II, for the last 23 years Milwaukee Road tie and rail installations have been below normalized levels. Of equal concern, the surge of ties installed in the forties is now coming up for replacement. While this pattern is not unique to the Milwaukee Road, it does represent one of the basic problems to be faced in attempting reorganization.

7. PLANT REHABILITATION COSTS WERE DEVELOPED FOR ALL OPTIONS

The Milwaukee Road's Engineering Department developed gross rehabilitation estimates for the entire railroad by line segment. These estimates were based on detailed examination of the plant and intimate knowledge of its maintenance history.

At the request of Booz, Allen & Hamilton, Harry Williamson, a Professional Engineer and formerly Chief Engineer of the Southern Pacific, inspected more than one-third of the Milwaukee Road's routes, concentrating his efforts on the main lines and certain secondary main lines.

Mr. Williamson prepared independent estimates of gross rehabilitation requirements for the lines that he inspected and these estimates, upon review, were found to be within 3.5 percent of the Milwaukee Road's estimates for those same lines. Mr. Williamson is in accord with the Milwaukee Road's methods and results, and for this reason these estimates were used as the basis for computing net rehabilitation requirements.

The rehabilitation work estimated by Mr. Williamson and the Milwaukee Engineering staff was, in general, to achieve a track condition which would permit safe, reliable main line operation at Class 4 speeds (60 mph maximum freight speed) on main lines east of Miles City and Class 3 speeds (40 mph maximum freight speed) west of Miles City and on secondary main lines. On most branch lines, the rehabilitation work would provide for Class 2 speeds (25 mph maximum freight speeds). If such a program were carried out over a short period, annual maintenance requirements would thereafter be below normalized for approximately four to six years.

In order to determine financial needs over a ten-year period, the rehabilitation required above normalized maintenance to achieve a track condition which will meet the operating needs of the various alternatives was estimated by Thomas K. Dyer, Inc. Consulting Engineers specializing in railroad maintenance programs. This is referred to in this report as the minimum rehabilitation/maintenance program.

The rehabilitation portion of the minimum ten-year rehabilitation/maintenance cost was estimated by Thomas K. Dyer, Inc. by subtracting track material replacement included in ten years of normalized maintenance from the estimated total track material replacement requirements over ten years. Total track material requirements were estimated by means of computer analysis of forty-three years of track material installation, the rehabilitation inspections and estimates of Mr. Williamson, and the Milwaukee Railroad engineering personnel. The minimum rehabilitation/maintenance cost is based on the assumption that rehabilitation/maintenance work would be well-planned and supervised and carried out effectively by trained, mechanized work crews.

The rehabilitation portion of the minimum ten-year rehabilitation/maintenance cost is referred to as net rehabilitation cost. This cost has been computed for each alternative system configuration.

8. NORMALIZED LOCOMOTIVE AND FREIGHT CAR MAINTENANCE WAS ASSUMED

The 1977 Milwaukee locomotive roster included approximately 705 freight units in 27 classes. The historical maintenance record of overhauls and maintenance costs of each class were analyzed to determine the degree of deferred maintenance. Maintenance costs were then developed for each type of operating service to which locomotives were assigned in 1977. After a review of manufacturers' recommendations and the maintenance experience of a number of Class 1 railroads, these costs were modified upward to reflect a "normalized" level of maintenance. This level of maintenance was expected to sustain a rate of 90 percent service availability for the total fleet.

In developing normalized freight car repair costs, it was not possible to prepare a bottom-up estimate of rehabilitation and repair unit costs as was done for locomotives. A detailed physical examination of the Milwaukee fleet of 25,000 cars was not possible and records are not available to reflect Milwaukee Road individual or fleet car condition and repair history. An alternative method was therefore developed to estimate normalized car repair expense based on current and historical car repair expense trends of six selected western railroad fleets.

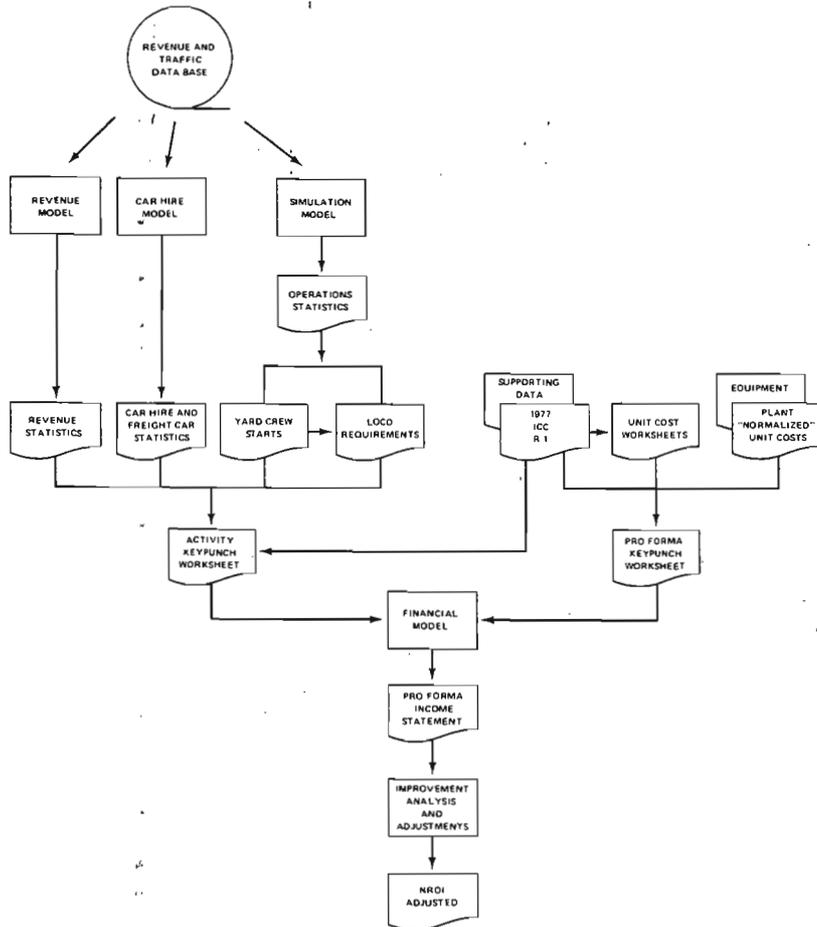
9. PRO FORMA INCOME STATEMENTS WERE PREPARED PRESENTING NET RAILWAY OPERATING INCOME (NROI)

The Milwaukee Road study includes the output of a computer-based financial model developed to analyze the revenues and costs for each traffic level resulting from the various system configurations studied. After analysis any necessary adjustments are determined to arrive at the adjusted net railway operating income (NROI). Exhibit V presents an overview of the financial process.

Pro forma income statements presenting net railway operating income on a 1977 ICC basis were prepared for the full system and at four traffic levels for each of the eight alternative configurations studied. The computer produced pro forma income statement prepared for the full system as of the end of 1977 (Base Case), was used as the comparative or calibration statement to Milwaukee Road's 1977 Form R-1 Report to the Interstate Commerce Commission. The revenues and costs, presented in the base pro forma equal the revenues and costs reported in the related ICC accounts for the railroad's 1977 operations, with the exception of those accounts directly impacted by the assumptions which increase cost levels to a normalized condition for maintenance of way and structures, locomotives and freight cars.

The pro forma statements prepared for the eight reduced system options present revenues and costs at a level comparable to 1977 operations for each of the reduced networks, as well as at the three assumed market opportunity levels: current, short-term and long-term. Normalized costs are also assumed for these pro forma statements. In addition, the cost benefits from the normalized expenditure levels and the shortcrew

EXHIBIT V
Financial Process Overview



labor agreement are included. The basic assumptions upon which the pro forma statements are prepared are presented in Chapter V of the second volume of the report.

(1) Reducing the "Scale" of the System Should Enable Management to Focus on Implementing the Turnaround

The managerial requirements reflecting the scale and complexity of the business will vary with each option. These requirements are particularly crucial if a turnaround is to be successfully accomplished. Principal determinants of the magnitude of the managerial requirements which can be quantified would include the "scale" of the system in terms of (1) revenues generated, (2) revenue carloads to be moved, (3) route miles to be maintained, and (4) the number of employees to be managed. Complexities of managing a turnaround with the various options are harder to quantify on an overall basis and are considered specifically under the various risks and opportunities discussed in the remainder of this chapter.

The various configurations have quite different "scale" dimensions as shown in Exhibit VI. For example the Sub Core, the smallest system analyzed, utilizes only 22 percent of the route miles of the System without Light Density Lines, but handles 53 percent of the carloads. On the other hand, Sub Core, with shorter hauls, retains only 35 percent of the revenues and requires 41 percent of the employees.

While managerial requirements might vary inversely with the Gross Freight Revenues related to the other "scale" dimensions (since higher unit revenues provide the managers with greater margins in which to manage), overall determinants of managerial requirements are the other "scale" dimensions: number of carloads to be moved, miles of road to be operated and maintained, number of employees to be supervised. Simple averaging

EXHIBIT VI
1977 Level Statistics

COMPOSITE INDEX "SCALE"	OPTIONS	GROSS FREIGHT REVENUE (\$MIL)		REVENUE CARLOADS (000)		MILES OF ROAD OPERATED (000)		ESTIMATED NUMBER OF EMPLOYEES (000)	
		Value	Index	Value	Index	Value	Index	Value	Index
1.10	Base	434.8	1.03	867	1.03	9.6	1.20	11.4	1.07
1.00	System w/o LDL	423.6	1.00	845	1.00	8.0	1.00	10.7	1.00
0.62	Core	248.2	0.59	645	0.76	3.9	0.49	6.6	0.62
0.69	Miles City Core	269.4	0.64	683	0.81	4.7	0.59	7.1	0.66
0.39	Sub Core	146.3	0.35	444	0.53	1.7	0.21	4.4	0.41
0.45	Miles City Sub Core	168.1	0.40	480	0.57	2.5	0.31	4.9	0.46
0.46	Kansas City Sub Core	182.0	0.43	498	0.59	2.4	0.30	5.1	0.48
0.61	Louisville Transcon	271.1	0.64	572	0.68	3.9	0.49	7.0	0.65
0.43	Twin Cities Transcon	168.8	0.40	270	0.32	4.5	0.56	4.3	0.40

of the index values of these three "scale" elements produces the composite "scale" index. Using this admittedly imprecise process the Sub Core options, and Twin Cities Transcontinental option result in managerial requirements of generally similar magnitude. Any of these options should be easier to manage from the stand point of "scale" than either of the Core options or the Louisville Transcontinental option, and far easier to manage than the present system or the system without Light Density Lines. Given the complexities of the various turnaround tasks involved in a reorganization, reducing the "scale" of the management requirements of the system should enhance the probability of success of managing a turnaround.

(2) Achieving the Full Level of Market Opportunities is a Major Management Challenge

As noted earlier, projecting future traffic levels for a railroad is always uncertain; projecting reversals of past trends involves even greater uncertainty both as to the extent and the timing of such a reversal. On the other hand, it is logical to expect that a railroad operating a rehabilitated plant with ample locomotives and equipment should be able to recover at least some of the traffic lost when it lacked these essential components of competitive service.

Achieving the full level of market opportunities represents a major management challenge. Although optimistic, it is not totally beyond reach, especially in the options where management attention can be focused and the prerequisite rehabilitation of track on key routes and concentration of the car and locomotive fleet can be accomplished quickly.

As shown in Exhibit VII, achieving the market opportunities in each option would result in a substantial increase in carloads and revenues compared with the 1977 traffic level (which, is substantially above Milwaukee's current total traffic level). The effects of economic growth based upon a macroeconomic forecast to 1986 result in more modest carload increases above the Market Opportunity level. Compounding economic projections with the market opportunities results in increases in carloads of 33 to 37 percent, with the exception of the Twin Cities Transcontinental which gains only 18 percent in carloads and 35 percent in revenues. Revenue gains on a compound basis run between 41 and 47 percent for the other options. While the System without light Density Lines shows the highest potential traffic growth, the risks of not achieving that growth are high because that option would permit very little concentration of locomotives, cars and management attention and would require the most massive rehabilitation program.

Based on Milwaukee's past performance, the projected carload and revenue increases are staggering; however, in the past Milwaukee's equipment and locomotive fleets as well as plant have been deteriorating rapidly while many of its competitors have added equipment and maintained or improved service. The survey of shippers, indicated that to recapture its traffic and secure new business Milwaukee must offer competitive levels of equipment availability and comparable service. The costs included in the investment base and estimates of NROI reflect both these conditions, so it is logical to assume that at least some traffic would be regained as a result.

EXHIBIT VII
Effect of Market
Opportunities and Economic Forecast

Percentage Increase In:	System w/o LBL		Miles City Core		Sub Core		Miles City Sub Core		Kansas City Sub Core		Louisville Trnscn		Twin Cities Trnscn	
	9	8	Core	8	Sub	8	City	Sub	City	Sub	City	Trnscn	City	Trnscn
Market Opportunities Vs 1977 Level	25	26	25	23	22	23	22	23	22	22	22	22	22	13
Carloads	34	32	31	26	26	27	26	27	27	30	30	30	26	26
Revenue														
1986 Economic Forecast vs Market Opportunities Level	8	9	9	11	10	10	10	10	9	9	9	9	4	4
Carloads	9	11	10	13	12	13	12	13	11	11	11	11	8	8
Revenue														
Long Term Compound Effect Vs 1977 Level	35	37	36	36	35	36	35	36	33	33	33	33	18	18
Carloads	47	46	45	42	41	44	41	44	44	44	44	44	35	35
Revenue														

(3) Shrinking the Plant Will Provide the Needed Cars and Locomotives

Shrinking the railroad should permit Milwaukee to concentrate its cars on its remaining customers and on new opportunities as well. The greater the reduction, the more of the traffic potential that can be covered by the existing car fleet and the less the new investment (and associated risk) involved. By shrinking its plant substantially, Milwaukee Road would have a short-term equipment windfall opportunity compared with some of its competitors which might have their car fleets dissipated over a larger customer base. In the larger system options, substantial equipment investments would be required, generally before the projected new traffic could be secured. There would, of course, be an increasing risk that the acquired equipment would not in fact attract the new business anticipated. However, as long as general equipment shortages existed for that equipment type, this risk would be at least partially offset by per diem receipts.

Improving service would also require adequate locomotives. Shrinking the system would reduce the locomotive investment required to provide the service improvements necessary to achieve the market opportunities.

All options except the System without Light Density Lines would require fewer locomotive units than are presently available in Milwaukee's normalized fleet even at the high traffic project. This will permit upgrading of the remaining fleet by retiring the less reliable units and will provide better coverage of train requirements which would enhance service levels.

(4) Plant Rehabilitation is Required Prior to Traffic Recovery

Rehabilitating the plant to competitive levels introduces major risks since, unlike locomotives and cars, the plant cannot be moved to more attractive markets or off-line if the competitive advantages expected are not realized. Additionally, customers indicated through the shipper survey that Milwaukee must prove over time it can provide consistent service before significant traffic recovery can be assumed.

The commitment for rehabilitation represents a major risk especially in the larger system options. As shown on Exhibit VIII, the total rehabilitation expenditure ranges from \$125 million for Sub Core to \$482 million for the System without Light Density Lines. Adjusting the rehabilitation estimate for coordinations currently under study would reduce the requirements as shown. The rehabilitation expenditures would be further reduced by rehabilitation projects currently underway such as the federally-funded project on the Milwaukee-Twin Cities corridor.

Since much of the restoration work required would be accomplished through normalized maintenance as visualized in the NROI calculations, net rehabilitation represents the minimum rehabilitation expenditure necessary in the next ten years in addition to normalized maintenance. With contemplated coordinations, the net rehabilitation requirements range from \$45 million for Sub Core to \$215 million for the present System without Light Density Lines.

EXHIBIT VIII
Plant Rehabilitation Estimates

	Millions of Dollars			
	Total Rehabilitation Requirement to Bring Track to Competitive Levels at the End of 1977		Net Rehabilitation Minimum Requirement in Excess of Ten Year Normalized Maintenance	
	Without Coordinations	With Coordinations	Without Coordinations	With Coordinations
System Without LDL	482	447	231	215
Core	248	213	103	87
Miles City Core	286	251	131	115
Sub Core	125	108	51	45
Miles City Sub Core	163	146	74	68
Kansas City Sub Core	159	128	72	60
Louisville Transcon	249	232	134	128
Twin Cities Transcon	258	258	130	130

The net rehabilitation required on options to the west coast would be from \$128 million for the Louisville Transcontinental to \$215 million for the System without Light Density Lines. The transcontinental traffic is highly competitive with both UP and BN. Each of these railroads had adequate equipment and transit times are less than half those presently required by Milwaukee. Thus, much plant rehabilitation investment would be necessary before competitive service could begin.

In contrast, the rehabilitation investment in the Sub Core options is much more modest and the Milwaukee's competitive position stronger with much of its traffic source on-line. In addition, many of the competitive rail lines are relatively weak with their resources, in some cases, spread over the systems equal in size to those now operated by Milwaukee Road.

(5) Achieving Operating Improvements will Require Specific Management Actions

The estimates of NROI for the high and low traffic projections for each option reflect some operating improvements beyond 1977 levels. While these operating improvements are included in the data generated by the various models, achieving them will require specific management action. Failing to implement these improvements is a risk inherent in those options. On the other hand, the level of improvement assumed in each case should be achievable, especially in the smaller, less complex operations.

In addition to the operating improvements assumed in the simulation and financial models for developing NROI, there are several potential improvements within the managerial control of the Trustee, which for technical reasons have not been included in the structure of the models. The potential improvements used to adjust the NORI are discussed in Chapter V of Volume 2 of this report.

(6) Accomplishing a Turnaround Will Place Great Demands on Milwaukee Management

To achieve the market opportunities and resulting NROI projected for each of the options will place great demands on Milwaukee Road's management. As previously noted, reducing the scale of the management requirements should offset in part these demands; however, achieving the full market opportunities will in itself be a major undertaking. Effective monitoring of the rehabilitation program to ensure that such investments are applied in the most productive manner is another major task. While many of the operating improvements assumed tend to flow naturally from the rehabilitation program, all will require careful direction and control to ensure that benefits are not dissipated. Additionally, some of the improvements assumed such as terminal productivity will require specific management commitment.

None of the improvements standing alone are probably beyond management's capabilities. On a cumulative basis, however, there are major risks that the entire program can be accomplished especially in the larger system configurations. From the previous analysis of the nature

and magnitude of the risks involved, it appears that the management risks are generally diminished as the size and complexity of the system is reduced.

(7) Events Beyond the Control of the Trustee Will Also Influence the Outcome

A number of major considerations influencing the risks and opportunities involved in the various options were outside the scope of this study and have not been specifically analyzed. These considerations include:

- . Inflation
- . Deregulation
- . Labor Protection
- . Revisions in Labor Agreements
- . Increases in Car Capacity
- . The Rock Island Situation and Potential Mergers
- . The Energy Situation
- . Changes in Per Diem and Demurrage

These additional considerations provide a background for considering the risks and opportunities represented by the various options confronting the Trustee.

2. NROI PROJECTIONS REFLECT IMPORTANCE OF IMPROVEMENTS AND REVERSAL OF TRAFFIC TRENDS

The financial results produced by these studies have validity with respect to their relationship with each other among the several configurations and levels of traffic. The absolute numbers that have been produced represent the numbers that would have resulted, assuming the particular situation described represents reality. The financial results also are subject to the many estimates and judgmental assumptions which enter into the final product.

Exhibit IX highlights selected financial results using three displays of NROI for the highest and lowest projected levels of traffic. In Exhibit IX, the first column indicates estimated NROI as produced by the computer models. The second column indicates NROI after making adjustments for improvements outside the model. Since these improvements should be obtained through prudent management practices, the figures from this column are used in subsequent exhibits and in estimating NROI ranges. The third column displays NROI with identifiable non-cash items taken out. The two traffic levels displayed represent anticipated results if traffic gains are only sufficient to return to 1977 levels and if long-term opportunities and growth are both realized.

(1) No Configuration Shows Positive NROI at the 1977 Traffic Level

From Exhibit IX it can be seen that no configuration produced a positive NROI at 1977 traffic levels. The projected NROI without improvements ranges from a negative \$60.9 million for the System without Light Density Lines to a \$26.6 million NROI deficit for the Sub Core option. Even with improvements, the NROI deficit ranges from \$55.3 million for the System without Light Density Lines to negative \$15.6 million for the Sub Core. Deducting identifiable non-cash items, the "cash" loss at the 1977 traffic level is still \$42.0 million for the System without Light Density Lines but only \$7.5 for Sub Core.

Since NROI does not include fixed charges it cannot be equated directly with profit or loss and a breakeven NROI would not normally be considered a viable situation. From this chart it can be seen that at 1977 traffic

EXHIBIT IX
Net Railway Operating
Income Estimates
(\$ Millions)

	NROI	NROI IMPRD.	NROI ADJUSTED FOR DEPRN.
<u>System w/o LDL</u>			
1977 Level	(60.9)	(55.3)	(42.0)
Long Term	(3.9)	+8.4	+22.5
<u>CORE</u>			
1977 Level	(40.2)	(33.2)	(23.3)
Long Term	(9.5)	+2.3	+12.8
<u>MC CORE</u>			
1977 Level	(42.5)	(36.0)	(25.7)
Long Term	(6.8)	+4.9	+15.8
<u>SUB CORE</u>			
1977 Level	(26.6)	(15.6)	(7.5)
Long Term	(11.4)	+3.8	+12.2
<u>MC SUB CORE</u>			
1977 Level	(28.3)	(18.4)	(10.0)
Long Term	(6.5)	+7.5	+16.2
<u>KC SUB CORE</u>			
1977 Level	(32.4)	(22.6)	(13.9)
Long Term	(10.6)	+3.5	+12.4
<u>L'VILLE TRANSCON</u>			
1977 Level	(36.1)	(29.0)	(18.7)
Long Term	+2.9	+15.0	+25.8
<u>T.C. TRANSCON</u>			
1977 Level	(31.2)	(21.4)	(14.5)
Long Term	(10.3)	+5.5	+13.5

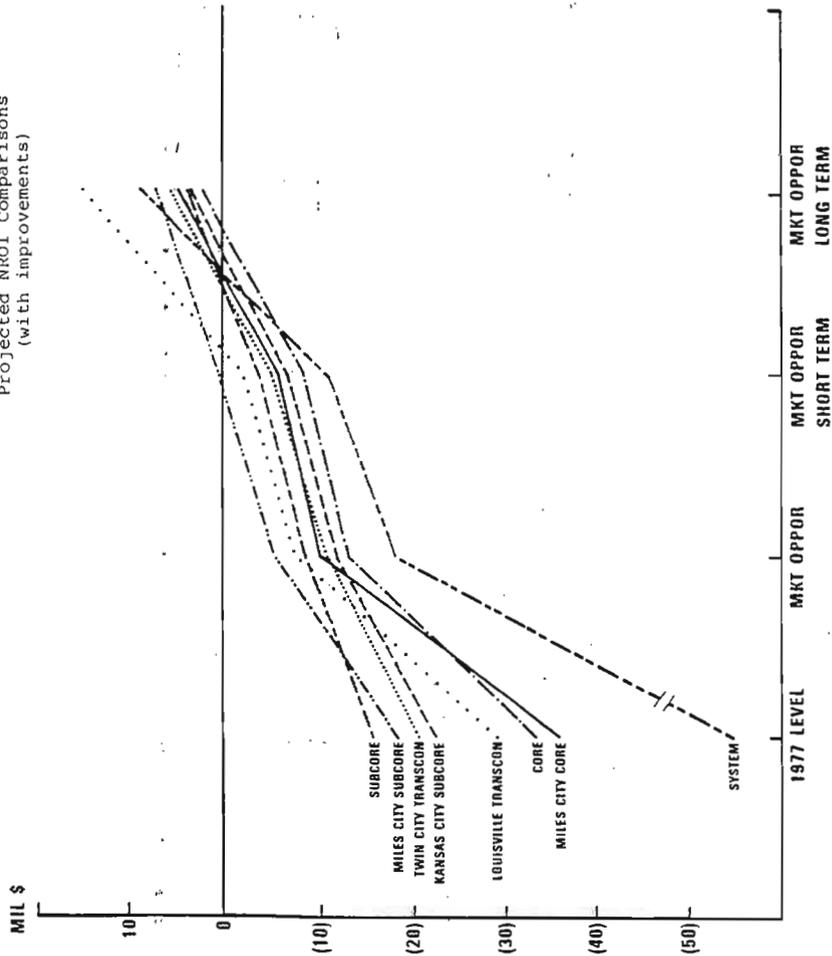
levels none of the options studied would be considered viable. On the other hand, the smaller systems, especially Sub Core, would be sustaining considerably smaller cash losses than the System without Light Density Lines.

Even if all of the operating improvements discussed earlier are achieved, recovery of traffic only to 1977 levels will not result in the railroad being a successful operation by normal investment standards. Further, the larger system configurations—which would of necessity require a longer time frame in which to achieve the market opportunities (even if successful)—would continue the cash drain for some time. In contrast, the smaller Sub Core configurations should have relatively small cash losses for a shorter period if they can achieve their market opportunities.

(2) Full Achievement of Market Opportunities And Operation Improvements Results in Positive But Marginal NROI For All Options

Assuming that the market opportunities are fully achieved, the projected NROIs (as improved) for the other options tend to cluster in a positive range of \$2 million to \$8 million. As shown graphically in Exhibit X, the options differ far more significantly on the downside (e.g., 1977 level) than on the upside (Market Opportunities Long Term). It should be noted that the horizontal axis of the chart reflects various levels of traffic recovery, and is not time related.

EXHIBIT X
Projected NROI Comparisons
(with improvements)



As discussed earlier, the timing of achievement of the various traffic levels would be approximately proportional to the size of the reorganized railroad and its rehabilitation requirements. Further, and chances of success would diminish as the system size and complexity increases.

If the market opportunities are realized in full, the most attractive option based upon NROI potential alone is the Louisville Transcontinental with a long-term positive NROI of \$15.0 million and a "cash" NROI of \$25.8 million. The risk associated with this option, as described earlier, is that it involves competing head-to-head with the Burlington Northern and Union Pacific in the East-Northwest market in which they presently have (1) transit times less than half that of the Milwaukee, (2) much higher traffic density (and therefore better opportunities for run-through service) and (3) large equipment fleets tailored to meet their customers' needs. This option requires that Milwaukee make very large rehabilitation and equipment investments before a competitive penetration of the market can be expected to succeed. In the meantime, "cash" losses of nearly \$20 million per year might be expected. The probability of ever penetrating this market beyond a token level is quite low, given the level of competition.

The Miles City Sub Core presents the lowest downside risk of the options and focuses on recovering traffic in markets where Milwaukee is already in a strong position. Since much of this traffic recovery is dependent upon re-allocation of cars and locomotives to key markets, the market opportunities should be achievable more quickly and with a considerably higher level of certainty.

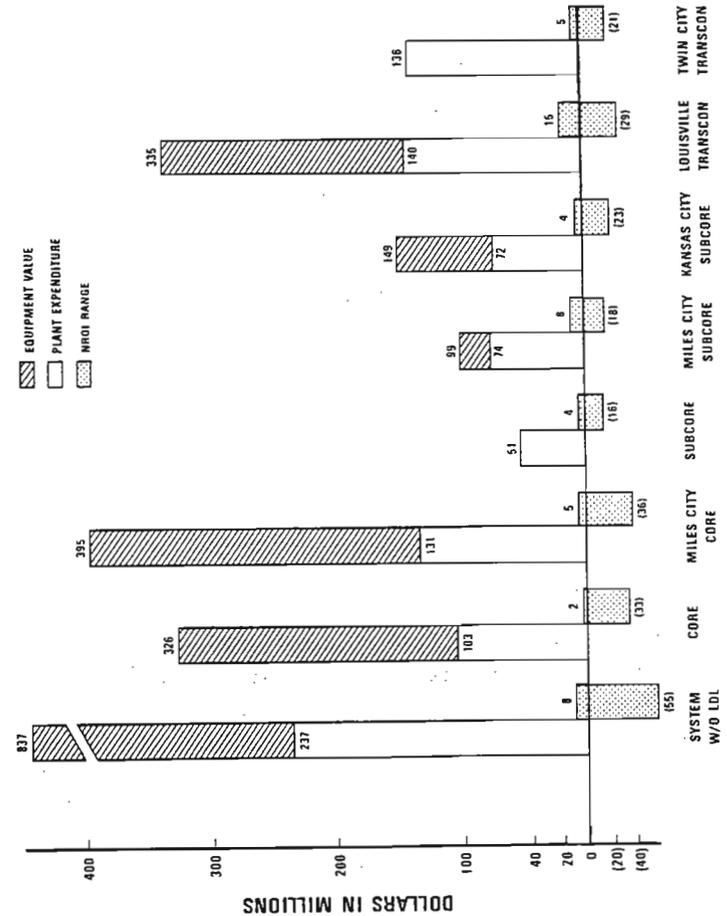
In contrast, System without Light Density Lines shows the largest potential loss until, and if, the long-term market opportunities are achieved. Successfully managing all aspects of a turnaround of the System without Light Density Lines in addition to the "scale" aspects of managing that property would require the maximum of good luck. Even if everything were to go right during that prolonged period, the railroad might drown in its own interim losses.

3. INVESTMENT COMMITMENTS VARY SIGNIFICANTLY AMONG OPTIONS

Investments in equipment and rehabilitation are required as well as some means of financing operating losses during any turnaround attempt. The chart shown in Exhibit XI reflects the estimated investment in net rehabilitation as well as the additional equipment commitments projected for each option. The chart also shows the range of NROI (as improved) for the "high" forecast (e.g., Long Term Market Opportunities) and the "low" forecast (1977 levels) for the individual options.

From this chart it can be seen that the investment commitments of the options vary significantly from \$837 million for System without Light Density Lines to only \$51 million for Sub Core. The System without Light Density Lines not only has by far the largest managerial requirement and investment commitment, but also has the greatest downside risk in terms of the NROI loss at 1977 traffic levels. On the upside, the potential NROI is modest compared with the other options. In addition, this option would be the most difficult and time-consuming to implement

EXHIBIT XI
Net Plant Expenditure and Additional Equipment
Values Assumed Compared to NROI
(1977 Dollars)



The Miles City Sub Core with only 12 percent of the investment commitment, has virtually the same upside potential and only a third of the downside risk. Only the Sub Core proper has a lower investment requirement, with slightly less upside potential and downside risk.

Extending the Sub Core to Kansas City requires three times the investment commitment as Sub Core, and has the same upside potential and a somewhat greater downside risk. This option was considered in detail because of the rapidly growing market potential served by the Kansas City gateway. While the analysis indicates that the Kansas City Sub Core is less attractive than either the Miles City Sub Core or the Sub Core proper because of the added investment, its long-term market potential should be reviewed. Additionally, the joint facility agreement with the Kansas City Southern for Milwaukee's terminal operations in Kansas City should be re-analyzed since it is a significant consideration in estimating the attractiveness of the Kansas City Gateway traffic.

The Core option (which was originally selected for analysis) and Miles City Core option require substantial investments and have high downside risks and offer no advantage on the high side.

As noted earlier, the Louisville Transcontinental option has the highest potential if the long-term market opportunities and operating improvements are achieved. On the other hand, at 1977 traffic levels the potential losses are greater than the Sub Core and Miles City Sub Core options. More significantly,

the Louisville option requires the second highest plant rehabilitation (\$140 million) and the third highest total investment commitment (\$335 million). Additionally, the investment commitment must be largely completed before any meaningful penetration of this highly competitive market can be anticipated. The risk is all at the front end on the Louisville Transcontinental option with Milwaukee Road coming from a position of weakness.

The Twin City Transcontinental option also requires a substantial rehabilitation commitment (over 2-1/2 times that of Sub Core) with little incremental gain on the high side and some increased risk on the low side. Actually this option could have disastrous consequences since the Milwaukee would walk away from its direct eastern and southern connections as well as the markets in which it has a strong position in Wisconsin. In doing so it would cast its lot in direct competition with the powerful Burlington Northern and Union Pacific for the business of the CNW, Rock Island, SOO Line and local connections to the west coast. It is not at all clear that CNW or even Rock Island would chose to favor the Milwaukee Road route over their much more significant connections with Burlington Northern and Union Pacific. On-line local traffic on Milwaukee's route west of the Twin Cities (other than the unit coal trains handled as well in the Miles City options) is minimal. While the long-haul revenues on the transcontinental routes are more attractive than short-haul revenues in the Sub Core options, the risks and investment requirements more than offset any division advantage.

4. SUB CORE AND MILES CITY SUB CORE APPEAR TO BE THE MOST ATTRACTIVE OPTIONS STUDIED

Since the range of NROI for the "high" and "low" forecasts on each of the smaller options is reasonably close, the magnitude of the investment and the management risks inherent with the size and complexity of each configuration are most significant in comparing the options. For the several reasons already discussed, the Sub Core proper option, requiring the minimum investment, is the most attractive. Extending Sub Core to Miles City improves the upside potential but also nearly doubles the investment commitment. On the other hand, the Miles City Sub Core has the least downside risk of any of the options across the range of potential traffic recovery. If the added investment can be covered with outside funds (reflecting the high level of public interest in this line), the Miles City Sub Core would be the most attractive of the options analyzed.

5. THE TRUSTEE MUST WEIGH OPTIONS AGAINST TOTAL LIQUIDATION

The alternative not analyzed in this study is total liquidation. The Trustee has previously retained the consulting firm of Ford, Bacon & Davis to participate in a study of the liquidation value of the property. From the analyses discussed in this report, it can be seen that all of the options considered involve substantial risks. It will be difficult to achieve all of the operating improvements while at the same time reorganizing the railroad, rehabilitating the plant, and recapturing the traffic. If the values reflected in the Ford, Bacon & Davis study could be achieved, and if future claims

such as their protection and costs of administration were not too substantial, the risks would seem out of proportion to the opportunities from a business, rather than a public interest perspective. On the other hand, the Sub Core and Miles City Sub Core options result in a substantial partial liquidation of the plant while retaining the heart of the railroad's traffic base and the portion of its route system on which it has the inherently superior plant. Since the investment required is moderate, and the turnaround time, if it is to be successful is not unreasonable, attempting to revitalize one of these options should not foreclose ultimate liquidation and may represent an equitable balance between the public interest and creditor rights.