F.D. 21478 (Sub No. 4)
Exhibit No.________(RFK-1)
Witness: R. F. Kratochwill

BEFORE THE

INTERSTATE COMMERCE COMMISSION

FINANCE DOCKET NO. 21478
GREAT NORTHERN PACIFIC & BURLINGTON LINES, INC. - MERGER
ETC. - GREAT NORTHERN RAILWAY COMPANY, ET AL.

FINANCE DOCKET NO. 21478 (SUB-NO. 4)
GREAT NORTHERN PACIFIC & BURLINGTON LINES, INC. - MERGER, ETC. -
GREAT NORTHERN RAILWAY COMPANY, ET AL. (CHICAGO, MILWAUKEE,
ST. PAUL & PACIFIC RAILROAD COMPANY APPLICATION
FOR INCLUSION IN BURLINGTON NORTHERN INC.
PURSUANT TO CONDITION 33)

TESTIMONY OF R. F. KRATOCHWILL

VICE PRESIDENT-FINANCE AND ACCOUNTING

Chicago, Milwaukee, St. Paul
and Pacific Railroad Company
516 West Jackson Boulevard
Chicago, Illinois 60606

TESTIMONY OF R. F. KRATOCHWILL

My name is Richard F. Kratochwill. I am Vice President - Finance and Accounting, of Chicago, Milwaukee, St. Paul and Pacific Railroad Company. My office address is Room 746 Union Station, Chicago, Illinois 60606. I have held the above position since October 12, 1966. Prior to that date I served as Comptroller of the railroad, from January 1, 1960 to October 11, 1966. My employment by the railroad began February 1, 1958 as Assistant Comptroller.

My previous employment was with the Chicago office of Ernst & Ernst, Certified Public Accountants, from July 1941 to January 1958, with an absence of four years for military service during World War II. I returned to Ernst & Ernst in January 1946, after serving as a supply officer for the Air Materiel Division of the Air Force. At the time that I terminated my association with Ernst & Ernst, I held the position of Assistant Manager in the auditing division of the firm. I performed audit and tax assignments and, in later years, was responsible for planning, supervising and reviewing accounting engagements for clients in varied businesses including manufacturers, retailers, banks and insurers. In addition, I participated, both as auditor and supervisor, in engagements for the Milwaukee Road, which had been an audit client of the firm since 1948.

I went to work for Ernst & Ernst upon graduation from the University of Wisconsin, School of Commerce, with the degree of Bachelor of Philosophy. I have been a Certified Public Accountant in Illinois since 1949.

The purpose of my testimony is to review briefly the financial history of the railroad, to point out some of the economic problems faced by the railroad over the last few years and to sponsor various data upon which the testimony of other witnesses may rely.

A summary of certain events in the financial history of the present Chicago, Milwaukee, St. Paul and Pacific Railroad Company from the mid-1920's is as follows:

On March 18, 1925, H. E. Byram, Mark W. Potter and Edward J. Brundage were appointed receivers of the property and franchises of the Chicago, Milwaukee and St. Paul Railway Company. On January 14, 1928, the entire property and its operations were taken over by the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

On June 29, 1935, the Chicago, Milwaukee, St. Paul and Pacific Railroad Company filed a petition in the District Court of the United States for the Northern District of Illinois, Eastern Division for the reorganization of said company under Section 77 of the Bankruptcy Act and by order dated October 17, 1935, as amended November 29, 1935, the Court appointed, as trustees, Henry A. Scandrett, Walter J. Cummings and George I. Haight, who took over control of the property on January 1, 1936.

On December 1, 1945, the Chicago, Milwaukee, St. Paul and Pacific Railroad Company assumed possession and control of the property in accordance with the plan of reorganization approved by the Interstate Commerce Commission in Finance Docket 10882, retroactive to January 1, 1944.

On May 11, 1971, Company adopted a plan for creation of a holding company to be known as Chicago Milwaukee Corporation ("CMC"). On June 24, 1971, CMC was incorporated in Delaware to engage in any lawful activity for which corporations may be organized under General Corporation Law of Delaware. A registration statement was thereafter filed with the Securities and Exchange Commission, and in November, 1971 an offer was made by CMC to railroad shareholders to exchange one share of CMC preferred stock and 0.75 share of CMC common stock for each share of railroad preferred stock, and one share of CMC common stock for each share of railroad common stock.

The offer was declared effective on January 14, 1972. As of December 31, 1975, CMC owned 477,946 preferred shares (92.2%) and 2,092,720 common shares (96.0%) of Milwaukee, the extent of control being (95.2%).

The financial history of the railroad indicates a correlation between the general economy of the country and the economy of the railroad. Certain indicators of the company's finances during a recent ten-year period appear later in my testimony.

Exhibit A-14 of the Application covers data for the transferor and transferee pertaining to freight car fleet, revenue carloads of freight, specific commondities by tonnage and also by revenue. This exhibit was prepared under my direction by my staff.

Exhibit A-18 of the Application calls for certain balance sheet data for both the transferor and the transferee. To the extent possible this data has been prepared under my direction by my staff.

Exhibit A-20 of the Application calls for certain income statement data for both the transferor and the transferee. To the extent possible this data has been prepared under my direction by my staff.

The Milwaukee Road for the last 10 years has been a marginal earner. The following table lists pretax ordinary income (loss) of the railroad as reported to the Interstate Commerce Commission after eliminating dividends from subsidiaries and equity in undistributed earnings of subsidiaries:

(Amounts in Thousands)

1966	$ 7,630	1971	$ (3,943)
1967	1,984	1972	(8,643)
1968	(538)	1973	3,405
1969	(15,388)	1974	868
1970	(14,163)	1975	(32,057)

Marginal earnings performance has caused deterioration of working capital position of the railroad, as shown by the following table covering the same 10-year period:

Net Working Capital (Deficit) (Amounts in Thousands)

1966	$ 15,301	1971	$ (4,162)
1967	22,127	1972	(6,494)
1968	16,252	1973	(7,453)
1969	2,075	1974	(7,936)
1970	(5,660)	1975	(13,841)

It is proposed that Burlington Northern Inc. acquire control of the Milwaukee Road and its subsidiaries including the principal subsidiaries, Milwaukee Land Company and The Milwaukee Motor Transportation Company. On a consolidated basis, the earnings performance of this group over the past ten years has been as follows:

Consolidated Pretax Income Before
Extraordinary Items (Amounts in Thousands)

1966	$ 14,772	1971	$ 2,403
1967	5,067	1972	2,174
1968	6,036	1973	12,771
1969	(5,641)	1974	13,169
1970	(10,992)	1975	(25,449)

Net working capital for the railroad and its subsidiaries on a consolidated basis for the past ten years is shown below:

Consolidated Net Working Capital
(Amounts in Thousands)

1966	$ 18,611	1971	$ 2,523
1967	24,833	1972	4,472
1968	19,020	1973	16,301
1969	6,749	1974	17,232
1970	480	1975	2,863

The railroad has vigorously pursued self-help opportunities. Total employment has been reduced from 14,074 employees in September of 1973 to 11,741 in September of 1976. The railroad has eliminated much of its passenger deficit by contracting with Amtrak (intercity passenger trains) and the Illinois Regional Transportation Authority (commuter trains in the Chicago area). It has coordinated its efforts with neighboring railroads to haul coal in unit trains and is making an all-out solicitation for business. It will shortly request aid under the 4R Act which, I expect, will conserve working capital; however, no reflection has been given in the pro forma exhibits described in this verified statement to possible 4R Act financial assistance or related facilities rehabilitation.

In Appendix B, I have set forth the impact in the last ten years of certain inflationary factors on the railroad's operating expenses. Historically, the railroad's principal inflationary problem has been in labor costs. The average annual compensation per employee for the Milwaukee for the year 1966 was $7,483. Three years later the average was $8,753, a 17% increase. In 1972 the amount was $11,779, or 57% more than 1966. By 1975 the average compensation per employee was $15,318, or double what it was in 1966. In addition, health and welfare benefits paid by the railroad per employee per year in 1966 were $268, $366 in 1969, $660 in 1972 and today $983, or 3.7 times as much as in 1966. Payroll taxes have also increased sharply. The maximum tax paid by the carrier per employee per year was $724 in 1966, $983 in 1969, $1,243 in 1972 and $2,889 in 1976, or just slightly under four times what it was in 1966.

Diesel fuel cost averaged 9.6¢ per gallon in 1966, 10.5¢ in 1969, 11.9¢ in 1972, and 16.8¢ in December of 1973. By June 1974 it was 27.38¢ and by December 1974, 29.87¢. The 1975 per-gallon average cost was 30.0¢, more than three times the price in 1966. At a consumption rate of about 8 million gallons per month, one cent a gallon increase amounts to $80,000 per month, or about $1,000,000 per year. The railroad's fuel bill more than doubled from $13.7 million in 1973 to $27.5 million in 1975 despite a 12% reduction in fuel consumed from 1973 to 1975.

Material prices other than fuel have doubled since 1966 according to the Association of American Railroads index for Western District Railroads, which is the district encompassing the Milwaukee.

Exhibit A-18 (viii) is a pro forma balance sheet of the transferee on a consolidated basis as of December 31, 1975, the "as of" inclusion date assumed for the purpose of this statement. It is the most recent date as of which full published financial information is available to us for Burlington Northern Inc. This pro forma balance sheet has been prepared on the basis of the inclusion having been carried out under purchase, rather than pooling, accounting.

Exhibit A-20 (viii) presents in summary form the forecasted consolidated earnings of Milwaukee Road and its subsidiaries on a pro forma basis assuming consummation of inclusion in Burlington Northern Inc. as of January 1, 1977, for each of the three years following that date. Burlington Northern Inc. earnings forecasts are not available to us for use in these pro forma statements, and accordingly I have not been able to prepare pro forma income statements for the transferee.

The base "historical" forecasts shown in these statements were prepared by our Corporate Services Department. Base figures for the year 1977 are the product of the railroad's regular forecasting process, using assumptions as stated in the two-page Appendix A to this verified statement. Figures for 1978 and 1979 were projected by Corporate Services from 1977 assuming no change in transportation volume, cost inflation of 5.3 per cent in 1978 and 6.3 per cent in 1979.

Exhibit A-20 (viii) reflects the pro forma effects of the inclusion having been carried out on the basis of purchase accounting rather than pooling. It incorporates purchase accounting adjustments and estimated recurring inclusion savings and costs anticipated according to Appendix 9 to the Application during the three years following consummation. Because the exhibit covers forecasted earnings of the transferor only, one-half of inclusion savings and costs are included. For the year 1977 only there is also provided an alternate pro forma showing based upon the ultimate annual total amount of estimated recurring inclusion savings and costs as shown by Appendix 9 as of the end of the ten-year period covered by the joint study.

Consolidated data are used for Exhibits A-18 (viii), A-20 (viii) and A-20 (ix) because the proposal contemplates inclusion of Milwaukee Road subsidiaries along with the railroad, and because consolidated financial statements would be required under generally accepted accounting principles (GAAP) for financial reporting by the transferee following inclusion. In order to illustrate the impacts of purchase accounting it was necessary to assume a purchase consideration amount. On the recommendation of counsel, the amount ($109 million) of the Going Concern Value developed by witness Benham, as shown in Appendix S of her testimony, was used as the hypothetical purchase consideration amount. A larger or smaller amount of actual purchase consideration would have the effect in Exhibit A-18 (viii) of correspondingly raising or lowering the pro forma amounts for properties and stockholders' equity. Such changes would also have the effect in Exhibit A-20 (viii) of producing larger or smaller depreciation charges to pro forma operating expenses.

In accordance with GAAP rules covering business combinations by purchase, long-term debt of Milwaukee Road and subsidiaries has been discounted in Exhibit A-18 (viii) at 10 per cent consistent with Appendix S (Worksheet No. 8) to the verified statement of witness Benham, and estimated Milwaukee Road liabilities discounted at 10 per cent have been provided for unfunded vested pension benefits and for one-time inclusion costs listed in Appendix N to the verified statement of witness Benham under the captions COMPASS installation, computer programming, cost of labor protection and upgrade Milwaukee property. Amortization of the amount of write-down, or discount, on these items has been reflected among the purchase accounting adjustments as interest charges in Exhibit A-20 (viii). Because of the absence of information available to us concerning the income tax affairs of Burlington Northern Inc., the discounted estimated liabilities referred to above in this paragraph are dealt with in Exhibits A-18 (viii) and A-20 (viii) without regard to possible future income tax benefits.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

1977 FORECAST ASSUMPTIONS

I. GENERAL ECONOMIC OUTLOOK

The most likely forecast for the U. S. economy shows a continuation of the economic pause through the fourth quarter, but a spontaneous re-acceleration of economic growth in 1977. This reacceleration is based on: 1) increased state and local spending financed by rapidly rising Federal grants; 2) business proceeding with its rising investment plans; 3) further housing recovery; 4) completion of the minor inventory correction in basic industries. These elements would produce a rise in consumer incomes that would fuel large gains in consumer spending.

The continued growth results in the following:

Real GNP	+ 5.1%	Housing Starts	1.74 million
Inflation	+ 5.2%	Car Sales	10.9 "
Real Business Investment	+ 7.4%	Unemployment	7.2%
Real State-Local Spending	+ 3.8%	Prime Rate	8.0%

II. OPERATING REVENUES

Freight Rate Increases

A 4% rate increase was filed with the I.C.C. on November 10, 1976 with a January 1, 1977 effective date. The revenue forecast contemplates an effective date of February 1, 1977 due to the uncertainty of regulatory action. The rate increase added approximately $1.4 million per month to gross freight revenue.

Gross Freight Revenue

A comparison of 1977 with 1976 is as follows:

	1977	1976	Increase	% of Increase
Revenues (millions)	$480.0	$433.0	$47.0	+ 10.9%
Carloads	944,000	920,000	24,000	+ 2.6%
Avge.Rev./Carload	$508	$471	$37	+ 7.9%

The 10.9% growth in revenues includes 5.4% of real growth and 5.5% of ex parte growth from Ex Parte's 318 (March 1976), 330 (Oct. 1976) and the 4% February 1, 1977 rate increase.

Marketing

The 1977 forecast is favorably enhanced by significant gains for the following commodities:

Grain & Soybeans - resumption of volume levels to a more normal activity.

Motor Vehicles - increased domestic production and import activity coupled with expansion of Chicago auto loading facility.

Freight Forwarder Traffic - impressive gains in container imports through port of Seattle.

Lumber & Plywood - expansion of housing starts along with new freight car deliveries (A-Frames).

Primary Forest Products - full year impact of WAM plan log distribution with the delivery of log flat cars late in 1976.

Coal - gains are projected due to consistent operation of power plant at Big Stone City, S. D., which had start-up interruptions in 1976.

Potential Marketing Opportunities

There are several revenue opportunities which may materialize in 1977 which have not been included in the basic forecast. They include:

Granite City ore	$3.5 million
Moses Lake Retrograde Alaska	2.4 "
Autos - long haul domestic and imports	1.9 "
	$7.8 million

When these specific proposals become more solidified, they will be added to the revenue forecast.

III. OPERATING EXPENSES, TAXES AND RENTS

Expenses are projected at 6.4% increase over 1976 with cost increases in labor and material representing 5.9% increase and 0.5% increase from equipment lease payments.

The operating and maintenance expenditures are held to the 1976 level of activity, which includes:

Equipment Maintenance - Running repairs only.

Roadway Maintenance - 430,000 new and secondhand ties.
15 miles ballast.
41 miles new and secondhand rail improvements.
62 miles new and secondhand rail replacement.
Accomplishment of special projects in conjunction with states, shippers and other railroads.

Operating - Service levels consistent with 1976 activity.

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APPENDIX B
Sheet 1 of 1

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

OPERATING EXPENSES AND ESTIMATED AMOUNTS

DUE TO INFLATION 1966-1975

(amounts in thousands)

Year	Total Operating Expenses	Portion Attributable to Inflation Amount*	Portion Attributable to Inflation Per Cent
1966	$205,886	$ 3,395	1.65%
1967	204,185	6,553	3.21
1968	219,545	6,353	2.89
1969	230,631	9,533	4.13
1970	237,411	11,674	4.92
1971	243,113	15,116	6.22
1972	265,411	14,516	5.47
1973	285,527	16,707	5.85
1974	313,578	26,840	8.56
1975	318,552	26,259	8.24

* Includes effect of general wage rate increases and increases in price of fuel and material other than fuel, but does not include payroll taxes, health and welfare benefits nor equipment rents.

STATE OF ILLINOIS)
) SS
COUNTY OF COOK)

VERIFICATION

R. F. KRATOCHWILL, being first duly sworn on oath, says that he is Vice President-Finance and Accounting of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company; that he has read the above Testimony and attached document and knows the contents thereof; and that the same is true to the best of his knowledge and belief.

R. F. Kratochwill

Subscribed and Sworn to before me this 23rd day of November, 1976.

F. A. Meier
Notary Public

My Commission expires My Commission Expires April 23, 1979