

**Chicago, Milwaukee, St. Paul  
and Pacific Railroad Company**

516 West Jackson Boulevard  
Chicago, Illinois 60606  
Phone 312/648-3000

February 16, 1979

Mr. Rick Applegate  
Director  
Center for Balanced Transportation, Inc.  
Box 1308  
Bozeman, Montana 59715

Dear Mr. Applegate:

I have read with interest your letter of January 24 to the Interstate Commerce Commission relative to the Commission's Environmental Impact Statement on the BN-Frisco merger, and the attached "Status Report" on the Milwaukee Road and the BN mergers. I'm afraid that your Status Report contains misstatements of fact which need to be corrected and implications which are erroneous. In setting the record straight, I shall confine my comments to those portions of your document which deal specifically with the relatively current activities of the Milwaukee Road and of Trustee Hillman.

You say on page 4 that the Milwaukee Road's "failure is having a profound impact in Montana and surrounding states." A realistic appraisal of the Milwaukee's current situation would immediately reveal that the railroad has not "failed" in any of the states that it serves. To the degree that has been permitted by its cash position and two successive severe winters, the Milwaukee has continued to provide the services for which it is obligated. While indeed there has been considerable public discussion and publicity about the Milwaukee's present condition and future prospects, I hardly think that this commentary equates to instant economic hardship for the state.

I suggest to you that even if the Milwaukee were to withdraw from Montana completely the state would suffer no irreparable economic hardship. No more than 1.5 per cent of Montana's population is dependent exclusively on the Milwaukee for rail service. The Milwaukee's share of the market for rail transportation in the state is only 3 per cent on originating tonnage and 8 per cent on terminating tonnage. Our employment in Montana is a mere fraction of the state's total job force--and comprises no more persons than Governor Judge, according to his recent State of the State address, will be eliminating from state government itself.

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It seems to me that your discussion of diversification by railroad companies on pages 4 and 5 is intended to leave the impression that assets of the Milwaukee Road were diverted from the railroad in the formation of Chicago Milwaukee Corporation. This is patently untrue. Chicago Milwaukee acquired its non-railroad subsidiaries through the method of acquisition known as "bootstrapping." Any weakening of the Milwaukee Road during the period in which Chicago Milwaukee Corporation came into being, and subsequently, came purely from the economic circumstances in which the railroad found itself. And it should not be forgotten that the Milwaukee Road had two of the best years it has had in recent history after Chicago Milwaukee Corporation was formed.

In any event, your speculation about the interests of Chicago Milwaukee Corporation is irrelevant. At present, Chicago Milwaukee Corporation has absolutely nothing to do with running the railroad. This responsibility is entirely the Trustee's. We as officers of the railroad severed our connections with Chicago Milwaukee Corporation a year ago.

You allude, also on page 5, to the findings of Forbes in 1975 and the investigation conducted by the Securities & Exchange Commission. You then conclude that "in sum, it appears that the circumstances of the Milwaukee Road collapse deserve very careful public scrutiny," and you raise questions about mismanagement of the railroad, an arrangement with the holding company which was possibly detrimental to the railroad, and whether the Milwaukee's debt situation actually necessitated the filing for bankruptcy. Were you to study the matter, you would find that the SEC's concern was not so much what the management of the Milwaukee and Chicago Milwaukee Corporation had done, but whether there had been adequate public disclosure of matters of importance to stockholders.

I personally regard it as extremely unfortunate that the process required by the SEC, by which the complaint and the settlement of the action came to light at exactly the same time, never permitted one extremely important fact to become equally well known: that if the alleged actions had indeed taken place, the reason was because the railroad's management was fighting a desperate battle to avoid bankruptcy in the late 1960's and early 1970's, the period in question. It is only in that connection that there is a relationship between the SEC matter and the 1977 condition of the Milwaukee.

That the railroad has been compelled to live in part off the earnings of its subsidiary Milwaukee Land Company is by no

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means a secret. Since 1920, the Milwaukee Road has received from Milwaukee Land Company a total of more than \$83,000,000 in interest, dividends and loans. It has used this money to help pay the cost of running the railroad. More than \$35,000,000 of this amount came to the railroad in 1975, 1976 and 1977.

I can assure you that the financial condition of the Milwaukee required it to seek the protection of the bankruptcy court in December of 1977. The issue was not, as you infer, its total debt relative to its total assets as the two figures might appear on the balance sheet, but the lack of cash. It was quite clear to the officers and directors of the railroad on December 19 that within a few weeks the railroad would not have sufficient cash to meet its obligations except by seeking the protection of the Bankruptcy Act. Its creditors very likely would have begun involuntary bankruptcy proceedings had the railroad not done so voluntarily.

You seem to be proposing, on page 6, that the Congress, the U. S. Department of Transportation, the ICC, and the "affected" states launch a study into the Milwaukee's circumstances. I'm sure you are well aware that there are already several studies of this nature underway under the sponsorship of several groups. And while it might well be a laudable exercise to undertake such a broadly based study, it's entirely impractical to think that such a study could be completed and any recommendations to come out of it be implemented quickly enough to meet the time constraints which are on the Trustee.

You indicate on page 8 that the Trustee has begun preparation of "studies and a reorganization plan." Mr. Hillman has yet to determine whether the Milwaukee Road can be reorganized. As to the statement that he made in February 1978 about not being dismayed by gloomy predictions and pronouncements, he was at that time referring specifically to the rather common assumption then being made by persons not familiar with either the facts or the provisions of the Bankruptcy Act which apply to railroads that the Milwaukee would cease operations very quickly. That, of course, did not happen.

First on page 8, and later at other points, you appear to confuse the Trustee's position about the Milwaukee Road in its entirety with his position on the future of the Milwaukee Road in Montana or as a transcontinental carrier. The two are by no means one and the same. Mr. Hillman determined in August of 1978 that if he attempted to include the transcontinental line in a reorganized railroad, the railroad couldn't be

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reorganized. His August statement constitutes no change of mind from his position of the previous February. Mr. Hillman did not say in February that all of the Milwaukee would always be operated by the Milwaukee.

On page 9 you refer to layoffs of maintenance-of-way employees and also to the railroad's cash position. The relationship between the size of the maintenance-of-way force and the availability of cash was discussed by Mr. Hillman at length in a letter to Mr. Geoffrey L. Brazier, the Montana Consumer Counsel, last September when this issue was first raised. Mr. Hillman discussed the issue again at Senator McGovern's hearing in Aberdeen on October 27. It appears from your statement that you were not aware of either discussion. I am enclosing copies of these two documents.

I might also point out to you that while it is true that the Milwaukee did for a short time enjoy a cash position in the neighborhood of \$23,000,000--which is not at all "embarrassingly high" for a corporation of this size whether it is in bankruptcy or not--the cash level rather quickly dropped with the onset of winter to the point that, on February 1, Mr. Hillman drew down from the federal government a loan of \$5.1 million dollars which he had arranged a year ago to bolster the railroad's working capital when it became necessary to do so. Our cash at present is quite marginal.

You mentioned on page 9 the names of Murchison and Reed in a context which suggest that they might have some influence on the reorganization proceeding. Mr. Murchison and Mr. Reed are directors of Chicago Milwaukee Corporation and of the shell Milwaukee Road corporation which, during the bankruptcy proceeding, have no control over the Trustee's activities. Mr. Hillman is responsible not to the directors but to the Court.

You indicate in your footnote to the comment on page 11 about a possible sale of certain line segments to the Union Pacific that it is now rumored that we and the Union Pacific have agreed on a price. This is not true.

On pages 25 and 26, you speculate that the Milwaukee, by eliminating most of its trackage-rights conditions in the Burlington Northern-Frisco merger, was "throwing in the towel, giving up the prospect that it could in fact compete with the BN across the northern tier states." It is indeed true that Mr. Hillman has determined that the Milwaukee cannot in the future operate across the northern tier states.

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The real question, however, is not whether the Milwaukee can compete only with Burlington Northern in this territory but whether it can participate profitably in a market for transportation services which embraces not only the BN but the Union Pacific, the Canadian railroads, motor carriers of many descriptions including private operators, and even water carriers whose existence, actual or potential, can reduce freight rates. Mr. Hillman has determined that the Milwaukee cannot, particularly in its present physical condition, and in the absence of any realistic opportunities to obtain the huge sums necessary for its rehabilitation. Accordingly, he will not pursue some of the BN trackage-rights conditions because even if granted they would not repair the fundamental economic deficiencies of the Milwaukee's transcontinental line.

Nonetheless, should it be able to avoid liquidation, the Milwaukee will continue to compete with Burlington Northern elsewhere than west of the Twin Cities. Conditions designed to compensate the Milwaukee for the damage that a BN-Frisco merger will do to the Milwaukee's revenues are still being actively pursued.

The first paragraph of your conclusion as to the survivability of the Milwaukee, on page 28, is curious indeed. Of the two choices available to him--to reorganize or to liquidate--Mr. Hillman has always said reorganization is the preferable choice. You must remember that his concern has to be with a company the great majority of which, on any objective basis that you care to use, lies outside Montana. I can think of no surer way to guarantee that the Milwaukee will be liquidated than to require it to perform all those services which it has performed historically whether they are needed or not.

Throughout your discussion you continually overlook a key point: While on the one hand Mr. Hillman has indicated that the Milwaukee Road can no longer survive west of the Twin Cities, he has never said that the lines of railroad which the Milwaukee presently operates west of the Twin Cities must inevitably disappear. There is always the possibility that, if these lines or any part of them do indeed have economic or social value, alternative ways can be found to operate them. Indeed, this is precisely the basis for the negotiations we currently have under way with Union Pacific.

I expect that in due course there will be similar negotiations with other parties concerning other portions of our present line. You must be aware that the state of South Dakota is

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giving serious consideration to acquiring those portions of our line in that state which it has already identified as being essential to the state's transportation network.

On pages 29 and 30 you present a rather one-sided discussion of the controversy centered around Operating Rule 704. I remind you that on November 9, 1978, Mr. Raymond K. Merrill, Vice President, Law, for the Trustee, answered your letter of October 16 on this subject. Mr. Merrill's reply, which is attached, places rule 704 in quite a different light.

You indicate, on page 30, that the only recent hearings on the Milwaukee situation were held by Senator McGovern in South Dakota. That hearing was held on October 27, 1978. I wonder if you remember that 15 days earlier, on October 12, Mr. Hillman appeared at a meeting called by Governor Judge in Helena in which he not only discussed at some length all the aspects of the Milwaukee's situation but answered questions from the audience. As I recall, you were at that meeting and asked Mr. Hillman some questions.

Lastly, I think that your comments about the need for the state of Montana to develop a better approach to transportation matters are quite well taken. I believe that Montana is the only state, or at least the only state in Milwaukee Road territory, which has yet to file a state rail plan with the FRA and thus make itself eligible for certain assistance provided by the 4R Act.

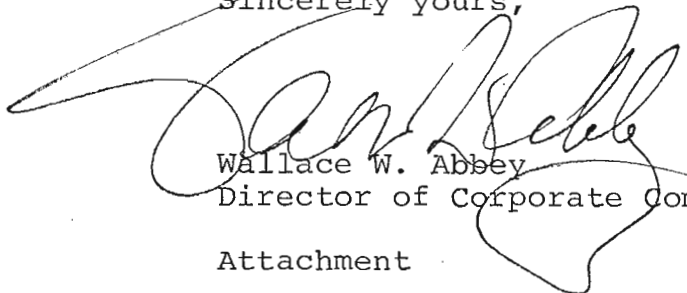
And while I can speak for the Trustee in saying to you that he continues to be open to any proposals from any qualified persons or organizations which address in a constructive manner the real problems and questions which are before him, the pressure of time is becoming extremely strong.

Setting aside for the moment the question of whether any plan which might be devised essentially in and for the state of Montana would really address the full scope of the issue

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of the Milwaukee's bankruptcy, and I suspect that it might not, the question remains whether the state or the federal government can act with sufficient speed to shape the future of this railroad in Montana--or whether there is really a need for it to do so.

Sincerely yours,



Wallace W. Abbey  
Director of Corporate Communications

Attachment

cc: Honorable Max Baucus  
Honorable George McGovern  
Honorable John Melcher  
Honorable Ron Marlenee  
Honorable Pat Williams  
Mr. H. Gordon Homme, Jr.  
Ms. Carole Dawkins  
Governor Thomas Judge