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Managers and Supervisors:

New Milwaukee Lines' proposed 3,550-mile employee- and shipper-owned railroad composed of much of the bankrupt Milwaukee Road would be an underfinanced system serving the interests of fewer rail shippers and states than would the railroad proposed by the Trustee in the Milwaukee's own reorganization plan.

It would not be financially self-sustaining and would fail in its first year, precipitating a transportation crisis because of the terms of the law which sponsored the presentation of its plan to the Interstate Commerce Commission.

It would require well in excess of a half billion dollars in aid from taxpayers and, even if it received that aid, would lose nearly \$700 million by 1986.

The plan upon which the proposed railroad is based offers only an illusion of compensation to the estate of the Milwaukee for the \$500 million in assets necessary to create the new railroad. The plan provides no assurance that the estate would be relieved of huge payments for labor protection even though most of the Milwaukee's present employees might obtain jobs with New Milwaukee Lines' railroad.

These are the principal reasons why Trustee Ogilvie told the ICC that the New Milwaukee Lines employee-shipper ownership plan is not feasible and must be rejected.

"New Milwaukee Lines' plan is an illusion without substance under the statute's requirements," Ogilvie's statement asserts. "It could only be a beginning step toward a railroad system with both capital and operations financed through continuing subsidies of great magnitude. The Commission should reject the plan under all of the statutory requirements."

Analyses of the New Milwaukee Lines proposal by the Trustee and his staff, by former Trustee Stanley E. G. Hillman, by Booz, Allen & Hamilton, and by Lehman Brothers Kuhn Loeb, Inc., show that:

-- "The New Milwaukee Lines plan vastly overstates the likely earnings performance of the contemplated railroad by assuming that revenue improvements can be obtained before or concurrently with substantial rehabilitation programs; by understating rehabilitation expenses in the early years; by understating equipment-rehabilitation costs; by understating equipment rents; by understating fuel costs; and by relying upon totally unsubstantiated improvements in labor productivity. Necessary corrections demonstrate that the New Milwaukee Lines railroad would lose nearly \$700 million in the period from 1980 to 1986. Losses are likely to exceed \$180 million in 1980 alone and to exceed \$50 million in 1986 after completion of rehabilitation programs. Accordingly, the proposed railroad cannot be operated on a self-sustaining basis."

-- "The New Milwaukee Lines' plan understates the public financing which would be required for its implementation by approximately one half billion dollars through the end of 1986. Nearly all of these funds would have to come

from the federal government. Thus, adequate public financing is not likely to be obtained under existing programs. In addition, the plan contains no agreements with labor organizations or with individual employees to waive protection claims against the Milwaukee's estate. Such financing was contemplated by the Act and is essential to the New Milwaukee Lines plan."

-- "The New Milwaukee Lines plan offers no direct compensation to the estate for the assets to be transferred. The plan overstates the assets which would remain with the Milwaukee Road's estate and understates claims against the estate if it were implemented. For example, a high-priority claim of \$153 million, representing liabilities now being paid in the course of business, would be left as a burden upon the estate and not properly accounted for. In addition, since the plan does not contain agreements by labor organizations or employees to waive protection claims against the estate, which might amount to \$640 million under New Milwaukee's calculations, the promised relief from such claims is not delivered. The proposed plan fails to compensate the estate for property having a value of about one-half billion dollars. It is not fair and equitable to the estate of the Milwaukee Road."

-- "The New Milwaukee Lines plan does not contain the assessment of operating practices required by the Act and offers only an unsubstantiated conclusion concerning labor-productivity increases. The requirement of the Act that agreements to make implementing changes be included is simply not met."

-- "The procedures described in the New Milwaukee Lines plan do not provide assurance that implementation will occur by April 1, 1980."

Ogilvie urges the ICC to take into account the fact that the New Milwaukee Lines' Puget Sound-to-Louisville railroad would serve only about 70% of the Milwaukee's present shipments. "Milwaukee II," the essentially midwest railroad proposed by the Milwaukee Road's preliminary plan of reorganization, plus sales of non-"Milwaukee II" line segments contemplated by the reorganization plan, would serve some 94% of the Milwaukee's present shipments.

"The Commission must also take into account the fact that a collapse of the New Milwaukee Lines railroad in its first year would cause a transportation crisis due to the prohibition of directed service in the Act," Ogilvie points out. The Restructuring Act prohibits the ICC from using its authority to direct other railroads to operate over the Milwaukee Road until April 1, 1981.

While the Restructuring Act requires that the New Milwaukee Lines railroad be self-sustaining, the organization's plan reaches this result only because it has "misconstrued the Booz, Allen study, made numerous errors and included hopelessly optimistic factors," the Trustee indicates. His statement includes a letter from Booz, Allen which details the deficiencies of the New Milwaukee Lines study in this respect.

A revised pro-forma income statement developed by Lehman Brothers Kuhn Loeb and Booz, Allen shows that the New Milwaukee Lines' railroad is more likely to lose about \$680 million over the next seven years -- if adequate financing to sustain such losses could be obtained, which is unlikely rather than the \$26 million which New Milwaukee Lines itself forecasts for the period. Losses for 1980 would be some \$189 million rather than the projected \$73 million. The year 1986 would see a loss of some \$55 million rather than the \$65 million profit which is projected by New Milwaukee Lines.

"The New Milwaukee Lines' cash forecast shows positive annual cash flows during the period 1981 through 1986 totaling \$104 million, resulting in an ending cash balance for the year 1986 of \$155.9 million. This overly optimistic cash forecast is made possible only by a vastly overstated forecast of operating performance, the substantial deferral of all types of debt service payments, the fact that New Milwaukee Lines assumes none of the current or long-term liabilities of the railroad except for conditional sales obligations, and the fact that its proposed acquisition does not include any cash considerations to be paid to the Trustee for the assets proposed to be acquired by New Milwaukee Lines," the statement says.

A cash-flow statement based on the proper pro-forma income statement "shows that New Milwaukee Lines will generate a cash deficit in 1980 of \$68.9 million which, if it cannot secure financing to fund that deficit, will result in the collapse of New Milwaukee Lines in its first year of operation." At year-end 1986, the cash deficit would be \$433.8 million. "If one were to assume that those deficits could be financed, which is absolutely out of the question, the annual interest costs in 1986 alone at 11% would total \$47.7 million."

A letter from Lehman Brothers Kuhn Loeb which accompanies Ogilvie's statement shows that there is grave doubt that New Milwaukee Lines could even achieve the private-sector financing for equipment which its plan contemplates. "While New Milwaukee Lines may wish to be able to obtain the limited public financing it purports to seek in its plan, the massive losses it will incur will render sufficient financing totally impossible to obtain," Ogilvie's statement says. Beyond the financing contemplated in the plan, some \$475 million in additional loans would be required to support deficits in cash flow.

When errors in New Milwaukee Lines' plan are corrected, the plan yields fewer, rather than greater, asset values for the Milwaukee's creditors than does the Trustee's reorganization plan, Ogilvie's statement to the ICC shows. "Rather than leaving the estate with a \$96.4 million surplus of assets over liabilities before consideration of labor protection and shareholder claims, the New Milwaukee Lines proposal would actually leave the estate with a \$110.6 million deficit." Correcting another analysis made by New Milwaukee Lines, Ogilvie's statement shows that the Trustee's reorganization plan, projected ahead to year 4 in a manner consistent with New Milwaukee Lines' own analysis, would yield a net liquidation value of the estate's assets of \$777.3 million, before creditor and shareholder claims, and liabilities, exclusive of labor-protection claims, of \$732.2 million, resulting in an improvement in values at December 31, 1983, over New Milwaukee Lines' proposal of some \$155.7 million.

New Milwaukee Lines' position that it would be fair to the estate of the Milwaukee for New Milwaukee Lines to take some \$500 million in assets without paying for them is based on the assertion that New Milwaukee Lines would thereby relieve the estate of labor-protection claims for 7,900 employees. Yet, "New Milwaukee Lines has failed to show that employees joining its railroad will forfeit their claims against the estate. Therefore, the Milwaukee Road will remain subject to the risk that the New Milwaukee Lines system will fail. The errors and omissions in New Milwaukee Lines' computation of the number of Milwaukee Road employees affected by its proposal casts even further doubt upon the extent to which the Milwaukee Road actually will be relieved of claims."

"The Trustee urges the Commission to be especially rigorous in enforcing the fairness and equity standards in its review of the New Milwaukee Lines plan because the procedures provided by the Act do not allow the opportunity for the interchange of ideas and the evolution of proposals which are typical in a railroad reorganization," the statement says.

Ogilvie calls the ICC's attention to the recent determination of the reorganization court that "an ESOP cannot be evaluated in the abstract under this new statute. It must be found to be 'fair and equitable' to the estate. This means to us that it must be at least as favorable to the creditors as any other plan which is brought to the attention of the ICC or the court."

New Milwaukee Lines' plan contemplates a railroad of some 3,550 miles plus some 1,675 additional miles of light-density lines, inclusion of which would be contingent upon further economic analysis. Ogilvie's statement to the ICC calls New Milwaukee Lines' treatment of the "contingency lines" and other lines excluded from its base system "extraordinarily vague and unrealistic." It assumes that all such lines could be immediately abandoned on April 1, 1980, which is unlikely, he said. While the plan contains indications that the "contingency lines" may be acquired by New Milwaukee Lines, it doesn't clearly indicate how New Milwaukee Lines proposes to compensate the estate for these lines. The "contingency lines" have a current net liquidation value of some \$75 million. But New Milwaukee Lines seems to propose to take them over by assuming \$58 million in claims which don't impose a cash-flow obligation on the new railroad.

"Fairness and equity to the estate with respect to the lines outside the New Milwaukee Lines plan would require immediate permission to abandon such lines, which may not be feasible; immediate execution of sales to other carriers, which may not be feasible; or acquisition by the New Milwaukee Lines with immediate compensation to the estate in cash or its equivalent, for which they have no financing commitments," the statement says.

"The New Milwaukee Lines employee-shipper ownership plan contains no agreements by either individual employees or the labor organizations representing those employees which waive labor-protection claims against the estate of the Milwaukee Road in return for job offers with New Milwaukee Lines' railroad," Ogilvie tells the ICC. "For the New Milwaukee Lines plan to be credited with relieving the estate of labor-protection claims, both the Commission and the court must find that any employee receiving a job offer with the new railroad must forfeit any further claim against the estate."

New Milwaukee Lines' plan totally fails to meet the statutory requirement that it contain an assessment of all operating practices and include agreements by labor and management to make implementing changes designed to achieve labor-productivity increases, Ogilvie's statement declares. "The New Milwaukee Lines' plan purports to meet this requirement with only a most generalized discussion of operations and a wish for improvements which is booked at a value of \$141 million over the seven-year period of its forecasts."

The Trustee, his officers and prior management of the Milwaukee have made a number of efforts to improve productivity, the statement says. "The bottom line with respect to labor productivity is that any improvements require extensive negotiations, much time to implement, and tend to yield benefits which are confined to attrition. Generalized promises simply have no value."

Employees on the Milwaukee's western lines have labor agreements with the railroad which are more burdensome to the railroad than are its agreements with employees on the eastern lines. "This productivity problem is particularly relevant to New Milwaukee Lines' assertions regarding the degree of commitment of employees to transcontinental operations. Historically the railroad has negotiated with the western employees in an attempt to obtain work and pay rules consistent with those in effect in the east. These attempts have generally been unsuccessful and some have been rejected by the very labor leaders now on New Milwaukee Lines' board of directors."

"The Trustee is aware that changing circumstances and actions by governmental agencies as well as positions taken by other parties to the proceedings may require alterations in the August 10, 1979, reorganization plan," Ogilvie says. "The Trustee will continue to take a flexible attitude toward propositions which could result in real improvements for the estate and the public. Unfortunately, the New Milwaukee Lines plan does not achieve this result."

New Milwaukee Lines' plan was filed December 1. Under the Restructuring Act, the ICC must determine by December 31 whether the plan meets a series of statutory tests and is therefore feasible. If the ICC finds the plan feasible, the reorganization court in Chicago then has 10 days to rule on whether the plan is fair and equitable to the Milwaukee's estate. If the court does so, New Milwaukee Lines has until April 1, 1980, to implement its plan.

New Milwaukee Lines is a developmental corporation which represents some 5% of the Milwaukee Road's 10,900 current employees. The organization's principal dedication is to the concept that continuing the Milwaukee Road as a transcontinental carrier is essential and ultimately the most beneficial to the bankruptcy reorganization. The Trustees of the Milwaukee Road's estate, Ogilvie and Hillman, have determined that transcontinental operations represent the greatest drain on the estate, obstruct the ultimate reorganization of the bankrupt carrier, and can be assumed by other railroads in the region without material disruption to shippers' interests or public railroad policy. In recent weeks Ogilvie has announced prospective sales of most of the line segments in Montana, Idaho and Washington which are needed to continue service to shippers now served exclusively by the Milwaukee Road.



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