1st MONDAY
3rd MONDAY

Prepared for employees by the
Milwaukee Road's Corporate Communications Department
516 West Jackson Boulevard Chicago, Illinois 60606
Telephone 312 648-3324

May 7, 1979

Managers and Supervisors:

On May 9, I will testify at a hearing conducted by the Subcommittee on Transportation and Commerce of the House Committee on Interstate and Foreign Commerce. I will use this opportunity to explain the Milwaukee Road's present situation and what is being done to reorganize the railroad on a viable basis. I will also offer suggestions on what the Congress can do to assist us in this process. I would like to share some of my comments to the Subcommittee with you.

Although the Milwaukee Road is a large common carrier that operates some 9,800 miles of route with about 10,000 employees, it is a fact of economic life that not many of our services are unique, irreplaceable or even essential. Much of the territory we serve is also served, quite well, by other railroads and other transportation modes. As a result, our average traffic density is quite low by rail industry standards. In 1977, we ranked seventh among the Class I railroads in mileage operated, but only 15th in total operating revenues.

Having tried through its history to support too many miles of railroad in relation to what could be earned by operating all those miles, the Milwaukee has long been financially marginal. It has not been able to accumulate the financial strength with which it could compete effectively against other railroads and other modes. Additionally, years of increasing costs and regulatory restraints have added to our financial problems.

The Milwaukee Road is bankrupt, unable to pay all its bills, for the third time in its history. We are now in the process of exhausting the last of our internal cash resources. The prospect of a complete shutdown of the railroad remains very real.

The effort to reorganize the Milwaukee under the Federal Bankruptcy Act has been under way since December 1977. For many reasons, not the least of which are the orderly continuation of essential rail services and a maximum number of jobs, reorganizing at least a part of the property as an operating railroad is preferable to liquidation. But the ability of the Trustee to retain Milwaukee Road service is limited by available cash and by the obligation of the Trustee and the court to safeguard the constitutional rights of the railroad's creditors.

There are several reasons why these factors have become limitations.

On top of some $100 million in losses in the three years prior to bankruptcy and losses of $82 million in 1978, the Milwaukee faces the prospect of losing more than $150 million in 1979, if the entire railroad remains in operation. It will take between $80 million and $90 million more cash than the railroad can itself generate to keep the entire 9,800-mile system operating for the balance of this year. Most of these funds would have to come from the Federal Government.

Furthermore, sufficient funds do not exist to rehabilitate the entire system to a point where it could become self-supporting. There are few if any signs that such funds for rehabilitation could be available soon enough to prevent

the collapse of the entire railroad. But frankly, we do not believe that the public interest or the interests of the railroad's creditors require that the entire railroad be rehabilitated.

Simply pumping money into the railroad as it exists today solves nothing. Indeed, loaning money to the Milwaukee, and doing that alone, will only postpone solving a fundamental problem and reduces the opportunity we may have to reorganize the railroad and make it self-sufficient.

The Trustee has put some $100 million into the railroad in the past 15 months, all the outside cash he could get and all the postponement of obligations which he could arrange. Yet the railroad's overextended and undermaintained plant continues to deteriorate. Our service continues to be less responsive to customer needs. We are now at a point where our secured creditors regard continued operations as an unconstitutional taking of their property. They are demanding that service stop and that the property be liquidated.

Milwaukee Road operations cannot continue as they exist today. Yet our essential services must continue. And I believe they can--if the Milwaukee can concentrate its resources on a smaller segment of its present operations. If we can direct our resources to the key segment on which the railroad can perform best and on which the cost of rehabilitation can be minimized, there is a reasonable possibility that a financial reorganization of the Milwaukee as an operating railroad can be achieved. The result would be the preservation of many jobs; the continuation of much existing service; and, quite possibly, a substantial saving to the nation's taxpayers. There is, however, no guarantee that a successful railroad might emerge, but I believe that the possibility warrants the try.

But time is critical. If there is any hope for the future of the Milwaukee, the Trustee must immediately stop the drain which operating the entire system is causing on the assets of the estate. The railroad has been going through cash at the rate of nearly $10 million per month more than it can generate. The last of our internal cash sources, the Milwaukee Land Company and the proceeds from the sale of non-essential railroad property, are being used. Further borrowing must come from outside sources, probably the Federal Government.

It is essential that we develop prompt evidence of the possibility of future viability or we quite likely will not be able to prevent an irreversible move through the court toward a complete shutdown and liquidation.

We have seen from the Booz, Allen report that it would take more than one billion dollars to rehabilitate the present 9,800-mile system. Clearly funds of that magnitude are not available. Only on a small segment of the present railroad can the investment risk be reasonably equated with potential return.

It was with these considerations before him that on April 23, the Trustee asked the court to direct him to embargo all but some 2,400 miles of the Milwaukee's routes, to substantially reduce employment, and to indicate to the ICC the possible need for directed service over the embargoed lines.

The request for the embargo came before the court last Friday. It will be more thoroughly explored by the court on May 15. At Friday's hearing, the Trustee advised the court of some modifications in his initial embargo plan. As the Trustee's request to the court now stands, the Milwaukee would operate

some 2,500 miles of route which connect Louisville, Chicago, Milwaukee, Minneapolis-St. Paul and Duluth; Chicago, Rockford, Beloit, Janesville, Madison and Portage; Milwaukee, Green Bay and Menominee; the main line with points in the upper Wisconsin Valley; and the Twin Cities with Miles City. This area includes the segment of the existing railroad which may produce the most attractive potential for net railway operating income relative to the necessary commitment to an investment in plant and equipment rehabilitation. We have also included the line to Miles City for the short term because assistance from the State of South Dakota has made it possible to do so. We are hopeful that additional actions will make the permanent inclusion of this line in the system possible.

The balance of the system, some 7,300 miles, would be embargoed. We would expect the ICC to develop a plan of directed service on the essential portions of these embargoed lines.

To assist the Commission, we have suggested a method whereby directed service over some 2,500 miles of embargoed lines would continue rail service for approximately 98.5% of the present business of these lines at an estimated cost to the taxpayers of about $10 million for the eight-month period of directed service. If the entire railroad were to operate for the same eight months, someone would have to pick up the estimated cash shortfall of between $80 million and $90 million.

If the Commission adopts our suggestion for directed service, the only lines of the Milwaukee which would not receive service would be those branch lines which are already candidates for abandonment and portions of main lines presently handling through, or "overhead," shipments which would be rerouted under the embargo.

We would need approximately 5,000 employees to operate the 2,500-mile core railroad. We estimate that some 2,000 of our present employees would be required by the directed carriers to provide service on portions of the embargoed lines. We would need perhaps another 200 persons for property protection, assistance to directed railroads, and to proceed with the ultimate plan for reorganization. At most, we visualize that the proposed embargo would create a force reduction of some 2,800 positions.

Measured against the possibility that 10,000 jobs, the Milwaukee's entire existing work force, would be in jeopardy were there to be a complete shutdown of the railroad, a maximum number of jobs would be preserved under a combination of embargo and directed service.

The Trustee's plan for a partial embargo in combination with directed service would provide time--an eight-month period which cannot be provided any other way. During this time the Milwaukee, government, other railroads, our shippers, and the unions which represent our employees can plan for the long-term solution. Together, we can approach with reason the question of what is to happen when the period of directed service ends. We know of no other way to buy such important time at such a low cost.

It is essential to remember why we are seeking this unprecedented embargo with its admitted broad consequences. We need it to relieve a pressing, critical financial problem. In the absence of external financial aid which is not presently in sight, financing which must be carefully devised if it is to protect the rights of the creditors as well as provide for the continuation of essential services, our only alternative is to begin to close down the railroad.

It is also important to note that the short-term relief we seek through an embargo must not be equated to an abandonment. We well recognize that whatever abandonment must come will come only through the established procedures of the ICC. The possibility also exists that the Trustee can lift the embargo on some lines if economic conditions permit.

In fact, such action has already taken place. We now plan to continue service to Miles City because South Dakota has pledged $2.3 million in immediate rehabilitation grants for this line. The state has also committed itself to help obtain long-term rehabilitation funds, and is also seeking a right of first refusal on the line. This action on the part of South Dakota is an example of a positive, mutual solution to the problems of the Milwaukee Road as it affects one state and indirectly a larger geographical area.

The Milwaukee Road must change dramatically. The only question is how. Inevitably job opportunities will be affected; employment will be reduced. My strongest recommendation to the Subcommittee was that it consider initiating legislation which, while permitting the Milwaukee to pursue its private-sector solution to preserving the self-supporting core of the railroad, would, for a reasonable period, provide federal assistance to employees who must inevitably be removed from the payroll.

Such legislation would be the best way the Congress could resolve the one problem, among the many we face, for which we on the Milwaukee may not have a solution.

W. L. Smith
President

First Monday / Third Monday
516 W. Jackson Boulevard
Room 824
Chicago, IL 60606

306 001080
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