1st MONDAY
3rd MONDAY

Prepared for employees by the
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April 7, 1980

Managers and Supervisors:

As you know, on March 19 the ICC rejected the three plans of reorganization for the Milwaukee which were before it: Trustee Ogilvie's, New Milwaukee Lines', and the stockholders'. The Commission found unacceptable to it the two plans designed to create an ongoing railroad of one or another configuration; it also found unacceptable the concept of total liquidation.

While on the one hand the Commission said many things about the plans, on the other hand it didn't really suggest with clarity how the reorganization process should proceed. It did of course leave the door open for the filing of new plans. Chiefly, the Commission seemed to be saying that neither plan for reorganizing the Milwaukee would create a railroad which would meet some new Commission standard for financial viability -- a standard which, ironically, the Commission has never applied before and one which, it could be argued, the Commission's own regulation of railroads has historically prevented railroads from attaining. It's not too much of an overstatement to say that we seem to find ourselves hung up on an abrupt change in the rules of the railroad-regulation game.

Whatever the reason for and meaning of the Commission's decision, its rejection of our plan really changed nothing for the short range. Some observers, who had confused the effort to create a financial plan for the Milwaukee with the effort to restructure it and reduce its operated mileage in order to preserve the assets of the estate, concluded in error that the ICC's action lifted the embargo and reversed the abandonments. It didn't. Apparently, some competing railroads and other detractors of our efforts concluded that the Commission's action shut off our funding. It didn't.

We still have an operating railroad -- a railroad which, not entirely by coincidence, looks very much like "Milwaukee II" -- and we still have much the same list of successes, goals and needs that we had before March 19. What we don't have, on the other hand, is a plan approved by the ICC by which we can pull everything together into an operation which will ultimately be profitable. But we do know what we're going to do to create such a plan, and we're certain that doing so is possible.

Not unexpectedly, immediately after the ICC's decision was announced the railroad's stockholders and its unsecured creditors moved to have Judge McMillen close down the railroad, because in their view there no longer remained a plan for its reorganization. Judge McMillen declined to do so on March 20. He pointed out that no decision had been made that the Milwaukee was not reorganizable. Several days later, in open court he said, with respect to the ICC's decision and analyses of it, "I don't agree with it, but nobody's asked me!"

Nonetheless, the Commission's decision brought two issues to the forefront: whether the Court could, in fact, continue the reorganization proceeding under the circumstances, and whether the FRA would continue to provide the short-term funds we need to get through to the day on which "Milwaukee II" can support itself. These questions became the subject of testimony and hearings on March 24 and March 27.

On March 24, Trustee Ogilvie reviewed for the Court the progress we've made in restructuring the Milwaukee and the benefits to the estate of our doing so. He indicated that he would make a thorough report to the Court on or before May 15 which "will provide guidelines for our efforts over the remainder of the year and an outline for another reorganization plan which will reflect actual experience with operating 'Milwaukee II.'" The new reorganization plan itself would come later, after perhaps six months' experience, said counsel John Rowe.

While further determinations will be reserved for the May report, Trustee Ogilvie's March 24 statement to the Court contained what it called a "manifesto for progress" for the Milwaukee -- a program which we shall follow while we seek to correct the deficiencies in our plan which the Commission found.

We intend to continue operating "Milwaukee II" using ERSA funds from the federal government, funds from the property-sale accounts, and earnings of Milwaukee Land Company. We'll continue to improve our service, equipment and physical plant, building on current successes and using 4R Act funds as they are made available. We'll market and sell aggressively, seeking commitments from shippers so that we'll have solid improvements to show in the May report. We'll continue the labor-protection settlement program, for which Trustee Ogilvie has finalized the $75 million in financing.

We shall thoroughly evaluate the physical configuration of "Milwaukee II" as the Commission deemed necessary. The results will be included in the May report. We'll cover the outcome of our study of the lines in northern Iowa, as well as a new demonstration of the importance of our Kansas City line as evidenced by the events associated with the Rock Island's demise. The FRA particularly wants to see these results, as well as new analyses of other lines.

We'll develop new forms of financial forecasts to show what "Milwaukee II" can do without the income of the Land Company. The ICC found it inappropriate for us to include the Land Company earnings in determining the viability of the reorganized railroad. But in our new statements we'll also show how "Milwaukee II" benefits if it isn't burdened with the debt of the present company -- something the Commission didn't work into its calculations. We'll confer with the governors of states affected by "Milwaukee II's" future to seek the firmest support for our efforts.

While we remain convinced that "Milwaukee II" can be reorganized as a self-supporting railroad, it's necessary, given both the ICC decision and the current position of the FRA, that we consider what we might do if it cannot be. Accordingly, Trustee Ogilvie indicated that while we shall continue the sale of non-"Milwaukee II" lines to others as we've been doing, we'll also explore whether all or most of "Milwaukee II" itself might be sold, as a package, to another railroad. While we believe that total liquidation of the estate's railroad assets is not in the best interests of the estate, we'll also look again at the question of liquidation.

On the issue of further funding, Finance Vice President Tom Power testified that we'll need $29.1 million in borrowings, under ERSA and from Land Company and property-sale sources, in April and May, plus the benefits to the cash position of the 4R Act equipment-rehabilitation programs in the form of repayment for inventory we've already bought. We'll need another $38 million for the balance of the year from June through December. After that, by our present projections, the operation of "Milwaukee II" should be self-sustaining from a cash standpoint. There are other essential cash needs, for rehabilitation and for funding the tender offer which would extinguish much of the railroad's debt, but we wouldn't need any more loans simply to keep the railroad going.

Judge McMillen had authorized the greater part of this borrowing for operating purposes on February 25, at the same time that he had ordered the partial embargo. Then, the FRA had indicated that it would provide up to $30 million in funds under ERSA on a fully subordinated basis, which means that the loans wouldn't displace the claims of the secured creditors. Judge McMillen had ordered the Trustee to accept the ERSA funds only on that basis. But on March 24, the FRA had a different view of what it could do.

The FRA's witness indicated that his agency, while supporting in general Trustee Ogilvie's plan for reviewing his options, could commit itself to ERSA funding only for 45 days and then only on a basis on which the government's claim would come ahead of all creditors' claims and even then only on a sharing basis with funds from the estate. While the FRA would go ahead with the 4R Act locomotive and car programs, it would hold off on the loan for improving the car building at Milwaukee Shops, and on the track-rehabilitation programs scheduled to begin soon, until after it had seen what the Trustee said in his May report.

It became clear in the course of the hearing that the FRA was being responsive to the influence of the Administration's Office of Management and Budget, and that OMB was tightening the credit programs of the government. Plainly, the FRA's position didn't have a great deal of longevity to it. When asked what plans the FRA has for the Milwaukee, the FRA's witness answered, in part:

"We believe there is a chance, reasonable chance, that there is a viable core within this three-state, essentially, traffic base from which the core has been designed.... It is a question of keeping the railroad in place, maintaining service in traffic levels and looking very carefully at what we see in 45 days."

There was a more positive side to the FRA's testimony, however. The witness said he'd expect the Trustee to show a stronger traffic base in his next report. He indicated that the FRA didn't agree with some of the ICC's conclusions about Trustee Ogilvie's reorganization plan. He said that the FRA was of the view that the ICC's test of viability might not be realistic. The FRA's own analysis of our reorganization plan earlier had been that it would properly serve all interests.

After hearing objections from creditors and further testimony in support of the Trustee's position, Judge McMillen on March 27 amended his order setting the priority of ERSA borrowings. He authorized the Trustee to obtain the loan -- up to $30 million under ERSA -- on the basis which the FRA now requires. In doing so, he pointed out that the ICC's decision on the plans of reorganization requires the Trustee to reorganize the railroad, and that the only way he can do so is to continue to borrow from the FRA.

The weeks between now and mid-May therefore become critical. The work is already under way to develop a strong statement in support of continued operations. In fact, the statement which will go to the court will, by John Rowe's characterization, be "two thirds of a reorganization plan." It will demonstrate that, through our BN agreement and its additional coal trains, through our assumption of Rock Island business worth many millions of dollars a year, through the continued improvement in our plant and equipment and for other reasons, the pessimists about the Milwaukee should take another look.

Placing all of this in perspective, we see just how far we've come in a little over two years of reorganization activity. We are, for all practical purposes, down to "Milwaukee II" and the benefits of the action are beginning to become evident. At the moment there doesn't seem to be any legislative or regulatory desire to turn us back down the road we've traveled so far. The ICC itself has supported virtually everything we've done to restructure the Milwaukee, as has the FRA. Not to diminish the significance of the event because it was very significant, but the ICC's rejection of our reorganization plan was the first real setback we've experienced in the course of doing many things which have never been done before.

It was Judge McMillen, on March 27, who said that just because the ICC rendered its opinion didn't mean that the Commission was right.

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