

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

August 4, 1980

To all Milwaukee Road employees:

In this regular issue of FM/TM, I would like to discuss Master Gray's recommendations to Judge McMillen on the future of the Milwaukee Road. In a special edition, which will be published simultaneously, I shall discuss Trustee Ogilvie's proposal for a deferred compensation program for all employees. As you shall see, the two issues are closely related.

As I indicated in FM/TM of July 7, once again we are before the Reorganization Court on the question of whether the Milwaukee should continue or be shut down and liquidated. This time, the question arose in early June, when representatives of the holders of most of the railroad's mortgage and debenture debt sought to prohibit further use of borrowed funds to meet future deficits and the railroad's stockholders asked for a hearing on the advisability of continuing the operations of the railroad. On July 8 and 9, for Judge McMillen, Master Gray held hearings on the question of whether there is a sufficient likelihood of a successful reorganization of the Milwaukee to justify continued use of the proceeds of property sales, the earnings of Milwaukee Land Company, and loans from the federal government which, under their terms, would be repaid before the claims of the mortgage-bond holders, debenture holders and stockholders.

Master Gray today recommended to Judge McMillen that Trustee Ogilvie be permitted to continue operations, but he attached certain conditions to his recommendation, and he phrased his recommendation in language which points up the importance of a contribution from employees toward the success of the reorganization effort.

In essence, whether or not the Milwaukee should be permitted to continue, or whether it should be compelled to shut down and liquidate, depends on the accuracy of the marketing and expense projections contained in Trustee Ogilvie's report to the Court of May 15. There is also the question of whether the reorganization which we believe to be possible is likely to be consistent with the public interest and is fair and equitable to the estate as required by the Bankruptcy Act. The mortgage trustees and stockholders challenged our numbers. They contended that even if the numbers were accurate "Milwaukee II" wouldn't be able to meet the criteria for a reorganization established by the ICC.

In his lengthy analysis of the law, the evidence and the arguments, Master Gray concluded that "a significant possibility of a successful reorganization exists, interim losses incurred to preserve that possibility will not be wasteful, and the sacrifices required of the estate will serve a useful purpose." He accepted our marketing and expense projections as being as accurate as they could be in the circumstances. He gave little weight to the expert testimony introduced in behalf of the creditors and stockholders.

But he went on to say, "The existence of a significant possibility of a successful reorganization does not, however, demonstrate that there will be such a reorganization, nor does it alleviate the necessity to reach a prompt and

definitive conclusion on that question. There is, in fact, substantial doubt with regard to the ultimate fate of 'Milwaukee II,' and this doubt must be resolved promptly to avoid dissipation of the estate.

"The sacrifices which may be required of the Milwaukee's estate are not infinite, and, in the circumstances presented here, are reaching their limit. The estate has suffered very substantial erosion in the form of cash deficits during 2-1/2 years of reorganization, and these cash deficits will apparently continue during the next several months. The ICC has already had one opportunity to consider the reorganizability of the Milwaukee, but failed to deal decisively with the ultimate issue before it -- the extent to which the Milwaukee's operations can and should be continued.

"The next several months must see a resolution of that issue. During these months the Trustee must demonstrate that the actual operating results of 'Milwaukee II' support the long-term validity of his projections, and that governmental entities, shippers, and employees will, in fact, supply funds essential to a successful reorganization. Unless such results and commitments are obtained, the 'Milwaukee II' experiment should be terminated."

Master Gray went on to point out the need to continue "Milwaukee II" for the remainder of 1980 to provide an operating history on which to base the decision to continue or to stop. He commented on the chain of events currently taking place "which will have an important bearing upon the chances for a successful reorganization," mentioning freight-rate increases, grants and loans from shippers and states, and potential equity investments by employees.

"Moreover the termination of operations outside 'Milwaukee II' on April 1, 1980, creates the possibility of a sale of all or most of the remaining lines to another railroad as a going concern, Master Gray said "The Trustee is actively considering such a sale which, if consummated, would provide benefits to the estate and the public which are not attainable through a forced liquidation. A decision having ramifications of the magnitude involved in the cessation of 'Milwaukee II's' operations should not be made upon the basis of speculation when the investment of a limited amount of additional time and money will provide more reliable information."

Master Gray recommended to Judge McMillen that the mortgageholders' petition to terminate our funding for future deficits be denied, subject to reconsideration if changing conditions warrant. He went on to make several additional recommendations, describing the need for them like this:

"Fairness to the estate requires that a definitive decision be made by the ICC (on a plan of reorganization) by May 1, 1981. To accomplish this result, the Trustee should be required to submit his reorganization plan to the ICC no later than January 15, 1981, and the ICC should be requested to consider the Trustee's reorganization plan on an expedited basis and make a determination by May 1, 1981. To protect the interests of the estate in the event a reorganization plan is not approved, the Trustee should be directed to file, if he has not already done so, an application of abandonment of all services currently being provided by the Milwaukee no later than January 15, 1981, and the ICC should be required to report to the Court on the application by May 1, 1981. The Department of

Transportation and other interested parties should be requested to cooperate with the ICC in developing contingency plans for an orderly cessation and liquidation of 'Milwaukee II' operations.

"During the next few months, the Court and the parties should be kept apprised of the progress of 'Milwaukee II' on a monthly basis. The Trustee should provide the Court and interested parties with monthly statements comparing the actual financial results of 'Milwaukee II' with the May 15 projections, providing a commodity-by-commodity comparison of projected and actual traffic, and stating the amount of the monthly cash deficit. These monthly statements should also include a summary of other developments which reflect upon reorganizability, and a statement of the Trustee's then current views on that question."

The Trustee concurs with most of these recommendations, although he intends to ask Judge McMillen to reject the recommendation concerning the filing of an abandonment application on the basis that the step is unnecessary given the embargo. I personally am concerned that taking this step would unduly alarm our shippers.

Judge McMillen is expected to rule in September on the issues covered by Master Gray's report. The emphasis which Master Gray places on employee participation in preserving the Milwaukee's operations is extremely significant. Trustee Ogilvie continues to stress that employee participation in an equitable manner, along with shipper, state and federal assistance, is vital to our success. I commend to your attention the special FM/TM now being published which outlines where we are with the wage-deferral program, and why we need it. Thank you.



W. L. Smith
President