# 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

February 4, 1980

Managers and Supervisors:

We've been asked, is there any way to tell what's going to happen March 1 -- and between now and then?

In part yes; in part no. There are several separate "dramas" being played out concurrently, nearly all of which will climax between now and March 1. Let's take them individually:

-- The reorganization process. Remember, the basic question isn't how much of the Milwaukee can survive bankruptcy, but whether any of it can. Something will survive if the ICC, the reorganization court, and those to whom the Milwaukee owes the huge amount that it does owe will ultimately accept a plan of reorganization to discharge these debts. If not, we liquidate as the Rock Island is doing. Our Trustee filed his proposed plan of reorganization last August and revised it February 1. S.O.R.E. and New Milwaukee Lines filed their plans in October. The railroad's stockholders filed a plan in January which calls for an immediate full embargo of service and complete liquidation.

The Milwaukee Railroad Restructuring Act didn't really address the question of reorganization so much as it gave New Milwaukee Lines additional time to try to install a scheme by which NewMil would acquire much of the Milwaukee. Under the Act, the process of considering the true plans of reorganization was put "on hold" until NewMil's so-called ESOP plan ran its course.

When the ICC rejected the NewMil acquisition plan December 31, the ICC returned to the task of considering the plans of reorganization which were on file or which would be filed. That's what the ICC is doing now, with the expectation that it will make a decision by March 1. When NewMil's acquisition plan was rejected by the ICC, NewMil amended its reorganization plan to pick up the basics of its acquisition plan. In the process, NewMil attempted to make it appear that the ICC was giving its ESOP plan a second chance, which it really wasn't.

As you can see, there's a lot of work yet to do to get a reorganization plan in place. Just the first step, the ICC's determination of which -- if any -- plan is feasible, is expected by March 1.

Under the Bankruptcy Act, the ICC may accept one of the four plans of reorganization, reject them all, choose one and amend it as it sees fit, or write a new plan of its own. If the ICC agrees to a plan, it'll certify that plan to the reorganization court. If the court concurs in the ICC's judgment, the plan then goes out for the approval of the various classes of claimants and creditors against the estate: bondholders, debentureholders, stockholders, prebankruptcy suppliers of goods and services, taxing authorities, employees to whom we owe back pay, the federal government for the funds we've borrowed to keep the railroad going and to rehabilitate it, etc. If the plan meets everyone's approval, it's put into effect by the court and the Trustee. If it isn't, either we start over and attempt to devise a new plan, we liquidate, or the court imposes a plan of its own.

Of interest, the Section of Rail Services Planning of the ICC's Office of Policy and Analysis has concluded that "the viability of 'Milwaukee II' as a reorganized railroad is achievable." In its report to the Commissioners, it says, "If the assumptions made by the Milwaukee and Milwaukee's anticipation of federal loans prove valid, we believe that 'Milwaukee II' has reasonable prospects of financial stability and success." As to the stockholders' plan, the study group said, "Because the potential for a financially viable rail system in the interest of the public exists and the creditors' claims are being addressed in the process, we do not view liquidation as a balanced conclusion." As to the NewMil plan, the ICC staff group concluded that "Its deficiencies and uncertainties make it impossible for us to recommend the NML plan as a viable reorganization plan for the Milwaukee Road."

-- The money question. We are operating the lines outside the reorganizable "Milwaukee II" core on federal dollars, and we have what we need to continue until February 29. But on that date the government funding for these lines expires. Beginning March 1, we shall have only what we can generate internally plus what we can borrow from Milwaukee Land Company, from the proceeds of property sales now in escrow with the mortgageholders, or under ERSA -- and in the past the FRA has said it won't lend us ERSA funds for non-"Milwaukee II" lines. Moreover, the Trustee is prohibited by the courts from spending outside "Milwaukee II" funds the borrowing of which would affect adversely the standing of creditors' claims. It would be argued that any of these borrowings would do just that. Hence, unless new financial arrangements are made by others, the Trustee has little alternative but to plan for an embargo of non-"Milwaukee II" lines effective March 1, or for the abandonment of these lines by that date with the court's approval.

Just what we must do on March 1, given the circumstances, is under active consideration now. Trustee Ogilvie is attempting to find ways to minimize the impact where states and others are themselves working toward a mutual solution -- as is the case, for example, in South Dakota, Wisconsin and Montana, and with prospective buyers of several individual lines and line segments.

On February 19, the court will hold hearings on the Trustee's application for authority to borrow up to $50 million to get "Milwaukee II" off and running beginning March 1.

-- The abandonment process. Take a look back at FM/TM of January 7. In it, I spelled out the process by which we are seeking the ICC's concurrence in the court's authority for the formal abandonment (or sale to others) of the non-"Milwaukee II" lines. The ICC has now recommended to the court that we be permitted to abandon all lines west of Miles City subject to certain conditions which the Commission would like to see the court impose. We are awaiting Master Gray's recommendation to Judge McMillen on the 18 cases covering 880 miles of uneconomic branch line in "Milwaukee II" territory. We've filed with the ICC our application to abandon the Terre Haute line and to obtain permanent operating authority over Conrail. We haven't yet filed the major application covering 1,573 miles of line in Iowa and South Dakota. The ICC soon will be making its recommendation to the court on the 328 miles of line in Wisconsin, Michigan, South Dakota and North Dakota.

In its report on the Pacific Coast Extension abandonment case, the ICC said, in part: "The presently structured Milwaukee can continue its operations west of Miles City only by incurring a massive rehabilitation outlay and significantly increased maintenance expenses, costs which would not be borne by anticipated revenue growth. . . . In the near term, the Trustee could be expected to

handle no more than about 200,000 carloads of traffic per year on the lines west of Miles City, and recovery to that level would represent a major accomplishment for the presently structured Milwaukee. . . . On an avoidable-cost basis, western operations have generated a positive cash flow, but that flow has declined significantly in the last three years. With a normalized maintenance program, cash generation would have been considerably lower, and considering the meager growth expectations, future flows would probably not exceed historic levels. . . . Continued operation of the lines west would require a massive rehabilitation investment, conservatively estimated at nearly $91 million. Such an expenditure would present an insuperable burden on the presently structured Milwaukee."

Leading up to the court's decision on whether to authorize the abandonment, Master Gray will hold hearings for Judge McMillen on February 11. The propriety of the ICC's suggested conditions, which concern the level of labor protection and the timing of the actual abandonment and dismantling of the line, will be argued during the hearing.

-- Dividing up the Rock Island -- and our noncore. Directed service on the Rock Island ends March 2. The FRA has initiated a "401" process through which it is identifying which railroads are interested in acquiring portions of the Rock Island. Concurrently, it's determining which railroads are interested in acquiring parts of the Milwaukee outside "Milwaukee II." There have been about 17 responses to each question, although few of the new "bids" are firm or detailed enough to constitute offers which the Trustees can accept or reject on their face.

As to the Milwaukee, in virtually every instance we were already aware of the interest of the "bidders": Port of Pend Oreille; Seattle & North Coast; Union Pacific; Burlington Northern; States of South Dakota, Wisconsin and Montana; Escanaba & Lake Superior; Potlatch; Weyerhaeuser; a few others. We've already announced what we can say about each, except for Montana. Trustee Ogilvie has agreed to sell to the state, for $55 million, all lines between Miles City and Marengo provided the state is assured of the financing by March 1.

We've indicated to the FRA our interests in the Rock Island. We desire to solidify our Kansas City line by acquiring West Davenport to Culver and Polo to Birmingham, where we presently run jointly with the Rock Island. We'd like Seymour to Allerton so that we could get to the rehabilitated Twin Cities-Kansas City route which the FRA is planning, and in which we're interested. If this multiple-use corridor comes about, we would be interested in some of the Rock's northern Iowa grain branches. We want to take over the Rock south of Muscatine as far as the new power plant at Fruitland. The DRI&NW, of which we own half, is seeking to acquire Rock Island industry service in the Quad Cities.

Precisely how the FRA will sort out the various offers and what it plans to do to continue service where service needs to be performed isn't yet clear to us. The Rock Island's Trustee is aware of our interests.

In order to answer some of the other current questions, I'll be writing you within a matter of days in an FM/TM Special.

W. L. Smith
President