

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

January 21, 1980

Managers and Supervisors:

In my letter of January 7, I suggested that we would see further evidence that other railroads and other parties were interested in acquiring parts of the Milwaukee which we cannot continue to support, once the ICC had rejected New Milwaukee Lines' financially unsound plan. Since then, several such events have indeed occurred. We're finding that the process of restructuring the Milwaukee is making history.

For example, two states are moving to acquire some of our lines. The states don't want to get into the railroad business in terms of being rail operators themselves, but they deem it essential that they acquire certain lines and then find other railroads or private operators to run them. The states are South Dakota and Wisconsin. Their objective is the same, but their approaches have different facets.

South Dakota divides its rail network into two parts. Our main line between the Twin Cities and Miles City constitutes one part, essential to the state because it provides a westward outlet for agricultural products and access to North Dakota and Montana coal fields. The balance of the state's rail system is the other part -- a network upon which the state's agriculturally oriented economy literally depends. Many of our lines south of Aberdeen form the core of this system.

We've agreed to operate the Twin Cities-Miles City line, to keep it as part of "Milwaukee II," in return for rehabilitation assistance which South Dakota and some of the other affected states are finding for us: \$2.3 million already provided and more expected to come. The rest of our lines are not self-supportable considering the amount of expensive rehabilitation which needs to be done. Neither we nor any other railroad operating in South Dakota could afford to continue these lines unaided.

South Dakota is establishing a state authority which has the power, and the funds, to buy the lines which must be retained, and then contract with railroads or others to operate them. Bills to create the necessary machinery in state government were introduced in the Legislature last week by Governor Janklow. We are going to be extremely interested in, and supportive of, Governor Janklow's efforts. The Governor himself has indicated that there isn't any other way in which the state can preserve the rail lines it needs.

Under Governor Janklow's plan, the state's rail lines are divided into several categories. The state's Division of Railroads figures that 1,537 of the state's 2,729 miles of operating railroad will survive into 1981 even though roughly a third of this mileage isn't sufficiently productive to survive an abandonment test. There's a "core" of lines in the state, some 429 miles, which is essential to the state rail network. In addition, there are some 825 miles of "local-option" lines which may be considered critical to local users in that they provide access to the state system.

Our lines from Aberdeen through Mitchell and Yankton to Sioux City, from Chamberlain through Mitchell to Canton, and from Canton to Sioux Falls form

the "core" which the state believes must be preserved. The Linton, Brampton and Platte branches in South Dakota, and the line segments between Chamberlain and Kadoka, Elk Point and Canton, Sioux Falls and Dell Rapids, and Wentworth and Madison are regarded by the state as "local-option" lines. In addition, Governor Janklow added these lines to the "local-option" category in the belief that users of any present line should have the opportunity for a "local-option" program: the South Dakota segment of the Edgeley line and the line segments between Madison and Bryant; Wentworth, Egan and the border; Egan and Dell Rapids; and Kadoka and Rapid City. Thus the state program, along with ours, covers our entire present mileage in South Dakota.

If the bills are passed, the state will purchase the "core" lines, rehabilitate them and lease them to an existing railroad company for operation under contract. If regional railroad authorities request, the state will buy "local-option" lines for them. Funds for the purchases will come from motor-fuel tax revenues which are now being refunded to agricultural users, from a tax on commodities produced in the state which generate a transportation need, and from general state funds.

Under the Janklow plan, the state would cover the shortfall of revenues of the "core" lines from the same sources. Regional authorities would lease their lines from the state and would be responsible for all costs of operation, including maintenance. Regional authorities could operate their lines themselves, contract with the operator of the state core lines, or contract with another operator.

Another facet of the Janklow plan provides for track rehabilitation on the state-owned core system and the acquisition of rolling stock essential to the movement of South Dakota's products. Using federal matching funds made available by the 4R Act, the state would rehabilitate its "core" lines. Using the tax on commodities which generate a transportation need, the state would buy freight cars which it would make available to shippers on a user-fee basis.

There are sizable amounts of money involved in the South Dakota program. Governor Janklow has requested the authority to issue \$33 million in bonds, \$25 million with which to buy rail lines and \$8 million with which to buy 160 grain hoppers. In fiscal-year 1981, the South Dakota Railroad Service Fund for the purchase, maintenance and operation of rail lines would require a total of \$6.7 million, not including the revenues generated by the rail lines themselves. The South Dakota Railroad Improvement Program for track rehabilitation and rolling-stock acquisition would require \$7.3 million in funds in fiscal 1981.

In Wisconsin, the state's plan contemplates state ownership, and contracted operation, of 378 miles of Milwaukee Road branch lines. It also contemplates the state's use of its "quick-take" powers of condemnation to acquire the lines and place their operations in the hands of contractors as quickly as possible.

Trustee Ogilvie and the Wisconsin Department of Transportation reached an agreement on this method, which materially reduces the time and expense of making the transfer, last week. Judge McMillen approved the agreement today, commending both the Trustee and the state for their work.

The lines which Wisconsin will acquire fall into two categories in terms of their progress through the statutory abandonment process. About 158 miles of line are already before the court for abandonment under the procedures revised

by the Milwaukee Railroad Restructuring Act. Master Gray held a hearing on these lines January 16. The court's decision is expected in February. Another 220 miles of line aren't yet before the court and some of them aren't yet before the ICC.

In the first category are these Wisconsin lines: Sparta to Viroqua, Monroe to Mineral Point, Milton Junction to Waukesha, Tomahawk to Heafford Junction, Walworth to Avalon, and Ripon Junction to Oshkosh. In the second are the lines from Durand to Eau Claire, Avalon to Janesville, Janesville to Monroe, North Milwaukee to Horicon, Horicon to Ripon, Horicon to Cambria, Granville to Menomonee Falls, Brandon to Markesan, and Iron Ridge to Fond du Lac.

Under the procedure which is now under way, the state will condemn these properties, make condemnation awards of cash to the Trustee for them and take title to and possession of them at that time. Later, in Judge McMillen's court, the fair market value of the properties will be established and any amount greater than the condemnation awards will be paid by the state.

The lines which are already before the court should be in the hands of the state in February if Judge McMillen approves their abandonment. Judge McMillen has already determined that the lines yet to come before him almost certainly would be approved for abandonment. A key factor here is that the state has agreed not to oppose their abandonment. These lines should go to the state in March.

In the meantime, the Trustee won't abandon any of the lines which are already before the court, and except for the Janesville-Monroe line he's agreed to operate the lines which aren't yet before the court until late June or early July. The specific dates to which he's agreed to operate the lines are tied to the dates on which the state will make its condemnation awards specified in the agreement, and also to the fact that the ICC must approve the state's ownership of the lines. An operator appears to be available for the line from Janesville to Mineral Point.

We'd come quite some distance in our reorganization with Wisconsin over the transfer to state ownership of lines which the state deems important, but we were still disagreeing over price. That obstacle is now removed.

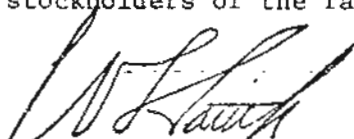
Meantime, we are moving closer to final agreements with Burlington Northern, Union Pacific and others over their acquisition of portions of the Pacific Coast Extension. Everyone has his eye on the calendar: After March 1, we cannot use funds generated by our own operations outside "Milwaukee II."

As you know, "Milwaukee II" is getting stronger all the time, thanks to the rehabilitation-funding provisions of the 4R Act. Judge McMillen approved the Trustee's application for a total of \$65.2 million in rehabilitation work on January 16. The work will begin as quickly as possible: upgrading the New Lisbon-Wausau line to handle the unit coal train which will begin moving in 1981; upgrading 42 track-miles of the Chicago-Milwaukee main line; rehabilitating 87 locomotives, 1,202 freight cars, 43 cabooses and the maintenance machinery needed for the track projects; renovating the heating system in and insulating CD-50, the major car-shop building at Milwaukee Shops.

Judge McMillen's opinion on the rehabilitation funding contained a paragraph which bears repeating. He had indicated that he was overruling the objections of the principal creditors: "In our opinion a reorganization of physical facilities based on the core proposed in the Trustee's reorganization plan is

possible. An available way is to test this out by permitting the railroad to operate the core under reasonably favorable conditions, even though this puts the stockholders and creditors to the business risk that their investment will erode. This is the type of risk which is taken by any investor and is fully justified so long as there is a reasonable possibility that the operation can become self-sustaining and the funds are not squandered or unnecessarily expended."

A word about the reorganization plan: We are now in the process of updating our plan, principally from a financial standpoint. Our revisions will go to the ICC soon. So will our comments on the other plans which have been filed with the Commission, of which there are now three: SORE's plan of last October; New Milwaukee Line's new plan which followed the rejection of its employee-shipper ownership proposal by the Commission; and a document filed by the stockholders of the railroad calling for the railroad's complete liquidation.



W. L. Smith
President

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

306 001140
TERMINAL MANAGER
THE MILWAUKEE ROAD
MILWAUKEE