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

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To all Milwaukee Road employees:

With this issue, FM/TM becomes a publication designed to report and interpret current events for all active Milwaukee Road employees. We are expanding the distribution at the request of the Labor-Management Action Group, to which the suggestion that we do so was made by a number of individual employees.

Using information on file with the Payroll Accounting Department, FM/TM will be mailed direct to your current home address. If you don't receive a copy, please check to see that our records on where you live are up to date.

Tomorrow, hearings begin before Master Milton Gray, for Judge McMillen, on the Trustee's report to the Reorganization Court of last May 15.

As you recall, this report indicates that "Milwaukee II" stands a chance of becoming profitable beginning in 1983. Financial reorganization of "Milwaukee II" as a going concern is preferable to liquidation, the report says, although even greater benefits for all concerned might come from selling "Milwaukee II" as a package to another railroad. The 3,500 route-miles of "Milwaukee II" are essentially what we should be operating. A new plan of reorganization which would satisfy the objections of the ICC will be filed early next year.

Not unexpectedly, the Trustee's report is under fire from certain quarters. For example, attorneys for the railroad's stockholders and for its general mortgage holders intend to introduce testimony which will contend that "Milwaukee II" can't be reorganized based on the Trustee's report. Some of this testimony contends that the May 15 report is merely a more optimistic version of the reorganization plan which the ICC rejected last March partly because it regarded the plan as too optimistic.

Trustee Ogilvie will support our position thus far: that "Milwaukee II" can become a viable railroad and that such an outcome is in the best interest of the estate. But, he testifies, a thorough review of our prospects undertaken since the ICC's decision shows that "a successful reorganization must have strong financial support from the federal and state governments, shippers, and the Milwaukee's employees. Without the contributions of each of these parties, the reorganization will likely fail."

On whether the May 15 report is too optimistic, the Trustee points out that here, for the first time, we've had the opportunity to do a shipper-by-shipper marketing study of traffic which we can attract through "Milwaukee II's" improved service, improved equipment supply, and more tightly focused marketing effort.

The marketing study contained in the May 15 report is supported by testimony from Mike Coomes, Assistant Vice President, Market Development and Pricing. The financial aspects of the report are supported by testimony from Tom Power, Vice President, Finance, and by John S. Guest, a Managing Director of the investment banking firm of Lehman Brothers Kuhn Loeb, Inc. From outside our own officer ranks, Mr. Guest takes the view that "the Trustee is likely to be able to create a surviving railroad which is viable."

There will be other witnesses. The hearings are expected to consume Tuesday and Wednesday at least. Judge McMillen will receive a report and recommendations from Master Gray. The Judge has indicated that he expects to rule on the issues raised by those opposing the Trustee's position -- in effect, on whether the Milwaukee can remain in operation and out of liquidation -- around the end of July.

On June 2, the judge in the Rock Island bankruptcy case ordered the complete abandonment of all Rock Island operations. He held that the Rock Island estate was not to be burdened with labor-protection obligations. His order has, in effect, been upheld by the U.S. Supreme Court.

As we indicated in a "To All Concerned" message on July 1, the Supreme Court's action didn't directly affect our labor-protection activities. Still, the decision does have important implications for the Milwaukee, as a letter from John Rowe, Counsel to the Trustee, has advised Larry Harrington, Vice President, Administration:

"First, the decision strongly indicates that if we are not successful in preserving at least some of the Milwaukee's operations there will be no labor-protection money beyond the \$75 million already authorized. Second, since the \$75 million presently being authorized for Milwaukee Road employees has been appealed, a final ruling in the Rock Island case in accordance with Justice Stevens' views would even jeopardize the funds presently available.

"The Trustee believes that this decision reinforces the need for each and every employee to redouble his efforts toward improving the railroad's profitability. Moreover, the decision underscores the importance of successfully implementing some type of wage-deferral program. In such a program, individuals whose wages are deferred would have claims for stock in a reorganized company under certain circumstances. We are discussing such a program with the Labor-Management Action Group and members of the General Chairmen's Association and expect to submit such a program in the very near future."

You'll recall that the Milwaukee Railroad Restructuring Act requires the Trustee to make a good-faith effort to design some form of employee stock-ownership plan as part of the reorganization process. The financial realities of reorganization dictate that we must find a way to reduce operating expenses below what they normally would be, a fact which has been acknowledged by Judge McMillen. With payroll expenses consuming around 56% of revenues, it follows that a relatively small reduction in payroll expense could greatly benefit the Milwaukee's ability to survive.

With these facts in mind, the Trustee and the General Chairmen who are on the Labor-Management Action Group are moving toward the approval of a deferred-compensation plan which should go to the Reorganization Court for approval soon. If the Court approves the plan and it is ratified as necessary by the various labor unions, the plan will be offered to all employees effective next year.

This is how the deferred-compensation plan would work: All employees represented by unions would be asked to defer payment of 7% of their wages during 1981, 1982 and 1983. All exempt employees would be asked to defer payment of 7% of their

salaries up to \$35,000 per year and 10% of their salaries above \$35,000 per year during the same period. If the Milwaukee is reorganized successfully, participating employees would receive preferred or preference stock in the new company in an amount equal to 1.3 times their deferred 1981 wages, 1.2 times their deferred 1982 wages, and 1.1 times their deferred 1983 wages. If "Milwaukee II" is sold to another railroad, participating employees' claims for deferred wages would be treated as a cost of administration of the estate, the highest priority for payment of claims. If the Milwaukee is liquidated and its operations sold piecemeal, all deferred claims would have a priority for payment greater than those of existing common stockholders but less than those of existing preferred stockholders. The deferred wages should not be taxable income to employees until payment is received by the employees at the time of the successful reorganization, sale or liquidation of the railroad.

It is anticipated that the stock would be paid either directly to participating employees or into an Employee Stock Ownership Trust. The Trust would take the form of a stock bonus plan or, if the law permits, an Employee Stock Ownership Plan. Contributions to and distributions from such a plan probably would receive favorable tax treatment. The stock which would be issued under this proposal would pay dividends at a fixed rate of not less than 5% per year before any dividends are paid on common stock. Provision would be made for additional dividends of up to 3% per year out of other income available for dividends on a pro-rata basis with common stock.

Participating employees who currently have claims for back pay would be able to exchange their claims for stock at twice the value of their claims.

The deferred-compensation plan wouldn't put an end to wage and salary increases. It would merely defer payment of the indicated percentages of whatever wages and salaries are earned. If the Trustee determines that nearly all unionized employees have agreed to participate in the program, he shall require the participation of all non-union employees. Thereafter, and as long as the program is in effect, management employees as a class would receive percentage wage increases not greater than those received by unionized employees who are participating in the program.

The proposed plan contains other provisions, but these are the major aspects. This description isn't designed as a proposal to employees concerning the plan, which has yet to pass several stages of review and approval. In three years, the plan should reduce salary expenditures by approximately \$49 million. If the Reorganization Court approves, Trustee Ogilvie would agree to spend this amount to rehabilitate the Kansas City and Wisconsin Valley lines, to rehabilitate equipment, and to make other improvements which otherwise wouldn't be possible.


W. L. Smith
President