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In a series of recent meetings with general and local chairmen of the BLE and UTU at various locations, Mr. T. F. Power, Jr., Vice President-Finance has focused on some of the problems facing the Milwaukee Road in its reorganization efforts.

Because his message is so timely and important it is felt all employees will benefit from sharing the financial facts Tom has used in his discussions. In his introductory remarks, he said:

The survival of the Milwaukee Road as a viable transportation company clearly depends on the inter-relationship of all employees of the company. The historical adversary relationship of management versus labor must be resolved if the Railroad is to succeed in the future. The reorganization of MR clearly centers around one issue and that is preservation of "jobs". I have reached this conclusion after analyzing the situation as it has developed over the last 3-1/2 years. The reorganization process deals with four major interest groups: (a) shippers, (b) creditors, (c) government/political environment and (d) jobs.

The shippers located on the reduced MR will be adequately served even if this Railroad ceases operations. Most major pockets of traffic are served either directly or by close proximity to another rail carrier. The experience of the west end clearly indicated that with the breaking up of the main line through Montana and Washington, the cluster of traffic is now being served by other carriers such as UP, BN, etc. with modest acquisitions by those carriers.

The position of the creditors of the Railroad has significantly improved over the past year and a half due to the successful sale of Land Company and Railroad properties. Reorganization or not, the creditors have a substantial pool of liquid assets to look to for payment of claims.

The concerns of government entities can be satisfied by assuring that vital services are performed by other carriers through sales or directed service type operations. The Federal government as a junior creditor will be satisfied along with the other creditors on a financial basis.

These are some of my reasons why the main concern of the reorganization is the preservation of the jobs that will be necessary for a viable operation. So the employees have the most at risk when addressing whether the Milwaukee succeeds or not. That is why labor and management must cooperate in putting together a structure which preserves the amount of jobs required for the future.

#### Where Have We Come and Where Are We Going

The size of the Railroad in the employment levels at various time intervals is shown below:

<u>Date</u>	<u>Route Miles</u>	<u>Employees</u>
12/31/79	9,500	10,200
12/31/80	4,200	7,300
05/31/81	3,900	7,600
1982 and beyond	2,900	5,800 (Estimated)

The above data clearly indicates that we have taken the physical restructuring, i.e., route miles, to as far as we can go. The employment levels at the present time reflect an inefficient operation. The reduction of the last 1,000 route miles (all lines West of Ortonville, MN and Central Wisconsin lines) will result in approximately 500 less jobs. This would indicate that there are at least 1,300 additional jobs which will have to be removed in order to reach for viability. The essence of this is that with a small railroad, preservation of approximately 5,800 jobs is the key to the reorganization. The reduced Milwaukee network represents a very compact system with a relatively high potential traffic density. It will not be burdened with uneconomic light density branch lines which tend to drag systems down.

#### Operating Results

The Milwaukee Road last reported a profit in 1974. The losses over the last few years have been staggering:

<u>Year</u>	<u>Losses (millions)</u>
1978	\$ 65
1979	105
1980	206

In 1980 the results of Milwaukee II and its nine months of operation indicated a \$63 million loss. It has been estimated that in 1981, Milwaukee II will lose approximately \$61 million. During the first six months of 1981 Milwaukee II lost approximately \$39 million. The Trustees have borrowed almost 1/4 billion dollars since 1978 in order to continue the movement towards a reorganization. Of the 1/4 billion dollars, about \$140 million was borrowed between April 1980 and the end of May 1981. Clearly the Trustees have made a substantial commitment to the shippers, government agencies and employees to continue the operation of the Railroad in search of viability. As you can imagine, the creditors view these borrowings as not only excessive but wasteful. The financial results included in the reorganization plan will depend to a large degree on the participation of the employees as the creditors, government agencies and shippers have made substantial commitments to this point.

#### Specific Comments About the First Six Months of 1981 Operations

It is unfortunate that the critical period of this reorganization process is at hand. There are those that say it is too bad that you have to reorganize in such dire recessionary economic conditions. But there is no escaping reality as we have very little impact on what is happening in the world and U. S. economy. Over the first six months revenue carloads and COFC/TOFC units have fallen short of our projections by almost 7%. This results in about \$19 million less operating revenues but stringent cost controls have been in effect which have produced expense savings of about \$16 million. We have fallen short on our bottom line projected results by almost \$3 million. This track record will not work in our favor as we approach the reorganization plan with its inherent projections of revenues and expenses for future years. The softening in grain markets has had the largest impact on our revenue shortfalls but we are anticipating a rebound in grain beginning in August and continuing through the balance of the year.

#### Cash Availability

Our source of cash to continue to run the operation and make facility improvements comes via court approval of escrowed funds that have built up from property sales. The court has approved for 1981 \$60 million for operations and an additional \$11 million for specific track projects. As of the 1st of July,

we have used about \$41 million of the operating cash and had not drawn down any project money. The Railroad's cash position could be on a very lean basis for the balance of the year. It has been estimated that with the resurgence of grain in August, sufficient cash flows should be generated to carry the Railroad through the end of the year without additional court authority for more funds.

#### Wage Deferrals

About 85% of the present employees participate in the 7% wage deferral in effect during 1981. In the last five months of 1980, the 10% deferral generated about \$7.3 million in capital and was used for various maintenance projects on the Railroad. In the first six months of 1981 approximately \$6 million has been generated for additional maintenance projects. Without this employee participation, maintenance of way and maintenance of equipment budgets would have been reduced and the physical improvements would have been deferred.

#### FRA Support

The Federal government through the 4-R Act has contributed substantially over the last three years to the rehabilitation of plant and equipment. About \$82 million has been provided for these purposes. We had anticipated approximately \$21 million of Federal funding during 1981 but it now appears that only \$4 million will be provided. The future participation by the FRA is expected to be nil. The message from Washington is that Milwaukee has been helped as much as it can and will have to do it on its own in the future. The Trustee asked the court and received authority to borrow \$11 million of escrowed funds this year in order to complete two major projects, i.e., Wisconsin Valley Line and Chicago-Milwaukee, which the FRA would not fund. The FRA also provides funds to support the labor protection program and we are currently authorized a total of \$75 million. Through July 1981 we have borrowed approximately \$37 million for separated employees. The anticipated additional restructuring will necessitate further use of these loans in order to minimize the impact of the severed employees. The Trustee is borrowing these funds in the range of 13-14% interest per year.

#### RTA

As of July 1, 1981 the Trustee has severed his operating agreement with RTA and is now operating under Illinois Commerce Commission direction. Fare increases of 75% were put into

effect in order to compensate the company for this operation. The RTA currently owes the Milwaukee about \$2 million, plus accrued interest, and the Railroad is attempting to collect these past due amounts by legal means if necessary.

#### Amtrak

Since the first of this year Amtrak has not been fully reimbursing the Milwaukee for its expenses incurred under its contract with the Milwaukee. Amtrak has taken the position that the amount of expense generated by the wage deferral program should not be reimbursed. In the first six months of this year the Milwaukee has been shorted about \$165,000. The Trustee has initiated a suit in order to recover the funds. The wage deferral funds are being used to rebuild the Railroad, and Amtrak is not reimbursing the Milwaukee and its employees for this rehabilitation.

#### Merger Activities

The UP/MOP merger will have a small impact on the Milwaukee. It has been estimated that about \$1-2 million a year in revenues may be lost when this merger takes place; however, we feel that the ICC will require UP/MOP to allow the Milwaukee to have direct interchange services with all other carriers in Kansas City, including DRGW which is petitioning for trackage rights over the UP and KC.

The Southern/N&W merger could have significant impact on this company. At Louisville the Southern Railway is our primary connection. Since the Southern would gain direct access to Chicago through the merger, the Milwaukee could stand to lose \$5 million plus per year in revenues; however, the Southern has agreed to maintain our rates and routes that are presently in place via Louisville in the future. They have also agreed that our current interchange arrangement through the KIT RR will be maintained.

#### Major Problems

While future market opportunities indicate some growth potential in traffic, the size of the labor force and current agreements may possibly preclude reorganizability because the Milwaukee at the present time lacks sufficient density to sustain itself.

In 1980 the Milwaukee paid out 61¢ of every revenue dollar for wages and fringes. As a comparison some other railroads in the same period paid out the following wages and fringes for every revenue dollar: Conrail 56¢; ICG 52¢; CNW 50¢; BN 46¢; Soo 43¢; UP 41¢ and SOU 40¢.

As traffic levels rise for the Milwaukee the labor expense proportionately will drop. For every 10% increase in revenues the labor proportion will only drop about 6%; assuming, of course, that no additional labor is needed to handle the 10% increase in business. Clearly we must find more productivity from our labor force and from the use of our capital assets, particularly locomotives and freight cars.

The reduction in labor related expenses, both union and management, can only occur by reducing the size of the labor force while handling higher volumes in the future. Work rules that have been developed over the past century must be reviewed and changed to reflect the economic reality of the 1980's. It is far better to have 5,800 productive compensated employees than to have over 7,000 employees in the unemployed ranks. In the adjustment of the work force in the future, it is clearly understood that management will also be a part of the reduction in the labor force. This management reduction could be in the neighborhood of 200 positions. The main concern from management should be focused not so much on the number but on the quality. This will involve the hiring of very competent people and extensive training of the present management. It will necessarily involve the development for future leadership which implies risk takers.

The ICC staff in late 1980 pinpointed many areas which they felt the Milwaukee will have to address before a plan of reorganization could be approved. They felt that in order to gain a 11-12% return on investment, significant productivity gains would be necessary in capital and in labor.

#### Reorganization Plan

On September 15 of this year the Trustee will file with the court and the ICC his plan for the future. The plan will outline a five-year business strategy and will also deal with the financial settlement of the various creditor groups. The business plan will focus on the reduced system and address such things as: revenue generating ability, operating performance, rehabilitation requirements, financing needs, fleet sizing, capital investments, and work force size. The results of the

business plan will set the tone of reorganization in that the needs of the various parties in the proceeding will be satisfied. A successful plan must be based on economic viability in the shortest period of time possible. If losses of the magnitude experienced in the last two years are projected, there will be no possible reorganization.

### LMAG

Initiation of the LMAG program is a major step in melding together all employees in the company. It has been a successful concept and should be continued in the future as a primary communication device. Only through the mutual support of labor and management can there be any hope of survival in the future.

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