

November 23, 1981

You should be aware that I have advised the Reorganization Court that up to \$60 million, in addition to the normal revenues of the railroad, will be required in order to continue to maintain and operate the Milwaukee Road through 1983.

Judge McMillen has set a hearing for November 30 on my request to borrow up to that amount from escrowed proceeds of sales and personal property as needed to fund capital improvements and continued operations of the Milwaukee Road. I want to share with you my testimony to the court in support of that request:

"There have been significant developments in three areas since I last appeared before this court in connection with a borrowing. The first, obviously, is my Revised Plan of Reorganization filed with this Court September 15, 1981. This plan contemplates the continued existence of a 2,900 mile railroad. The second is the experience of operating the Milwaukee II system in a time of economic distress. The third is the discussions which I have begun with Grand Trunk Corporation regarding the possible integration of Milwaukee rail operations with the Grand Trunk.

1. On September 15, 1981, I filed with this Court, my Revised Plan of Reorganization. This plan of reorganization provides for the fair and equitable settlement of all claims against the estate and shows that a 2,900 mile Milwaukee system has the potential for an income-based reorganization as an operating railroad. It has been transmitted to the Interstate Commerce Commission for consideration. The Plan was produced by my staff. I reviewed it and considered it before allowing it to be filed with this Court. The reorganized railroad operations part of the Revised Plan is based on the Five-Year Corporate Plan prepared under the supervision and direction of an outside consultant, Mr. Paul Johnson. I directed Mr. Johnson to undertake a ground-up study of the prospects for profitability of an operating railroad. Neither the study nor the reorganization planning were undertaken with the preconception that reorganization of a sufficiently profitable operating railroad was the necessary outcome, although I have kept the public interest in continued rail service firmly in mind. Neither is reorganization a foregone conclusion at this point. The Milwaukee is, at the moment, doing reasonably well compared to other railroads but is not doing well as a business. I am pleased with the efforts of my staff to maintain revenues and control costs under current conditions. Those efforts have kept the likelihood of an operating reorganization alive under difficult conditions. However, the estate has already lost a large amount of money from railroad operations during the course of this reorganization and we project additional losses prior to profitability. But, if railroad operations do not progress substantially in accordance with the Revised Plan and current levels of losses continue unabated, I would soon have to recommend liquidation to this Court. Moreover, the Revised Plan identifies specific hurdles to be overcome. For example, if the employees do not agree to contributions such as the wage reduction and the reduction of crews, no operating reorganization will be possible and I will recommend liquidation.

At this time, however, I see improvements being made in the areas which are under the Milwaukee's control and am of the opinion that there is still a

substantial likelihood of reorganization. I have not come to that conclusion easily or lightly. I have come to it only after careful consideration of the railroad's prospects for the future and its ability to weather the current recession and adverse market conditions.

With regard to the labor contributions, I have been in contact, with the help of William Usery, former Secretary of Labor, with the national leadership of railroad labor. My staff has held a series of twenty or more in-depth informational meetings at locations throughout the Milwaukee system with the rank and file. These sessions were well attended. We estimate that over 2,000 employees participated. Full and frank discussions were had and the meetings generally ran over four hours. Overall, we have found the leadership and rank and file understanding and constructive. I am encouraged by and appreciative of the positive response we have received. Of course, without the wage deferral previously agreed to with the employees, it is unlikely that the railroad would be operating today.

My Revised Plan shows that after use of \$60 million of escrowed funds to continue operations until the railroad can become self-sustaining the estate will still have sufficient assets to pay off all existing claims. Thus, this borrowing preserves the public interest in continued rail operations without harming the creditors.

Approval of borrowings is necessary for continued operations. At minimum, this will allow the Interstate Commerce Commission and the Reorganization Court an opportunity to consider my Revised Plan, as well as modifications to it which may be submitted. More basically, it is necessary to keep alive the railroad's chances of becoming profitable.

2. There are a number of positive achievements in 1981 which help me reach my conclusion that the Milwaukee is reorganizable. The most disappointing aspect of 1981 results, of course, has been the failure of the economy and the grain and coal markets to function as expected, causing a shortfall in projected revenue. Faced with these unexpectedly adverse conditions, the Milwaukee has shown effective management ability in adjusting its expenses to its revenues, without sacrificing its ambitious but necessary track and equipment rehabilitation programs. Notwithstanding these problems the Milwaukee has maintained a competitive position vis-a-vis other rail carriers. My Marketing Department has also managed to maintain volume by penetrating markets for other commodities. These gains will enhance the performance of Milwaukee II when grain and coal begin to move. In short, the Milwaukee is doing well in those areas which are under its control.

Specific projects being undertaken now will yield expense savings in years to come. The elimination of deferred maintenance results in lowered maintenance costs in the future as well as reducing labor, fuel, and casualty costs and improving service. The reopening of the Marquette-River Junction Line has reduced transit times and mileage between St. Paul and Kansas City. The Shop at Savanna, Illinois and the hump yard at Milwaukee, Wisconsin are being eliminated. These actions yield annual labor and maintenance savings as well as reducing the amount of capital invested in the rail assets. Many other operating improvements which will improve efficiency and lower costs are also being studied or implemented.

Finally, it is worth pointing out that on a consolidated basis, the estate has out-performed projections. The estate has benefitted from the success of the sales of Milwaukee Land Company Timber Property, the tender offer for First Mortgage Bonds, the \$15 million sale of tax benefits and the prepayment of federal loans at beneficial discount rates. The single adverse circumstance is the continuing drain on the estate's assets necessitated to reach profitability in 1983.

3. I have repeatedly said that the most desirable outcome for this proceeding would be the acquisition of Milwaukee II by another carrier for continued rail operations. Now, for the first time, there are serious discussions being conducted concerning the possibility of such a sale. I am unable to report to the Court any details of those discussions but I can assure the Court and the estate's creditors that the discussions are being pursued diligently and expeditiously. If there is a transaction that can be effected between the Grand Trunk Corporation and the Milwaukee that is in the best interests of the estate and is acceptable to the GTC, we will propose that to the Court. It is, of course, too early to predict what the outcome will be.

Beginning Sunday, November 8, 1981 in Duluth, my principal officers and I met with the chief officials of the Grand Trunk Corporation and proceeded with a week-long inspection of the Milwaukee system through Ottumwa, Iowa. Enroute stops were made to inspect the shop facilities and meetings and dinners were held with the Secretaries of the Iowa, Illinois, Wisconsin, Minnesota and South Dakota transportation agencies and certain shipper and community representatives. The expression of support for both the September 15, 1981 reorganization plan and the prospects of a Milwaukee-Grand Trunk Corporation integration was unanimous. Approval of the requested borrowings is absolutely essential to preserve the prospects for acquisition of Milwaukee Road rail assets by the Grand Trunk Corporation or any other carrier and full realization of the values for those assets by the estate.

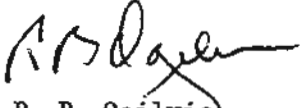
While there is much left to be done to achieve a successful reorganization and while much of that left is difficult and uncertain, I would remind the Court and the parties that we have already achieved things which once appeared improbable, if not impossible.

By establishing the three year working cash fund and authorizing an initial use of up to \$28 million through the first six months of 1982, the Court will allow me to continue these efforts and provide the time necessary to permit ICC review of the plan.

Finally, let me put this \$60 million borrowing in perspective. During this reorganization the railroad portion of the estate has suffered \$439 million in losses on an ICC basis. It has borrowed \$72.2 million from property sale escrow accounts and borrowed or received dividends for operations of \$88.6 million from the Milwaukee Land Company. We have reached a point where there must be an end to continued drain on the estate and delay to the creditors in payment of claims. I have no intention of seeking further borrowings in any significant amount beyond this \$60 million for operating purposes. If the Milwaukee Road cannot be successfully reorganized with this final operating cash infusion, I will instead ask that the Court relieve the estate of further railroad operations. I do reserve, of course, the right to elect to seek additional borrowing authority for operations in relatively minor amounts should the \$60 million be marginally inadequate and the success of the plan justifies the request.

The reorganization process has reached a critical stage and the success of the railroad in achieving the business plan in 1982 and 1983 will determine whether I continue to recommend railroad operation by the estate.

For now, my recommendation to this Court is clear. The reorganization should proceed as set out in the Revised Plan, and the \$60 million fund should be created to facilitate that process.


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