SERVICE DATE

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INTERSTATE COMMERCE COMMISSION
Washington, D.C.

Finance Docket No. 29171

RICHARD B. OGILVIE, TRUSTEE OF THE PROPERTY OF CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY--SUBMISSIONS UNDER SECTION 6 OF THE MILWAUKEE RAILROAD RESTRUCTURING ACT

AGENCY: Interstate Commerce Commission.

ACTION: Decision.

SUMMARY: New Milwaukee Lines (NewMil) filed a plan to convert a part of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company (Milwaukee) into an employee-shipper owned company. The Commission has determined that NewMil's plan lacks adequate financing, is not fair and equitable to the Milwaukee estate, and does not propose a railroad that can be operated on a self-sustaining basis. The agency has found that the plan is not feasible.

DATES: This decision shall be effective immediately.

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SUPPLEMENTARY INFORMATION:

On November 4, 1979, the President signed into law the Milwaukee Railroad Restructuring Act, Public Law No. 96-101 (MRRA). Section 6 of that act provides that no later than December 1, 1979, an association composed of representatives of national railway labor organizations, employee coalitions, and shippers (or any combination of these) may submit to us a single plan to convert all or a substantial part of the Milwaukee into an employee or employee-shipper owned company, and a method for implementing the plan. The plan must include a comprehensive evaluation of the Milwaukee's prospects for financial self-sustainability. The MRRA further provides that within 30 days of submission of such a plan we must approve the proposal if we find the plan feasible. Our finding respecting feasibility must be made pursuant to section 554 (the adjudication provision) of the Administrative Procedure Act, 5 U.S.C. §554.

In anticipation of a plan submission, and because of the stringent time constraints imposed by the new legislation, we established a procedure to govern the matter by a decision entered November 7, 1979. The procedure provided for a notice of intent, and for the filing of initial and reply statements.

NewMil, a nonprofit corporation formed under the laws of the state of Washington, submitted an employee-shipper ownership plan (ESOP) on December 1, 1979. Following a preliminary review of the plan by our staff, we propounded a number of questions to the applicant and interested persons by a notice dated December 6, 1979. We requested responses to those inquiries in the initial statements filed in support of or opposition to the plan. NewMil's proposal has generated a large volume of comments and statements, including many highly detailed analyses.

On December 10, 1979, NewMil requested an oral hearing before the entire Commission. We concluded that oral argument was appropriate, limited to our solitary determination of the plan's feasibility, and scheduled argument for December 19, 1979. Several members of Congress and the representatives for NewMil, the Milwaukee Trustee, secured creditors, unsecured creditors, Chicago Milwaukee Corporation (the holding company which owns 96 percent of the outstanding capital stock of the Milwaukee), the Railway Labor Executives' Association, the state of South Dakota, and the Union Pacific Railroad Company appeared for argument.

THE LEGISLATION

Passage of the MRRA manifested congressional cognizance of the Milwaukee's dire financial plight. Severe operating losses and deteriorating physical condition threatened the cessation of much or all of the railroad's service. Recognizing the serious repercussions which cessation would have on the states in which the Milwaukee operates, and the thousands of railroad and other workers dependent upon its service for employment, Congress declared a need for emergency measures. The MRRA was passed to alleviate the problem by providing, inter alia, for the orderly restructuring of the Milwaukee.

Among the eight congressional findings contained in section 2 are three that deal specifically with Milwaukee employees: (1) cessation of operations would result in the loss of many thousands of rail jobs, (2) experienced railroad employees make a valuable contribution toward strengthening the railroad industry, and (3) the ownership by employees or by employees and shippers of part or all of the Milwaukee may be a valuable tool in reorganization and should be given serious consideration. This emphasis on railroad employees can also be found in the Conference Committee Report discussion of section 26. Section 26 mandates that any federal relief provided for the surviving portion of the Milwaukee be conditioned upon a good faith effort by the Trustee to establish an ESOP which would include purchase of qualifying employer securities equal to 25 percent of the amount of Federal relief. The report notes that "the conferees believe that the future revitalization and recovery of any part of the Milwaukee Railroad will depend to a large degree upon the commitment of its employees towards its success." H.R. Rep. No.

96-583, 96th Cong., 1st Sess. 31 (1979). The conferees found that the most effective way to ensure an employee commitment was to give the employees a major equity interest in their company.

Section 6 of the MRRA requires us to consider, on an expedited basis and to the exclusion of all other proposals for the restructuring of the Milwaukee, a single plan submitted by employees or employees and shippers. Indeed, section 22 requires the Milwaukee to continue service over its entire system as it existed on October 15, 1979, until an ESOP is either (1) not submitted by December 1, 1979, (2) found by the Commission not to be feasible, or not acted upon by the Commission within 30 days, (3) found by the bankruptcy court not to be fair and equitable to the estate, or (4) not implemented by April 1, 1980. Further, section 5 provides that only upon the occurrence of one of those events (but not later than April 1, 1980) may the bankruptcy court authorize the abandonment, sale, or transfer of Milwaukee lines.

Congress has plainly indicated its support for employee ownership and operation of the Milwaukee. It is in the light of those congressional expressions that we must consider our function in this proceeding. Section 6(a)(3) of the MRRA provides that:

> The Commission shall make a finding that the plan submitted under this section is feasible if it determines that-
>
> (A) adequate public and private financing is available to the proponents of such plan;
> (B) such plan is fair and equitable to the estate of the Milwaukee Railroad;
> (C) implementation of such plan will occur by April 1, 1980;
> (D) the railroad proposed to be operated under the plan can be operated on a self-sustaining basis; and

(E) the plan contains an assessment of all operating practices, and includes agreements by labor and management to make implementing changes designed to achieve labor productivity increases (which may include changes in work rules to increase productivity) consistent with safe operations and adequate service.

For purposes of the determinations under this paragraph, adequate financing shall include all sources of private funds, the probable value and priority of valid claims against the estate, and federal, state, or local funds available under programs (in existence as of January 1, 1980) which are or will be available to the proponent and which the proponent is likely to obtain.

The criteria which we are to apply is feasibility as thus defined. We are without discretion to look further.

THE PLAN

NewMil was formed by a coalition of various Milwaukee employees and shippers, joined by representatives of a number of Northern Tier States. The organization's purpose, as declared by its articles of incorporation, is to "undertake and coordinate federal, state, local and private efforts to provide for continued competitive railroad service in regions currently serviced by the Milwaukee Railroad." Toward that end, NewMil has directed its efforts at organizing, obtaining funding for, and acquiring necessary licenses and agency certifications for a new company (the New Railroad) to purchase and operate a substantial portion of the present Milwaukee system. The proposal contemplates that NewMil would cease to exist, and that the New Railroad would acquire, own, and operate the proposed system.

Under the plan, the New Railroad would acquire and operate a transcontinental system of main and secondary main lines extending from the North Coast ports of Seattle, Tacoma, and Portland through the Twin Cities to Milwaukee, Chicago, and Louisville, and amounting to approximately 2,900 route miles. The system would also embrace about 630 miles of lighter density or branch lines, primarily in the states of Illinois, Wisconsin, and Minnesota. An additional 1,400 miles of contingent lines would be included if four conditions are met: (1) it can be determined that the lines would make a positive contribution to the system, whether from operating revenues, surcharges, or external subsidies, (2) any required rehabilitation would be borne by a third party such as a State agency or shippers, (3) the aggregate inclusion of such lines would not adversely affect the system's revenue and expense structure, and (4) arrangements to compensate the estate for such lines would not adversely affect the cash flow or financial position of the system during its formative years.

The plan anticipates conveyance to the New Railroad of land, rights-of-way, track, ballast, trackage rights, equipment, leaseholds, inventory, and material and supplies appurtenant to the proposed system; all of the Milwaukee's operating equipment; and a motor transportation subsidiary. Total track rehabilitation expenditures necessary to achieve long-term market opportunities and economic growth are estimated at 211.3 million (1977) dollars. Proposed capital additions to the plant total 61.5 million (current) dollars over the 1980-1986 period.

During the period covered by the plan's projections, the New Railroad would seek to acquire over $500 million (1980) of equipment. The plan also calls for the New Railroad rebuilding 3,000 boxcars at a cost of 63 million (1980) dollars over the years 1980-1982, and alleviating 15.93 million (1980) dollars of deferred equipment maintenance during the years 1980 and 1981.

NewMil projects that the New Railroad base system would realize positive income (in current dollars) from operations beginning in 1982 and would generate a positive cash flow from operations beginning in 1983. The proponents forecast significant unit cost improvements from improved equipment utilization, productivity gains, higher capacity equipment, and a rehabilitated physical plant. The plan incorporates an annual productivity savings adjustment of $12 million (1977) into its financial projections to be realized in the first full year of operation (1980).

Current dollar projections contained in the plan include an increase in operating freight revenues of from 344.9 million dollars in 1980 to 853.2 million dollars in 1986. NewMil ascribes the increases to a restoration of traffic to a "normalized" 1977 level, achievement of specific market opportunities, long-term economic growth, and selective rate increases. The plan attributes the majority of the growth to expected improvements in service levels and competitive standing relative to other railroads operating in markets that the New Railroad would serve.

NewMil forecasts that the New Railroad would enjoy a turnaround and a superior operating ratio, and that the carrier's earnings would outpace inflation in later years. According to the plan, that gain would be attributable to the New Railroad's strong projected operating ratio, and to its performance of major improvements in the early years (when costs are lower) and its realization of the benefits in the later years (when, due to inflation, expenses are higher).

The capital needs of the New Railroad are projected to be met through a combination of private and public financing. Sources of private money would include a modest amount of shipper-contributed venture capital. Sources of public money would include federal funds available under sections 505 and 511 of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976) (4R Act), state and local funds available to support light density lines, and a joint Economic Development Administration (EDA) and Farmers Home Association (FmHA) loan to finance the ESOP's equity contribution.

THRESHOLD ISSUES

NewMil's provision for inclusion of contingent lines only upon the meeting of specific conditions has generated adverse response. A plan embracing a contingent line category does not fulfill the requirements of section 6(a)(1) of the MRRA, it is argued, because such a proposal either fails to provide for a "single plan," or fails to include "a comprehensive evaluation." We do not agree. NewMil developed its projections excluding contingent lines. A provision for the possible inclusion of additional lines if such inclusion would not hinder the base system's viability does not render the plan defective.

We also do not agree with the contention that the ESOP submitted under section 6 must constitute a plan of reorganization as envisioned by section 77 of the Bankruptcy Act, 11 U.S.C. §205. The NewMil plan contemplates a conveyance of assets rather than a reorganization of the railroad, and in fact would be the first step toward liquidation of the Milwaukee estate. We do not believe that such a proposal fails to comport with the requirements of section 6 of the MRRA, however, or that it in some manner violates the intendment of section 77 of the Bankruptcy Act. The primary purpose of section 77 was to continue existing railroad lines in operation whenever possible, and, under appropriate circumstances, the sale of the Milwaukee's operating assets could clearly accomplish that result. <u>See In Re Tennessee Central Ry. Co.</u>, 304 F. Supp. 789, 793 (1969).

In light of our findings on the proposal, we need not consider whether the procedure we adopted has afforded opponents an adequate opportunity to respond to the plan, nor whether the plan might implicate the commodities clause, 49 U.S.C. §10746, or the antitrust laws.

PRELIMINARY NOTE

In passing the MRRA, Congress has itself determined that the public interest would best be served by a Milwaukee restructured in the ESOP form. Thus, Congress has charged us not with determining whether an ESOP submitted under section 6 would comport with the public interest, or whether it would better serve the public interest than the Trustee's or any other plan, but only with determining whether the ESOP submitted is feasible.

We are very concerned about competition in the Pacific Northwest and across the Northern Tier. The Milwaukee plays an important role in providing transportation in those regions, and we recognize the potential economic and social costs associated with the loss of that service. We understand the adverse implications that our determination here will hold for the western lines, given the Trustee's current reorganization proposal to cease operations west of Miles City, Montana.

However, that NewMil's plan would provide continued transcontinental service is not dispositive of the ESOP's feasibility. In this proceeding, the Trustee's plan is only important as a point of reference in gauging the ESOP's fairness to the estate, and, as discussed below, even that comparison is not determinative. All that we here decide is that, as presently proposed, the NewMil plan is not feasible. We make no findings concerning the Trustee's plan.

We note that in Finance Docket No. 28640 (Sub-No. 5), Chicago, Milwaukee, St. Paul and Pacific Railroad Company Reorganization (Plans of Reorganization), NewMil has filed a plan of reorganization to compete with the Trustee's plan. The NewMil and Trustee reorganization proposals and any other plans submitted in Finance Docket No. 28640 (Sub-No. 5) will be compared and considered under, and shall be subject to the requirements of, section 77 of the Bankruptcy Act.

SUMMARY OF FINDINGS

The railroad contemplated by the plan cannot reasonably be expected to operate on a self-sustaining basis. For the foreseeable future, the proposed system would be entirely dependent upon massive amounts of external funding, almost certainly derived from the public sector.

The proponents of the plan appear to have available, and could possibly obtain, the financing that their plan contemplates. We foresee operating losses in considerable excess to those projected by NewMil, however, and the sources of additional funds necessary to cover such losses are uncertain. Therefore, we cannot conclude that adequate public and private financing is available.

In return for assets estimated by NewMil to be worth 387.8 million dollars, the New Railroad would assume the Milwaukee's obligation to run a railroad and the need to incur debt to maintain service, and would relieve the estate of potential labor protection claims. We do not believe that such consideration provides adequate compensation for the assets proposed to be acquired. Therefore, we find that the plan is not fair and equitable to the estate.

With some reservation, we find that had we approved the plan, "implementation" could have occurred by April 1, 1980. The legislative history seems to indicate that Congress did not intend a literal reading of the statutory term, but rather meant a less restrictive interpretation. Our reservation stems from the announcement by NewMil that it does not intend to become operational by April 1, 1980.

Finally, we conclude that "the plan contains an assessment of all operating practices, and includes agreements by labor and management to make implementing changes designed to achieve labor productivity increases." NewMil's proposal does not include labor-management agreements, but again the legislative history would seem to admit something less.

SELF-SUSTAINABILITY

Self-sustainability is the central finding the Commission has been directed to make. Therefore, we will address this issue first.

A review of NewMil's forecast, in the light of the various studies contained in the record, leads us to conclude that the New Railroad could not attain the levels of earnings and cash flows projected in the plan. A number of problems with the plan, including highly optimistic traffic projections, inflation factors well below currently projected values, and very low cost estimates, lead us to the conclusion that the New Railroad cannot be self-sustaining. While it is difficult if not impossible to quantify each of the many variables involved, the cumulative impact of the problems raised below would be crushing to the new enterprise.

The plan projects a 15 percent increase in 1980 (the first full year) over approximate 1979 carloadings. Between 1980 and 1982, NewMil expects to increase carloadings another 36 percent, with a more moderate 8 percent increase between 1982 and 1986. Net freight revenue increases between 1979 and 1980 approximate 22 percent; between 1980 and 1982, 82 percent; and between 1982 and 1986, 42 percent--all in current dollars. The proponents of the plan state that in the early years, traffic will be increased by recovery to 1977 levels and realization of market opportunities, and that after 1982 traffic increases will come about purely through economic growth.

However, a number of factors are likely to frustrate the expectations of rapid growth. The plan calls for the attainment of an average transit time of 25 m.p.h. on the Chicago-Tacoma line by the end of 1980, the attainment of an average transit time of 40 m.p.h. by 1982, and the achievement of competitive track standards on 85 percent of the system by the end of 1984. By NewMil's own estimates, these goals will be difficult, if not impossible, to achieve by the projected dates.[1/] However, the plan projects a return to 1977 traffic levels and the realization of all market opportunities by 1982. Traffic increases would undoubtedly lag behind service improvements, and service improvements in turn would lag behind rehabilitation expenditures. We do not believe it reasonable to attribute the full realization of such large market opportunities before the completion of rehabilitation. Further, the situation would be exacerbated by any delay in the plan's ambitious rehabilitation schedule.

1/ The New Milwaukee consultant indicates that between Miles City, MT, and Maple Valley, WA, average tie replacement needs to bring track up to FRA standards are as follows:

a. Class I--400 ties/mile
b. Class II--945 ties/mile
c. Class III--1,083 ties/mile
d. Class IV--1,625 ties/mile

In addition, he says that necessary major surfacing and track raising cannot be done efficiently until Class III is reached. The track section covered represents about 40% of the total main line track or roughly 1,000 miles. Therefore, to bring the track to Class II standards--which in itself would really not be competitive--would require almost 1 million ties. The remainder of the system would need substantially more ties than that. We believe a reasonable estimate would exceed 2 million ties for the entire system.

The New Rail Plan, however, calls for the placing of only 800,000 ties per year. Thus, achievement of Class II standards could not be reached until 1982.

In order to become marginally competitive, Class III should be reached which could further postpone the day they achieve a competitive position. In addition, of course, nearly 200,000 ties per year are needed for yard work, but no provision for this had been made in the Plan that we can see.

A major portion of the anticipated growth would derive from the recovery of former Milwaukee traffic from other carriers. Western shippers are undoubtedly interested in the New Railroad's success, but they are also concerned with service. We would expect shippers to continue to use present transportation services until such time as the New Railroad has demonstrated that it can provide reliable service. NewMil argues that it can provide reliable, although slow, service before its track reaches Class II standards and that this level of service would be attractive. While we agree that large blocs of traffic are not time sensitive, we disagree that reliable service can be provided over trackage which is as deteriorated as that of the Milwaukee's western lines. Furthermore, NewMil's competitors could respond by offering better service and faster speed. Therefore, we expect shippers to continue to divide their traffic among the carriers currently serving them until such time as the New Railroad has completed its track rehabilitation program. One of our consultants projected that a 2-year delay in achieving predicted traffic levels in the initial years of the plan, accepting all other NewMil assumptions, would result in an additional $175 million shortfall.

The projected earnings also include a productivity savings adjustment of 12 million (1977) dollars per year. A part of the savings would come from work rule changes, but we note that productivity increases accomplished through reduced crew consist agreements generally come about through attrition. A long time may pass before a railroad can realize the full potential of such agreements. The productivity improvement projected by NewMil would be extremely difficult to realize fully in the first few critical years. However, we recognize that some employees have begun to leave the railroad.

We also believe that projected lease costs for new and rebuilt equipment are understated by nearly $30 million over the seven-year period. The plan's lease rates of 6 percent on new equipment and 7.2 percent on rebuilt equipment are at least two percent below current average lease rates. Considering the risk of the New Railroad operation and the large amount of funds involved, the low rates anticipated by the plan probably would not be obtainable.

One challenged aspect of the NewMil plan was its projected operating ratio in 1986. The plan's proponents forecast the achievement of a ratio more favorable than that of the Union Pacific Railroad Company (UP). NewMil's projected operating ratio for 1986 is 75.4; UP's operating ratio in 1978 was 83.1. A large portion of UP's industry-leading efficiency has resulted from over 20 years of substantial investment in the maintenance of road and equipment. Indeed, the UP has pointed out that its operating ratios are under increasing pressure from high inflation rates. We believe it doubtful NewMil can achieve such ratios within the projected time frame.

To obtain a more realistic financial forecast, we have adjusted the NewMil's ratios to a level which we believe would be more appropriate--i.e. UP's 1979 nine month operating ratio of 86.3. Applying the ratios on a basis declining to 86.3 percent in 1986 to the current dollar pro forma statement of NewMil, we found an additional cash shortfall of $363.6 million over the seven-year period. Deducting the non-cash depreciation expense of $48.7 million, we foresee a cash shortfall of approximately $314.9 million, beyond that projected by NewMil. The calculations have retained the NewMil revenue projections as well as the net rent estimates, the former which we believe to be too high and the latter too low. Projected productivity increases were also accepted. That amount does not reflect the interest payments paid on moneys needed to finance the shortfall.

We have not attempted an exhaustive discussion of each point of disagreement with the NewMil projections but rather have sought by example to point out the plan's weaknesses. The various statements and reports submitted in this proceeding contain reasoned predictions of understated expenses and overstated revenues, and anticipate cash shortfalls of from $200 to $600 million.

Traffic increases lower than NewMil has anticipated, coupled with costs higher than it has expected will, we believe, result in greatly increased losses for the railroad. The requirement of substantial additional capital would, of course, result in increased interest costs. Heavy debt financing of operations in the formative years would burden the carrier with debt service and cripple its ability to fund necessary future capital improvements. For this thinly capitalized plan, whose viability depends heavily upon the attainment of highly optimistic revenue gains and cost experience, any performance shortfall would jeopardize continued operations. Therefore, we cannot find that the New Railroad could be operated on a self-sustaining basis.

FAIRNESS AND EQUITY TO THE ESTATE

NewMil plans to operate a transcontinental railroad by assuming those assets necessary for this purpose from the present Milwaukee system including all the necessary tracks and structures; rolling stock; materials and supplies; and various other Milwaukee assets including Milwaukee Motor Transportation Co. Total assets to be conveyed are valued by NewMil at about $388 million based on a pro rata breakdown of the appraisal prepared earlier by Ford, Bacon & Davis. The Trustee believes the assets to be transferred have a value in current dollars of approximately $533 million. All of these assets would be transferred free and clear of all encumbrances with no cash consideration being involved at all, except for the assumption of $14 million of equipment debt.

In exchange, NewMil asserts it will relieve the Estate of its common carrier responsibilities, and relieve it of labor protection responsibilities for those who will be employed by NewMil.

The Milwaukee Estate will be left with the track and structures which will not be part of the NewMil plan. It will also retain its cash and accounts receivable and most of the Milwaukee Land Company (a part of this will be taken by the NewMil for operating purposes). The Estate will also be left with all presently existing liabilities estimated in the NewMil plan to be $417.4 million, should the NewMil Plan be implemented. These claims include equity claims for which the Trustee has already made preliminary settlement suggestions.

The NewMil plan values the consideration it intends to convey to the Estate on the basis of the net present value of the future operating results, potential asset sales, dividend payments of the operating subsidiaries, and miscellaneous assets left with the estate--comparing such values with similar evidence of value to be realized should the Trustee plan become operable.

Offsetting both of the above valuations are the claims against the estate. Aside from labor protection claims, the only difference in these claims is the need, should Trustee's Milwaukee II system be operated, to borrow an estimated $131 million in government funds over those already borrowed in order to accomplish the goals set forth in the Trustee's programs.

The labor protection claims for which the Estate would be liable are estimated to be $75 million to $326 million should the Trustee program become operable, and $36 million to $160 million should the NewMil plan be accepted. The difference between the two plans lies in the fact that NewMil plans to employ 7,900 to 9,000 employees, whereas the Trustee plan calls for the employment of 5,900 to 6,700 employees. This difference also assumes that those employees who might be hired by NewMil would absolve the Estate of all labor protection liabilities. This probably would not be the case. The statement of the Railway

Labor Executives Association indicates that while individual employees may waive their protection rights, there is no reason to believe they would do so. It would seem to us that few would do so. In light of our appraisal of the viability of the NewMil plan, we are concerned that NewMil could fail anytime during the 1980-86 period with the protection liabilities for the 7,900 to 9,000 employees who will work for NewMil then reverting to the Estate in amounts considerably greater than those projected for the Trustee plan. In this event, the actual dollar value of the contingent liability would depend on when in this period the NewMil determined it could no longer continue operations.

The NewMil method of valuation for the cash flows has many imponderables, such as varying discount rates, differing assumptions of asset values, timing of property sales, actual future operating results and other judgment issues, a change in any one of which could change the value of the consideration significantly. For instance, the NewMil plan computes a net present value to the Estate of the operating cash flows, dividends, property sales and assets remaining to the Estate under this plan to be $204.8 million, whereas the net present value under the Trustee Plan would be only $120.4 million. However, if we equalize the discount rates used, and assume that $100 million of the property passing to NewMil were retained by the Estate and sold by them over the next three years, the present value of the Estate under the Trustee's plan would exceed that under the NewMil plan by over $25 million. The highly subjective nature of the valuation methods employed by NewMil make it very difficult to find the amount of the consideration to be conveyed to be fair and equitable.

Furthermore, from the point of view of liquidation values, we see the NewMil acquiring assets which the plan's proponents value at about $388 million (and which the Trustee claims to have a value of $533 million) for which no real consideration is provided--except for the assumption of $14 million of equipment debt. In exchange, the Trustee is relieved of incurring an estimated $131 million of future debt in addition to relief of $38 to $166 million in potential labor claims, from which they may not in fact be absolved. Of course, preventing the Trustee from incurring debt on which he believes he will earn an attractive return is at best a dubious benefit to the estate.

In addition the NewMil plan calls for the conveyance of these assets free and clear whereas they are in fact encumbered by specific and general mortgages to the extent of about $150 million. The secured creditors have supported the NewMil plan, provided they are paid off in full at the time of conveyance. But there are no funds in the plan to provide for such a liquidation. Ar the secured creditors have also noted, in order for the plan to pass constitutional muster, sufficient cash must be paid to the estate to eliminate those liens before the property to which the liens are attached is transferred. See Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

We find that the plan is not fair and equitable to the Milwaukee estate.

AVAILABILITY OF ADEQUATE FINANCING

NewMil proposes to obtain the funds necessary to cover startup costs, rehabilitation expenses, and cumulative operating losses almost entirely through federal loan programs. The funds include (a) $101.5 million in redeemable preference shares issued under section 505 of the 4R Act, (b) $21.7 million in loan guarantees under section 511 of the 4R Act, (c) $15 million from loans guaranteed by the EDA and the FmHA and (d) $10-15 million from the issuance of 12 percent noncumulative preferred stock to shipper-investors.

The section 505 funds would be used for road rehabilitation and the general capital improvements program. The plan assumes that no dividends would be paid or accrued before the seventh year after the planned rehabilitation is completed. From that point, a 27-year life is assumed. No more than 50 percent of the available section 505 funds may be issued to any one railroad. The amount currently available is about $203 million; the $101.5 million which the New Railroad would request falls just within the limit.

The section 511 funds would be used for, among other things, yard rehabilitation in Tacoma. The loan would be for 20 years at 12-percent interest plus a 3/8-percent service fee. Payment would be postponed for four years, and principal and interest would be paid over the remaining 16 years.

The ESOP trust would be funded through the loan guaranteed by the EDA and FmHA. The duration of the loan would be 10 years and the interest rate 13.5 percent. The loan would be amortized by payments from the New Railroad to the ESOP trust over a 10-year period beginning in 1980. As the debt to the ESOP trust is extinguished, the stock in it would be made available to the employees. NewMil has been invited to make application for those funds.

With respect to the preferred stock sale, the actual form of the financing had not been fully determined. Present estimates of cash flows have been built around the proposal that $10 million of 12 percent noncumulative preferred stock would be issued to shippers. Comments submitted by shippers thus far indicate only mild interest.

Rather than embark on a major equipment purchase program, the New Railroad would acquire new equipment through leverage lease arrangements. The plan calls for the lease of new equipment costing $540 million (1980) at a six percent rate, and for a rebuilding program costing $63 million (1980) through sale and lease back at 7.2 percent.

We believe that NewMil's plan identifies sources of loans and investment capital required to finance the New Railroad, assuming the accuracy of NewMil's revenue and cost projections, and assuming that the consideration it is offering the estate is fair and equitable. Given our conclusions as to the validity of these projections and the fairness of the considerations, NewMil would require substantial additional financing. We do not believe the funding is available from private sources or from currently available public sources. Because of our doubt that NewMil's performance projections can be achieved, we seriously question the ability of the New Railroad to attract private sector financing, even in the far future. Neither can we identify public sources for the additional funds which we believe would be necessary simply to sustain operations through the projected period. Further, some supplemental financing mechanism would undoubtedly be required to provide adequate compensation for the assets being acquired from the estate. We cannot find that adequate public and private financing is available to the NewMil plan proponents.

IMPLEMENTATION BY APRIL 1, 1980

The term "implementation" is not defined in section 6. In the usual sense, the term means "fulfill" or "carry out," and thus we might interpret the statute as requiring the New Railroad to take operational control of the properties on the critical date. The proponents quite clearly could not accomplish such a task. The legislative history indicates that Congress intended a less stringent criterion, however:

> I do not want to see an employee-shipper acquisition survive the Interstate Commerce Commission and bankruptcy court review process, obtain adequate public and private financing, but then fail due to the fact that the last "i" has not been dotted and the last "t" not crossed on, for instance, rehabilitation loan financing documents which the Federal Railroad Administration has not completely processed by the deadline. In other words, the fact that necessary financial commitments have been made, but not all of the funds have been dispersed by April 1, 1980, should not render the plan's implementation a nullity. 125 Cong. Rec. S15755 (daily ed. Nov. 2, 1979)(remarks of Sen. Baucus).

To effect "implementation" as we believe Congress intended that term, NewMil would need to make substantial progress toward operational control before the April 1, 1980, deadline. At a minimum, commitments for adequate financing, hiring of upper-level personnel, and agreements between labor and management would be required. Although we believe that accomplishment of these goals would represent a major undertaking, we conclude that, had we approved the plan, those goals could have been achieved by April 1, 1980, and the plan implemented by that date.

ASSESSMENT OF OPERATING PRACTICES
AND LABOR-MANAGEMENT AGREEMENTS

The NewMil ESOP has been criticized as not meeting the specific requirements of section 5(a)(3)(E). The plan does contain a generalized discussion of operations, and a letter of understanding from the president of the Brotherhood of Railway and Airline Clerks, who is also chairman of the Transportation Policy Committee of the Railway Labor Executives' Association. In light of our other findings we need not belabor this matter, but we only note that the Conference Committee Report indicates that the term "agreements" in the MRRA

> is not to be construed as requiring formal finalized labor agreements. Rather, the intent is that binding written commitments will be made in the form of letters of intent or any other appropriate manner. H. R. Rep.No. 96-583, 96th Cong., 1st Sess. 18 (1979).

We conclude that the NewMil plan contains an assessment of operating practices, and includes labor-management agreements to make implementing changes to increase labor productivity.

CONCLUSIONS

It should be emphasized that the Commission supports the concept of rail competition across the northern tier States. Specifically, this plan seems sensible from the standpoint that, should it be feasible, it would maintain the presence of a successor to the Milwaukee as a rail competitor across the northern tier States. It is in this respect consistent with past pronouncements by the Interstate Commerce Commission in such cases as the Northern Lines Merger case, 331 I.C.C. 228 at 282, 288, wherein the Commission made provision to strengthen the competitive position of the Milwaukee Railroad.

Given that the aims of the plan are salutary, and to that extent meet the goals sought by the Congress, we are confronted by the necessity of determining whether the information that has been placed before the Commission provides a sufficient level of assurance that the plan is likely to achieve the congressional goals. We have tried to make allowances in our analysis for the fact that under the statute, a very short time has been available for the development of the plan. We are also cognizant of the fact that the Commission is not being called upon to guarantee that the plan will work. But at the same time, we recognize our obligation to determine objectively whether within reason the plan is feasible. After as careful an analysis as is possible under existing conditions, we reluctantly must conclude that the plan is not feasible.

"Members of Congress have indicated an interest in the Commission's projections of the necessary capital to make this plan feasible. It is difficult to give a precise answer. However, we believe a minimum of $500 million in additional capital, above that provided for in the NewMil Plan, is necessary to finance anticipated operating losses and to make necessary payments to the Estate.

This figure is derived by adding the anticipated operating losses which NewMil will realize with a more realistic operating ratio (approximately $300 million) and considering staggered traffic growth (approximately $175 million).*/ Also funds must be available to relieve the estate of secured liens (approximately $150 million) and to compensate the Trustee for contingent labor protection claims (cost of indeminification uncertain).

Much of this additional financing would have to be in the form of grants or equity capital to avoid crushing debt service

*/ See pages 13 and 14. It is difficult to assign a total that avoids double counting, but we believe the additional operating losses would be in the neighborhood of $350 million.

payments in subsequent years. Even with such a commitment of funds, the success of the venture would involve significant risks."

FINDING

We find that the employee-shipper ownership plan submitted by New Milwaukee Lines is not feasible within the meaning of Section 6 of the Milwaukee Railroad Restructuring Act, Pub. L. No. 96-101 (November 4, 1979).

It is ordered:

This proceeding is discontinued.

By the Commission, Chairman O'Neal, Vice Chairman Stafford, Commissioners Gresham, Clapp, Christian, Trantum, Gaskins, and Alexis.

Commission Trantum voted for the decision finding that the plan is not feasible but conditioned his vote on a number of changes in the decision which were not accepted by a majority of the Commission. These changes would indicate (1) that the Milwaukee provides transportation in the Pacific Northwest and across the Northern Tier rather than plays an important role in providing transportation in those regions; (2) that the $314.9 million shortfall described on page 14 may represent only about one half of the additional funding necessary to carry the railroad through 1986; (3) that, even if the capital shortfall were to be extinguished by public funding, the heavy burden of interest payments on the Milwaukee during the years following 1986 would severely diminish the likelihood of repayment; and (4) that a description of specific programs to achieve productivity improvements is not required and was not submitted. In connection with (4) Commission Trantum would have the decision say: "It appears, however, that the attainment of the project cost levels would require significant changes in current work rules, and perhaps, wage levels. We have no assurance that such changes would be forthcoming."

Commissioner Christian did not participate in the decision.

AGATHA L. MERGENOVICH
Secretary

(SEAL)