1st MONDAY 3rd MONDAY

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

May 18, 1981

To all Milwaukee Road Employees:

On Friday, May 15, Trustee Ogilvie filed an application to abandon the Milwaukee Road main line west of Ortonville, Minnesota, and to discontinue trackage rights over the Burlington Northern between Miles City and Billings, Montana.

In his May 15, 1980, "Report and Recommendations for the Future of the Milwaukee Road," the Trustee stated that the line between the Twin Cities and Miles City is "an economically marginal part of Milwaukee II; but a part which should be maintained, if possible, in the public interest." He described three major steps he felt were necessary to preserve the line.

The first was that the rehabilitation would have to be financed with low interest loans from the Federal government under Section 505 of the 4R Act or by interest free state and shipper loans. Later in 1980, the Trustee set a deadline of February 15, 1981, for this assistance to materialize, or he would file for abandonment of the line. The Trustee twice extended the deadline with the final extension being to the date of application May 15, 1981. The Trustee, shippers and states having been unable to secure the necessary financial assistance, the Trustee followed through on his pledge to seek abandonment.

No service reductions are anticipated pending ICC and Court consideration of the abandonment application. Should the abandonment be approved, service will not be affected until the fall of 1981. In the interim, the Trustee is exploring alternative means to keep the line in service, possibly through sale to the users or other parties.

The Trustee's two other conditions for preservation of the line concerned the Sisseton and New England branch lines and the rate on coal movements between Gascoyne, North Dakota, and Big Stone, South Dakota. On March 13, 1981, the Trustee filed his applications for abandonment of the Sisseton and New England branches based principally upon these branches' need for rehabilitation in order to handle modern day traffic. Subsequent to the May 15, 1980, report, the Trustee negotiated an increase in rates on the Big Stone coal movement. In the Trustee's opinion, while these rates make a substantial contribution to the line, this contribution is insufficient to warrant financing of the necessary rehabilitation by the estate.

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An agreement which will result in the Milwaukee dropping its opposition to the proposed merger of the Norfolk and Western and the Southern railroads has been reached.

The agreement provides that:

1. The Milwaukee and Southern shall preserve and continue, to the extent warranted by traffic volumes and operating conditions, their practices existing on December 4, 1980, in connection with handling freight traffic in SR-Milwaukee through routes.

2. Both the Milwaukee and Southern shall maintain and keep open all through routes existing between them (including their connections) via Louisville on December 4, 1980, unless and until otherwise authorized by the Commission or unless otherwise agreed by the parties. Whenever Milwaukee or Southern establishes with another carrier a new or changed rate via Louisville or Cincinnati between SR territory, on one hand, and Milwaukee territory (or, for two years following consummation of the NWS consolidation, stations on British Columbia Railway, Northern Alberta Railways Company and Canadian National Railways west of, and including Thunder Bay or Armstrong, Ontario), on the other hand, it will upon request of the other party agree to establish the same rate over the corresponding SR-Milwaukee through route via Louisville.

3. SR shall keep open to reciprocal switching for Milwaukee all industries served by SR and presently open to Milwaukee and all present and future industries located on the K&IT in the Louisville Switching District.

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In another merger proceeding, the Trustee and his officers filed verified statements last week with the ICC in connection with the Union Pacific - Missouri Pacific - Western Pacific case.

Essentially, we asked that the Union Pacific and Missouri Pacific keep open the through routes and competitive rates and continue run-through operations with the Milwaukee at Kansas City. Fifteen of our important shippers have supported our position.

Additionally, the Denver & Rio Grande Western has requested trackage rights over the Missouri Pacific between Pueblo and Kansas City. The Milwaukee supports the DRGW's request for trackage rights and requests conditions that will result in run-through service for DRGW-Milwaukee traffic similar to that for Missouri Pacific-Milwaukee traffic.

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Last week Special Master Milton Gray issued his recommendations to Judge McMillen on our present borrowing request. He recommended that we be allowed to borrow up to $27.2 million from the real estate sale escrow account as necessary to continue operations through December, 1981. Also that we be authorized to borrow up to $22.1 million from the FRA for the Wisconsin Valley line and the Camp Douglas to Milwaukee and Techny to Lake Forest rehabilitation projects under Section 505 of the 4R Act. He stated if we fail to obtain funding for the Valley line and the Techny to Lake Forest projects by May 20, that we be authorized to borrow up to $11 million from the escrowed sale account to fund those rehabilitation projects. He recommended that we not be granted authority to borrow from the escrowed property sale account to fund the Camp Douglas to Milwaukee Rehabilitation project. (i.e., if FRA does not fund.)

Judge McMillen is expected to rule on the Trustee's request for funds this week.

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In FM/TM of March 16 the continuation of Davenport, Rock Island and North Western Railway operations of Rock Island properties in the Quad Cities area was discussed. The DRI&NW Railway, which is owned equally by the Milwaukee and the Burlington Northern has been serving certain embargoed stations by authority of the Interstate Commerce Commission. Arrangements were made to continue to serve Rock Island properties east of the Mississippi River until June 30. A shipper group has requested the DRI Line to extend the Milan, Illinois, service for an additional 90 days, during which time the shippers would agree to compensate the BN and Milwaukee on a per car surcharge to cover our rental of that line.

In addition, the shipper group has encouraged us to negotiate the purchase of the line and work out a surcharge to compensate us for the investment expense, be it purchase or lease. If we, with the BN, are unable to do this, then the group will negotiate directly with the Rock Island Trustee and work on some other financial arrangement, including the possibility of utilizing industrial development bonds.

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It has come to our attention that a number of employees were not issued a "Statement of Deferred Wages" during March. There were also some employees who received incorrect statements. These errors are in the process of being corrected. Rather than attempt to identify each employee who either received no statement, it is easier and less expensive to reissue statements to everyone. All employees participating in the "Wage Deferral Program" will be mailed a new statement during the month of June. This Deferred Wage Statement will give your total deferred wages for the period of August 1, 1980, through April 30, 1981.

W. L. Smith
President

P.S.

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The response to the first issue of P.S. was gratifying. Your comments and suggestions are welcome. Especially appreciated were the sharp-eyed individuals who pointed out an error in the compilation of the fringe benefits paid by the company for exempt positions. Our pencil did, in fact, slip when we jotted down the benefits paid for the Metropolitan Dental Plan and a one became a seven in the process. The actual amount paid by the company for this program is $14.47 monthly, not $74.47 as was erroneously reported. The other figures for both exempt and contract positions and the totals, however, were correct as stated.

So everyone will be totally aware of the reorganization planning process, the following summarizes recent statements made and testimony given in Reorganization Court proceedings.

Trustee Ogilvie has engaged the services of some of the top transportation consultants in the country to aid in developing a working document for reorganization. They provide technical guidance and focus upon departmental analysis of future requirements and the interrelations among the separate departments. The reorganization process can be viewed in three phases. Phase 1, which is essentially completed, was the restructuring of the railroad into an approximately 3,700 route mile regional railroad from a 10,000 route mile transcontinental road. The anticipated financial improvements from the elimination of the unprofitable western end of the railroad and certain other branch lines form the primary basis for the first Milwaukee Road reorganization plan. That plan was rejected by the ICC on the basis of inadequate return on capital. Phase 2 of the reorganization process involves an in-depth study of the potential for improving rail earnings to a level commensurate with adequate returns on the capital embodied in the assets retained in rail service, new capital required to modernize and rehabilitate those assets and any interim operating losses. For all practical purposes, this phase began with the submittal of the Trustee's May 15, 1980, report to the Court. That report outlined proposed operations within the core and sought time to operate that core and gain experience from which projections could be made. The third phase will begin with a decision either to reorganize the railroad as a going concern or to liquidate rail operations in an orderly manner.

Phase 2 deals primarily with the corporate planning process leading to the development of a five year business plan complete with earnings projections. Such a corporate plan will consist of financial conclusions, pro forma financial statements, and numerous other analyses and reports relating to the financial results, the operational adjustments and the "cause-of-change." It is this plan that will provide the Trustee with the information upon which the reorganization decision can be made. Marketing, Car Management, Transportation, Maintenance of Way, Maintenance of Equipment, Administration and Finance will provide input and be responsible for developing their respective parts of the corporate plan. Their primary emphasis will be in the development of the following: Operating plans consistent with the traffic projections; capital additions for replacement and efficiency improvements; operating goals consistent with the application of

modern assets and effective management of assets in manpower; action plans to control the achievement of these goals; and the development of operating expenses and capital outlays consistent with financial resources.

The Corporate Planning office will coordinate the development of the corporate plan and is responsible for reporting the results to the President and Trustee. A part of this effort is the analysis of strategic alternatives. These alternatives concern certain network changes and, in some instances, market changes to better fit the restructured Milwaukee to its regional needs. The results of these and other strategic alternatives will be included in the corporate plan.

As a key aid to the planning process, a computerized model of the restructured railroad is being developed. This model is known as the Operations Cost Methodology or OCM. The model is being developed by the Milwaukee staff working with the consulting firm of DNS, Inc., of Lexington, MA. The objective of this model is to simulate train operations consistent with a five-year traffic forecast and to generate a statement of operating expense. The model contains a detailed description of the Milwaukee Road network; each track and yard is included. Train operations are described in terms of blocking strategies, train frequencies, permissible tonnages and lengths, train types and power assignments. The results of the simulation are such measures as train miles, car miles, gross ton miles, car handlings and switching requirements by all track segments and yards in the Milwaukee system.

Costs are then applied to such service units by means of numerous cost equations and the resultant products are statements of operating expenses. OCM will give us the ability to produce such data rapidly and allows us the flexibility to evaluate the ramifications of changes in traffic forecasts, operating plans, network configurations, unit costs and capital programs.

Operating expenses as generated by OCM, in conjunction with the input from key departments, will produce a comprehensive plan complete with income projections for the Milwaukee Road through 1985. These income projections will be the basis for detailed financial analyses designed to evaluate the feasibility of reorganization.

W. R. Bickley
Director of Corporate Relations