

Estonia's railway operator has a new controller

By Robert Wright in London

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Estonia's government has completed the renationalisation of a two-thirds stake in the national railway company, ending a long-running dispute that has illustrated the sometimes hidden risks of investing in transport infrastructure.

The sale follows almost constant pressure on Baltic Rail Services, the private consortium that owned 66 per cent of Eesti Raudtee, the national railway, since the election in 2003 of a left-wing government opposed to the privatisation.

The new government changed the rules about how much of its track capacity Eesti Raudtee had to make available for other - mostly Russian - train operators. It also reduced what it could charge to below economic levels.

Both sides had announced in November that BRS intended to sell back the stake, but the transaction was completed only on Sunday, when the government paid BRS \$200m for its 66 per cent stake, originally purchased for \$58m.

Henry Posner III, chairman of Railroad Development Corporation, a Pittsburgh-based company that invests in emerging economies' railways and was a shareholder in BRS, said the outcome was a victory for the Estonian politicians involved.

"It was a draw for the investors and a loss for the Estonian people," he added.

Edgar Savisaar, Estonia's minister of economic affairs and communications, in November blamed the problems on differences of interpretation between the two sides. "We absolutely could not agree to BRS's interpretation of the privatisation agreement, their understanding of tariffs, investment principles and many other issues," he said.

Ed Burkhardt, an American rail entrepreneur whose Rail World vehicle owned just under 28 per cent of BRS, said that, while BRS had received more than it paid for its stake, the payment still undervalued it.

BRS's equity in the company had been valued at €340m (\$440m) two years ago, when the investors were contemplating a stock market flotation, he claimed.

Eesti Raudtee announced net profits of EKr347m (\$28.6m) on EKr1.74bn in revenue in 2003, the last year for which its accounts were approved before the dispute broke out.

The issue at the heart of BRS's problems - the price it could charge for use of the infrastructure - is a crucial one for the growing number of infrastructure investors. Governments often have a say over charges for the use of nearly every kind of asset popular with investors, including toll roads, airports and ports.

Robert Bain, a credit analyst for Standard & Poor's, the rating agency, said investors often ignored or downplayed the political or regulatory risk of infrastructure investments.

It could be hard to predict what might happen in difficult circumstances.

"What happens in stress scenarios has often not been tested in these countries," he said. "You can look at the contract and what the contract says . . . but what the government says it will do and what it does are not always correlated."

Mr. Posner of RDC said it was impossible to protect fully against politically-motivated revisions of a contract.

However, BRS had not been naive when it signed the privatisation contract, he insisted. It had included the option to take any dispute to arbitration before the Stockholm Chamber of Commerce's arbitration institute, an option the company eventually took and had helped force a settlement with the government, said BRS.

Such legal action has often rescued infrastructure investors. In Canada, a state government which wanted to revise the privatisation terms for the ETR 470 toll road found itself prevented from doing so by legal action.

Mr. Burkhardt said the government had initially thought BRS could be made to leave with payment of only its initial \$58m investment. "We called them out on that when we took them to arbitration," he said.

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