

# ANATOMY OF THE SWINDLE OF THE CENTURY

Date 27.10.2006  
Channel Pärnu Ekspress (Russian edition)  
Circulation 1500  
Author Igor Teterin

## How American businessmen Edward Burkhardt and Henry Posner III managed to hog Estonian railway having brought to their knees the people, politicians and businessmen of this small Baltic country?

### Simple, accessible, livable...

I must say honestly that communicating with mister henry Posner III is a pure pleasure. He always wears his flashy bow tie, as if trying to explain to his companion that he is an artistic person. I don't know, if takes it off in the beach, but in the city of Sochi, where we met last spring at the party organized by Russian railroaders and transport lords at the swimming pool of hotel Radisson-Lazurhaya, the bow tie was present. Although the format of the even was announced as a "meeting with no ties".

He makes contacts very easily with any person, producing a charming smile and trying to wind into somebody's favor using some very simple tricks. For example, after having learned that I am from Estonia and my mother tongue is Russian, he immediately switched into this language, having really knocked me all of a heap. Although the vocabulary of my companion in the great and powerful language turned out to be not very considerable, but still, I liked it.

By the way, let's ask a question – what for henry Posner III needs Russian? "Why shouldn't I? I want to be a right guy for EVR locomotive crews and track gangs," explained my interlocutor. "These people are mainly Russians..." A little later he confesses in his sincere love to Estonia - "I have an Estonian soul, I like this country very much..."

And to my question why he likes the Baltic land so much, he, without moving a muscle, said "I feel here like in Disneyland!"

Well, adventures of our hero in Estonia really remind an amusement ride. Well Henry Posner III together with his companion mister Edward Arnold Burkhardt were the main characters in the story of privatization of Estonian Railway. The story that today has come to its final phase and, for sure, in the future this story will be called not otherwise, but the swindle of the century.

Because immediately after having taken the seats of shareholders and members of EVR supervisory board, these gentlemen rose in a twinkling to the height many dream of. Because they clenched in own hands one of the main nerves of our country. Though, let's start from the very beginning.

### Investors from nowhere

It is worth to remember that selling of EVR to foreign capital from the very beginning reminded a big wildcat venture. In spring

2000, when Estonian Privatization Agency announced the state wish to sell 66% of EVR shares to a strategical investor by international tender. Adventurers and knights of fortune of all colors, having smelled easy meat, flew to Tallinn like flies to honey.

Among them Americans were all-fired sure of themselves, in front of whom Estonian postillions of privatization from Mart Laar's government were practically bowing. The overseas "businessmen" understood quickly that here they were received somehow too enthusiastically. Probably the unforgettable Khlestakov felt the same when he came to a small Russian town in the middle of nowhere (*famous negative character of Russian classical literature – tr.*). Head of Privatization Agency Väino Sarnet confessed later that at that time the target of the state was to sell the railroad only to Americans at any price. They didn't want to let even Finnish capital to privatization of EVR, Swedish and German ones were under a big question mark, not speaking about participation of Russian investors in the "tender". Such hot sympathy to Americans were explained by the priorities of Estonian foreign policy based on the wish to join the EU and NATO as soon as possible. Well, if you don't make a favor to Americans you cannot get to the NATO. This is the way of thinking of people in ministerial chairs of Mart Laar's team who happened to be on Toompea (*Estonian Parliament – tr.*). The results of such a "targeted" policy turned out to be miserable. Implementation of political targets by pen-pushers resulted in the fact that initially American "consortium" Rail Estonia was recognized as the winner. However, soon it turned out that under the name of Toni Massei, Rail Estonian project manager, somebody Antonio Angotti is hidden, who was detected by FBI for money laundering and financial fraud and his associates in reality were a gang of swindlers.

An awful scandal broke out. Combinator Massei Angotti became a lamster. Results of the "tender" had to be reconsidered with paying multimillion honoraria to British consulting company GIBB, which had found Rail Estonia investment offer as the best one.

As the result, in March 2001 in the atmosphere of increased secrecy a contract was modified and signed, according to which 66% of EVR shares were sold to BRS that had been the second bidder in the sinister tender. This company was knocked by

Estonian businessmen Jüri Kõo, Guido Sammelselg and Americans Edward A. Burkhardt together with Henry Posner III.

The dream of pen-pushers from Mart Laar’s government came true – American participation in EVR was ensured. However Estonia got to a trap, and getting out this trap will be long and painful.

**Gold vein in monopolistic wrap**

To understand what a sweet piece of property received our American heroes, we should compare Estonian “iron road” with other assets they own. For example, an overview of Henry Posner’s railway ownership can illustrate the whole picture. It is rather Rail Development Corporation (RDC) headed by Henry Posner III.

RDC headquarters is in Pittsburgh, Pennsylvania, USA. From the first glimpse it might show a powerful international corporation, as RDC participates in ownership and management of railway assets in several continents - in the USA, in Latin America, in Africa and, finally here, in Estonia, i.e. in Europe.

Doing justice to Henry Posner III we should admit that – unlike Khlestakov mentioned earlier – he is not carried away in his unjustified boasting. I myself heard him saying to his colleagues by professional guild: “We are a small company that never had enough money to acquire serious railway assets”. Henry

explained this was to people, who understand at least something in this business, that there is simply no sense to hope for free investment funds that might be in his pocket.

Basic specialization of RDC is management of railway business under extreme or crisis conditions. It means that they are involved in management of knowingly risky transport assets that more respectable colleagues of Henry Posner II are simply not interested in.

For example, they got concession for Honduras railroad practically for free, as after natural disasters and regional laxity the railroad sank into degradation. In Peru RDC manages a high-altitude railroad in the Andes. The is the second highest railroad (highest point 4818 m above the sea level) after the recently opened Tibet railroad in China. In Africa mister Posner’s company manages a railroad operating between Mozambique and Zambia. Major freights there are corn, sugar, cement, tobacco. Annual volume does not exceed EVR’s two-tree day’s volume.

However, look at the table showing all RDC assets and their results as of January 1, 2005. I think this is enough to understand: EVR turned to be a gold vein for the company headed by henry Posner III as well as for his business partners. EVR is the only in our country company with its own infrastructure. In other words – a monopoly!

Country	Company	Length of tracks, km	Number of locomotives	Number of wagons	Freight volume hauled, M tons
USA	Iowa Interstate Railroad	1.005	42	1.821	8.5
Argentina	ALL Central	5.350	70	3.605	3.4
Argentina	ALL Mesopotamica	2.740	36	1.670	1.4
Guatemala	Ferrovias Guatemala	322	15	200	0.15
Peru	Ferrocarril Central Andino	591	26	709	1.7
Mozambique	Corredor de Desenvolvimento do Norte	797	24	439	0.3
Estonia	EVR	593	102	3.533	42.4

Source: RDC web site (USA)

**Shearing wool in presence of “customers”**

Having rich practical experience in Latin America and Africa, where, as it is well known, towardness of civil servants is directly connected with the amount of bribes given to them, Henry Posner III and his team got in Estonia to a familiar and even in near and dear environment. Being the owner of only 5% of the shares of BRS that in 2001 privatized EVR, he nevertheless has delicately developed the strategy of implementation of this transaction.

Now, after several years we can only wonder how they managed to talk the Estonian party into selling them the state owned railroad for practically nothing. “Shearing wool” from naïve customers started in fact in the phase of signing privatization contracts. For example, Americans insisted on buying from overseas 74 locomotives that earlier had never been used in Estonia or on railroads of other post-soviet countries. A contract

signed earlier for purchase of locomotives from Lugansk, was urgently cancelled.

And nobody was confused by the fact that Edward A. Burkhardt, a man, who owns 25.5% of BRS shares via American company Rail World, took over delivery of locomotives. Equally nobody dared to mention even the direct conflict of interests, when Burkhardt, being a member of EVR supervisory board, started to deliver locomotives to EVR via Rail World Locomotive leasing, LLC, he had founded in 2001. Without tenders and other similar conventions accepted in the world of civilized business.

Later quite incredible things started to happen. Americans promised to invest “stacks of money” in EVR development – initially it was spoken about annual financial injection in the amount of 500 million EEK. And this within 10 years. In fact it turned out that they pledged EVR property in banks, took loans and started to call this money investments.

It is difficult to believe that Henry Posner III, a graduate of Princeton University as well as of one of the best American educational institutions in business and finance – the famous Wharton School – didn't know that calling loans investments was a purposeful deception of the public. Equally the profit received from freight operations and used for further EVR development is not an investment. However, a fact remains a fact - the new owners of the railroad, being a full monopolist in the freight transportation market, have not brought any own investment assets to the railroad.

Moreover, having tasted accounting balancing tricks, "investors" intended to carry out revaluation of EVR assets, having increased their value almost three times. Accordingly, it would provide opportunities for getting new credit lines and, should there be were a wish, to sell out part of assets without any reduction of the initial stock capital. And at this moment the state started to balk.

#### **An open secret**

One may ask, who then must cover loan burden of EVR private "investors" ensuring at the same time bed of roses to the latter? There is no secret here – it was assumed from the very beginning, that Russian business would carry this yoke. I.e those Russian companies that carry their export freights through Estonia.

I remember, when in spring 2006 during the visit of the president of JSC Russian Railways Vladimir Yakunin one Estonian journalist asked him a naïve question:

- Do you see any possibility for participation in investment programs aimed at improvement of EVR capacity?
- Excuse me, maybe I understood the question in a wrong way, - expressed Yakunin his amazement – but it seems to me that Russian businessmen already participate in development of your railroad carrying freights via Estonia. On these carriers EVR earns snug revenues that allow it improving infrastructure.
- The amounts of revenues were really presentable – average EVR annual revenues counted 1.7 billion EEK. However, the owners of the "iron road" could ensure sustainable cash flows only under one condition – if they manage to keep the market monopoly that enables them to dictate own rules of game. And consequently – own tariffs and prices.

But with every year exactly this suits private operators and the state less and less. Transport companies saw that they were racked for using the infrastructure that was decaying with every year. Step by step they started to insist to be allowed to get to the rail business in capacity of independent transport operators. The state, as expected, began to feel itself in the role of a "hayseed" used by shrewd "thimblerriggers". A classical conflict of interests emerged.

#### **Money over honor**

However even shy attempts of the state to sort out the mess on EVR were accepted by its private owners as an encroachment on their rights to pump out fast bucks from their monopoly business.

Estonian Ministry of Economic Affairs, as a co-owner of EVR, was acting quite logically and consistently. First, it refused to approve the 2004 report, where the company assets, due to the artificial revaluation, were whirled up almost three times. Secondly, it shaped its course at de-monopolization of rail transport market, where in 2004 private operators were still allowed to get an access. Besides, the state wanted to improve EVR competitiveness in the international freight market and for this in 2005 it was decided to reduce the tariff for haulage of one ton of transit freights through Estonian by \$0.5.

As it turned out, even because of these modest retaliations on the monopolist, the whole "business strategy" of the overseas EVR owners started to bulge at all seams. They simply were not able and didn't want to operate under the conditions of a developed transport market. Because having used not own investment funds, but bank loans for buying EVR, American "investors" one way or another, were forced to cover the debts. And they had no other revenue sources, but the revenues from the profitable railway business in Estonia.

Panic and nervousness began. Chairman of the supervisory board of the company Edward Burkhardt declared publicly: under such conditions they simply would not be able to comply with the investment plan. Henry Posner II, being a member of the supervisory board, launched into an active PR activity aimed at creation of the image of "offended privatizers", who as if were suffering from inconsistent actions of Estonian government.

Other "mechanisms" were also involved for rescuing the faltered situation of EVR, which in no way complied with the norms of straight business. For example, in April 2005 Estonian security police arrested Oleg Ossinovski, chairman of the board of Spacecom, when he was leaving a plane. Head of a successful company belonging to the Russian concern Severstaltrans was detained on an absolutely absurd accusation ... cartel agreement with EVR management.

Let's clarify. Cartel is an agreement of several companies that using their monopolistic market situation want to preserve high prices and super-profits. Ossinovsky's company, on the contrary, became the first independent operator on EVR infrastructure, having really impinged upon the monopoly of the latter. And therefore it was interested in reduction of the existing freight tariffs.

However, it did not confuse the organizers of the arrest show. It is common knowledge: where money becomes more valuable than honor, usual logic of human behavior recedes into the background. It is doubtful, that once we learn how the

“privatizers” managed to use Estonian secret service in their intrigues. Probably their rich experience of cooperation with local authorities in Latin American and African countries also helped here. But a fact remains a fact – in the history of struggle for EVR there used to be similar dark pages.

**Feckless “privatization” of EVR will cost 2.35 billion EEK for Estonian residents – over 2 thousand of direct costs per each taxpayer. The money will be taken from the amounts we pay to the budget for support of health care and education, culture and pensions.**

#### **Russian effigy as a marketing element**

Within the last year Henry Posner III, being the most prominent public figure in BRS team managed pretty shrewdly to create an impression as if Estonian government intended to take away the perspective business by force. He touched upon this issue in numerous interviews and back rooms of international transport conferences, etc.

At the same time it should be reminded that namely American co-owners of EVR were the first in spring 2005 to declare their intention to sell the ownership in the company. And they publicly announced the price they wanted to get for BRS shares – 2.5 billion EEK.

Estonian Ministry of Economic Affairs decided to bargain and offered 2.1 billion and even threatened by cancellation of the privatization agreement, having started the process of nationalization of the railroad. But it turned out impossible to outmaneuver out American friends. Against Estonian authorities they decided to use representatives of big Russian business as the weapon, who, according to Americans’ hints, were ready to pay BRS had voiced. Head of Russian investment company “Industrial Investors” Sergei Generalov came to Estonia; other well-known Russian businessmen also showed their interest to EVR.

In fact, this was a tricky marketing move, which brought expected results. Knowing that local politicians are afraid of the increase of Russian economic presence in Estonia like the devil, Americans started to terrify Estonian authorities by their open contacts with Russians. Analysts of security police urgently released a report with the description of numerous risks including political ones that would appear in case of EVR transfer under Russian control. Image of Sergei Generalov was demonized by the efforts of Estonian press to the role of a “living horror”.

By the way, in real life Sergei Generalov is an intelligent person without any self-trust display. I had a chance to talk to him on the issue of resale of BRS owned EVR assets. He showed a good awareness of specific features of Estonian privatization business and characterized the situation simply – BRS took Estonian state by the throat.

Well, this is a very precise characteristic. If to call a pikestaff a pikestaff, American privatizers not only managed to take over EVR for peanuts, but at the same time brought to their knees Estonian politicians and the people of our country. Thanks to the efforts of their lawyers the privatization agreement was made in such a way that any nationalization was out of the question. Whether long litigation in national and foreign courts in the course of which nothing would remain from EVR assets, or agree to all BRS terms including the offered price for buying back EVR shares. This was the way the alternative looked like.

Finally, Estonian Ministry of Economic Affairs, taken by the throat by “privatizers” had to accept practically all BRS terms: the amount (2.35 billion) with distributed dividends (150 million) will just make 2.5 billion EEK. The state in fact surrendered at discretion of the winner – sly dogs from BRS.

#### **Instead of epilogue**

And now let’s draw conclusions to our story-telling. Anrei Filatov, head of Severstaltrans, who was a consistent votary of returning EVR to Estonian state, said: “In my opinion you can celebrate your new independence when you take back railway infrastructures”.

Well, there is a considerable part of truth in this statement. After buying back EVR shares from the hapless “investors” Estonia will really become a more independent state.

But it will not become a richer state. Because we will have to pay this amount, 2.5 billion EEK, from our own pocket. About 2 thousand EEK per one Estonian resident. The money will be taken from the taxes we pay to the state budget.

We didn’t become richer also due to the fact that during the period of the strange economic experiment, when EVR was in the hands of private owners, wonderful opportunities were lost to use the money from EU Structural Funds for renovation of the railroad. In fact EU funds are not allocated to private businesses – only to the state.

How much have we lost finally? Of course, it’s impossible to indicate exact numbers. But for comparison I’ll give the example of Latvia, where in 2005 total amount of EU structural funding was around 500 million euros (i.e. over 7 billion EEK).

On the other hand those, who huddled this swindle through – American and Estonian owners of BRS - will become richer. Their income will account hundreds of millions EEK. Maybe also those will get something, who served “privatizers” during all these years – lawyers, managers, political lobbies, etc.

And there is no doubt that individuals who once blessed the suspicious privatization of EVR will carry no liability for this shameful story – even moral one, not talking about legal. In our country we have not yet learned to ask for such deeds, as is well-known. Therefore let’s at least recollect the names of these people.

Let's start with the non-inglorious Mart Laar, head of Estonian government in 1999-2001, therefore formally responsible for the swindle of the century. Now, as everyone knows, he is a member of Estonian parliament and again is spoiling for power. Laar's allies Toivo Jurgenson (the then minister of transport) and Mihkel Pärnoja (minister of economic affairs in 2001), who were the direct managers of EVR privatization, also feel quite well. Director of Privatization Agency Jak Liivik is less lucky, as he got even behind the bar for a short period of time for aggregate of crimes, including legal fiction when signing EVR privatization agreement. He was able to include a provision in the privatization agreement about the state liability to compensate the buyer possible damage in the amount of 100 million EEK and for this he spent 6 months behind the bars.

It seems to be all I wanted to say. A natural question arises – will we learn a lesson from this story? Will we become cleverer and more prudent when planning economic future of our country? We are not quite sure.

Swindles like privatization of the railroad are possible only when state decisions are based on elementary human stupidity. And at this point it's not a sin to recall an aphorism attributed to German Chancellor Otto von Bismark: "Stupidity is a gift of God, but one shouldn't abuse it".

I am saying that because it's a high time for our politicians to learn to listen to such advises... It's really a high time!

#### **DRAMATIS PERSONAE:**

**Mart LAAR**, politician, MP, advisor to the President of Georgia Mikhail Saakashvili. Chaired the government that blessed the swindle with EVR privatization. Was not exposed to any liability – legal or moral. Again is spoiling to the power as the prime minister candidate from the united party of nationalists.

**Sergei GENERALOV**, president of Russian Industrial Investors group, involuntarily became a "Russian effigy" to Estonian politicians, having made Estonian state a bargain in considering BRS ultimatum demands.

**Andrei FILATOV**, managing director of Severstaltrans, was a consistent votary of returning EVR to Estonian state. He said: "In my opinion you can celebrate your new independence when you take back railway infrastructure".