

## "Estonian Railway Will Dispute the Railways Act, at the Same Time Obeying It"

8/12/2005

[ INTERVIEW ]



Eesti Raudtee (Estonian Railway or EVR) privatization is the first and the only example in the territory of the former Soviet Union of selling a strategically important asset to a private company and turning it into a private enterprise. Today Baltic Rail Services, of which Railroad Development Corporation (RDC) is a shareholder, owns 66 % of the shares of EVR. The other shareholders in BRS are Rail World Estonia, a subsidiary of Chicago-based Rail World, Inc., Netherlands based Emerging Europe Infrastructure Fund, and Ganiger, a consortium of Estonian investors. The Chairman of RDC Henry Posner III answers the questions of The RZD-Partner International.

### **Mr. Posner, why did RDC decide to participate in the tender on purchase of the shares of EVR? What strategic objectives did RDC set?**

RDC's business is investment in and management of railways in a number of countries, we are focused on what we describe as "emerging corridors in emerging markets". Our company owns railway assets in the USA, Argentina, Guatemala, Peru, Malawi, Mozambique and Estonia. And every case has its own particular history. Argentina was the first country to "privatize" railways, Guatemala became the first example of 100% abandoned national railway restored by private sector, in Peru the railway is the highest in the world. Speaking about Estonia, it is the only vertically-integrated privatization of a national railway in Europe. Investment in EVR for us is a strategic opportunity to become involved in the former Soviet rail system, which is still the world's largest.

### **Could you tell us a bit more about privatization of EVR?**

We could speak of four key reasons of Estonia's decision to privatize railway: to upgrade the railway's assets to the best international standards; to eliminate financial demands on the state; to generate cash from privatization, dividends etc.; and to reduce costs and improve service, thereby improving the competitiveness of the transit sector. Thus, core infrastructure and freight business were privatized through sale of majority of the state's shares; freight operators got provision for open access; intercity passenger service also moved to private companies and urban passenger service moved to a public company. We took part in the tender. Initially offer of Baltic Rail Services (BRS), of which RDC is a shareholder, was the second place one, as another consortium offered a higher price for the shares. However, that offer proved to be illusory and the government subsequently accepted ours. This ultimately resulted in BRS owning 2/3 of the shares of EVR, the other 1/3 of the shares remain in state hands.

### **Has BRS faced any difficulties in Estonia? Could you define peculiar features of work in the market on the territory of the former Soviet Union?**

Initially there were some difficulties, as BRS bought the stock of a company, EVR, that, while relatively well organized and efficient still suffered from years of underinvestment in locomotives and infrastructure. But we were able to make major operational improvements by replacing the entire fleet of main line locomotives with more efficient General Electric units, and quickly moved to modernize and improve the organizational structure.

Concerning features of work on the territory of the former Soviet Union, I would like to mention that former Soviet republics are characterized by very high rail market share and heavy density of traffic. In this regard, they are the closest to the railways of North America. The institutional environment, however, is much different as the vast majority of the network is state-owned and the environment is much more heavily regulated. EVR heavily depends on Russian cargo flows to be carried in the highly competitive Baltic corridor; our greatest challenge is to influence Russian cargo flows despite having little influence over Russian tariffs.

**Could you comment on the disputable situation of American Locomotives' operating in Estonia?**

EVR purchased 74 used General Electric (GE) locomotives and with minimal modification put them into immediate service on EVR. They have proven as reliable and efficient in Estonian service as in the USA and Peru (where, on our Central Andino affiliate they operate reliably at 4200 meters), and we are very pleased with their performance; at the time of purchase, locomotive prices in North America were low and this was an important step in the economic fulfillment of our business plan. I have ridden on our GEs in both Estonia and Peru many times – these are good locomotives!

There have been allegations that the locomotives have somehow compromised safety and other considerations; however, we pride ourselves on our safety record and more to the point as business people would not consciously set out to cause accidents or damage the infrastructure that a few years ago we paid USD 60 mln for.

**Please, evaluate the situation after the Railways Act implementation in 2003.**

Estonia's Railways Act of 2003 was passed under the guise of adherence to the EU norms but represents a far more punitive and confiscatory regime than can be found anywhere else in Europe and is especially difficult for a private company. As a highly competitive market, the Baltic transit business is not driven by regulation, but rather competition. The Railways Act was thus based on a highly flawed justification, and further has made it more difficult to manage the company as both our operations and revenue stream are now controlled by a newly appointed government agency, the Railway Inspectorate. But more to the point, there was a very specific Open Access regime agreed to at the time of privatization in 2001; this was arbitrarily superseded by the Railways Act of 2003. When we bought the shares of EVR Open Access capacity amounted to 20% and in 2003 it was increased to 100%. This had the effect of confiscating much of the value that BRS paid for. Due to the Railway Inspectorate's imposition of an unsustainable access tariff regime, on a financial basis EVR has gone from profitable to marginally profitable last year. And if in the short-term view the situation is profitable for clients as infrastructure tariff is extremely low, in long-term outlook it leads to lack of financial resources for infrastructure maintenance and development.

Despite all these, we believe that EVR is a model for Europe in terms of efficiency. We hope, in the long-term interests of not only EVR but also the Estonian transit business this can be resolved fairly.

**How could you characterize the existing competition in Estonia?**

As mentioned above, the Baltic transit business is highly competitive; EVR's job is to make Estonian ports competitive with Russian, Latvian, Lithuanian terminals. However, now we face competition using our own infrastructure, at prices that are not only below market but also below cost. Thus, we are competing with one hand tied behind our back. In other words, we are bound by the Railways Act and are obeying the law, while at the same time challenging the Act on a number of fronts.

**What are RDC' further plans in the Estonian market? Is EVR planned to be sold?**

RDC has no plans to sell its interest in EVR. For us it is strategic to have a presence in the former Soviet Union. While this investment has proven to be much more difficult than anticipated, it is a story that is just beginning and we are in it for the long haul. And we are interested in organizing transport business in the

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CIS in future. The key point is to find the right partners, as we have in BRS. We feel our business strengths to be in railway operations and investment but have no particular advantage when it comes to the understanding of politics, culture or local economics. For this reason, in every country in which we operate our strength is measured by who our partners are and how well we work with them.

**Our Reference**

*A founding principal of Railroad Development Corporation (RDC) in Pittsburgh, Pennsylvania, Mr. Posner entered railway service at Conrail, where he served in various Operating, Marketing, Planning and Sales positions.*

*Mr. Posner serves as Chairman of RDC and as such is responsible for identifying transactions and defining RDC's participation in them. He serves as Chairman of Iowa Interstate Railroad; Chairman of RDC's Guatemalan affiliate Ferrovias Guatemala; a Director of America Latina Logistica-Central (Argentina); a Director of Eesti Raudtee (Estonia); and as Vice President of The Hawthorne Group.*

*A graduate of Princeton University (BS – Civil Engineering), Mr. Posner also holds an MBA in Finance from the Wharton School. He is a member of the Transportation Research Board's Surface Freight Regulation & Economics Committee, a member of Princeton University's Operations Research and Financial Engineering Advisory Council, a Trustee of the Winchester Thurston School and has lectured and published extensively on railway matters, with a particular emphasis on developing countries. He is active in welfare programs for the Jewish community in the Former Soviet Union and is the recipient of a Paul Harris Fellowship from Rotary International for his civic work in Guatemala.*

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