

# **THE STRUCTURING OF RAIL CONCESSIONS: Economics and Ethics**

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Good morning. I would like to talk about a subject that is seldom discussed at conferences like this, which is not the technical aspects of railways nor even particularly their economics, but rather the ethics behind the structuring of railway concessions. I felt that this is an interesting topic for this particular venue because now with the railway privatization movement almost 10 years old (in fact, one of the fathers of the movement – Jorge Kogan – is here in attendance), it is about time to talk about the ethics behind the economics.

## **BACKGROUND ON RDC**

RDC is a Pittsburgh based company whose current business is in the privatization of railways. I would also like to add that we are active in many countries but this is probably less impressive than you think; everything RDC does is a joint venture with local partners and in most cases we are minority partners in these ventures.

I am proud to say that as of August 31, 2001 we are now active in Europe. With the privatization of Estonian Railways, the first vertically integrated railway privatization in Europe is now open for business as well as the first privatization of the former Soviet railways.

## **USA SHORT LINE TRENDS (BUYER’S PERSPECTIVE)**

I would like to compare the USA’s railway sector with the rest of the world. In the USA the competition to buy railways is other railway companies; in this context the competition is therefore not trucks but rather other bidders. Because there are so many groups interested in owning railways, there is intense competition and the prices for these businesses have gotten very high.

While the Short Lines in the USA have continued to be very effective in terms of feeding the big railways’ network, the fact is that the big railways have done a lot to reduce their costs, which was the original driver of the Short Line movement. In effect the Short Lines have become less useful to the big systems as they have gotten their own problems under control. This is one of several reasons that RDC has not found a more significant role for itself in its own country.

If one is interested in owning and operating railways, what are the options in this environment? The straightforward answer is to be an *Innovative, Aggressive, Successful Entrepreneur*. And yet any reader of the U.S. trade magazines will soon learn that there is nobody in the industry who is not Innovative, Aggressive, Market Driven and Successful.

So how do you differentiate yourself from that type of competition? The short answer is that you need to know the rules of the game and figure out how to exploit those rules. In particular, you can offer a high price and before the deal is closed, cut the price. Or you can pay a high price and then go to your local government and ask them to give you money because it is not fair to be competing with subsidized trucks. You can also extend your payables, which is a very nice way of saying, "Don't pay your bills." Yet another option is to look overseas for opportunities, and this is the path RDC has chosen.

### OVERSEAS TRENDS

In general, RDC has found opportunities overseas to be a very interesting business. Outside of Europe, railways' competition is trucks, not other railways; and because the railways are often quite inefficient, there is a tremendous opportunity for improvement.

However, there is tremendous risk in evaluating businesses because revenue, which is the single biggest determinant of value, is often very difficult to measure. For example, this was the case in Guatemala where the railway was abandoned for three years before RDC got it reopened. There are also language, cultural, distance and other considerations that make this a very different business from what is typical in the USA.

In this environment you can play many of the games played in the USA in terms of having successful bidding with these concessions. But the environment is fundamentally much healthier because quite often the government is looking for a railway operating the most efficient service as opposed to looking for the highest price. But even in recent years there has been a creeping presence of some of the tricks used in the USA into the overseas businesses. For example, the privatization of Estonian Railways, which has been a problem and an embarrassment for all concerned. (Please note that this example is not intended to embarrass anyone from Estonia!)

Don't just look at the economics...look at the game behind the rules.

Since the initial offer of the highest bidder was a 70% higher price than the second highest bidder, the government really had no choice but to move forward with that party. This party was subsequently revealed to be a shell company with virtually no assets, and first named their strategic investor as CSX; and after that named their strategic investor as Union Pacific; then Canadian Pacific; and at some point even the Association of

American Railroads was mentioned as an investor. Each of these so-called investors

subsequently denied their involvement and it ultimately did come to a happy ending. But this situation made it very difficult for the government and for the other bidders who were basically put on the sidelines while this charade was played out. This is a lesson for other countries – don't just look at the economics, but look at the game behind the rules.

### **CONCLUSION**

In the USA I believe RDC will continue to be a marginal player. We do not have the ability to be as “clever” as our competitors and there would seem to be many competitors for these transactions.

However, the overseas market is a much different market; it requires a knowledge of culture and there is more risk involved. This market is much easier for a small company like ours to enjoy a competitive advantage.

Finally, thank you for the opportunity to address this forum and I hope that what I have said is something you probably have never heard at a railway conference and that I have not wasted your time.

Thank you very much.