

In the matter of the dispute between AS Eesti Raudtee and AS Spacecom,
Tallinn City Court, Judge Piret Randmaa Presiding
Civil Matter Number 2/31-7903/04

STATEMENT OF LOUIS S. THOMPSON

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My name is Louis S. Thompson and I live at the address above.

I was educated at the Massachusetts Institute of Technology from which I hold a Bachelor's Degree in Chemical Engineering and at Harvard University from which I hold a Master's Degree in Business Administration. I worked for three years as an engineering consultant (project manager) for The Badger Company, Cambridge, MA (two years of which were in the Netherlands). I worked for five years at the U.S. Department of Transportation as a budget specialist and as a policy development specialist, with emphasis on railway policy and investment. I then worked for five years with Richard J. Barber Associates, Washington, DC, as a consultant in transport and anti-trust regulation. I then worked for eight years at the U.S. Federal Railroad Administration, a part of the U.S. Department of Transportation. During these eight years I held various positions including Director of the Northeast Corridor Improvement Project, Associate Administrator for Intercity Programs, Associate Administrator for Policy Development and Acting Deputy Administrator. In these positions, I supervised: the US\$2.5 billion upgrading of the passenger and freight railway between Washington, DC and Boston, MA; the development and presentation of the Amtrak budget (and served as the designee of the Secretary of Transportation on the Amtrak Board of Directors); a series of U.S. Federal Government programs of guaranteed loans and direct grants to freight railroads; and, ultimately, development of U.S. Federal railway policies in both the passenger and freight areas. I then worked for the World Bank for 17 years as the Railways Adviser, where I oversaw the development of World Bank lending to all of the Bank's members. In this job, I traveled to nearly every World Bank member country in the world (specifically including Estonia, Russia, Finland, most of Eastern Europe and all of Western Europe) and was involved in lending for both passenger and freight-oriented railway projects. After retiring from the World Bank in 2003, I established Thompson, Galenson and Associates (TGA), LLC, a consulting company specializing in rail policy and financial issues world wide. Specific TGA experience has included analysis of rail infrastructure access charges throughout the E.U. and elsewhere, and analysis of the experience worldwide with involvement of the private sector in rail franchising, concessioning and privatization.

The current case involves a dispute between AS Spacecom (Spacecom) and AS Eesti Raudtee (EVR) as to the correct amount that EVR should be allowed to charge for Spacecom's use of EVR's rail infrastructure. In broad terms, this case has two aspects.

The first aspect is the question of the specific calculation of an access charge, based on detailed examination of the books of account of EVR and with reference to appropriate methods of cost and activity allocation using normal railway operating and management methods. This has been the area of concentration of Chris Osborne of LECG Limited in conjunction with Mr. Ardo Ojasalu, with my assistance and advice as requested. I have reviewed the work of Mr. Osborne and Mr. Ojasalu and, to the extent that railway expertise is applicable (as opposed to accounting expertise for which I am knowledgeable but not an expert), I concur with their work product.

The second aspect is typical of most railway regulatory decisions, and deals with the reasonability of the proposed decision in the light of a number of significant, broader considerations that might suggest that the proposed numerical calculations be adjusted in line with the conduct of the parties. Specifically, in this case, those considerations may be:

1. Has EVR operated efficiently? If not, then at least some part of the allocation of an accounting calculation of actual costs might not be justified.
2. Has EVR operated safely in accord with international practices? If not, the accounting-based calculations of access charges might be adjusted downward to penalize EVR for unsafe behavior.
3. Is the proposed access charge consistent with the access charges of comparable and competitive railways elsewhere? If, for example, the proposed EVR charge were much higher than comparable charges elsewhere, it might suggest both an unreasonable result for Spacecom and one that would distort traffic flows in the region by shifting traffic from Estonia to, for example, Finland, Lithuania or Latvia.
4. To what extent is the initial calculation of an access charge being shaped by external policies or decisions imposed by agencies beyond EVR and Spacecom without those external agencies being required to compensate the parties for the consequences of their decisions. Specifically, what is the impact on this decision of the policy of arbitrarily **defining** EVR's total infrastructure costs as 30 percent fixed and 70 percent variable with traffic and of requiring that passenger trains not pay an access charge? More broadly, what are the implications on this decision for consistency with E.U. law and of the Government's recently announced decision to renationalize EVR?

My statement will focus on the second aspect of the case. In the course of preparation for this statement, I have reviewed all relevant documents and, during a visit to Estonia in April and May of 2006, interviewed representatives of EVR, Spacecom and the Government of Estonia.

To date, the issue of an appropriate access charge has been the subject of many studies. For a number of reasons, including different access to data, differing degrees of detail in analysis, and different specific interests, a number of differing access charges have been suggested, as shown in the table below.

Comparison of various calculations of access charges

	KPMG Using EVR Budget for 2004*	KPMG Budget excl asset revaluation*	KPMG using actual expenses*	KPMG actual excl asset revaluation*	Rimess**	EVR estimate***	Railway Inspectorate	Experts' Estimate (Osborne and Ojasalu)***
WACC (%)	12.88	12.88	13.35	13.35	8.77	13.35		10.84
Infrastructure operating cost (EEK 000)	415,534	415,534	395,278	395,278	369,000	408,925	413,348	389,717
Capital investment component (EEK 000)	318,340	318,340	325,093	325,093	119,000	348,725	129,323	293,969
Value of asset base (EEK 000)	2,667,093	1,502,863	4,732,637	1,807,245	1,014,000	2,865,834		1,557,475
Owner's return (EEK 000)	343,522	193,569	631,807	241,267	88,928	382,589	179,720	168,830
Additional services (EEK 000)	9,302	9,302	-	-	162,278	3,595		-
Total Infrastructure cost (EEK 000)	1,086,698	936,745	1,352,178	961,638	739,206	1,143,834	722,391	852,516
Train kilometers	8,655,924	8,655,924	8,655,924	8,655,924	8,655,924	8,655,924	8,655,924	8,655,924
Gross ton-km (000)	19,503,244	19,503,244	19,503,244	19,503,244	19,503,244	19,503,244	19,503,244	20,228,000
Tons	42,833,229	42,833,229	42,833,229	42,833,229	42,833,229	42,833,229	42,833,229	42,833,229
Train-km cost (EEK/train-km)	37.663	32.466	46.864	33.329	25.620	39.643	25.037	29.547
Gross ton-km cost (EEK/gross ton-km)	0.0390	0.0336	0.0485	0.0345	0.0265	0.0411	0.0258	0.0295
Equivalent average access charge/ton	25.37	21.87	31.57	22.45	17.26	26.70	16.87	19.90
Average access charge/gross ton-km	0.0557	0.0480	0.0693	0.0493	0.0379	0.0586	0.0370	0.0421

* KPMG, 7 June 2005, ** Rimess report (numbers in italics cannot be replicate), *** LECG Final Report with Ojasalu concurrence

The range in the proposed average access charges is almost a factor of two, from the EEK 16.87/ton of the Railway Inspectorate, (EEK 17.26 in the Rimess analysis) to EEK 31.57/ton calculated by KPMG using actual expenses and revaluing EVR's assets. The reasons for the variation result from widely varying assumptions or valuations of the factors that drive the calculation, including Weighted Average Cost of Capital (WACC), infrastructure operating cost, the capital investment component, including the value of the asset base, the owner's return on investment, and the effect of additional services. Of these, it is clear that the treatment of capital investment is the most significant component. For example, the proposed average rate of EEK 19.90/ton would fall to EEK 19.15/ton if the Rimess WACC of 8.77 percent were used, would fall to EEK 18.53/ton if the Rimess estimate of EEK 1,014,000 were used for the value of the asset base, and would fall to EEK 18.04/ton if both assumptions were changed together. The experts' calculation, with which I concur, is an average of EEK 19.90/ton, or EEK 0.0421/gross ton-km, somewhat lower than the average calculated by the other international consultants.

Has EVR operated efficiently?

Measuring railway "efficiency" is at best an inexact science, partly because of inherent differences among railways, and partly because of incomplete or inaccurate data. Inherent differences might include: the size and scale of the railway; freight and passenger traffic mix; freight commodity mix; ownership (as between private and public); and, the predominant objective of the railway, ranging from commercial to social. In order to address the question of efficiency, I have decided to employ a sample of countries, partly because of regional comparability, partly because of ownership variations, and partly because of the availability of information. The sample¹ will, when data exist, include Estonia, Latvia, Lithuania, Finland, Sweden, Germany, Poland, Russia and the Class I railways² in the United States. Overall, this sample covers a wide range of scale and efficiency, both in a regional, a European, and an international context. Data have been collected from public sources, including the "Statistics of Class I Railroads"

¹ In the case of the E.U. railways presented, the statistics represent the sum of the infrastructure company and the operating companies, consistent with UIC reporting practice.

² Class I railways in the United States are defined as enterprises generating at least US\$319.3 million in revenue in 2005 (AAR, Handbook of Railroad Facts, 2006 edition, pg 3).

published by the U.S. Surface Transportation Board (STB), various issues of the “Costed Waybill Sample” published by the STB, various issues of “International Railway Statistics” published by the International Union of Railways (UIC) in Paris, Railway Statistics – Synopsis 2005 published by the UIC, Annual Reports of the railways, and the World Bank’s Railway Database (in some cases updated from original sources).

The basic sample is displayed below.

	Measures of Size and Scale						Operating Measures					
	Total Route-km	Passengers (000)	Passenger-Kilometers (000,000)	Freight Tons (000,000)	Freight Ton-km (000,000)	Staff	Average Lead, Freight (km)	Average Lead, Passenger (km)	Traffic Density (000 of TU per km)	Employees per km of Line	Total Wages / Total Revenues	Employee Productivity (000 TU/empl)
Estonia	959	5,200	248	44.8	10,311	3,300	230	48	11,010	3.44	0.213	3,184
Finland	5,732	63,500	3,478	40.7	9,706	10,471	238	55	2,300	1.83	0.586	1,268
Germany	34,218	1,785,400	72,554	274.6	88,022	224,600	321	41	4,693	6.56	0.401	715
Latvia	2,375	25,900	894	54.9	17,921	14,600	326	35	7,922	6.15	na	1,289
Lithuania	1,772	6,700	728	49.3	12,457	11,300	253	109	7,441	6.38	0.264	1,140
Poland	19,507	218,000	16,742	155.1	45,438	127,700	293	77	3,188	6.55	0.479	487
Russia	85,542	1,335,128	164,262	1,212.2	1,801,601	1,204,300	1486	123	22,981	14.08	na	1,747
Sweden*	9,867	34,900	5,673	42.8	13,120	13,000	307	163	1,905	1.32	na	1,424
USA:Class I*	153,787	24,164	8,681	1,733.0	2,478,912	162,438	1430	359	16,176	1.06	0.230	15,260

* includes Amtrak passenger data

Green Cargo tons for 2004 based on 2003 number

"TU" (traffic units) are the sum of ton-km plus passenger-km

EVR is the smallest of the railways in the sample measured by route-km, passenger traffic and staff size (number of employees). In freight tonnage and ton-km, however, it is larger than Finland and roughly comparable to Latvia, Lithuania and Sweden. It is, of course, far smaller than Russia or the U.S.

Looking at the Operating Measures, however, a somewhat different picture emerges. On one key measure of freight competitiveness – average freight lead (ton-kms/tons) – EVR (230 km) is nearly the same as all but Russia and the US.^{3, 4}

Another key determinant of railway economics – the average traffic density (expressed as Traffic Units (the sum of ton-km plus passenger-km) divided by km of line) -- a similar picture emerges. EVR (11.0 million Traffic Units/km) has a higher traffic density than all but Russia and the U.S.: only Latvia and Lithuania are even close.

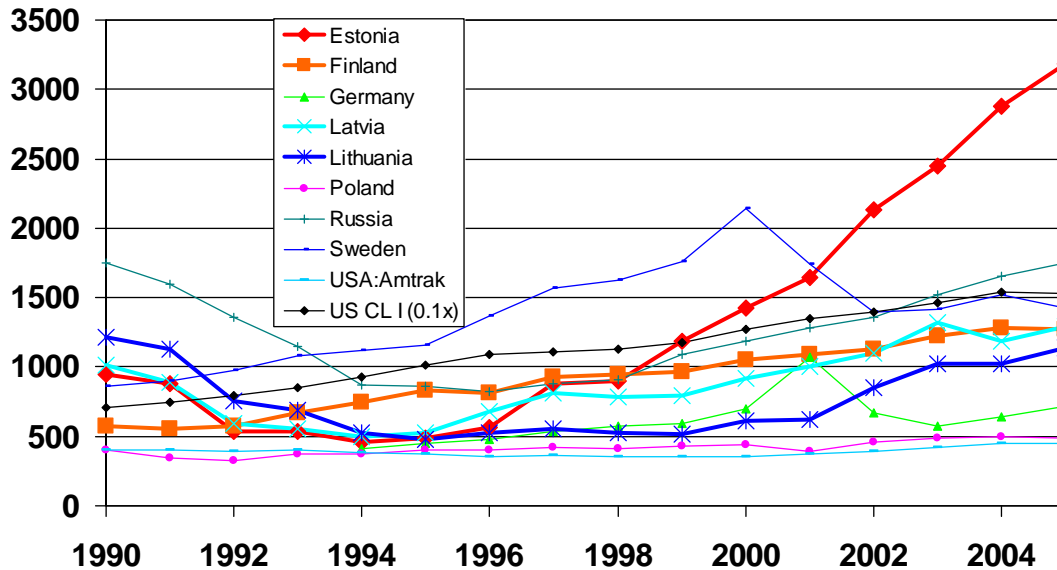
The key determinant of railway costs worldwide is labor productivity. The ratio of wages to revenues from freight and passenger traffic is a basic measure of the importance of labor costs, and this measure shows EVR to be fully comparable with the best world practice, with a ratio (0.213 in 2004) even slightly better than the U.S., significantly below that of Lithuania (data for Latvia are not available) and only half (or less) that of other E.U. countries in the sample.

³ Compared with trucking, railways require large load sizes and have high loading and unloading costs. Moreover, railway service tends to be slower and less reliable than trucking, but it is cheaper. As a result, railway’s competitive advantage tends to emerge for lower valued commodities and at longer average distances. In fact, all of the average railway leads except Russia and the U.S. tend to be at the lower edge of competitiveness. Fortunately, since EVR’s traffic tends to be Russian export/import traffic, EVR’s effective average lead is longer than the purely domestic statistics indicate.

⁴ I will not discuss rail passenger economics in this statement, as the issues are not relevant.

The foundation for EVR's favorable ratio is shown in the traffic density measure and the employee productivity measure. EVR has been able to operate with relatively few employees/km of line (allowing for its high traffic density) and it has been able to produce freight traffic for less labor input than any railway other than the U.S. Probably more significant for this case is the trends that have emerged in labor productivity since the collapse of the former Soviet Union, as shown below:

Annual Output per Employee (000 TU/Employee)



Estonia has risen from the middle of the pack in the mid-1990s to having the best labor productivity in the sample except for the U.S. Class I railroads (note that the actual U.S. levels are 10 times higher than shown in order not to compress the scale for all other railroads). To be accurate, this trend began in Estonia before the actual privatization, possibly because the intention to privatize enabled efficiency improvements that would not have occurred otherwise. In any event, the improvement in labor productivity accelerated after EVR was established, and it far outstripped the productivity growth in, for example, Latvia, Lithuania and Finland.

Conclusion: *As discussed, railway efficiency is difficult to measure conclusively, for a number of complex reasons. With this acknowledged, however, both the absolute levels and the relative trends in the various measures of efficiency show that EVR would meet an acceptable standard of efficiency by any reasonable international standards. There is no reason to argue for reducing the proposed access charges on the ground that EVR might be inefficient in its provision of freight, or infrastructure, services.*

Has EVR operated safely in accord with good international practices?

Safety records of railways are particularly difficult to compare because accident data are often not reported publicly and, when they are published, employ definitions of

“incident” or “casualty” that are not readily comparable, or estimate the value of accident damage on widely differing bases. The data suggest that EVR has an accident rate that is comparable to or better than that of other railways, and below that of the U.S.

Allowing for the difficulty of comparing safety among railways, it may be more significant to compare EVR’s performance over time.

	2000	2001	2002	2003	2004	2005
EVR personal injuries	27	24	15	8	9	6
Work Days Lost	1101	687	561	270	296	208
Injury Rate/200,000 working hours	0.659	0.621	0.443	0.286	0.362	0.231

Source: EVR statistics

The accident experience improved significantly since EVR began managing the railway, in absolute terms of injuries and work days lost, and in the rate (accidents per 200,000 working hours).

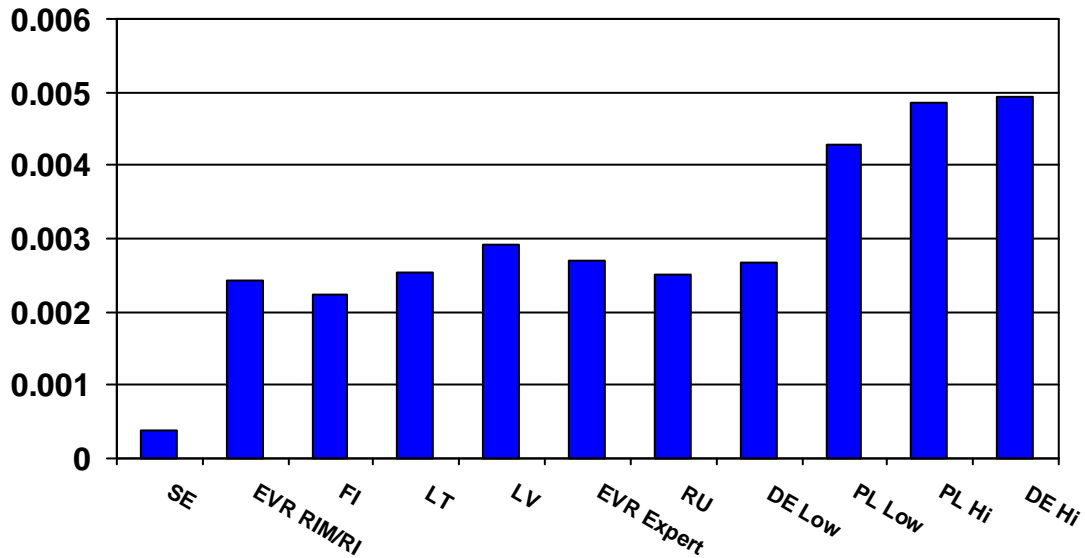
Conclusion: EVR’s accident experience has significantly improved over that of the old Estonian Railways, and is at least comparable with international practice. There is no basis for reducing the proposed access charges on safety grounds.

Is the proposed access charge consistent with the access charges of comparable and competitive railways elsewhere?

Recent studies⁵ have shown that the system of E.U. railway access charges is an inconsistent patchwork of different levels and structures. The differences are caused by three main factors: differences in the underlying cost structures of the various infrastructure agencies that naturally cause access charges to be different; differences in the financial objectives that governments set for the infrastructure provider, with some providers required to collect their full costs from users with no support from government (EVR, for example), and some expected to collect only marginal cost, or less, from users (Sweden); and, the use of two-part versus simple charging mechanisms. With these caveats in mind, a comparison of average access charges (in €/gross ton-km) is shown below.

⁵ See, for example, ECMT, “Railway reform and Charges for the Use of Infrastructure,” Paris, 2005

Average Access Charges in €gross ton-km



In this comparison, I have included both the experts' estimate of the appropriate access charge for EVR and the estimates developed by Rimess and the Railway Inspectorate (combined and shown as RIM/RI). These comparisons are based on the best available estimates of access charges, and use official rates of exchange. The estimate for Russia must be regarded as an approximation based on an indirect calculation.

The direct comparison shows the experts' finding to be fully comparable with the access charges of the other area railways, with the Rimess/Railway Inspectorate calculations slightly below the other area railways. It is not clear, however, what policies Latvia and Lithuania have concerning the percent of the total costs that are considered "fixed" versus "variable." I do know that Latvian and Lithuanian passenger trains pay significantly higher access fees than do Estonian passenger trains: with higher passenger access charges, Latvia and Lithuania would naturally have somewhat lower freight access charges (the impact of Estonian policies on both these issues will be quantified below).

Given that Estonia enjoys the shortest and most economical route for export shipments from Russia, it appears that access charges for EVR at the proposed level would be unlikely to divert traffic from Estonia to competing routes. Imposing a rate at the level proposed by Rimess or the Railway Inspectorate would thus have the primary impact of diverting earnings from EVR to other operators without generating any significant increases in export traffic.

Conclusion: *The experts' proposal falls well within the range of the access charges in the area. The Rimess and Railway Inspectorate proposals are low by comparison with adjoining countries, and, if imposed, might simply have the effect of reducing EVR's income and investments while not generating any increases in traffic.*

There is another question that has been raised that relates to access charges. It has been alleged that EVR has been under-investing in the infrastructure. If true, then the Court might at first glance wish to reduce the proposed access charge until adequate investment levels are demonstrated as a way of encouraging more investment. Aside from the fact that lowering the access charge for competing users would actually lead to lower investment, it appears likely that EVR's investment has been adequate if not higher.

Because fully comparable investment data are not available for most countries, I have only been able to compare EVR's practice with that of the U.S. Class I railroads, for which good data are available, and which have freight traffic that is similar to EVR's patterns. The comparison is below, expressed as the percent of revenue used for infrastructure investment.

	2001	2002	2003	2004	2005
EVR	15.8	17.4	14.6	21.8	24.6
US C I I	12.8	13.1	12.4	12.2	11.6

Sources:

EVR Income Statements

STB, Statistics of Class I Railroads, Accts 1 and 378

As shown in the basic sample data above, the U.S. Class I railroads operate at a traffic density (TU/Km) that is nearly 50 percent higher than EVR. Though not shown, the U.S. Class I railways actually operate at a higher axle load than EVR, which should impose a higher burden on their maintenance budgets. Under these conditions, the U.S. Class I railroads have been spending 11.6 to 13.1 percent of their revenue on investment in their infrastructure and, by doing so, have provided a well-maintained infrastructure for a traffic mix that is similar to Estonia. EVR has, by comparison, been spending 14.6 to 24.6 percent of their revenues on infrastructure investment, a level well above that of the US.

The table below displays the same comparison in terms of infrastructure investment per Km of line, a measure of the actual effort expended.

	2001	2002	2003	2004	2005
EVR	17,042	20,341	17,115	25,346	29,591
US CL I	21,592	22,236	22,054	24,250	26,830

It is, of course, always difficult to make comparisons involving currencies, and the above is acknowledged to be approximate, using official rates of exchange. Nevertheless, it is, in my opinion, significant that EVR's investment has been comparable to, or above, that of the U.S. Class I railroads despite the higher traffic density and higher axle loads of the U.S. system.

Conclusion: *EVR's investment in infrastructure has been adequate, or better. There is no basis for reducing the access charges recommended on the basis of investment performance.*

To what extent is the initial calculation of an access charge being shaped by external policies or decisions imposed by agencies beyond EVR and Spacecom?

There are two specific issues that many of the expert analyses have raised, and a more general set of issues that deserve attention. The specific issues are the exemption of passenger trains from the train-km (capacity) charge and the arbitrary assumption that EVR's infrastructure costs are 30 percent fixed and 70 percent variable. The more general issue will be the validity of the Railway Inspectorate's approach in the context of the E.U. railway policies and the implications of the policies for Estonia if the currently proposed re-nationalization of the railway is consummated.

Exempting the passenger trains from the train-km charge. Passenger trains generate approximately 30 percent of the train-km on the line. In addition, the fixity of the passenger schedules and the relative speed of the passenger trains mean that the impact of passenger trains on capacity in general is likely to be somewhat greater than the train-km percentage would indicate. There appears to be little validity to the decision to exempt the passenger trains from a capacity-related charge: the only basis appears to be a desire to force freight operators to pay the passenger-related costs and thereby avoid a related charge to the Government budget. If the total infrastructure costs are 30 percent fixed (a highly questionable assumption as discussed next), the passenger trains should be paying about EEK 76.7 million per year that freight users are now paying. This would reduce the average charge by EEK 1.79/ton, from EEK 19.90/ton to EEK 18.11/ton – a 9 percent reduction. A 9 percent reduction in the average charge per ton-km would further reduce the access charge range in the area's railways and make EVR even more comparable with regional railways.

The effect of the assumption of 30 percent fixity in EVR's costs. The Railway Inspectorate has concluded that EVR's infrastructure costs are 30 percent fixed, and 70 percent variable with respect to traffic. This leads to the allocation of only 30 percent of the total infrastructure costs to train-km (use of capacity) and 70 percent of total infrastructure costs to gross ton-km (the generator of wear and tear).

I am unaware of any factual basis for this assumption. In fact, current discussions elsewhere in the E.U. would support the reverse conclusion -- or even more -- with marginal costs (those that vary year-to-year with use) being only around 20 percent of total costs. Other experts concur.⁶

The 30 percent fixed assumption, when combined with the exemption of passenger trains from the train-km charge, is a significant hidden factor. If total costs were actually 80 percent fixed (that is, if 80 percent of costs were assigned to the train-km factor and 20 percent of costs were assigned to the gross ton-km factor) and if passenger trains paid, as

⁶ See, for example, Price Waterhouse Coopers analysis dated 21 October 2003.

arguably they should, 30 percent of the fixed costs as their share of the train-km charges, then passenger trains would be paying EEK 204.5 million in added access charges, and the experts' recommended charge per ton of freight would fall by an average of EEK 4.77/ton or EEK .0101/gross ton-km (a reduction of 24 percent). A reduction of 24 percent would put the recommended EVR access charge for freight users fully into the competitive range with (actually somewhat below) area railways. Put another way, **it is the Government policy of shielding its budget from passenger-related costs by taxing freight shippers that is forcing EVR's freight access charges upward and accordingly reducing the competitiveness of Estonia's railway routes and ports.**

Conclusion: *As an expert, I believe that the Court should take cognizance of the effect of these two policies on the freight access charges. Whether the Court can (or should) order that the policies be changed is beyond my expertise; but, I do believe that the effect of the policies should be acknowledged when deciding what a proper access charge should be.*

The broader E.U. context. It is not within my purview to make a legal argument as to whether the Estonian regulations actually **contravene** E.U. law: perhaps even this Court would be reluctant to do so. The basic framework of E.U. law requires: that the infrastructure manager must receive, in total, revenues from access charges or government support that will cover full financial costs; that **all** users should pay access charges that at least cover marginal costs; that governments ideally should not require infrastructure managers to cover full financial costs from users, but should instead provide enough support to the infrastructure provider so that access charges should only cover marginal cost; and that, if a government requires that the infrastructure provider collect more from users than marginal costs, the infrastructure provider should develop "mark-ups" on marginal cost that would not distort the usage of the system from the pattern that would occur if the manager did charge marginal cost access charges.

The clear implication of the E.U. law is that governments would own and manage infrastructure and support it fully beyond the collection of marginal access charges from users. If governments chose, for budgetary reasons, to require the infrastructure manager to collect more than marginal costs from users, there is also the clear implication that non-discriminatory "mark-ups" on marginal cost would suffice.

The contrast in the Estonian case is obvious. Unlike the inherent assumptions of the E.U. model, EVR is (or was – the implications of re-nationalization will be discussed below) a private concern that has no guarantee from government for support of any kind. EVR must therefore expect to collect from access charges (explicit or imputed) in total enough income to support the full financial cost of infrastructure, including returns on its investment therein. If Government policy imposes an access charge regime on EVR such that a **company competing with EVR pays less for the use of infrastructure than EVR must collect**, then EVR will be at a competitive disadvantage **and** will find it more difficult to maintain its infrastructure. A direct effect of requiring that competing users pay less than full cost for access, especially if that required access charge is artificially

low, must be that EVR loses traffic that it could carry, and that EVR will be unable to collect, in total, enough to maintain its infrastructure.

To see why this is so, consider the logical result of an imposed and unreasonably low access charge. Assume for the moment that EVR's train operating costs are the same as those of a competitor that wants access to the EVR infrastructure. In this case, if EVR's tariffs to its customers reflect an allocated infrastructure cost that is higher than the access fees charged to competitors, then the competitors would under price EVR and it would lose its traffic. The net result would be that EVR would collect in total an amount below the full costs of infrastructure, and it would be financially broken. If EVR did price its services based on the imposed access charge, then all of the traffic together (no matter who carried it) would generate inadequate access revenues, and EVR would again go broke. The fundamental contradiction is that EVR is a privately financed company that must collect its full financial costs, in total, but that the inevitable result of unduly low, imposed access charges – in the absence of public compensation – will produce a result that contradicts both E.U. goals and common sense.

If the Estonian government wanted to ensure that the infrastructure provider does cover its full financial cost, then it would have to pay the fixed costs of the infrastructure provider and impose access charges to collect only marginal costs from users. Or, it could elect not to contribute to infrastructure costs by ensuring that all users paid charges such that, on a non-discriminatory basis, the infrastructure provider collected its full financial costs and was indifferent whether the traffic moved by its carrier or a competitor. Anything less would (whether strictly legal or not) clearly contravene the objectives of E.U. policies. In this regard, it is worthwhile noting that E.U. law only applies to E.U. members: nothing in E.U. law would force EVR to develop access charges for traffic from non-E.U. members that are the same as for E.U. members. The basic objective of E.U. policy as enumerated in Directive 91/440 was to promote railway efficiency, boost the market share of railways in the E.U. transport sector, and foster competition among E.U. railways on the E.U. railway infrastructure. I know of no other cases in which E.U. law has been construed to require that non-E.U. carriers should enjoy access to an E.U. member's infrastructure on the same terms as other E.U. members.

Conclusion: *the Estonian Government and the Railway Inspectorate were pursuing a policy that is inconsistent with the objectives of E.U. law and with the long range financial stability of EVR. A consistent policy is available: either permit access charges that are, in total, consistent with the coverage by the infrastructure provider of total financial costs; or, let each user, including EVR, pay marginal costs, and have public funding for the remainder between access charge revenues and full costs. The court may not be able to command the second approach, but it can certainly ensure the first.*

The broader Estonian context. It would serve no purpose to ignore the agreement that has been announced between Government and EVR to renationalize the railway, infrastructure and all. This would be an entirely legitimate exercise of public policy and, so long as the repurchase price is not confiscatory (I express no opinion on this, but do note that the price was freely negotiated), is certainly a logical resolution that is

consistent with E.U. law. It does, however, raise a crucial point that will serve to put the discussion above into perspective.

When the repurchase is fully consummated, then the newly public infrastructure agency will face exactly the same issues of setting access charges as are raised in this case, but from a very different perspective. After repurchase, the agency will either have to collect its full financial costs from users, or Government will have to support it. If, as suggested, Government privatizes the new EVR freight operator, then that operator would have to be allowed to pay the same access charges as all other users and, presumably, this would be the same as the charges that Rimess and the Railway Inspectorate now believe are appropriate for Rimess. It is agreed that charging all users the same access fees recommended for Rimess would not generate full financial costs. What then?

Conclusion: After re-nationalization, Government will face exactly the same choices it faced before, but will find them harder to resolve. If it wants to continue to subsidize passenger trains, and does not want to support infrastructure explicitly, then freight access charges will have to rise (exactly to the levels recommended or higher). Moreover, if the efficiency under public management falls to the levels exhibited elsewhere in the region or the E.U. (that is, if falls by half or more – see the sample of comparable railways above), then access charges will have to rise even more. In addition, if Government continues its policy of not supporting infrastructure financially, then the access charges of the infrastructure agency will need to go up even more (or it will not survive). The policy of hiding the passenger access charges within the freight system and of distorting the fixed component of the infrastructure cost will no longer be cost-free to the Government. It would be appropriate for the Court to take this contradiction into account in its decision.

STATEMENT OF VERIFICATION:

I hereby attest to the following:

That the report above, pages 1 through 12, is my product based on research I performed and on consultations with Chris Osborne of LECG;

That the facts cited are to the best of my ability to determine correct and based on reliable sources;

That the conclusions reached are my own, and are based solely on my experience and the facts cited.

Signed: -----

Date: -----

VERIFICATION:

I hereby attest that Louis S. Thompson appeared before me and signed the above statement and certified to its truth and accuracy.

Name: -----

Date: -----

Notary Public