



RAIL BALTIC JOINT VENTURE STUDY

MAIN REPORT

February 2013
Tallinn, Estonia



Co-financed by the European Union
Trans-European Transport Network (TEN-T)

TRINITI
TALLINN RIGA VILNIUS



TABLE OF CONTENTS

2. LEGAL	35
2.1. Functions of the Joint Venture	35
2.2. Structure of the Joint Venture, Type of the Legal Person	36
2.3. Options of Creating the Joint Venture	39
2.4. Share Capital Requirements	43
2.5. Allocation of Shares	44
2.6. Corporate Governance of the Joint Venture	48
2.7. One-tier vs two-tier management structure	48
2.8. Composition of the Supervisory Board and the Management Board	50
2.9. Requirements for the Supervisory Board and Management Board members	51
2.10. Professional profile of the Joint Venture CEO	52
2.11. Shareholders' Agreement	53
2.12. Railway Legislation	58
2.12.1. Railway Infrastructure Fees	58
2.12.2. Specific Regulatory Issues	60
2.12.3. Proposal to Create an International Legal Body "Baltic Rail Commission"	63
2.13. Public Procurement	68
2.14. Compulsory Expropriation	72
3. TAX	74
3.1. VAT	74
3.2. Corporate income taxation in Estonia	76
3.3. Corporate income taxation in Latvia	78
3.4. Corporate income taxation in Lithuania	81
3.5. Property taxation	84
3.6. Invoicing for track access and use charges of three Baltic States	87
3.7. Two-tier structure	89
3.8. One tier structure	98
3.9. European Economic Interest Grouping (EEIG)	105
4. FINANCING	107
4.1. EU Financing	107
4.2. Project Management Costs	112
4.3. Private sector financing	122
4.4. The difference between capital sources and financing structures	122
4.5. Definitions of Concession and PPP	123
4.6. Overview of PPP and Concession utilisation in similar projects	124

4.7. Investors in PPP	128
4.8. Sentiment of market participants & expert assessments	129
4.9. Analysis of different options	131
5. INTERNATIONAL EXPERIENCE	133
5.1. Øresund Bridge	133
5.2. Eurotunnel	138
5.3. Brenner Base Tunnel	143
5.4. Railion Denmark	150
5.5. The Central Commission for Navigation on the Rhine (CCNR)	153
5.6. European Rail Networks for Competitive Freight	157
5.7. Best practice and recommendations	158

2. LEGAL

2.1. Functions of the Joint Venture

The general outlines for the Implementation Programme of the Rail Baltic project have already been identified in the AECOM Study.

The participating states need to agree on the division of different steps of the Implementation Programme between the national bodies and the Joint Venture. In particular in the planning and implementation phase the common approach to the matters of EU financing, spatial planning and procurement is of vital importance for the successful implementation of the project.

Short-term functions (Phase I) of the Joint Venture would include:

- 1) Overall project management and centralized administration
- 2) Coordinating information between member countries
- 3) Preparing programme finance applications and subsequent implementation
- 4) Monitoring programme progress and funding
- 5) Organising centralised public procurement tenders
- 6) Contract management
- 7) Legal coordination
- 8) Preparing technical specifications for design and construction of railways
- 9) Creating a team of 1435 mm railway experts and ensuring progeny
- 10) Reporting to the national governments and European Union agencies
- 11) Marketing of the project to future clients (freight and passenger operators)
- 12) Coordinating constant communication with the public about the project's progress
- 13) Strategic stakeholder consultations
- 14) Risk management

Please note that in the initial stage after the establishment of the Joint Venture its three primary functions which could not be sufficiently covered by the Task Force or other civil servants would be:

- A) Pre-marketing of the new infrastructure to future clients and co-operation partners (freight and passenger services, logistics companies, terminal managers, service providers, etc);
- B) Development of the business plan (incl forecast of cargo and passenger flows, risk analyses and mitigation, market surves, etc);
- C) Financial plan (incl the plan of preliminary cash-flow, analyses of the necessary the capex investments, preliminary dialogue with the potential financeers, etc.).

Long-term functions of the Joint Venture with respect to the entire Rail Baltic network:

- 1) Single point of reference for the railway infrastructure management
- 2) Single point of reference for the maintenance of the railway infrastructure
- 3) Single point of reference of safety management
- 4) Single point of reference of the capacity allocation
- 5) Single point of reference for infrastructure charges and collection thereof
- 6) Single point of reference for the management of railway traffic
- 7) Cross-border co-operation

2.2. Structure of the Joint Venture, Type of the Legal Person

In principle it is preferable that the entity to be placed in charge of this project is under direct state control. Additional layers, even if controlled by state, would complicate the process, prolong the command and reporting chain, hinder and distort the flow of information etc. Infrastructure development projects of this scale are defined by the EU as state governed projects. However the current laws in each of the Baltic States prohibit each of Estonia, Latvia and Estonia to directly invest into foreign companies, therefore considering that it is recommendable to start with the foundation of the Joint Venture as soon as possible, then at least at the start-up of the Joint Venture the states have to participate through 100% owned holding companies.

Both NIB and EIB pointed out that the key to the structure has to be government guarantees and state backing of the project. The involvement of the railway companies was not seen as an immediately positive factor. NIB also highlighted that all of the state railway companies are currently leveraged and when additional loans would be required, they would have to get consent from the current debt holders, as restrictions and covenants have been set for additional material debt. NIB has first-hand knowledge of the issue, as they have experience with all three country railway companies. Majority of the feedback from the local railway companies suggests that the most optimal solution would be a joint company where the railway specialists from all three countries would be involved. This legal entity should be separated from the current rail companies and stay under direct state control. This would also ease the process of requesting EU support. Both Latvian and Estonian railway companies specified that they could act as consultants for the newly formed entity and provide the current railway know-how.

The counter-arguments for directly involving the railway companies are the following. Firstly, the scale of this project is much greater than the extent of their current operations. In addition, two of the incumbent national railway infrastructure managers believe that this new project could seriously influence the current rail traffic in the Baltics and fear that money generated by the east – west line would be used to subsidise the newly established Rail Baltic line. This would possibly make the current rail transit more expensive and the current operators and expeditors would have less interest in investing in future developments. The additional complication is decision-making, in case all three rail companies have to agree on consensual decisions.

However, there is also an example of a different approach. Although currently on hold for a variety of reasons, in the new Ignalina nuclear power station project, the state-controlled power companies were proposed as the shareholders of the SPV, not the states themselves.

It has to be noted that as Lithuania has already started the development and modernisation of their railway connections to Poland on the 1435 mm gauge, the position of the Lithuanian Railway Company on direct involvement is much more supportive.

Analysis of pros & cons

The pros and cons of different approaches are reported in the table below. However, these are not mutually exclusive as, for example, existing employees of railway companies could still be involved in state-owned JV, etc.

Table 1 - Pro & Cons of direct state control and control through existing railway companies

	Pros	Cons
Direct state control	<ul style="list-style-type: none"> • New company and structure • Single focus • Direct state control over the management and clear delegation of authority and tasks to the supervisory board • Direct state ownership likely to simplify loan and EU support negotiations • Can still use the expertise of government owned railway companies 	<ul style="list-style-type: none"> • New company and structure needs to be established • Direct pressure on governmental budgets and debt levels • No legal „firewall“ between the state as a shareholder and the Joint Venture
State control through railway companies	<ul style="list-style-type: none"> • Leverage of the current railway know-how, personnel and other capabilities of railway companies • Railway experience immediately available and functional without the initial set-up period of a new company • Certain economic benefits, like efficiency • Wider involvement of stakeholders • Use of existing 1435 mm gauge railway expertise (in case of LG) 	<ul style="list-style-type: none"> • Unclear interest and even scepticism from some railway companies • Conflict of interest with the current east - west lines (and the new 1435 mm sections in Lithuania) • Existing RI may have to cross-subsidise the initially unprofitable Rail Baltic • Rail Baltic could easily overwhelm the current organisational structure, goals and capabilities • Could complicate the EU funding process • Current companies are already leveraged and would require approval from current debt holders • Difficulties to control and monitor their peer companies • Conflicts of interest due to Baltic railway companies being direct competitors

Type of the Legal Person (Domestic Type vs Societe Europeanne)

With respect to the type of the legal person the main question is whether the Joint Venture is established as a „domestic company“, e.g. AS in Estonia and Latvia or AB in Lithuania, or whether an European company (Societas Europaea or SE)¹ should be considered as a type of a legal person for the Joint Venture. Joint Venture has pan-European reach involving activities in at least three countries of European Union. Therefore in case a one-tier company structure is used for a Joint Venture (single legal person registered in any of the Baltic countries with branches or representation offices which separately are not legal persons), it should be considered whether that one-tier company is SE or a „domestic company“.

Analysis of the material issues pertaining to the SE can be found in Annex 6.

¹ Council Regulation (EC) No 2157/2001 as of 8 October 2001 on the Statute for a European company (*Official Journal L 294, 10/11/2001 P. 0001 – 0021*)

Pros and cons of SE²:

Pros of SE:

- EU-wide legal recognition compared to „domestic“ legal vehicles. It is reported to have an advantage especially for companies in small countries, in Eastern Europe;
- Cost reductions through the reduction of the number of subsidiaries;
- Solid and uniform group structure;
- Simplified reporting proceedings, less accounting and auditing formalities and costs;
- Ease of transfer of registered office from one Member State to another;
- Input of share capital from a single point, not distributing among all three participating companies.

Cons of SE:

- SE as a company form is relatively unknown in the Baltics which may cause practical difficulties with the domestic laws and relations with authorities;
- SE used primarily in services industry (23% of all SE's are active in financial services sector, 19% in commercial services, but 3% in transport sector)³;
- Encumbersome foundation procedures compared to a „domestic“ company;
- Employee participation requirement as set forth in the SE Regulation is uncommon in each of the Baltic States legal system.

² See also REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL The application of Council Regulation 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) (Text with EEA relevance) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52010DC0676:EN:NOT>

³ As of 1.10.2012 - <http://www.worker-participation.eu/European-Company-SE/SE-COMPANIES/Facts-and-Figures>

2.3. Options of Creating the Joint Venture

Current laws in each of the Baltic States establish prohibition for the State to invest into foreign companies, for example in case the Joint Venture is established in Latvia, the laws of Estonia and Lithuania respectively preclude the Republic of Estonia or Republic of Lithuania from acquiring shares in such a Latvian-registered Joint Venture.

There are also limitations with respect to the type of the commercial entities where the State can acquire participation, mostly referring to domestic companies. For example in case a SE is used for the Joint Venture, the current laws preclude the acquisition by each of the states participation in a SE. This can be remedied through a use of a holding company 100% in the ownership of the respective participating State or by amending the laws, the latter obviously being the more time-consuming option.

Please see Annex 7 with respect to the limitations on the acquisition of participation in the non-domestic companies in Estonia, Latvia and Lithuania.

In connection with the setting up of the Joint Venture, there are multiple choices. We have narrowed the choices down to the following five:

OPTION I – FIRSTLY SETTING UP HOLDCOS IN EACH PARTICIPATING STATE

(Non-direct participation in the JV)

In this option the shares of the JV are not owned by the respective participating States directly, but by companies 100% owned by the respective participating state.

1st step – setting up holding companies for each participating State in their respective jurisdictions.

In this scenario each participating State would establish in its jurisdiction a joint stock company („HoldCo“). The participating State would pay into the HoldCo a share capital contribution in the amount that corresponds to that participating State’s portion to cover the estimated project management costs as per the agreement between the participating states.

As regards the division of share capital contribution between the nominal value and share premium or reserves, we recommend that the the registered share capital should be kept to a minimum. The minimum net equity requirements in each of the Baltic States are generally similar and require that at all times the net equity of a company is at least 50% of its registered share capital. As losses are expected at first, then a high nominal share capital would cause the need for additional capitalization sooner than with a minimum share capital.

At the end of the first step:

- in Estonia there is registered an Estonian HoldCo (owned 100% by the Republic of Estonia) with share capital of 25000 EUR and with total owner’s equity as agreed by the participating States
- in Latvia there is registered an Latvian HoldCo (owned 100% by the Republic of Latvia) with share capital of ~35 715 EUR; and with total owner’s equity as agreed by the participating States

- in Lithuania there is registered an Lithuanian HoldCo (owned 100% by the Republic of Lithuania) with share capital of 43 500 EUR; and with total owner's equity as agreed by the participating States

2nd step – setting up the JV

After the registration of the Estonian HoldCo, Latvian HoldCo and Lithuanian HoldCo is completed, these companies would establish the Joint Venture in the jurisdiction as agreed between the participating States.

Each HoldCo would contribute into the JV its part of the total capital cost. With this foundation we also recommend to use the minimum share capital and pay the rest of the equity in as share premium.

This foundation assumes that a Joint Venture that is founded as a „domestic“ company. As an SE can not be founded from zero, but has to result from a cross-border merger (or a reorganization, where the reorganized company has been active for at least 2 years), then a SE can be used in this structure basically only if purchased off-the shelf and the seat transferred in accordance with the Regulation.

At the end of step 2, the Joint Venture would be registered in one of the participating States with a minimum share capital permitted in that jurisdiction and with a total owner's equity as agreed by the participating States.

3rd step - Joint Venture sets up the subsidiaries or alternatively registers the branch offices.

Depending whether the two-tier holding company/subsidiaries structure is used or a one-tier single company is used, the Joint Venture would set up the subsidiaries or register branch offices. In principle this is a simple corporate action, but the participating States would need to agree on certain conditions relating to the subsidiaries, e.g. the objective and functions of the subsidiaries, the amount of capital that will be put into the subsidiaries etc.

OPTION II - SETTING UP THE HOLDCOS AND CREATING THE JOINT VENTURE AS AN SE (Non-direct participation in the Joint Venture)

1st step – setting up the holding company for each participating State in their respective jurisdiction.

Same as step 1 in case of Option 1. Each participating State establishes in its jurisdiction a HoldCo.

2nd step – the HoldCo's set up the subsidiaries in each participating states („Second HoldCo's“) where each respective HoldCo will own 100% in each of the Second HoldCo in their respective jurisdiction.

3rd step – cross-border merger of Second HoldCo's creating SE (the Joint Venture)

HoldCo's carry out cross-border merger creating the Joint Venture. The cross-border merger may also be carried out so that an SE is created.

At the end of the step 3, the Joint Venture has been registered in one of the participating States with a minimum share capital permitted for SE (120 000 EUR) and with a total owner's equity as agreed by the participating States.

4th step – Joint Venture sets up representation offices (branch offices) in each of the participating States (representation offices are not separate legal entities and are not subject to registration in the commercial register of the jurisdiction where the representation office has been set up.

OPTION III – SETTING UP THE HOLDCOS AND A SUBSEQUENT MERGER SCENARIO

(Direct participation in the Joint Venture)

1st step – setting up the holding company for each participating State in their respective jurisdiction.

Same as step 1 in case of Option I. Each participating State establishes in its jurisdiction a HoldCo.

During this first step the national laws are amended so that the participating States may acquire shares of foreign companies.

2nd step – cross-border merger of HoldCo's creating the Joint Venture

HoldCo's carry out cross-border merger creating the Joint Venture. The cross-border merger may also be carried out so that a SE is created.

At the end of the step 2, the Joint Venture has been registered in one of the participating States with a minimum share capital permitted in that jurisdiction and with a total owner's equity as agreed by the participating States.

3rd step – Joint Venture sets up the subsidiaries or alternatively registers the representation offices.

Same as step 3 in Option I or step 4 in Option II.

OPTION IV – SETTING UP THE JV DIRECTLY BY PARTICIPATING STATES

(Direct participation in the JV)

In this option the shares of the JV are owned by the respective participating States directly. This option is not available under existing laws, so either these have to be amended or separate laws have to be adopted to override the current restrictions. This legislative process may delay the establishment of the Joint Venture.

1st step – setting up the JV

Basically this is the same as step 2 in Option I, but instead of the HoldCo's, the contributions would be made and shares obtained by the participating States directly. Our recommendations as regards the share capital, share Premium, etc are the same as above.

The participating States may also acquire an off-the-shelf SE if laws are amended so that an acquisition of shares in the SE is permitted.

2nd step - Joint Venture sets up the subsidiaries or alternatively registers the branch offices.

Same as step 3 above.

OPTION V - SETTING UP THE HOLDCOS AND CREATING A TWO-TIER JV

(Direct participation in the JV)

1st step – setting up holding companies for each participating State in their respective jurisdictions.

Same as step 1 in case of Option 1. Each participating State establishes a company („Subsidiary“) in its own jurisdiction.

During this first step the national laws would be amended so that the participating States may acquire shares of foreign companies.

2nd step – setting up the JV

After the registration of the Estonian Subsidiary, the Latvian Subsidiary and the Lithuanian Subsidiary is completed, the participating States would establish a Joint Venture in the jurisdiction as agreed by the participating States.

For the shares issued at the foundation by the participating States, the States would pay with the shares they own in their respective Subsidiaries (non-monetary/in-kind contribution).

At the end of step 2, the Joint Venture would be registered in direct ownership of the participating States and the Joint Venture would be owning the Subsidiaries, i.e. completing the two-tier structure of holding and subsidiaries.

2.4. Share Capital Requirements

From the financial point of view, large paid-in or registered share capital would not provide any immediate economic benefits and we believe that it should be kept at the minimal level. Additionally, neither EIB nor NIB have specified any precise requirements for the share capital or the corporate structure in the case of projects where either implicit or explicit government guarantee is involved. The only exception would be an unusual corporate structure, e.g. an off-shore company. The same sentiment is prevalent in the case of private sector participants.

EIB also pointed out that the cost of the funds would not depend on the domicile of the Joint Venture. All Baltic States have the same member state risk profile and overall country ratings are irrelevant. From a practical perspective, the JV would be generating significant losses during the development phase and thus a capital injection above the minimum required level would be best structured either as paid-in-capital-over-par or some kind of reserve, in order to avoid going through the continuous cycle of decreasing and increasing the share capital.

In case of PPP, the requirements to capital structure are very specific and cannot be worked out at the current stage, as these vary from project to project and depend mostly on the risk profile of the project and risk transfer.

At the current stage we are not aware of any specific requirements for the increase of the share capital before the construction phase.

However, we would like to highlight that the project management cost of 75 MEUR does not contain any financing of the total capital costs (3.6 bn euros) of the project. The newly established JV needs to develop a comprehensive and detailed cash flow plan as soon as there is more clarity on the financing set-up, in order to address the full financing requirements and financial contribution into the Rail Baltic project.

2.5. Allocation of Shares

Multiple options are available for the the distribution of shares in the Joint Venture. We have narrowed the choices down to the following three⁴:

- A) Equal distribution
- B) Distribution of shares pro rata to the length of railway in each country
- C) Distribution of shares pro rata to funding.

Division of shares depending which option is used (based on the assumptions and estimations in the AECOM Report)

	Lithuania	Latvia	Estonia
Equal distribution	33,33% (i.e. 1/3 of shares)	33,33% (i.e. 1/3 of shares)	33,33% (i.e. 1/3 of shares)
<i>Pro rata</i> to length of railway in a country ⁵	36,26%	32,28%	31,46%
<i>Pro rata</i> to funding ⁶	36%	35%	29%

A) Equal distribution of shares

An equal distribution of shares among the rail operators' respective legal entities or governments of the countries involved is sometimes considered for political reasons, in order to give each party identical weight.

Equal distribution of shares assumes equal financial contributions by the participating states, otherwise this option could prove difficult to justify if the various shareholders do not contribute equal amounts of funds to the JV. As the Rail Baltic project will require substantial funding in order to construct and manage the new railway line, it might be difficult to publicly explain if one country (or the rail operator from such country) receives a shareholding that exceeds its share of financial contributions to the JV as effectively the other shareholders would be paying more.

Pros:

- A straight-forward principle, including for the purposes of explaining to the public
- Equality of partners (assuming that the financial contributions will be equal as well)
- The application of consensus is easier as the actual shareholdings are equal
- Facilitates the „one Rail Baltic network, not a sum of national railway sections“- approach

Cons:

- May be difficult to explain to the public in a country that contributes more that the actual length of track in that country

⁴ Please see also the Annex

⁵ Length of the preferred route as set forth in the AECOM Study (total length 728 km – Estonia 229 km, Latvia 235 km and Lithuania 264 km) – Rail Baltic Final Report Executive Summary, p. 15 http://www.sam.gov.lv/images/modules/items/PDF/item_3195_Rail_Baltic_Final_Report_Executive_Summary_31_05_11_FINAL_v2.pdf

⁶ According to the estimation of capital cost in the AECOM Study – Rail Baltic Final Report Executive Summary, p. 18

B) Distribution of shares pro rata to the length of railway in each country

A second option is to allocate shares pro rata to the length of the railway line in each participating country.

Compared to the equal allocation in option 1, such an allocation method has the advantage of being more closely linked to the use and size of the rail line in each country. However, unless the financial burden is shared by each participating country in such a way that each country bears the funding requirements for constructing and operating the railway line in its own country, such an allocation might result in other countries sharing a higher financial burden (compared to their shareholding) and might be considered unfair. Even if the parties agree that each country bears the funding obligations for the part of the tracks in its country (and possibly operating costs), depending on the geological situation certain parts of the rail line over difficult terrain might be more expensive than tracks in easier geological areas.

Pros:

- A straight-forward principle, including for the purposes of explaining to the public;
- In case the option is used where each country shall be separately responsible for the operation of the track on its territory, it would facilitate efficient use of resources and cost management;

Cons:

- Depending on the geological situation, this option could be unfair to the participating State where the cost of track kilometer is higher than in other(s) (e.g. difficult terrain, more river crossings, etc).⁷
- Induces „sum of national railway sections, not one Rail Baltic network“ approach.
- The application of consensus may raise difficulties as actual shareholdings are not equal. Practice has indicated that even if the parties of a shareholders' agreement agree on the consensus principle (100% of shares voting in favor of a decision to be adopted), then when one shareholder has more shares than the others (e.g. shares are divided 35%/33%/32%), that can lead to a situation where the shareholder with more shares may seek to dominate the joint venture merely with an argument that it has contributed more than the others.

⁷ On the basis of the track length assumptions and capital cost estimation in the AECOM Study: (a) 1 km of track in Lithuania is estimated to involve capital cost of 4,83 MEUR; (b) 1 km of track in Latvia is estimated to involve capital cost of 5,20 MEUR and (c) 1 km of track in Estonia is estimated to involve capital cost of 4,55 MEUR;

C) Distribution of shares pro rata to funding

A third option is to allocate shares pro rata to financial contributions (equity contributions, possibly combined with shareholder loans) of each participating country. Such a distribution takes into account the amount of funding contributed by each participant. Funding does not necessarily have to be in cash but could also include contributions in kind, such as making required land available (either by contributing ownership of required land to the JV or granting long-term access under a lease or similar right of use, furthermore by contributing other assets). From a commercial point of view this seems to be a fairer with each shareholder receiving shares in relation to the funds it contributes. Such an allocation could lead to a situation where a big contributor effectively finances parts of the railway that is constructed in other countries, but then such “big” contributor also gets a larger share in the profits generated by the JV.

Another advantage of a share allocation according to funding is that in case of future funding requirements, new shares may be issued. A country that does not wish to contribute future funds would get its shareholding diluted. Compared to the two other options such a country would find it difficult to protest against a dilution as the contribution of funds is the fixed criteria for allocation shares, so that there is no change in the system. This concept also makes it easier to part-privatise the JV or to admit private investors or other countries. Such new investors would get a share pro rata to their total equity contributions.

This approach has a precedent in the DSB-Railion joint venture when the Danish State Railway contributed its rail cargo business to Railion against the issue of shares in Railion GmbH (and a cash consideration). The parties then used the approximate revenues and the amount of business to determine the percentage of shareholding DSB would get in Railion. However a major difference compared to the Rail Baltic project is that the DSB-Railion project did not involve substantial financing needs as no major investments were planned. Furthermore the tracks remain with the track operator (Deutsche Bahn in Germany, DSB in Denmark) in each country, which retained responsibility for keeping the tracks operational.

An allocation of shareholding could be based on the amount of capital contributed by a partner, the amount of existing business which would transfer to the new Rail Baltic project (assuming that a certain amount of cargo traffic would be moved to the new rail line), the contribution of assets and land required.

Pros:

- A straight-forward principle, including for the purposes of explaining to the public;
- Fairer principle – each shareholder will receive shareholding (and future revenue/dividend) in direct correlation to its financial contribution

Cons:

- Does not enhance the efficient use of resources and management of cost;
- May encourage over-investment to achieve larger shareholding;
- Requires strict supervision of what is included in the project and in the capital cost. The participating States may be interested in including other projects that are not directly related to Rail Baltic.
- The application of consensus may raise difficulties as the actual shareholdings are not equal (see above).
- **Induces** the „sum of national railway sections, not one Rail Baltic network“ approach

Payment for the shares/contribution into the share capital

Upon the foundation of the Joint Venture, the participating States would pay for the shares and contribute to the share capital by monetary contributions or contributions in kind (non-monetary, assets). The amount of the share capital would depend on the agreement between the participating States and upon foundation the amount to be paid in would depend on the functions of the Joint Venture at the start of the implementation phase.

In principle it is possible to pay in a minimum share capital and proceed with the additional capitalization once a more detailed business plan is prepared by the management of the Joint Venture and more importantly, more is known about the financing of the project by EU and IFIs. It is possible that for the financing purposes, the share capital contribution by the participating States (own financing) could be relatively low and the percentage of financing that is not available from the EU, could be covered for example by EIB and/or NIB.

The principles of share capital contributions would be further elaborated in the shareholders' agreement, in particular what pertains to the land acquisitions (in this regard whether or not EU funds will cover the cost of land acquisition for the participating States shall play a pivotal role) and how and to what extent the already constructed or planned 1435 mm track in Lithuania will figure into the capitalization structure (questions of EU funding are also relevant in this regard).

Dilution of shareholding

In addition to a straightforward „all equally“ or „x km (or x EUR capital cost) = x % of shareholding“, project-based joint ventures that are established for the implementation and operation of a new-built project may sometimes foresee agreements between the shareholders on the dilution of the shareholding of a shareholder or shareholders that do not perform targets and deadlines agreed between the shareholders (and correspondingly increasing the shareholding of other performing shareholders).

In practice this would mean agreeing in the shareholders' agreement specific targets that a party to the Joint Venture must perform. In case the target is not met, then the shareholder's participation may be subject to adjustment.

2.6. Corporate Governance of the Joint Venture

The principles for corporate governance will be established in the shareholders agreement between the participating States and in the statutes/articles of association of the Joint Venture.

2.7. One-tier vs two-tier management structure

Regarding the management structure, the main options are either one-tier or two-tier corporate governance. In a one-tier corporate governance system, the company would be managed by the management board directly subordinated to the shareholders. In a two-tier corporate governance system, the activities of the management board would be supervised by a supervisory board, which in turn is accountable to the general meeting of shareholders.

Each of the corporate law systems of Estonia, Latvia and Lithuania support both the one-tier or two-tier management structure, in Lithuania the law foresees a mandatory position of a general manager, but he or she can be incorporated into the management board in a CEO capacity. Therefore as regards the corporate structure, the jurisdiction of the JV is not of decisive nature.

One-tier or two-tier corporate governance systems can also be used in case a European company (SE) is used for the Joint Venture.

Pros and cons of one-tier corporate governance

Pros:

- Simplified management structure
- Flexible
- Less expensive than two-tier management
- Quick decision-making
- Direct information flow

Cons:

- One-tier management structure is primarily advisable in case of a controlling shareholder employing a hands-on approach
- For large and complex companies such as the Joint Venture, the one-tier approach is not common in the Baltic practice, one-tier is in such cases primarily used in Anglo-American business cultures
- Curtailing the power of the CEO may pose difficulties

Pros and cons of two-tier corporate governance

Pros:

- Supervision of the company's activities is enhanced
- Primary venue of discussions regarding company policy to facilitate an agreement between the shareholders in case of difference of opinion;
- CEO's authority is somewhat curtailed by the Supervisory Board and powers of the Chairman of the Supervisory Board
- Common for large and complex companies such as the Joint Venture

Cons:

- Higher cost
- Facilitation of information flows from the management board up to the shareholders must be balanced, both from the information gathering side and the dissemination of information to the higher levels.
- Increased exposure to third party interest compared to one-tier structure

International experience

As indicated in the Annex, more than ¾ of SE companies are using the two-tier model.

In the case of recent railway joint ventures analysed, the following management structures have been used:

- Øresund Bridge - the consortium's affairs are conducted by a board of directors and a managing director;
- Eurotunnel - Groupe Eurotunnel SA has a Board of Directors (11 members, including 7 independent)⁸ and an Executive Committee (6 members)⁹
- Brenner Base Tunnel - BBT SE has a management board consisting of 2 members and is supervised by the Supervisory Board consisting of 12 members (6 from Austria and 6 from Italy)¹⁰
- Railion (DB Schenker Rail) – the company is managed by a management board consisting of 6 members.

⁸ <http://www.eurotunnelgroup.com/uk/eurotunnel-group/corporate-governance/board-of-directors/>

⁹ <http://www.eurotunnelgroup.com/uk/eurotunnel-group/corporate-governance/executive-committee/>

¹⁰ <http://www.bbt-se.com/en/company/management/>

2.8. Composition of the Supervisory Board and the Management Board

Based on the above pros and cons and international experience in similar railway projects, we recommend using a two-tier corporate governance structure for the Joint Venture, whereby the Joint Venture's day-to-day business would be managed by a Management Board and supervised by a Supervisory Board.

Supervisory Board

We would recommend considering that the Supervisory Board should consist of 6 members to be elected by the shareholders. Each of the Member States would have the right to nominate 2 members respectively. A bigger number of Supervisory Board members is also foreseeable, in which case it should be considered whether the agreement between the participating States would also foresee a minimum number of board members who could be „independent“, i.e. not part of the governmental apparatus of any of the Baltic States.

The Chairman of the Supervisory Board would be elected by the Supervisory Board. We recommend that the position of the Chairman should be rotated among the Member States periodically e.g. after each 12 months the nominee of a different participating State would be elected as Chairman.

We also recommend that the positions of Vice-Chairmen (two) should be introduced, whereas each participating State whose nominee is not acting the Chairman, would have the right to nominate a Vice-Chairman, assisting and replacing him upon need or respective agreement.

In joint ventures with several large shareholders it is not uncommon that the positions of the Chairman and the Vice-Chairmen are periodically rotated between the appointees of the shareholders. Our experience and analysis recommends that the positions of Chairman and Vice-Chairmen of the Supervisory Board of the Joint Venture are rotated on a yearly basis.

Management Board

The Management Board would be appointed by the Supervisory Board, the number of the Management Board members would be agreed by the participating States in the agreement, taking into consideration the nature of the operations of the Joint Venture and the legal structure (in particular whether a holding structure with subsidiaries would be used).

The participating States should also consider whether: (a) to leave the number and names of the Management Board members to the full discretion of the Supervisory Board or (b) to foresee that the team would be chosen by the CEO and approved by the Supervisory Board. The first option has a number of disadvantages, primarily that such direct involvement from shareholders on the management board may negatively influence the possibility of the CEO (Chairman of the Board) to form and manage an efficient team.

2.9. Requirements for the Supervisory Board and Management Board members

As a general rule, each of the Management Board members should have a flawless reputation and business experience. As regards the Supervisory Board members, it should be considered that the Joint Venture would be a company owned by governments, therefore civil servants in principle should not be excluded from the scope of the Supervisory Board membership. Therefore the prerequisite of prior business experience should not be the primary basis of qualification for Supervisory Board membership. The participating States should agree in the Shareholders' Agreement the applicable balance between the civil servants and non-civil servants on the Supervisory Board.

The Shareholders' Agreement must establish limitations which persons can not be Supervisory Board members or Management Board members (e.g. persons with a previous criminal record or a conflict of interest, etc).

The qualifications of Supervisory Board members or Management Board members have also significance in connection with the licensing of railway companies, for example the national laws of the Baltic countries prescribe that a railway infrastructure license can not be issued to a company whose management includes persons that are not of good repute, e.g.:

- persons whose acts or omissions have resulted in the bankruptcy or compulsory liquidation of a company; or
- the revocation of the activity licence of a company; or
- whose activities have shown that they are not capable of organising the management of a company in such a manner that the interests of the shareholders, members, creditors and clients of the company are sufficiently protected; or
- persons who have been punished for an economic offence, official misconduct or offence against property or offence against public trust etc.

2.10. Professional profile of the Joint Venture CEO

It is the conclusion of the consultant that, in order to achieve the cross-border and interdisciplinary goals of the company and to overcome the various business, political and cultural challenges of the project, the CEO of the future Joint Venture has to be:

- a business professional recruited from amongst the best candidates on the international labour market through an open competition and/or designated headhunting process,
- an internationally experienced business manager and a team-leader to cope with the multinational, multilingual and multicultural nature of the venture,
- a knowledgeable expert on large infrastructure construction, financing and management matters.

Stemming from these key characteristics, the professional profile of the CEO should include several specific requirements, such as:

- a recognised university diploma (at least the equivalent of a master's degree)
- several years of international management experience
- a track record of team-building and management experience
- fluent command of English
- financial expertise
- rail operations/infrastructure management knowledge (rail transportation, safety, logistics and management, strategic and business planning and quality systems development)
- diplomatic skills
- a follow-through attitude
- honesty and integrity

His/her professional tasks would include:

- the co-ordination of the planning, design and construction of the new railway
- the professional and effective management of the railroad
- ensuring the balance of the development of the company between the stakeholders, efficient reporting and communication with the representatives of the shareholders on the Supervisory Board
- building professional and transparent relations with the regulating bodies
- developing a diverse portfolio of passenger and freight operators of the new railway to ensure their fair and equal treatment and customer satisfaction
- orientation to quality, safety and customer service
- team-oriented leadership

2.11. Shareholders' Agreement

In addition to the most material issues that need to be discussed and agreed on the highest decision-making level of the participating states (outlined in clause 1.2. of the Executive Summary), there are number of issues for future shareholders of the Joint Venture which will have to be agreed and reflected in the shareholders' agreement.

Please find below some of the material issues and important terms for future co-operation that would normally be included in a shareholders' agreement. We also propose below suggestions how these agreements have customarily been solved. These customary suggestions and options will be reflected more thoroughly in the draft shareholders' agreement to be prepared after the approval of the Final Report.

A) Share capital

In addition to the amount of registered share capital necessary and optimal for the foundation of the new company, it would be advisable for the shareholders to set forth also the timeline and stages of the foreseeable share capital increase(s) corresponding to the consequent (financing) phases of the Rail Baltic project.

The exact division of shares between the shareholders, the number of shares, their nominal value and share premium (if any) shall also have to be agreed and fixed upon the incorporation of the new company.

B) Further financing

In addition to the foreseeable increases of the registered share capital, the shareholders are well advised to agree their legal relations and co-operation also in situations where additional contributions to the equity of the company are required in the future.

In particular the rights and obligations of shareholders need to be set forth in detail when an increase of share capital is necessary and one or more of the shareholders does not contribute additional equity funding, whereas other Shareholder(s) do(es). It is customary that in such case the respective shareholding of the non-contributing party shall decrease and the shareholding of contributing shareholder(s) shall be increased accordingly.

C) Business plan and annual budget

It is customary and prudent for the company of this size, purpose and with multiple shareholders to discuss, prepare and agree a detailed multi-year (e.g. 5-10 year) rolling business and financial plan which will set forth the main tasks and goals of the business venture, as well as prescribe financial milestones and indicators against which the performance of the company is regularly measured. A detailed business and financial plan is also a standard requirement of the financiers of the company.

It is also standard that prior to each financial year, in line with the adopted business plan, the management of the company should prepare an annual budget, to be typically considered and adopted by the supervisory board. In the shareholders agreement the shareholders should agree on the timing and format of the annual budget, as well as the quorum requirements necessary to approve such a budget at the respective supervisory board meetings (it is customary that the management board of the company is required to prepare the business plan at least 2-3 months prior to the end of the ongoing financial year).

D) Co-operation

It is advisable, due to the very specific and competitive nature of business of the joint venture and because the future shareholders are directly (or indirectly) involved in the railway and transportation business (whether as regulators, shareholders or indirect stakeholders), that they duly disclose, discuss and agree how to deal with the present and likely future conflict of interest situations.

Likewise, the shareholders' agreement shall set forth the obligation of the shareholders to promote the business and affairs of the joint venture (and its subsidiaries) and to ensure that sufficient management time and commitment is provided by them to the company to facilitate the promotion and successful implementation of their respective businesses.

E) Operations of the company

There are several standard issues to be included in the shareholders' agreement with regard to the everyday management of the company:

- Beginning and close of the financial year (normally a calendar year)
- Auditing (qualifications, costs and timing – normally the auditors should be internationally reputable auditing firm with presence in each of the Baltic States)
- Dividends and other payments to shareholders

F) Management and conduct of the company

Under this chapter the issues pertaining to the powers, responsibilities and procedures for the shareholders, the supervisory board (to exercise supervision of the management board and approve transactions outside the scope of the everyday management of the company), the management board and other officers of the company should be as specified, including:

- **the Supervisory Board** (total number of members, requirements to the qualification of the board members, term of office, principles of remuneration, direct designation rights of the shareholders, rotation of the position of the chairman and vice-chairmen, replacement rights for shareholders, etc)
- **the Management Board** (total number of members, requirements to the qualifications of the board members, term of office, principles of remuneration, position and signatory rights of the chairman and vice-chairmen, etc)
- **Board Meetings** (minimum notice periods, agenda, frequency of meetings, legal rights to delegate votes or participate via phone or other technical means, possibilities to adopt resolutions without the convocation of a meeting, fees and expenses, quorum requirements for a meeting to be legal and for the adoption of resolutions, etc).
- **the list of supervisory board reserved matters**, i.e. matters where a higher number of votes (or consensus) of the board members is necessary for the adoption of a resolution e.g.:
 - the appointment or removal of any member of the management board;
 - approval of a guarantee or a loan by the company;
 - the commencement or settlement of any significant litigation;
 - the adoption, replacement or modification of the annual budget or multi-year business plan;
 - any decision by the company to seek a public listing, etc.
- **Meetings of Shareholders** (Ordinary and extraordinary general meetings of the shareholders, minimum notice periods, agenda, frequency of meetings, legal rights to delegate votes or participate via phone or other technical means, possibilities to adopt resolutions without the convocation of a meeting, quorum requirements for a meeting to be legal and for the adoption of resolutions, etc).

- **Shareholder Matters** requiring the consensus of all shareholders, which could include inter alia:
 - any proposed amendment, alteration or modification of the Articles of Association or other constitutional documents of the company;
 - any proposed dissolution, reorganisation or liquidation of the company;
 - any change to the size or membership of the Supervisory Board or the Management Board;
 - any material sale, transfer, licensing or disposal by the company (otherwise than in the normal course of trading) of all or a substantial part of its business, undertaking or assets whether by a single transaction or series of transactions related or not;
 - the company making or being party to any acquisition of, merger or consolidation with, or scheme of arrangement involving any other company, partnership or entity or any shares or loan capital of such persons, in each case however effected;
 - the issue of shares or the increase or decrease of the share capital, or cancellation or alteration of any rights (including the right of first refusal)
 - the declaration, making or payment of any dividend or other distribution by the company to its Shareholders;
 - the appointment of the auditors of the Company, etc.

G) Right of first refusal for new securities, additional shareholders

It is customary to foresee in the shareholders' agreement, that each of the shareholders shall have the right of first refusal to purchase or subscribe for any new securities which the company may issue in the future.

It is also customary to foresee that in the event a shareholder does not purchase or subscribe for any or all of its pro rata portion of the new securities the other shareholders shall have the right to purchase or subscribe for such unpurchased shares.

H) Transfers

It is usual that the shareholders of a company agree and set forth a detailed procedure for any transfer of shares between shareholders and to third parties (incl to affiliates or related parties), including substantial penalties for any transfer not permitted by the shareholders agreement.

I) Tag-along rights

In order to secure the co-operation and co-ordinated activity of all strategic shareholders in a possible exit situation, specific legal mechanisms are often included in shareholder agreements, which procure that the parties shall not transfer any shares to any third party or to another shareholder unless the terms and conditions of such transfer contain a binding purchase offer also to all other shareholders.

Such tag-along rights ensure that the controlling interest in the company can not be transferred to a third party without the consent, or at the expense, of another shareholder.

J) Representation, Warranties and Indemnification of the Shareholders

It is usual and customary that upon entering into a shareholders agreement, the parties provide certain representations and warranties to each other, which can mutually be relied on e.g.:

- Organisation and good standing
- No violation of laws
- Authorizations and consents
- Enforceability, etc

It is also standard contract practise that each shareholder agrees to hold the other shareholders un-harmed by damages incurred by it, and indemnify and defend the other shareholders against such losses arising out of its failure to perform the material obligations required under the agreement. It is advisable to agree the specific procedure and limits related to the enforcement of the representations, warranties and indemnification obligations of the parties in detail.

K) Regulatory Matters

It is highly advisable in a cross-border multinational joint venture in a regulated area of business, that the parties agree on the principles of co-operation with each other to ensure that all necessary information for the mutual performance of the agreement is duly exchanged between them and that any required notifications or filings with applicable authorities are made accurately and promptly.

Also the shareholders should agree on how to handle situations where some material action is being taken or threatened by a competent regulatory body (whether on a national or on an EU level) and whether any modification to the terms of their shareholders agreement, articles of association or national regulations or law should be made.

L) Settlement of Disputes

In the event of any dispute (of whatever nature) between any of the parties, whether arising either by reason of failure to agree any policy matter affecting the company or in connection with the shareholders agreement (or any associated agreements) or the breach, termination or invalidity of the agreements, it is customary that the obligation for consultations on an amicable basis is prescribed. Failing to reach an agreement, there should be a binding recourse to arbitration. It is customary in the Baltic States to refer the disputes to the arbitration in a neutral and competent venue e.g. the Arbitration Institute of the Stockholm Chamber of Commerce.

M) Deadlock

As the size of shareholding and the number of votes of all shareholders is likely be similar and a number of shareholder and board resolutions would require a unanimous approval of all parties, a contractual mechanism to resolve deadlock situations should be discussed and agreed immediately.

The aim of such a mechanism would first and foremost be to avoid situations where a shareholder deliberately and without good reason is voting against or withholding its consent to any issue or proposal, in case such consent is required in order to enable the company to carry on its business properly and efficiently.

A shareholder's failure to send its duly authorised representative to attend meetings of the supervisory board or attend meetings of shareholders on a consistent basis, resulting in the meeting having to be adjourned or cancelled due to the absence of the required quorum, is also often contractually treated as causing a deadlock.

N) Term and Termination

In the light of the Rail Baltic being a long-term project, it is advisable to discuss the issues pertaining to the term of the joint venture and also legal mechanisms and consequences related to the possible termination of the shareholders agreement with regard to one or several of the shareholders (due to a material breach of the contract or the use of contractual termination rights). A number of important issues require agreement under this chapter, e.g. would the remaining shareholder(s) be

entitled to acquire the shares of the departing shareholder, at what price and on which terms would such a transfer take place, the definition of fair value of the shares, etc.

O) Other material terms

In a long-term and complex contractual relationship, such as the contemplated Rail Baltic joint venture, also several other material contract issues need to be negotiated and set forth in the shareholders agreement. Such issues include:

- The governing law (Estonian, Latvian, Lithuanian, other or a combination of the above – customarily the law of the jurisdiction would be used where the Joint Venture is registered);
- Confidential information matters and co-ordinated public relations activities;
- The division and compensation of expenses, incurred in connection with the negotiation, preparation, execution, consummation or enforcement of the agreement (e.g. the fees of the legal counsel, accountants and other advisers; translation costs, business travel and accommodation, etc);
- Fees and commissions (if any);
- Amendments and waivers;
- Successors and assigns, etc.

P) Articles of Association

Depending on the jurisdiction chosen for the main seat of the joint venture, several of the substantial terms of the shareholders agreement above may have to be included also in the Articles of Association (Statutes or By-Laws) of the new company in order to give legal force to them.

2.12. Railway Legislation

2.12.1. Railway Infrastructure Fees

General

An overview of the national methodologies for the calculation and charging of Railway Infrastructure Fees (RIFs) in Estonia (EE), Latvia (LV), Lithuania (LT) and Poland (PL) are provided in the Annexes 3 and 3.1. There are material differences in the national methodologies influenced by the goal of controlling the RIFs established by the incumbent (Infrastructure Managers (IMs), which control the existing public Railway Infrastructure (RI) (1520 mm) almost entirely.

Upcoming Amendments

- In EE, there are no amendments to the existing methodology currently being processed.
- In LV, certain amendments concerning technicalities are in the process of adoption.
- In LT, the RIF methodology has been recast very recently.
- In PL, amendments are being discussed, but have not yet been published, as there are several ongoing court disputes (incl. infringement proceedings initiated by the European Commission) pertaining to the present regulation.

Please note that in the next coming years the current methodology in all EU countries is likely to be changed completely, especially in the light of the Directive 2012/34/EU, establishing a single European railway area (the SERA Directive), which took effect as recently as in December 2012 and requires the Member States to implement the directive fully by 16 June 2015, whereas before this date the European Commission has to adopt implementation measures inter alia for the calculation of the charges for the minimum access package and for access to RI connecting service facilities.

General Approach to be Agreed

Given the timetable for making Rail Baltic operational, the creation of the best suitable RIF calculation and charging methodology for the Rail Baltic is important but should not withhold the incorporation of the Joint Venture. Due to the implementation period of the SERA Directive and also the new regulatory initiatives indicated by the European Commission, only the general approach needs to be agreed between the stakeholders presently. The Rail Baltic Task Force should however monitor the development of the regulatory framework on a constant basis.

Options for Achieving a Unified Regulatory Framework

From the point of view of the railway undertakings expected to provide international rail transport services on the Rail Baltic infrastructure, a “one-stop shop” principle should be implemented in practice to make rail transport more attractive in comparison with other transport modes (road, sea). Therefore, the RIF calculation and charging methodology needs to be transparent, legally certain and uniform. There are three options for achieving this:

- An agreement between the states for using one of the effective national RIF calculation methodologies (as updated to implement the SERA Directive) throughout the Rail Baltic network. The drawback of this option is that the other states may not be willing to relinquish their authority without some mechanism to ensure that their interests are adequately accounted for in the case of domestic legislative processes;
- Preparing amendments to the current national regulations by adopting identical national methodologies along the principles established by the SERA Directive (and its implementation measures

as adopted by the European Commission). The drawbacks of this option are (i) the details of the implementation measures to be adopted by the European Commission are presently unknown, (ii) the identical regulations may not take sufficiently into account the diverging situations in the stakeholder states and (iii) the co-ordination of legislative procedures needs to be achieved in the stakeholder states;

- Creating a supranational regulatory framework for the calculation and charging of the Rail Baltic RIFs in support of implementation of the “one-stop shop” approach. Such a long-term “lock-in” of the participating states would provide additional stability to the legal environment and this may be mitigated by delegating the authority to establish the RIF regulatory framework for Rail Baltic and the supervision of its implementation to a neutral body.

Railway Market Developments

The European railways have experienced major changes over recent years, connected both to a generally unfavourable economic situation and the development of the regulatory framework, particularly on the European level. The 2009 economic crisis has had a significant impact on rail freight traffic. On the EU level, it nevertheless appears that the rail sector’s modal share is now comparable with pre-crisis levels. The effects of the crisis have been much less pronounced for rail passenger transport. Passenger transport numbers are increasing, but rapid increases are hindered by considerable differences that still remain between the Member States with railway networks. Freight volumes have been increasing, but are not yet on the level of 2008. Despite a significant rebound, 2010 levels have remained some 15% below those recorded in 2008 in most Member States.

More in-depth analysis on these issues are presented in Annex 3 of the Final Report.

2.12.2. Specific Regulatory Issues

The comparative overview of the regulatory bodies (both market and technical/safety aspects) and key regulation areas in respect of the construction, management, access to and use of public railway infrastructure in the three Baltic countries is provided in the Annex 3.4.

Based on the observations made on the basis of the comparative study, the following may be outlined:

General Remarks on the Regulative Environment.

In EE a single act of law (raudteeseadus) provides the comprehensive material legal regulation addressing the management of and operations on the railway and the authorisations for the governmental agencies for the implementation thereof. In LV and LT, the regulation is provided by several acts of law, which may complicate the amendment procedures, if necessary. A more detailed legal technical analysis of any proposed amendments (within specific scope) is required in order to be able to provide any draft proposals.

Rights to Own and Manage Public Railway Infrastructure

In EE and LV, public railway infrastructure may be owned and managed by legal entities regardless of their ownership. In LT, the existing public railway infrastructure is within the exclusive ownership of the state, whereas the management of public railways can only be trusted to government-owned companies, currently the state-owned JSC "Lithuanian Railways". It is currently unclear, whether and when this regulation is going to change. Until such changes are effected in LT, the Joint Venture will have to enter into a contractual arrangement with JSC "Lithuanian Railways" regarding the management rights of the new public Rail Baltic infrastructure. A substantial risk remains that JSC "Lithuanian Railways" will attempt to gain preferential treatment or influence competition in the market (against the JV or other Rail Baltic operators). This risk needs to be reasonably mitigated and the current regulation needs therefore to be amended, to the very least, by allowing other persons (such as the JV) to manage public railway infrastructure in LT, in line with EU railway legislation. At the same time it is evident that the EU railway legislation is decisively moving in the direction of harmonization and unification of regulation, to achieve full opening of the railway markets of the member countries (e.g. the SERA Directive and the 4th railway package under preparation), which will inevitably bring along the abolition of the special rights and preferential treatment of the state-owned railway companies.

Proposed Amendments to the Existing Regulatory Framework

It must be noted that the EU legislation in the railways sector is likely to be revised further in the coming years (the Commission's proposal for the 4th Railway Package). On the national level in the short run, amendments to the existing regulation are inevitable in connection with the implementation of the SERA Directive 2012/34/EU (implementation date by 16 June 2015). The regulatory environment therefore requires ongoing monitoring as the Rail Baltic project develops. It may be assumed that greater uniformity of the national regulatory regimes will be achieved due to the EU regulatory initiatives.

Structure of National Regulatory Powers

The distribution of competence between the various regulatory bodies varies. The implementation of the Directive 2012/34/EU may bring further changes to the structure and competence areas of the national regulatory agencies. In general, the **current** competence areas of the national regulatory bodies are as follows:

- In EE the authority to enact secondary (implementation) regulation is vested in the Government (which also decides certain issues of general public interest) and the Ministry of Economic Affairs. The technical, safety, certification and practical operations (incl. capacity allocation) issues are allocated to the Technical Surveillance Authority, which also functions as a technical supervisor for other sectors. Licencing and safeguarding issues are allocated to the Estonian Competition Authority as the national regulator tasked with monitoring and implementing competition regulation.
- In LV the **State Railway Administration** is responsible for the registration of railway infrastructure and railway vehicles, the supervision of the independence of the performer of the IM's essential functions, the issuing of carrier licences for freight transport, the supervision of the freight transport market and competition and for the resolution of disputes between IMs and the carriers. The **State Railway Technical Inspectorate** controls the performance of technical and safety requirements for operating the railway, investigates railway accidents and keeps the relevant records, examines rail infrastructure construction projects, issues building permits and supervises their execution and issues safety certificates to the carriers. The **Transport Accident and Incident Investigation Bureau** investigates serious railway accidents. The **Regulator of Public Utilities** oversees the railway passenger transport market and enacts methodologies for calculating railway infrastructure fees (RIFs), as well as promotes competition in the rail passenger transport.
- In LT the regulatory functions below the Governmental and ministerial level (i.e. the public policy and international relations issues) are divided between 3 regulatory authorities. The **Competition Council** monitors the competition of railways markets. The **Transport Investment Directorate** is responsible for the administration of EU-funded investment projects in infrastructure. The **State Railways Inspectorate** is authorised to implement the licencing, safety capacity allocation, RIFs etc. of railway-related regulation.

Effect on the Joint Venture

The different structure of Regulatory Bodies and their authority areas by itself should not materially affect the operations of the Joint Venture as long as the regulation itself is materially similar (as based on EU regulation) in respect of cross-border RI and operations. Nevertheless, the experience of co-operation on a practical level is limited due to the lack of cross-border railway operators in the Baltic States (on the North-South route). **The case studies of major European cross-border transport infrastructure projects have clearly demonstrated that the different administrative and legal regulation and practices tend to cause considerable hindrances for the overall implementation and operation of the projects.**

It should also be stressed that such large cross-border co-operation projects and joint ventures result in harmonisation of the respective national laws of the participating states in the long-term. It is therefore recommendable to embrace that consequence of the project and start the co-ordination process in a constructive and pro-active way already in the early stages.

Licencing Requirements for the Management of Public Infrastructure

Notable differences exist for the licencing requirements for the management of public railways:

- EE: the management of public railways is subject to licences issued by the ECA based on eligibility criteria (incl. mandatory insurance, financial capability, professional skills etc.). In order to be eligible for any rail-related operating licences, the registration of a subsidiary company or a branch in Estonia is required;
- LV: A licence for infrastructure management is not required (the registration of RI objects and safety authorisation are required);
- LT: Formally, a licence is not required for the management of public railway infrastructure (a safety authorisation is required). However, the existing public railway infrastructure in Lithuania is within the exclusive ownership of the state, whereas the management of public railways is currently trusted, by virtue of law, to the state-owned JSC "Lithuanian Railways" (see above).

Safety Authorisation

The regulation for the safety authorisation for the management of public railway infrastructure in Latvia and Lithuania is based on the EU Railway Safety Directive (Directive 2004/49/EC), whereas the current Estonian regulation does not formally differentiate between safety authorisations issued to the managers of public railway infrastructure and the safety certificates issued to the railway undertakings. The Estonian regulation is intended to be brought into compliance with the Railway Safety Directive by amendments currently being prepared by the TSA/MoEc. As a minimum for the purposes of the Rail Baltic project, these amendments should be adopted and effected in Estonia. It must be noted that the European Commission has expressed its intention to introduce a common EU safety certification system by the tentative 4th Railway Package. If adopted and implemented, this would simplify the obtaining of safety authorisation for the Joint Venture on the "One-stop shop" principle for the management of the Rail Baltic in Estonia, Latvia and Lithuania.

The Construction of Rail Baltic Infrastructure

Commissioning a specific comparative study of the regulations applicable to the construction process is recommended in order to establish a workable time schedule and budget for the spatial planning, design and construction phases of the Rail Baltic infrastructure objects as well as for public procurement terms and conditions.

Access to Railway Infrastructure and Allocation of Capacity

Based on the comparative review of the applicable regulations in Estonia, Latvia and Lithuania, the current regulation for providing access to and the allocation of capacity on public railway infrastructure in Estonia, Latvia and Lithuania diverges notably, as inter alia:

There is no uniform timetabling procedure in the Baltic states;

- in Estonia and Latvia, the allocation of capacity is carried out by the IMs under the supervision of an independent authority (unless the IM is not independent of the applicants, in which case the independent authority – i.e. performer of the essential functions of the infrastructure manager – will perform such functions). In Lithuania, the capacity allocation on public railway infrastructure is performed by the State Railways Inspectorate;
- The level of details concerning the terms and the set of rules for contracts regulating the use of rail infrastructure use is different in Estonia, Latvia and Lithuania;
- The powers and structures of the national regulatory authorities are different in respect to capacity allocation (incl. in case of depleted capacity).

2.12.3. Proposal to Create an International Legal Body “Baltic Rail Commission”

As the differences in national railway regulations are significant so is the need for adjustment and harmonisation of the existing legislation. Both the market participants and the regulators acknowledge that although all Baltic countries have been the members of the European Union since 2004, identical conditions for operations (including the distribution of the capacity of the future railway, cross-border interoperability of locomotives and drivers, etc) and still not being achieved.

Please see the Annex 3.4 for the overview of the setup of current regulatory bodies in Estonia, Latvia and Lithuania).

It would also be unreasonable to ignore the fact that the object of the current Baltic railway regulations is a historically different railway infrastructure and the simultaneous significant amendment thereof in all three Baltic countries will be complicated, timetaking and likely to meet opposition from the historically conservative railway community.

Taking into account that the new Rail Baltic infrastructure will be built as a greenfield project and will technically differ from the existing 1,520 mm railway infrastructure, a specific set of uniform rules for access to and the allocation of capacity (timetabling, network statements, application and co-ordination proceedings, handling of congested or depleted capacity) on the whole Rail Baltic infrastructure should be agreed and implemented in Estonia, Latvia and Lithuania.

Although not a pre-condition of the establishment of a Rail Baltic Joint Venture, it is our recommendation that the stakeholder states should agree to set up a cross-border independent body to supervise the access issues and a body to act as a dispute resolution forum, the awards of which would be recognised and enforced by the national legal systems. The substantive regulation concerning access to the Rail Baltic infrastructure should be based on the relevant EU legislation and its implementation should be supervised by a regulatory agency which is neutral and independent of the domestic regulatory and political interests.

Reasoning for the Proposal

- The regulatory environment for the management the Rail Baltic railway infrastructure has two dimensions – the national level, i.e. the national rules of all the states traversed by the Rail Baltic infrastructure, and the EU level, which attempts to unify the national regulations in order to facilitate the efficient use of limited resources, universal safety and free accessibility for railway undertakings on non-discriminating and competitive terms;
- Based on the case studies of major European cross-border transport projects, the Rail Baltic infrastructure should be developed and managed on commercial principles by a Special Purpose Vehicle (Joint Venture), set up by the stakeholder states for the purposes of constructing and later management of the Rail Baltic infrastructure. Two elements must, however, be noted: (i) the JV as an Infrastructure Manager of the Rail Baltic must observe the administrative, management and budgetary independence requirements set forth by the SERA Directive; and (ii) the decision-making procedure should provide an equilibrium between commercial viability and national interests;
- With the perspective of creating an attractive North-South passenger and cargo transport op-

tion, the Joint Venture needs to set up and offer a “one-stop shop” service for the railway undertakings interested in gaining access to the Rail Baltic infrastructure. This in turn needs a unified legal environment throughout the extent of Rail Baltic in order to be able to provide competitive, transparent and well-functioning infrastructure services to the railway undertakings;

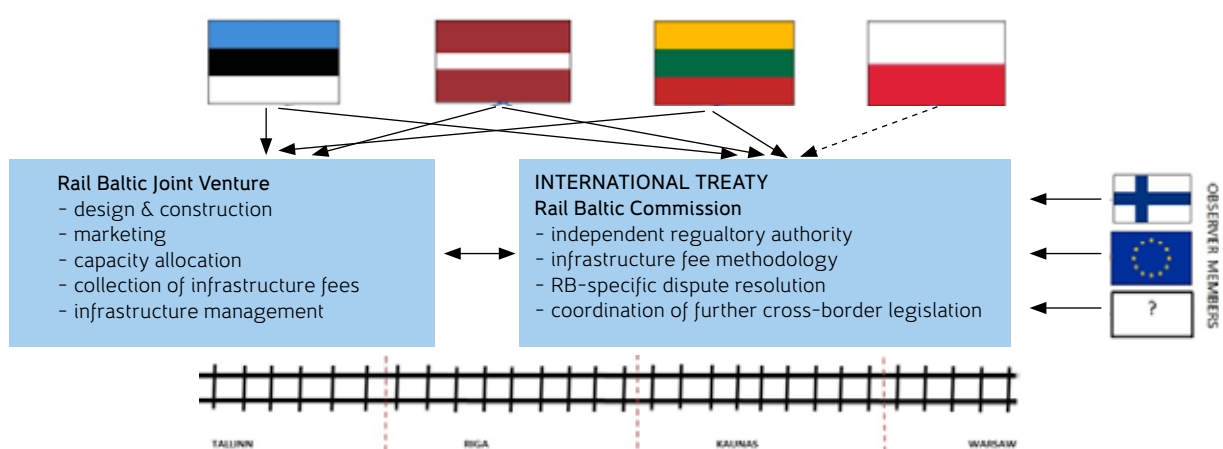
- It is necessary to consider to what extent the safety, environmental, etc. issues pertaining to Rail Baltic shall remain within the national legal systems to regulate. The issues related to competition and market regulation, such as access to the Rail Baltic infrastructure, allocation of capacity and the fees for use of the railway infrastructure, need to be unified in respect to the whole of the new cross-border Rail Baltic corridor;
- Today, the existing regulation in Estonia, Latvia and Lithuania is unified to a certain extent inasmuch as harmonization has been achieved within the framework of the EU railway regulatory packages. Notable differences still exist (e.g., the rights to own and manage public railway infrastructure, timetabling procedures) as the regulation is primarily addressed to the opening up of the existing 1,520 mm railway infrastructure (as managed by the state-owned railway companies). It must also be noted, that although the EU-led harmonisation of national regulations encourages the regulatory bodies of the member States to co-operate in matters related to cross-border rail connections, in reality such practice does not really exist yet on the part of EE and LV (due to the practical priorities arising out of the existing East-West oriented railway infrastructure);
- On the EU level, there is political intent to further harmonise, standardise and unify the regulation of the railway sector, e.g. by striving for universal EU safety certification. This tendency will eventually reduce the regulatory difference, however, the implementation schedule imposed by the EU may be too long for the purposes of the Rail Baltic. It is therefore essential, that the regulatory framework is set up in co-operation between the Baltic States, independent of the domestic issues and ahead of the domestic implementation schedule.

An efficient way to overcome the differences in the national legislation of Estonia, Latvia and Lithuania (and, possibly also Poland re: the section of track or portion of capacity between PL/LT border to Warsaw) is to set up, by means of an international agreement between the participating states, creating a permanent international independent body, the main task of which is to (i) establish the transparent and efficient terms and conditions for access to the Rail Baltic infrastructure; (ii) establish the methodology for calculation of the fees charged for the use of the Rail Baltic infrastructure rules; (iii) act as independent body authorised to intervene in the capacity allocation procedures and (iv) provide a first instance forum to settle disputes between the Joint Venture and the railway undertakings pertaining to the access and capacity allocation issues. For ease of reference, such international body shall tentatively be called the “**Baltic Rail Commission**” (BRC) in this Study.

As evident in the case studies analysed for this Study, most European cross-border transport projects have had or developed over time some form of an inter-state agreement laying out the groundworks, decision-making procedures and the implementation bodies for the project. In this light, the Baltic Rail Commission could be modelled on the examples of the Central Commission for Navigation on the Rhine and on the management model devised by the Regulation (EU) No. 913/2010 of the European Parliament and of the Council for the development, operation and management of the selected Rail Freight Corridors. The historical experience, development and best practises of these

and other international organisations as well as the EU regulatory environment should be further analysed in these respects. It must be noted that neither of the two exemplary models can or should be automatically extended to the Rail Baltic structure, because:

- the CCNR is aimed at a different transport mode and the organisation structure dates to the pre-EU period. Today, the integration and co-operation between EU Member States is much deeper and the overall organisational structure can be devised more efficiently utilising the existing knowledge base and elements of the national railway regulatory structures;
- the Rail Freight Corridor regulation is based on the existing rail networks and devised to ensure management on both national level as well as on the level of the IMs. While in LT certain elements of the future Rail Baltic infrastructure have been planned, already under construction or even completed and the law also designates JSC “Lithuanian Railways” as an infrastructure manager, in EE and LV such infrastructure managers do not exist yet (as also the 1435 mm gauge rail infrastructure is yet to be built).



Benefits of the Baltic Rail Commission Model

Independence

The BRC would be independent of the Joint Venture - the commercial body managing the Rail Baltic infrastructure and having the business interest to offer its services to railway undertakings. On the other hand, the BRC would be independent of the present national regulating bodies, thus minimising the risk of creating administrative barriers to foreign railway undertakings or furthering the interests of domestic undertakings wishing to use the Rail Baltic infrastructure.

Pros:

- The long-term “lock-in” of the contracting parties, mitigating the political risks arising from election-cycle;
- Provides the opportunity to engage Finland, Poland and the European Commission in the management and supervision of the new corridor;
- The Baltic Rail Commission approach in general is in line with the existing EU railway regulation, satisfying the requirements of the independence of the Joint Venture from the railway undertakings and from the national authorities;
- Eliminates the potential conflicting impact of national regulation;
- Transparency and legal certainty for the railway undertakings and potential multimodal operators.

Cons:

- The stakeholder states need to reach an agreement on all aspects (incl. commitments, staffing, expenditure etc.) of the Rail Baltic project architecture to the level sufficient for a workable agreement between the states;
- Such agreement between the states needs to be achieved soon, in order not to impair the availability of the EU funding for the Rail Baltic project;
- The Baltic Rail Commission needs to be staffed, seated and start working by the time the Joint Venture shall be seeking external financing and customers.

Transparent Access Terms and Independent Supervision

BRC would be in the position to establish and supervise transparent and efficient procedures for timetabling, access to, capacity allocation etc. in respect of the Rail Baltic, based on the relevant EU regulations (Directive 2012/34/EU/ and implementing acts), which the Joint Venture would then comply with and implement;

Pros:

- Existing competence gained from the preparatory works undertaken in LT in connection with the newly built 1435 mm gauge tracks and participation in the management structures of Rail Freight Corridor No. 8 could be utilised;
- The Joint Venture can operate independently and without the historic burden and concerns of the existing 1520 mm gauge network (i.e. starting from a “clean sheet” as regards to cost accounting, budgeting, etc.)

No Need for Parallel Regulation

The domestic national regulation and the functions of the national regulatory agencies may continue to address and supervise the existing national 1520 mm railway networks. They will also continue to supervise the local safety issues. The BRC shall have only limited and well defined authority. The experience and know-how of the staff of the national regulating bodies (especially such expertise as already accumulated in LT in the course of the construction of the 1435 mm gauge rail infrastructure) may be utilised by appointments to the Baltic Rail Commission.

Membership and Decision-making

Estonia, Latvia, Lithuania (and Poland) would be logical signatories to the treaty. The decision-making procedure in the BRC may be arranged in such a manner that all stakeholder states can have their interests represented, decisions through consultations and consensus are a recommended process of decision-making in order to achieve national recognition and implementation of these agreements. The EU may also be considered as a member (High Contracting Party) in the BRC to ensure that the Rail Baltic functions as part of the Single European Railway Area, TEN-T and other European initiatives.

Observing Members

States which have bona fide interests in the Rail Baltic infrastructure as a transport corridor (Poland, Finland, Russia) may be invited to participate in BRC as observing members to facilitate the flow of information, promote trade and interoperability.

Possible Extension of Rail Freight Corridors

As the BRC/JV structure follows the governance structure of the Rail Freight Corridors as set forth in Regulation EU No. 913/2010, the Rail Baltic, to the extent completed, may be further included, without unreasonable administrative effort, in the existing, modified or new Rail Freight Corridors as laid out in the referred Regulation.

Co-ordination of the Member States and Specific Jurisprudence

As a permanent international organisation (with its regular plenary sessions and standing committees) the BRC could co-ordinate the policies of the member states as regards to the new European-gauge transport corridor and develop, implement and safeguard a uniform jurisprudence in the Rail Baltic specific matters. Issues between the member states would be solved through political-diplomatic consultations and enforced only after reaching a consensus.

Independent Arbitration Tribunal

In order to avoid the development of differing “national Rail Baltic legal practices” which will be inevitable in time if these disputes (e.g. between the infrastructure manager and railway operators) would be handled by the existing national courts, the BRC should also act as an (institutional) arbitration tribunal in case of disputes between the Joint Venture and the railway undertakings related to access and capacity allocation matters. The awards of such tribunal shall be recognised and enforced by the national courts. The European Court of Justice could be considered as an appellate court in order to ensure impartial judicial review of the decisions of the BRC arbitration tribunal.

2.13. Public Procurement

The main principles of public procurement procedures in all three Baltic States are based on EU law, however the differences are mainly in the dispute procedures. When planning future centralized public procurement procedures for the Joint Venture, it is our conclusion that the Estonian procurement system should be preferred, where possible. The main arguments for using Estonian public procurement system are:

- 1) In Estonia, an appeal cannot be lodged after concluding a procurement contract. In Latvia and Lithuania an appeal can be lodged up to 6 months after the signing the contract.
- 2) In Estonia, an appeal can be lodged in 7 working days from the purchaser's activity. In Latvia and Lithuania it is in some cases up to 15 days.
- 3) A relatively low percentage of public procurements are appealed in Estonia (4-5 percent). In Lithuania it is similarly 3 percent, compared to 13-14 percent in Latvia.
- 4) An average public procurement dispute through all the court stages in Estonia takes a maximum of 5-6 months, but in most cases it ends up by the ruling of the Appeals Committee (30 days from filing an appeal to reaching a decision). In Latvia it can take 2-5 years in court, in Lithuania it can take up to 10 months.
- 5) The local threshold for the value from where to hold a public procurement procedure in Estonia is higher than in Latvia. In Lithuania there isn't even an exact threshold. International thresholds are enacted in EU legislation.
- 6) In Estonia, the definition of a purchaser is the most accurate. All the private and public entities that are obliged to arrange a public procurement are described in more detail than in Latvia and Lithuania, thus there is less room for disputes.

A comprehensive overview of public procurement legislation in the Baltics is available in the Annex 5, below is a short summary of the key findings:

Question	Estonia	Latvia	Lithuania
1) Which public entities are covered by the law (as purchasers)?	The state and its institutions, local authorities and other public legal persons in all of the Baltic States.	The state and its institutions, local authorities and other public legal persons in all of the Baltic States.	In Lithuania, the additional premise to consider a public legal person as a public purchaser is that all or part of its activities are intended for meeting the needs of general interest, not having an industrial or commercial character, and financed or controlled by the state or local authorities. Only public legal persons in Lithuania engaged in water, energy, transport or telecommunication activity are <i>a priori</i> public purchasers.

2) Are any private entities covered by law (as purchasers)?	<p>Non-profit associations and foundations, controlled or financed by the state or local authorities. legal persons, acting in public interests and controlled or financed by some purchaser mentioned above. entities operating in certain fields³ which have sole right in this field or are financed or controlled by purchasers. public utility managers commissioning construction works, using public funds.</p>	<p>Legal entities which currently are established or operate in order to ensure the needs of the public, which are not of commercial or industrial nature and are controlled or financed by the state, local authorities or other purchasers.</p>	<p>Any private legal person, if all or part of its activities is intended for meeting the needs of general interest, not having an industrial or commercial character, and controlled or financed by purchasers. Also any private legal persons engaged in water, energy, transport or telecommunication activities.</p>
3) What minimum value of contracts require public procurement?	<p><u>International thresholds are enacted in EU legislation.</u></p> <p><u>Domestic thresholds:</u></p> <p><u>40 000 euros</u> in the event of a public supply contract, a public service contract and a design contest and <u>250 000 euros</u> in the event of a public works contract and a public works concession.</p>	<p><u>International thresholds are enacted in EU legislation.</u></p> <p><u>Domestic thresholds:</u></p> <p><u>LVL 20,000 (approx. EUR 28,457)</u> for public supply or service contracts; <u>LVL 120,000 (approx. EUR 170,745)</u> for public construction works.</p>	<p><u>International thresholds are enacted in EU legislation.</u></p> <p><u>Domestic thresholds:</u></p> <p>If the contract value net of VAT is less than <u>LTL 100 000 (EUR 28 962)</u> for supplies or services, or less than <u>LTL 500 000 (EUR 144 810)</u> for works, the procurement shall be deemed a small value public procurement, therefore the simplified procurement procedures could be applied.</p>
4) What are the main options for public procurement procedures (open, restricted, negotiated procedure etc)?	<p>In all of the Baltic States, the open or restricted procedure is the main type. Other types (certain premises must be fulfilled to use them): a competitive dialogue; a negotiated procedure with or without the publication of a contract notice.</p>		
5) What are the basic principles for determining the best bidder?	<p>In all of the Baltic States, a contracting authority shall specify in contract documents whether it awards the public contract on the basis of the most economically advantageous tender or solely on the basis of the lowest price. In the first case, the objective criteria must be specified in the contract documents.</p>		

6) What remedies are there available for bidders who deem that their rights have been infringed?	Lodging an appeal against an activity of the contracting authority to the Public Procurement Appeals Committee (and challenging its judgment in court); lodging an application for compensation of loss with the Appeals Committee within one year from the award of the public contract; filing a complaint to the Estonian Ministry of Finance.	Filing a complaint with the Procurement Monitoring Bureau (and challenging its judgment in court); disputing the validity of the procurement contract, its terms, requesting the Administrative Court to amend the contract, and claiming losses (optional).	The right to refer <u>to a court for:</u> the annulment or amendment of the decisions of the contracting authority which do not meet the requirements of the Law on Public Procurement; compensation for damage; nullification of the public contract; imposition of alternative sanctions. No special authority as in Estonia and Latvia.
7) Which judicial bodies are authorised to deliberate public procurement disputes?	The special Appeals Committee and the three-level court system.	Procurement Monitoring Bureau; Administrative Court (regional Administrative Court – 1 st instance; and the Supreme Court (<i>Senate's Administrative department</i>) – Cassation).	The ordinary court system, no special body as in Estonia and Latvia.
8) What is the timing in case a party intends to apply for the remedies?	Generally <u>seven working days</u> from the day when the appellant became aware of or had to become aware of the violation of its rights or harming of its interests, <u>but not after the award of the public contract</u> . An application for compensation of loss may be lodged with the Appeals Committee within <u>one year from the awarding of the public contract</u> .	10 days – if the bidder is notified on the results of the procurement procedure via email or fax, 15 days – if the results are delivered by post.	A supplier shall have the right to file a claim with the contracting authority, file a request or bring a lawsuit before court in 5-15 days (depends on the procedure). <u>3 year prescription shall be applied with respect to claims for the compensation of damage.</u>

9) What timing is available after the signing of the contract?	<p>After the signing of the contract, the bidder cannot generally lodge an appeal against the activity of the purchaser to the Appeals Committee, unless the procurement contract is changed unlawfully. Still, if negotiated procedure without prior notification is used or in case of illegal direct award, the deadlines for lodging an appeal are respectively 30 days after publication of the contract notice and in the second case it is 6 months after the conclusion of the contract. An application for the compensation of loss: within 1 year from signing.</p>	<p>30 days to 6 months – to dispute the procurement contract, its terms and conditions (exact timing depends on the conditions how the bidder was informed about the contractor the rejection of his tender).</p>	<p>A supplier shall have the right to bring a lawsuit for the nullification of a public contract within 6 months from the awarding of the public contract.</p>
10) How often are public procurements disputed?	<p>about 4-5 % of the cases.</p>	<p>1314%</p>	<p>3-4%</p>
11) How long would an average public procurement dispute take?	<p>30 days in the Appeals Committee + 1,5-2 months in Administrative Court + 1 month in Appeals Court + 1 month in Supreme Court in urgent cases, where concluding the contract is pending. In less urgent cases it may last a couple of months longer.</p>	<p>1-4 months at the Procurement Monitoring Bureau; 2-5 years in court (considering all instances).</p>	<p>The current practice shows that the case takes about 6 months until the decision of the appeal court. When a cassation is also lodged, the dispute takes a couple of months longer.</p>
12) What is the possibility to change the contract after the signing?	<p>When the amendment is objectively reasoned and cannot be solved with another public procurement</p>	<p>Only if it is provided in the contract or if the contracting party is changed due to reorganization or in the case of the transfer of an undertaking (enterprise).</p>	<p>Only with the consent of the Public Procurement Office to such changes of the terms and conditions of the public contract, unless the value of the contract was under 2900 EUR or the contract was concluded after a simplified procedure.</p>

2.14. Compulsory Expropriation

Based on our comparative analysis (please see Annex 4) it has to be concluded that the compulsory expropriation procedures in the Baltic countries differ significantly. Although eventually the land can be expropriated from current owners for public purposes and at the later stage the same land can be transferred for exploitation to the Joint Venture in one way or another in all three countries, it is strongly advisable to review and amend expropriation legislation in Latvia and Lithuania in order to support a swift and simultaneous expropriation process in all related jurisdictions.

In order to assure a swift and simultaneous process in all related jurisdictions and to ensure that the proposed timeline is honoured, it is advisable to change both Lithuanian and Latvian legislations so that the overall expropriation process would also take ca 1,5 years as in Estonia.

Taking into consideration the initial project timeline, as set forth in the AECOM Report, where these two phases – spatial and regional planning and procurement (including expropriation) processes – are separated, it is advisable that in Lithuania these two processes should also be separated.

In Latvia it is advisable to change the legislation so that the expropriation decision would be made on a governmental level instead of adopting a separate law by the Latvian Parliament in each instance. This could help to avoid possible contestations of the special expropriation law in the Constitutional Court and to avoid potential delays that this may cause.

It is also advisable to change Latvian and Lithuanian legislation, at least for the purposes of large cross-border infrastructure projects, so that contesting the expropriation decision in any stage of the process would not affect the process timeline.

Time-frames of current expropriation procedures

- In Estonia roughly 1,5 years starting from the moment the thematic general plan of Rail Baltic comes into effect.
- In Latvia the timing can't be specified. Considering that the legislative procedure is involved as well as a potential dispute resolution in the Constitutional Court, it can be roughly estimated to be 2-3 years.
- In Lithuania the exact timing can't be specified either. Considering that the expropriation process is tied and carried out simultaneously with special planning procedures as well as the possible time of potential dispute resolution processes, it can be very roughly estimated to be 2-3 years.

Likely perils

- In Estonia - to ensure that the rights of all persons subject to legal expropriation proceedings are effectively protected, the existing Estonian legislation and court practice needs to be changed to ensure public funding for sufficient, timely and competent legal advice and representation to be available for all persons in such need.
- In Latvia - the owner can dispute the law of expropriating his land in the Constitutional Court. This affects the whole process, including access to expropriated land for performing construction or other works. It is strongly advisable to change relevant legislation in order to avoid affecting the expropriation process.
- In Lithuania - the expropriation procedures for the purposes of significant public importance (like Rail Baltic) are carried out (at least in part) simultaneously with the special planning procedures.

This affects the timing of the whole process, as filing a claim in the planning procedure literally stops all processes, including the expropriation process. It is advisable to separate these two processes – spatial and territorial planning from one side and expropriation from the other side – in Lithuania.

Carrying out compulsory expropriation procedures

- Only the state (the Government) can be the compulsory expropriator of property. Consequently no private entities are allowed to carry out compulsory expropriation in any of the Baltic countries.
- However, in all Baltic countries the state is entitled to transfer the expropriated land to a private entity exclusively for the purposes for which the land was initially expropriated. Nevertheless, the conditions of transferring the expropriated land differ slightly – in Estonia and Latvia the title of expropriated land can be transferred while in Lithuania it's only allowed to trust, lease or give the land for free possession.
- In order to allow private law entities (such as the Rail Baltic Joint Venture would be) to carry out compulsory expropriation directly, laws in all Baltic countries must be changed significantly (most likely on a constitutional level) which is not likely to be feasible or reasonable for the purposes and the foreseen timeline of the RB project..

Other important notes

- The procedures for getting final and binding expropriation decisions in the Baltic countries differ significantly. The final and binding decisions are made as follows:
 - in Estonia by the Government of the Republic of Estonia
 - in Latvia a special law must be adopted by Saeima (Parliament of the Republic of Latvia)
 - in Lithuania by the National Land Service.
- The price of expropriated land is determined based on an evaluation carried out by an impartial and licensed evaluator. In Estonia the price of an expropriated land can also be settled via a mutual agreement between the state and the owner after the expropriation decision is made but before the evaluation is made.
- In Estonia and Lithuania disputes regarding the amount of compensation (price of expropriation) do not affect the expropriation process and access to expropriated land for the purposes of construction works. In Latvia the regulation is unclear, although the law can be interpreted so that such a dispute would not affect access to expropriated land for the purposes of construction works. Thus it is strongly advisable to amend the regulation in Latvia to fix clearly which disputes would or would not affect the process.
- We fully appreciate the timescale and difficulties in changing material domestic laws, as compulsory expropriation regulations undoubtedly are. Still, such need appears inevitable in case a unified timetable of the Rail Baltic project and related EU finding is intended to be kept. Perhaps limiting the changes of national laws to the specific purpose of implementation of large cross-border international infrastructure projects, or achieving the result by entering into an international treaty on a level of sovereign states re: special legal regime for the planning, construction and management of Rail Baltic, could prove as more acceptable solutions for the national parliaments and the general public.

Comparative tables on compulsory expropriation are available in Annex 4 of the Final Report.

3. TAX

3.1. VAT

ESTONIA

Standard VAT rate: 20%

9% for:

- Accommodation services
- Books and educational workbooks
- Periodicals, with the exception of those with mostly pornographic content
- Pharmaceuticals, birth control products, sanitary and hygienic products, medical aids meant for use by the disabled

0% - export, Intra-Community supplies etc.

Exemptions:

- Supply of certain goods and services of social character
- certain health services
- certain educational services
- universal postal services
- financial and insurance services
- securities with some exceptions
- supply and letting of real estate (unless the taxpayer opts for taxation)
- lottery and gambling
- investment gold

LATVIA

Standard VAT rate: 21%

12 % for:

- medicaments, medical devices and goods, special baby care products according to the list approved by the Cabinet
- newspapers, journals, bulletins and other periodical publications
- domestic public transportation services
- heating to individuals
- payments for accommodation in hotels, motels, guest houses

0% - export, Intra-Community supplies etc.

Exemptions:

- certain cultural services
- approved medical services
- the supply of gold, coins and banknotes to the Bank of Latvia

- insurance and reinsurance services supplied by insurers and insurance brokers
- rental payments made by individuals under a lease or tenancy of habitable premises, excluding payments for accommodation in hotels, motels, guest houses, campsites and tourist hostels and for rural holiday accommodation
- certain financial services
- certain postal services by providers of universal postal services relating to letters weighing no more than 2 kg, parcels weighing no more than 10 kg and postage-paid labels
- copyright royalties in respect of works created by authors, composers, artists and writers; and
- dental services

LITHUANIA

Standard VAT rate: 21%

9% for:

- heating energy supplied to residential premises, hot water supplied to residential premises, cold water supplied to residential premises for preparation of hot water, and heating energy used for the heating of that water (extension until 31 December 2013)
- books and not periodical press
- newspapers, magazines and other periodicals subject to certain restrictions (since 1 January 2013)
- passenger transportation according to the regular routes determined by the Ministry of Communications or an institution authorised by it, as well as transportation of passenger luggage referred to above (since 1 January 2013)

5% for:

- pharmaceuticals and medical aid products, where the acquisition of such good is fully or partly financed according to the provisions of the Law on Health Insurance (extension until 31 December 2013)
- disabled technical aid products and their repair work (since 1 January 2013)

0% - export, Intra-Community supplies provided that certain conditions are met, etc.

Exemptions:

- health care goods and services
- social services and related goods
- education and training services
- cultural and sport services
- certain services and goods supplied by non-profit organizations
- postal services and postal stamps
- insurance services and financial services
- payments collected from participants of lotteries and gambling games
- letting or leasing of immovable property with some exceptions
- sale of immovable property subject to certain conditions
- special cases when supply of goods and services and acquisition of goods from another EU member state is exempt

3.2. Corporate income taxation in Estonia

Taxable income and tax rate

In Estonia the rate is 21% but it applies only to the distributed part of the profit. Retained profits are not subject to corporate income tax in Estonia. As opposed to the other Baltic countries, the taxation period is a calendar month (instead of a calendar or financial year).

Tax amortization and depreciation

Due to its different corporate income tax principles, no tax amortization or depreciation regulations exist in Estonia.

Carry forward of losses

In Estonia no specific regulations for the carrying forward of losses exist. The Estonian tax regulations rely on the Estonian Commercial Code according to which dividend distributions are possible only after covering the losses of previous years. Accordingly, no specific regulations are required for taxation purposes. The negative side is that should a loss-making company make distributions from its equity (other than dividends) or any non-deductible expenses, then corporate income tax is payable even by the loss-making company.

Consolidation of profits and losses for tax purposes (group taxation)

According to the Estonian law, all companies are considered to be separate taxpayers. Group taxation is not available.

Dividend payment flows - avoidance of double taxation

Receipt of dividends is tax exempt for an Estonian company. Any distribution of dividends from an Estonian company is automatically exempt from Estonian corporate income tax if it is based on dividends received from a subsidiary situated in the European Economic Area or Switzerland (except low tax territories) where the Estonian (holding) company (at the time of dividend receipt) held at least 10% of the shares or votes. There is no minimum holding time requirement.

Taxation of capital gains if a subsidiary is sold by the holding company

Due to the significant investments to be made into land and railway infrastructure, it could be assumed that the **subsidiaries** will own significant real estate assets. Thus it may be considered that they would be regarded as real estate companies. In case the shares of a subsidiary are sold, then capital gains realized from the sale of such a subsidiary can be subject to taxation in the country where the subsidiary is located.

According to the **Estonian** domestic law, income tax at 21% is charged on gains from the sale or exchange of shares only if the transferred holding is a holding in a company which owns real estate located in Estonia. In the latter case, the capital gain on the sale of the shares is subject to tax if the non-resident holds at least 10% of the shares of a company whose property consists for more than 50% (or consisted during the two preceding years) directly or indirectly of immovable assets or immovable structures located in Estonia. The law looks through a higher tier company to the assets of the lower tier subsidiary.

The status of a real estate company would not be changed if the land would be owned by another person (e.g. state) and the Joint Venture uses the land on the basis of a long term building title (in

Estonian “hoonestusõigus”). This is because the railway infrastructure would be also considered as real estate and the latter would constitute the main part of the Estonian company’s assets. Land itself would constitute an immaterial part of the total assets of company.

On the level of an Estonian **holding company**, the sale of a subsidiary (irrespective whether it is a tax resident in Estonia or abroad) does not cause any tax liability in Estonia. However, any profit distributions (e.g. dividend payments) from the holding company will be subject to Estonian corporate income tax. No tax exemptions are available for capital gains realized by an Estonian (holding) company.

Transactions between related entities (transfer pricing)

Estonia applies transfer pricing regulations - all related party transactions shall be arm’s length.

Due to the estimated size of the Rail Baltic operations the Estonian business unit (irrespective whether a subsidiary or a branch (permanent establishment for tax purposes)) shall establish its detailed transfer pricing documentation, the aim of which is to describe the arm’s length pricing of related party transactions.

Thin capitalisation and any other restrictive measures

Many countries apply so-called thin capitalisation regulations for limiting the amount of tax-deductible interest expenses if the debt originates from a related party. The thin capitalisation regulations may be of restrictive nature both to the holding company and to the subsidiaries.

Estonia does not apply thin capitalisation rules. Accordingly, an Estonian company could be financed mainly through debt if required (no restrictions).

3.3. Corporate income taxation in Latvia

Taxable income and tax rate

In Latvia the general corporate income tax rate is 15%. A reduced 9% tax rate is available only to small enterprises (whose turnover does not exceed EUR 100 000 per year and the number of employees does not exceed 5).

The accounting profit is adjusted in accordance with the Latvian Corporate Income Tax Law.

The taxable period may differ from the calendar year.

Tax amortization and depreciation

In Latvia¹¹, fixed tangible assets are divided into five depreciation categories. However, tax depreciation is not available for assets that are not subject to physical or moral degradation, e.g. land. For assets of Categories 1 and 5, high-tech production equipment acquired after 31 December 2005, light motor vehicles, motorcycles, sea-going and river vessels and aircraft, depreciation must be calculated for each asset separately; assets of the other categories are depreciated on a pool basis, with a separate pool for each category. Tax depreciation must be taken at the prescribed rates, whether or not a tax loss has been incurred or is thereby incurred.

The annual depreciation rates:

	Category/type of asset	Rate (%)
1	buildings, constructions and long-term plantations	10
2	railway rolling stock and technological equipment, technical equipment of the merchant marine and harbours; energy equipment	20
3	sea-going and river vessels	20
4	computers and ancillary equipment, information systems, software products and data storage systems, means of communication, copiers and ancillary equipment	70
5	other fixed tangible assets, excluding the items listed in Category 6	40
6	oil exploration and extraction platforms, together with the on-board equipment necessary for their functioning, oil exploration and extraction vessels	15

Depreciation is computed under the declining-balance method. It is calculated by applying the depreciation rates in the above table to the tax depreciation value of the pool of assets or to separate assets, as the case may be, at the beginning of the tax year.

Carry forward of losses

In Latvia, losses may be carried forward indefinitely. Losses incurred in taxable periods prior to 2008 may be carried forward for 8 years. Losses brought forward are set off in the order in which they were incurred. Losses may not be carried back.

In the case of a change of control of a company carrying old losses, the loss carry-forward is restricted. An exception applies where the loss-making company continues to carry on its basic type of business during a period of 5 years after the change of control. That type of business must have been the company's basic business for at least 2 years preceding the change of control.

¹¹ Z.G. Kronbergs, Latvia - Corporate Taxation sec. 1., Country Analyses IBFD (accessed 3 Dec. 2012).

Consolidation of profits and losses for tax purposes (group taxation)

Tax losses can be transferred from a non-resident subsidiary to the Latvian holding company only if the non-resident subsidiary cannot carry its tax losses forward to another tax year. Many additional conditions apply.

Dividend payment flows – avoidance of double taxation

Starting from 1 January 2013, dividends received by a Latvian resident (holding) company are exempt from corporate income tax, except where dividends are received from residents of tax havens.

Taxation of capital gains if a subsidiary is sold by the holding company

In Latvia, residents must withhold tax at 2% from the purchase price of the shares of a **real estate company**. The term “real estate company” refers to participation in an entity more than 50% of whose assets in the taxable period or in the immediately preceding taxable period consists of Latvian immovable property, except where those participations are securities publicly quoted in an EEA country. **If the shares are purchased by a non-resident company, no withholding tax has to be withheld** and, unless there is a permanent establishment, the capital gain is not taxable in Latvia.

The status of a real estate company would not be changed if the land would be owned by another person (e.g. state) and the Joint-Venture uses the land under the long term building title. This is because the railway infrastructure would be also considered as real estate and the latter would constitute the main part of the Latvian company’s assets. Land itself would constitute an immaterial part of the total assets of company.

Any capital gains realized by a Latvian tax resident (holding) company from the sale of subsidiaries are tax exempt (since 1 January 2013).

Transactions between related entities (transfer pricing)

Latvia applies transfer pricing regulations – all related party transactions shall be arm’s length.

Due to the estimated size of the Rail Baltic operations the Latvian business unit (irrespective whether a subsidiary or a branch (a permanent establishment for tax purposes)) shall establish its detailed transfer pricing documentation with the aim of describing the arm’s length pricing of related party transactions.

Thin capitalisation and other restrictive measures

In Latvia, for interest paid to others than credit institutions that are residents in the EU/EEA or in a country with which Latvia has an active double tax treaty, in excess of the greater of the two following amounts is not deductible: i) interest calculated using 1.2 times the average short-term interest rate in the last month of the tax period and ii) interest calculated on a company’s average debt in excess of 4 times opening equity. For interest paid to registered financial companies, only ii) limitation should be applied.

In the case of Latvian branches (permanent establishments) of non-resident companies, only the statistical average interest rate limitation applies and not the equity test. A Latvian branch would be treated as a separate entity for corporate tax purposes and from the accounting perspective the obtained funds would be like a loan from the parent entity. Thus, thin capitalization regulations should apply. This, however, is a general view and a deeper analysis of the loan agreement with the

bank may bring a different answer (e.g. the loan amount allocated to Latvia is specified, branch pays interest directly to the bank etc.).

The Latvian thin capitalization regulations do not apply to loans from credit institutions situated in Latvia, in another EU country or a country which has a Tax Treaty with Latvia. In addition, the regulations do not apply to loans from the Latvian State Treasury, the Nordic Investment Bank, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank, the Council of Europe Development Bank and from the World Bank group.

3.4. Corporate income taxation in Lithuania

Taxable income and tax rate

In Lithuania the general corporate income tax rate is 15%. A reduced tax rate of 5% is available to small enterprises if the average number of employees does not exceed 10, and its income during the taxable period is not higher than LTL 1 million (additional restrictions may apply). In addition, a 0% tax rate applies to social companies and a 5% tax rate to agriculture companies if certain conditions are met. Also, special provisions are available for non-profit organisations.

The profit of legal persons calculated as income less than non-taxable income, allowable deductions and limited allowable deductions.

The taxable period being different from a calendar year may be accepted by the authorities if it is based on a reasoned application.

Tax amortization and depreciation

In Lithuania¹², the acquisition costs of fixed assets must be depreciated over the period of their use. The period of use is determined by the taxpayer, but for tax purposes may not be shorter than the period determined by the Lithuanian Law on Corporate Income Tax. The straight-line method is normally used for depreciation (amortization) of fixed assets. Alternatively, the double declining-balance method and production method are allowed in respect of certain groups of fixed assets. The selected method must be applied consistently.

Land is not depreciable. The value of land may be written down to the fair market value if, for unusual reasons (e.g. pollution), the fair market value has fallen permanently below the acquisition cost, but the write-off amount is not tax deductible.

For buildings, the straight-line method applies generally, but the declining-balance method may be used when certain conditions are met. The depreciation base is the acquisition or construction/manufacturing cost, including accessory costs, such as notary fees and registration fees. Depreciation is not calculated on buildings included in the Register of Immovable Cultural Properties of the Republic of Lithuania (except if their reconstruction was carried out after 1 January 2002).

Buildings can be depreciated as follows:

Category of fixed assets	Method [1]	Minimum period (years)
new buildings used for activities and reconstruction of buildings included in the Register of Immovable Cultural Properties of the Republic of Lithuania, if these new buildings are built or their reconstruction is carried out after 1 January 2002	stl or ddb	8
dwelling houses	stl	20
other buildings	stl	15

[1] Stl = straight-line method; ddb = double declining-balance method.

¹² T. Vaičiuliene, Lithuania - Corporate Taxation sec. 1., Country Analyses IBFD (accessed 3 Dec. 2012).

Plant, machinery and equipment can be depreciated as follows:

Category of fixed assets	Method [1]	Minimum period (years)
Plant and machinery	stl or ddb	5
Equipment (structures, wells, etc.)	stl	8
Electricity transmission and communications fittings (except for computer networks)	stl	8
Rolling stock (diesel locomotives, carriages, tanks), ships	stl	8
Pipelines, aircraft, arms	stl	15
Furniture, except when used for hotel activities	stl	6
Furniture and stock used for hotel activities	stl or ddb	6
Computer and communications equipment (computers, computer networks and equipment)	stl or ddb	3

[1] Stl = straight-line method; ddb = double declining-balance method.

Different minimum depreciation rates can apply to fixed assets intended for the use and used in scientific research and experimental development activities.

Carry forward of losses

In Lithuania, losses from ordinary activities may be carried forward for an unlimited period of time if the entity continues to carry on the activity that caused the losses. Loss carry-back is not allowed. Losses on the disposal of securities and financial derivatives (with certain limitations) may be carried forward for 5 successive tax years and can be used to reduce profits from the disposal of securities and financial derivatives only. Losses incurred by foreign permanent establishments of Lithuanian companies that are subject to tax abroad cannot be carried forward under Lithuanian laws. Change of ownership does not influence the carry-forward of losses, provided that the entity continues to carry on the activity that resulted in losses. In case of change of the legal form of an entity, the losses can be carried forward further only if the owners of the entity remain the same and the entity carries on the same activity for at least 3 years. In addition, special provisions apply to the carry forward of losses in case of restructurings or reorganisations.

Consolidation of profits and losses for tax purposes (group taxation)

Tax losses can be transferred from a non-resident EU subsidiary to the Lithuanian holding company only if the EU non-resident subsidiary cannot carry its tax losses forward to another tax year. Many additional conditions apply.

Dividend payment flows - avoidance of double taxation

Dividends received by a Lithuanian (holding) company are exempt from Lithuanian corporate income tax if:

- Received from a European Economic Area company whose profit is subject to corporate income tax or similar tax, or
- Received from the foreign company other than mentioned above provided that the Lithuanian holding company owned at least 10% of the foreign (non-tax heaven) company paying the dividends for an uninterrupted period of at least 12 months and the profit of the foreign company is subject to corporate income tax or similar tax.

Taxation of capital gains if a subsidiary is sold by the holding company

Capital gains derived by non-residents from the sale of shares in Lithuanian companies are not taxable in Lithuania.

In case the holding company is situated in Lithuania, the participation exemption is available if the holding company has held for an uninterrupted period of at least 2 years at least 25% of the shares of the subsidiary, which is a corporate income tax or similar tax payer, established in a European Economic Area or Double Tax Treaty country. The holding period of 3 years could apply in special cases depending the way the shares were acquired (e. g. in exchange for the newly issued own shares).

Transactions between related entities (transfer pricing)

Lithuania applies transfer pricing regulations - all related party transactions shall be arm's length. Due to the estimated size of the Rail Baltic operations the Lithuanian business unit (irrespective whether a subsidiary or a branch (a permanent establishment for tax purposes)) shall establish its detailed transfer pricing documentation with the aim of describing the arm's length pricing of related party transactions.

Thin capitalisation and any other restrictive measures

In Lithuania, interest expenses incurred on a controlled debt are not deductible for Lithuanian corporate income tax purposes. Under the Lithuanian thin capitalisation rules, a controlling lender is one who at the end of the Lithuanian company's tax year: (i) directly or indirectly holds more than 50% of the shares or rights in respect of dividends of the Lithuanian company or (ii) together with related parties, holds more than 50% of the shares or rights in respect of dividends of the Lithuanian company, where the creditor's holding is not less than 10%. Members of the group of a controlling lender are also regarded as controlling lenders.

A controlled debt exists when there is a debt from a controlling lender (including a debt from third parties guaranteed by the controlling lender and a debt guaranteed by a third party if this third party has a guarantee from the controlling lender) and the debt to equity ratio exceeds 4:1 (only the excess part is treated as a controlled debt). The ratio is computed as at the end of the relevant tax year but the equity does not include the result for that year. However, under Lithuanian tax legislation, the thin capitalization provisions will not be applied if the Lithuanian subsidiary can prove that the arm's length nature of the transaction is preserved.

3.5. Property taxation

ESTONIA

Estonia applies only land tax. The tax is levied on the taxable value of all land based on the authorities' valuation. The tax rate is decided by each local municipality, the range of potential tax rates is between 0,1% and 2,5% of taxable value per calendar year. Various tax exemptions are available to:

- 1) private individuals for their residential property;
- 2) land where economic activities are prohibited by law or pursuant to the procedure provided by law;
- 3) land of strict nature reserves and special management zones of protected areas and land of special management zones of species protection sites;
- 4) land adjacent to the buildings of diplomatic missions and consular representations of foreign states or parts thereof;
- 5) land in the use of a foreign state or international organisation on the basis of an agreement entered into between the Government of the Republic and the foreign state or international organisation;
- 6) cemeteries;
- 7) land under places of worship of churches and congregations;
- 8) municipal land under the jurisdiction of a corresponding local government, with some exceptions;
- 9) land in public use;
- 10) land in the use of the headquarters of allied forces.

The holding structure of railway infrastructure will not impact the burden of land tax in Estonia.

Use of state-owned land by the Joint Venture on the basis of a long term building title (in Estonian "hoonestusõigus") would not change the land tax liability.

LATVIA

In Latvia, real estate (immovable property) tax is levied by local authorities on land and buildings located in Latvia. The rate of immovable property tax is 1.5% of the cadastral value of the land or building.

The land under the railway is not subject to property tax. The railway would be exempt from property tax if it is (1) owned or in legal possession by a state or local government or by a capital company owned by the state or local government or (2) used to **provide the regulated public services**. Use of state-owned land by the Joint Venture under the long term building title would not change the exemption from the real estate tax.

LITHUANIA

In Lithuania, the Law on Real Estate Tax establishes that real estate (buildings, premises, constructions) located in Lithuania are subject to real estate tax. Exceptions apply for real estate for which construction has not been completed and real estate which was created or acquired based on the public private partnership agreement (if used as indicated in the private partnership agreement). Since 2013 real estate tax rate ranges from 0.3% to 3%, while each municipality confirms tax rates applied to the real estate situated on the territory of the municipality.

The law on Real Estate Tax also provides for certain exemptions for legal persons, *inter alia*, real estate tax is not applied to:

- real estate owned by diplomatic missions, consular offices, international intergovernmental organizations
- state or municipal real estate
- real estate owned by companies established in a free economic zone
- real estate used by environmental protection and fire protection, general purpose items (e. g. certain transport infrastructure) according to the list confirmed by the Government of Lithuania
- etc.

Based on the Resolution of the Government, general purpose items include public railway infrastructure and access railway tracks in general use. According to the current legislation, public railway infrastructure is owned by the state, therefore based on the proposed structure where real estate is owned by the private companies (irrespective whether the land is state-owned or not) the exemption would not be available. However, the Lithuanian tax authorities have expressed an opinion that despite the current wording of the laws real estate tax could also not be applicable in case the rail way infrastructure is owned by a private entity. Thus, the exact tax treatment of the Joint Venture should be confirmed with the Lithuanian tax authorities through a non-binding or binding ruling immediately after its incorporation. If the ruling would be negative for the Rail Baltic joint venture then the change of the legislation should be considered in order for the Joint Venture to qualify for the exemption.

Land owned by legal persons and situated in Lithuania is subject to land tax, except for forest land and agriculture land where forest is planted. Since 1 January 2013 land tax is calculated on the market value of the land (based on mass valuation) with the rate varying from 0.01% to 4% in different municipalities.

Land tax does not apply to the land occupied by the general use roads. Therefore, land occupied by the railway tracks could possibly not be subject to land tax. In practice, the tax authorities rely on the position of the Register of the Real Estate, therefore in order to apply for the exemption, documents issued by the Register of the Real Estate should indicate that the land is occupied by the general use road.

Also, land tax does not apply to, *inter alia*:

- territories and buffer zones of national parks, regional parks, landscape, landscape/cultural, geological, geomorphological, botanical, zoological, botanical/zoological, hydrographic and pedological reserves, except for built-up territories and land occupied by roads and water
- land of buffer strips along water bodies

- land of natural monuments, except for built-up territories and land occupied by roads
- land of archaeological monuments (except for cultural layers of old towns) and historical monuments (closed cemeteries and burial grounds), except for built-up territories and land occupied by roads and water
- land of historical, architectural and art monuments and their territories in rural areas.

The Council of Municipality has the right to reduce the tax or exempt from the tax.

Land lease tax is payable instead of land tax if the land is leased from the state. As of January 10, 2013 the rate of land tax is in the range of 0,01-4% and transitional period until 2016 (including) is applied. In comparison of two potential taxes applicable (land tax vs land lease tax) the tax burden would be very likely higher if the land is leased from the state. This is because tax exemption is potentially available only for land tax (no land tax applied to land occupied by general use roads).

3.6. Invoicing for track access and use charges of three Baltic States

Independently from the legal structure, the invoicing model for track access and use charges needs to be analysed separately.

One invoice for track access and use charges of three Baltic States

It is also necessary to understand, which entity and for which part of the track access/use charges shall invoice the infrastructure operators.

In this scenario, an operator shall receive one joint invoice reflecting the track access charges of different countries.

If the supply is deemed to be generated in the country where the respective part of the track is situated, then the VAT treatment depends on whether the recipient of such a service (i.e. infrastructure operator) is registered for VAT in the respective country. As for the part of the track situated in the country of establishment (of the holding company, subsidiary, head-office or branch who submits the invoice), the respective charge would constitute a local supply taxable based on the rules of the respective country. As for the parts of track situated in non-establishment countries, if the recipient of service is registered for VAT in the respective country(ies), then the infrastructure manager could apply 0% VAT to the part of the track access/use fee connected to the country (countries). Nevertheless, in case the infrastructure operator is not registered for VAT in one or several countries, then situation would occur where the reverse charge mechanism could not be applied and this would bring along a potential VAT registration obligation for the infrastructure manager in order to be able to declare and pay VAT in country(ies) of non-establishment.

As for **Estonia**, in the case where an Estonian taxable person receives services connected to the immovable located in Estonia from a foreign taxable person, the Estonian recipient of service is expected to self-assess VAT upon such service (i.e. apply reverse charge mechanism). However, if a foreign person renders the said service to a person who is not registered as a VAT liable person in Estonia, this would bring along an Estonian VAT registration obligation for the foreign person.

If the supply is deemed to be generated in the country where the respective part of the track is situated (e.g. the services are treated as services connected with immovable property), the below **Lithuanian** VAT implications should be considered:

- In case the Latvian or Estonian holding company, subsidiary, head-office or a branch invoices the operator for the part of the track situated in Lithuania, the supply would be subject to VAT in Lithuania and the supplier would possibly have to register as a VAT payer in Lithuania.
- In case the Lithuanian holding company, subsidiary, head-office or a branch invoices the operator for the part of the track situated in Latvia and Estonia, VAT legislation of the respective countries should be considered.

The treatment is similar in **Latvia**.

Therefore, in our opinion, the implementation of a one-invoice model could be complicated. It can easily trigger multiple VAT registration obligations for persons in the three Baltic countries, which would add to the administrative burden of the persons.

Furthermore, the entity that collects the track access charges from the infrastructure operators would be invoiced by the other entities/subsidiaries for the part of track charge to be allocated to their country (countries) of establishment.

It is necessary to receive the tax authorities' opinion on the VAT treatment of charges connected to infrastructure situated in several countries. A more precise opinion can be obtained once the taxable persons in question are established.

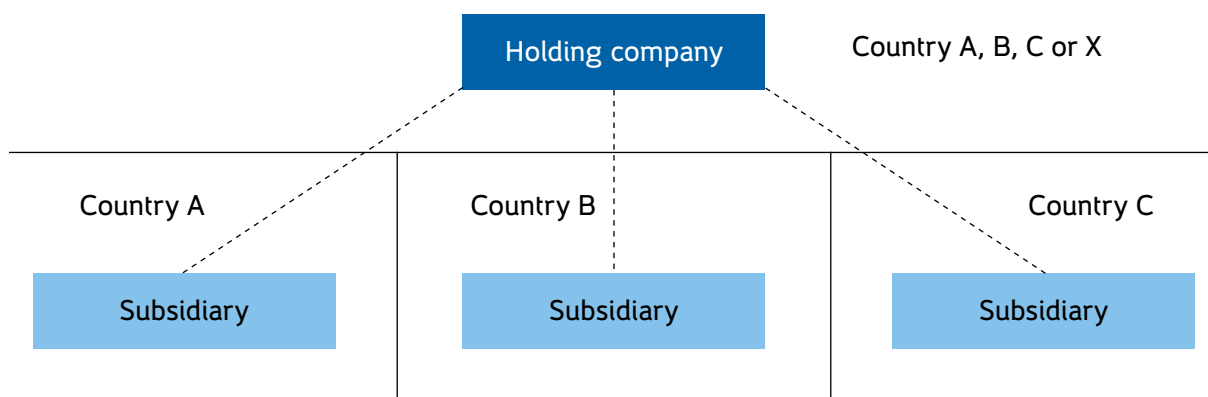
Separate invoices in each country for the respective part of track access charge

In case each subsidiary or unit of the one-tier company (head-office or a branch) invoices the operator for the part of track charge connected to its establishment country, then each of such units would invoice the infrastructure operator for their respective part as foreseen by the local laws of each country (assuming that the track access charge is deemed to generate a local supply in each country in question).

To sum up, separate invoices by local subsidiaries, branches or head-office of a one-tier company for the respective part of track access charge described would be more preferable since it would prevent multiple VAT registrations of persons in the three Baltic countries.

3.7 Two-tier structure – a joint holding company with subsidiaries in each Baltic country

Estonia, Latvia and Lithuania would jointly hold shares in a holding company which owns a 100% stake in three subsidiaries (one in each Baltic country). The participation in the holding company is to be decided separately (whether each country holds equally 33,33% or the participation depends on the length of Rail Baltic railway in each country).



In principle the holding company can be established in any country. In the table comparing the potential location for the holding company, we have also included the Netherlands as one of the potential holding company locations. The choice of alternative holding company location was based on the fact that the Netherlands is the only country which has (from a holding company's perspective) favourable bilateral tax treaties with all three Baltic countries. Namely, based on the tax treaties, only Dutch tax resident shareholders can sell shares in Estonian, Latvian and Lithuanian real estate companies without any taxation of capital gains (in the country where the subsidiary is situated). The comparative table in the analysis of a two-tier structure shows that the Netherlands may be considered as potential alternative to Estonia, Latvia or Lithuania.

However, we have not performed a thorough analysis of Dutch tax regulations because of the following reasons:

- 1) In case of a Dutch holding company, substance issues may arise. The holding company should be considered as a Dutch tax resident. The substance requirements mainly relate to the activities and management of the Dutch Holding company. To our knowledge there has been no plan to perform any activities related to the Rail Baltic Joint Venture outside the countries where Rail Baltic will operate;
- 2) Politically it may be questionable whether participating countries could and should agree on a structure that is mainly driven by tax reasons;
- 3) The benefit of a Dutch holding company mainly relates to the situation where the holding company decides to sell one or more of its subsidiaries. To our understanding the main level for entry and exit of investors should be the holding company itself. It may be the case that there will be no entries and exits to and from single subsidiaries;
- 4) A detailed analysis of the Dutch tax regulations is not within the scope of this analysis.

Each subsidiary would be responsible for developing the part of Rail Baltic infrastructure in its country. After completing the development phase, each subsidiary would earn income from granting the access to and the use of the infrastructure to passenger and freight operators (track access charges).

According to the AECOM study¹³ the track access charge is paid by the passenger and freight operators (hereinafter Operators) to the rail manager. It is a reservation charge and allows the Operator to use the infrastructure that is provided by the manager for a specific train path. The EC document 2010/O253(COD) 'Proposal for a Directive of the European Parliament and of the council establishing a single European railway area (recast)' outlines proposals for changes to the directives covering the rail sector. This document includes changes to the principles of charging (article 31); and introduces exceptions to charging principles (article 32) to improve the coherence of national track access charging schemes through the introduction of common criteria for identifying market segments on which operators may be able to pay a mark-up in access charge.

The EC document indicates that the starting point for setting track access charges should be a calculation of direct costs to the rail manager of the services running. This is calculated based on the total rail managers maintenance cost over the appraisal period, and the total number of train km. Article 32 of EC document 2010/O253(COD) states that mark-ups may be applied to obtain full recovery of the costs incurred by the infrastructure manager. Therefore, track access charges have been calculated in an iterative process to minimise the financial losses of the rail manager whilst still providing financial returns for the operators.

The following optimal track access charges were determined in the AECOM study:

- Passenger services € 3.95 per train km
- Freight services € 5.92 per train km

In principle, the agreement(s) with Operators could be signed in two ways:

1) **Each subsidiary has its own agreements directly with the Operators.** In such case the income of the holding company would mainly consist of dividend income to be received from its subsidiaries. Depending on whether the holding company renders any support services to the subsidiaries, management fees or similar charges may be payable by the subsidiaries to the holding company. In case any fees are payable by the subsidiaries to the holding company, the fair (arm's length) fees should be determined. The choice of an appropriate transfer pricing model usually requires a separate detailed study. However, it can be assumed that (based on practice with similar arrangements) the pricing model where the fee to be paid to the holding company would be calculated as "costs + x% profit margin". Before applying that method, any typical shareholder costs shall be excluded from the cost base. In the Annex 2 to its Communication¹⁴ of 25 January 2011 the European Commission made a non-exhaustive and non-prescriptive list of typical shareholder costs. The list includes *inter alia*:

- costs for the meeting shareholders of the parent company, including advertising costs;
- costs for the issuing of shares of the parent company;
- cost of the board of directors of the parent company that is associated with costs for the compliance of the parent with the tax law (tax returns, bookkeeping, etc.);
- costs relating to reporting requirements of the parent company including the consolidation of reports;
- costs for the audit of the parent;

¹³ AECOM. Rail Baltica Final Report. Executive Summary. Pages 18-19.

¹⁴ European Commission. Communication from the Commission to the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period April 2009 to June 2010 and related proposals 1. Guidelines on low value adding intra-group services and 2. Potential approaches to non-EU triangular cases http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/forum/c_2011_16_en.pdf

- costs for initial listing on a stock exchange of the parent and costs for the activities related to stock market listing of the parent, in the years after the initial listing (e.g. preparation of documents required by the stock market supervisory body);
- investorrelations' costs of the parent company.

2) **One joint agreement at the level of holding company.** After deducting the reasonable operating costs of the holding company (expenses related to the support services rendered to the subsidiaries) the remaining part could be distributed between the three subsidiaries according to the length of railway in each Baltic country. For this, the local subsidiaries would invoice the holding company. The reason for deducting the operating costs is that the holding company would be the main negotiator and contracting party to the Operators. The part of income that would be allocated to the holding company would be calculated similarly to the above (after excluding the shareholders costs, the "costs + x% profit margin" would be used). The remuneration to be received by the holding company depends on the functions performed, assets used and risks taken by the holding company.

Based on the conclusions made in paragraph 2 above ('Invoicing for track access and use charges of three Baltic States') separate invoicing of track access charges in each country is advisable.

VAT

It is the common approach of tax authorities of all three countries that definite confirmations are available only to taxpayers themselves. In the case of Rail Baltic project, the taxpayer does not yet exist. Moreover, the answers highly depend on the details of the transactions. Thus, it is not possible to give any final and definite answers. Although the conclusions below are clear enough, it is still strongly advisable to prepare written queries to tax authorities of all three countries immediately after the incorporation of the legal structure and when more detailed info regarding the operational structure is available.

Eligibility of VAT costs in the frame of Connecting Europe Facility (CEF)

Based on the Proposal for a Regulation of the European Parliament and of the Council establishing the Connecting Europe Facility/* COM/2011/0665 final - 2011/0302 (COD) Article 8 (7), VAT is not an eligible cost. If this wording would come into effect, this would mean that input VAT would not be eligible expenditure under CEF. At the same time, the Opinion of the Committee of the Regions on the 'Connecting Europe facility' 2012/C 277/12 point 26 states that the eligibility of expenditure, as defined by CEF, can be a limiting factor in the implementation of projects; therefore it should be modified in terms of eligibility dates and particular items of eligible costs, such as preparation costs, non-recoverable VAT, land purchase. The Opinion also includes recommendations for amendments, among which amendment 8 suggests the wording 'Non-recoverable VAT shall be an eligible cost'. If this amendment was to be taken into account, this would make all non-recoverable VAT costs eligible, which in turn would decrease project costs.

Based on the above, it is very crucial that if the VAT cost remains as a non-eligible cost in under CEF, then the input VAT is deductible under tax provision. This would mean that VAT is not a cost for the Rail Baltic project.

Taxation of track access charges

From the VAT perspective, each subsidiary would be registered for VAT in its country of establishment, following the regulation of the respective country.

The **Estonian** Tax and Customs Board have explained that track access charges and track use charges are taxed based on the Estonian VAT Act article 10 (2)(1), which states that the place of supply of services is Estonia if the services are connected with an immovable located in Estonia (including but not limited to services like construction, valuation or maintenance, or services for the transfer of the immovable, for preparing or co-ordinating construction works, etc).

Further, the Estonian tax authorities have confirmed that, under the current VAT regulations, the track access/use charges would be treated as services connected to an immovable, which are taxed with the local general rate VAT.

According to the **Latvian** legislation, the railway is considered as immovable property. Therefore track access and use charges supplied by the infrastructure manager would be treated as services connected to immovable property in Latvia. Consequently, track access charges and track use charges for the Latvian part of the track are expected to generate the taxable supply in Latvia.

As for **Lithuania**, neither the Lithuanian law on VAT nor its official commentary provides a clear answer on the VAT treatment of the track access and use charges. Based on current understanding, the track access and use charges are likely to be treated as remuneration for the services connected with immovable property (i.e. either as the rent/lease of infrastructure or other services connected with immovable property). The exact treatment should be confirmed with the Lithuanian tax authorities in a written query immediately after the incorporation of the Rail Baltic joint venture legal structure.

Should the track access and use charges be considered as rent/lease of immovable, then based on the Lithuanian law on VAT, a taxable person may choose to tax the rent/lease of property immovable, which generally falls under VAT exemption, provided that the property is rented/leased to taxable persons registered as VAT payers in Lithuania/foreign country or persons specified in Article 47 of the Law on VAT (for example, for diplomatic missions, consular posts, EU institutions and their established offices, particular international organizations, etc.). This option (if exercised) is valid for not less than 24 months with respect to all transactions concluded by the VAT payer.

Therefore, in case the track access and use charges are treated as the remuneration for the rent/lease of immovable property, which generally falls under VAT exemption, it is likely that an option to tax the rent/lease of immovable property could be exercised, provided that the operators are taxable persons registered as VAT payers in Lithuania/a foreign country.

In case the track access and use charges are treated as remuneration for any other services, the supply of these services, based on our understanding, is likely to form a VAT taxable supply for the infrastructure manager.

Consequently, even if the track access charge would be regarded as a VAT exempt service in Lithuania, applying the taxation option would result in the generation of a taxable supply.

Input VAT deductibility

In order to be able to deduct input VAT upon costs, the **Estonian** subsidiary should register as a taxable person for VAT in Estonia based on provisions of article 19 of the Estonian VAT Act. As the taxable supplies would be created in the distant future, the company could voluntarily apply for VAT registration in Estonia. In order to be registered, the company must provide proof of being engaged in business in Estonia or being about to commence business in Estonia (e.g. business contracts, accounting documents etc.).

In order to be able to deduct input VAT upon costs, the **Latvian** subsidiary should register as a taxable person for VAT in Latvia. As the taxable supplies would be created in the distant future, this would be a voluntary application for VAT registration in Latvia. In order to be registered, the company must provide proof of being engaged in business in Latvia or being about to commence business in Latvia (e.g. business contracts, bank account, information confirming ownership or lease title to the premises of structural units, the composition and value of owned and rented fixed assets and other information if required by the State Revenue Service).

From the **Lithuanian** VAT perspective (Article 72 of the Law on VAT), a Lithuanian taxable person may voluntarily register as a VAT payer in Lithuania, if the person is carrying out or intends to carry out an economic activity (irrespective of the amount of consideration received for goods/services supplied), except for the case when the person is carrying out or intends to carry out only such activity in respect of which input VAT could not be deductible. Generally, input VAT incurred before taxable supplies could be deducted provided that the purchased goods/services are intended to be used in the VAT taxable activities of the VAT payer.

The impact of the long investment period

Taking into the account that in this particular case the time period between VAT registration and the first taxable supply could be 10 – 15 years and the fact that only input VAT would be reported in that period, it would be advisable to receive a confirmation from the tax authorities regarding input VAT deduction.

Please note that currently the local law provisions of the Baltic States do not contain any provisions that would clearly exclude the possibility to deduct input VAT in the case at hand. Moreover, the EC Directive 2006/112 does not provide any restrictions to be applied by the Member States in this respect. The deductibility of input VAT is one of the main principles for avoiding VAT accumulation and unreasonable restriction of the VAT deductibility is to be avoided. Consequently, we assess the possibility that in the current case any of the involved Member States would wish to restrict the deductibility of input VAT, to be relatively low. In order to receive 100 per cent certainty, the matter should be addressed to the tax authorities of the three Baltic countries once the respective taxable persons are established.

In summary, the generation of a taxable supply would allow the deduction of input VAT (paid on the goods and services that will be used in the course of developing and maintaining the railway infrastructure). Consequently, there would be no VAT costs for the subsidiaries, since the input VAT upon business costs would be fully deductible. On the other hand, in case of non-deductible input VAT (costs made towards tax exempt supply, costs not related to business), the eligibility of VAT costs would come to question. The opinions and experience of the tax authorities would need to be obtained in this respect.

VAT conclusions for the two-tier structure

Comparison of VAT implication of three Baltic countries under the two-tier structure:

	Estonia	Latvia	Lithuania
Possibility to voluntarily register as a taxable person	Yes, the person must be able to provide proof of the planned business. (+)	Yes, the person must be able to provide proof of the planned business. (+)	Yes, the person must be able to provide proof of the planned business. (+)
Expected VAT nature of track access/use charges	Service connected to immovable which is a taxable supply. (+)	Service connected to immovable which is a taxable supply. (+)	Service connected to immovable which is either: A taxable supply, or VAT exempt with an option to tax. (+)
VAT compliance obligations	Must fulfill all the obligations set to taxable persons by the local laws.	Must fulfill all the obligations set to taxable persons by the local laws.	Must fulfill all the obligations set to taxable persons by the local laws.
Input VAT deduction	Yes, as long as is connected to the taxable supplies of the taxable person. (+)	Yes, as long as all the conditions set by the local law are met and connected to the taxable supplies of the taxable person. (+)	Yes, as long as is connected to the taxable supplies of the taxable person. (+)
Invoicing	Separate invoices by the local subsidiary in each country for the respective part of track access charge prevent multiple VAT registrations.	Separate invoices by the local subsidiary in each country for the respective part of track access charge prevent multiple VAT registrations.	Separate invoices by the local subsidiary in each country for the respective part of track access charge prevent multiple VAT registrations.

Corporate Income Tax

• Taxation of subsidiaries

For **subsidiaries** it has been assumed that the main income will be generated from track access charges (to be directly or indirectly (through the holding company) collected from the Operators).

In Latvia and Lithuania, the general corporate income tax rate is 15%. In Estonia the rate is 21% but it applies only to the distributed part of profit. Retained profits are not subject to corporate income tax in Estonia.

• Taxation of holding company

It could be assumed that the income of the holding company would be generated mainly from the following types of income:

- Dividends from subsidiaries;
- Capital gains from the sale of shares in subsidiaries;
- Support services to be rendered to the subsidiaries;
- Financial income (e.g. (incidental) interest income from debt financing of subsidiaries);
- Other business income.

Irrespective, whether the holding company is situated in Estonia, Latvia or Lithuania, the **dividend income** of the holding company would be tax exempt at the level of the holding company.

Due to the significant investments to be made into land and railway infrastructure, it could be assumed that the subsidiaries would own significant real estate assets. Thus it may be considered that they would be considered to be real estate companies. In case the shares of a subsidiary are sold, then capital gains realized from the sale of such subsidiaries can be subject to taxation in the country where the subsidiary is located (it is not the case in Lithuania when the shares of Lithuanian subsidiary are sold).

According to the **Estonian** domestic law, income tax at 21% is charged on gains realised by a non-resident shareholder from the sale or exchange of shares only if the transferred holding is a holding in a company which owns real estate situated in Estonia. In the latter case, the capital gain on the sale of the shares is subject to taxation if the non-resident holds at least 10% of the shares of a company whose property consists for more than 50% (or consisted during the two preceding years) directly or indirectly of immovable assets or immovable structures located in Estonia. The law looks through the higher tier company to the assets of the lower tier subsidiary. Accordingly, if a non-resident holding shareholder sells the shares of the Estonian subsidiary, capital gains would be subject to 21% income tax in Estonia.

In **Latvia**, residents must withhold tax at 2% from the purchase price of the shares of a real estate company if the shares are purchased by a Latvian tax resident. If the shares are purchased by a non-resident company, no withholding tax has to be withheld and, unless there is a permanent establishment, the capital gain is not taxable in Latvia.

Capital gains derived by non-residents from the sale of shares in **Lithuanian** companies are not taxable in Lithuania.

On the level of the **holding company**, the taxation will take place as follows:

- In case the holding company is situated in Latvia, any capital gains from the sale of subsidiaries will be tax exempt from 2013.
- In case the holding company is situated in Estonia, the sale of a subsidiary does not cause any tax liability in Estonia. However, any profit distributions (e.g. dividend payments) from the holding company will be subject to Estonian corporate income tax.
- In case the holding company is located in Lithuania, the sale of the Latvian, Estonian or Lithuanian subsidiary shall be tax exempt if the shares of the subsidiary were held for an uninterrupted period of least 2 years. The required holding period might be three years in special cases, depending on the way the shares were acquired (e. g. in exchange for the newly issued own shares).

Any other income of the holding company (e.g. fees for supporting services or interest income) should be subject to general corporate income taxation in the country of the holding company's tax residence.

- Choice for the holding company location

Comparison of holding company locations

	Estonian holding company	Latvian holding company	Lithuanian holding company	Other (Netherlands)
Taxation of dividend income	Exempt (+)	Exempt (+)	Exempt (+)	Exempt (+)
Taxation of holding company's operating profits (i.e. interest, management fees, etc.)	Tax rate: 21% (-) Timing: postponed (+)	Tax rate: 15% (+) Timing: immediate (-)	Tax rate: 15% (+) Timing: immediate (-)	Tax rate: 20% (below EUR 200,000 per annum) or 25% (-) Timing: immediate (-)
Tax exemption on retained income	Exempt (+)	Immediately taxable (-)	Immediately taxable (-)	Immediately taxable (-)
Thin capitalization regulations for shareholder loans	Do not exist (+)	Related party debts cannot exceed 4*equity. Interest rate cannot exceed 1.2 times average short-term interest rate (-)	Related party debts cannot exceed 4*equity, unless there is proof that the loan is at arm's length (-)	Abolished from 2013 (+)
Tax liability in the subsidiary country if holding company sells shares of a subsidiary	EE sub: no (+) LV sub: no, if sold to non-resident (+/-) LT sub: no (+)	EE sub: immediate 21% tax (-) LV sub: no (+) LT sub: no (+)	EE sub : immediate 21% tax (-) LV: no, if sold to non-resident (+/-) LT sub: no (+)	EE sub: no (+) LV sub: no (+) LT sub: no (+)
Taxation in the country of holding company on capital gains realized from the sale of subsidiary	Taxable at 21% but deferred until profit distribution. (+/-)	Exempt (as from 2013). (+)	Possible to achieve exemption if requirement for the holding period of 2 (or 3) years is met (+/-)	Exempt (+)
Recognition of foreign losses	Not available (-)	Very limited (only if the non-resident subsidiary cannot carry its tax losses forward to another tax year. There are also other criteria which must be fulfilled (e.g. taxation periods are the same etc.) (+/-)	Very limited (only if the non-resident subsidiary cannot carry its tax losses forward to another tax year). Recognition of the Estonian loss is questionable (+/-)	Not available (-). Only in case the foreign subsidiary is liquidated and the Dutch entity would suffer a loss upon liquidation of the subsidiary, that loss may be deductible under circumstances. However, this is not utilizing tax losses of the subsidiary.
Total score	7	5,5	4,5	6

Note: each "+" equals to 1 point; each "+/-" equals to 0,5 points and each "-" equals to 0 points.

Pro's and Con's of the two-tier model

Pro's:

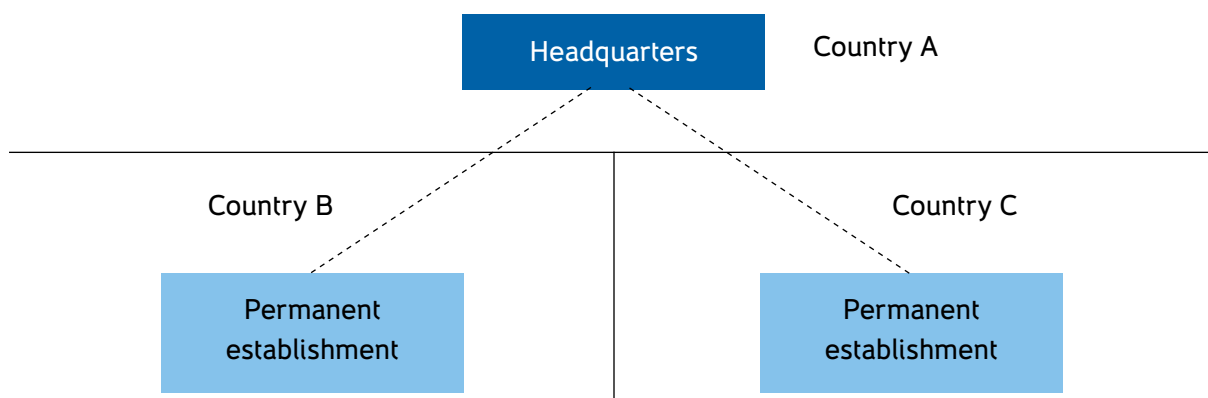
- Based on the existing tax law of the Baltic countries, the holding company's dividend income is not taxable. There would not be any significant tax cost in the country where the holding company would be situated.
- If necessary in the future, the holding company can sell the shares of its Estonian, Latvian and Lithuanian subsidiaries. Capital gains from the sale of shares are entirely tax exempt if the holding company is situated in Latvia or Lithuania (in Latvia the exemption is available from 2013; in Lithuania the requirement for the holding period of 2 (or 3) years shall be preserved). In case the Estonian holding company sells the shares of a subsidiary, then any capital gains are subject to a 21% corporate income tax but the tax is payable at the time of profit distribution.
- The participating countries share the potential income and risks jointly (through the holding company).

Con's:

- The profits and losses of different subsidiaries cannot be set against each other. For example, a loss in one country does not reduce the corporate income tax payable in another country.
- The country of the subsidiary may tax capital gains realised from the sale of securities in the real estate company (particularly the case for the Estonian subsidiary if owned by a Latvian or Lithuanian holding company).

3.8. One tier structure – a company registered in one country which has branches in the two other countries

The potential tax implications of this model may be different because the transactions and cost allocations within the same legal entity (between the headquarter (HQ) and the branches) may result in a different taxation outcome. Activities in the frame of the Rail Baltic project have a permanent nature and therefore the branches of a company headquartered in one country most likely would create permanent establishments (PE) in two other countries.



Tax consequences are expected to be similar to the ones described under point 1 above. Nevertheless, certain branch-specific variations could occur. For example, the provision of services between the headquarter and its PE or between the two PE's of a single legal entity does not create a supply, i.e. it is out of the scope of VAT.

From the corporate income tax perspective, tax laws of the countries may limit the tax-deductibility of certain expenses that are allocated within the same legal entity.

Based on the prior experience of Deloitte, taxation of permanent establishments tends to be rather vaguely regulated and thus, different interpretations of the tax law may exist.

VAT

From the VAT perspective, the company would bear costs and generate supplies in three different countries. We assume that the company (acting either through its head-office or respective branch) is registered for VAT in the respective country.

Once registered for VAT, the company (acting either through its head-office or PE) must start fulfilling the obligation set to taxable persons (e.g. adding VAT to the taxable value of the goods transferred or services provided, calculating the VAT due, submitting monthly VAT returns and paying VAT to the tax authorities, preserving documents and maintaining records, and issue invoices in accordance with the requirements set by the respective country's legislation).

ESTONIA

VAT compliance obligations

A VAT-registered PE of a foreign company must fulfill the obligations set to taxable persons (e.g. adding VAT to the taxable value of the goods transferred or services provided, calculating the VAT due, submitting monthly VAT returns and paying VAT to the tax authorities, preserving documents and maintaining records, and issuing invoices in accordance with the requirements set by the Estonian VAT Act).

VAT treatment for transactions between PE and HQ

The Provision of services between the headquarter (HQ) and its PE or between the two PE's of a single legal entity does not create a supply, i.e. it is out of the scope of VAT.

As for the transfer of goods between the HQ and its PE, this is to be treated as a EU supply/acquisition of goods under general conditions, even if the goods are transferred without remuneration.

Input VAT deduction

Based on the Estonian VAT Act, input VAT connected to the provision of the said services between the PE and HQ or between the PEs is deductible by the provider of service on the condition that the respective cost is made towards the taxable supply of the recipient of service. Otherwise it would not be deductible. For example: if the Estonian PE renders construction services to its foreign HQ for the VAT exempt services of the HQ, the PE could not deduct the respective input VAT upon the service.

LATVIA

VAT compliance obligations

Once the PE is registered in Latvia as a Latvian VAT payer, the PE must comply with the Latvian VAT requirements set forth by the Law on VAT, e.g., the calculation of VAT due, submitting VAT returns for the respective taxation period (one month, quarter or half a year, depending on the type of activities and amounts involved), issue proper VAT invoices, preserve documents (e.g., VAT invoices) supporting output VAT calculations and input VAT deductions and other.

Input VAT deduction

According to the Law on VAT, the right to deduct input VAT for goods and services received occurs under the following conditions:

- 1) the person is registered with the State Revenue Service as a VAT taxable person;
- 2) the person has received goods or services and the VAT invoices are formed with in accordance with the requirements of legislation;
- 3) the VAT invoices are received from other VAT taxable persons registered with the State Revenue Service;
- 4) the goods or services received are used to ensure VAT taxable transactions.

Considering that it would take many years for the PE to complete the railway infrastructure work before VAT taxable transactions are performed, then to justify the rights of input VAT deduction, the PE must be able to provide sufficient evidence to the State Revenue Service that the whole infra-

structure is developed to be used for the provision of VAT taxable activities by the PE in the future. In practice, the State Revenue Service may request board meeting protocols or other documentation confirming the intention/ purpose of the railway infrastructure work, the technical project (if already developed) and other supporting documentation.

According to the current input VAT repayment procedure set by the Law on VAT, the State Revenue Service must approve overpaid input VAT within 30 days after the submission of the VAT return. However, this deadline may be extended if additional information is required. Once the overpaid input VAT is approved, it should be repaid to the VAT payer's bank account within 10 days under certain conditions. With respect to overpaid input VAT incurred for the development of fixed assets, a VAT repayment must be made upon the VAT payer's request, provided that the input VAT amount exceeds LVL 100 (~EUR 142).

VAT treatment for transactions between PE and HQ

The Law on VAT does not clearly state that the provision of services between the headquarter (HQ) and its PE or between the two PE's of a single legal entity is out of the scope of VAT. However, following to the ECJ judgments, the Latvian State Revenue Service has issued binding rulings confirming that the provision of services between the HQ and its PE may be treated as out of the scope of VAT. However, since only the tax payer to whom the binding ruling is issued may benefit from it, we would recommend to seek an official opinion from the State Revenue Service confirming this position prior to the provision of services.

Transfer of goods between the HQ and its PE should be treated as a EU supply/acquisition of goods under general conditions, even if the goods are transferred without remuneration.

LITHUANIA

The consequences would be similar to the ones described under the two-tier scenario. The difference would be in the fact that for VAT purposes, the services (e.g. reselling track access charges) between the HQ and the branch or between the two branches would not create or be recognised for VAT purposes.

If the supply is deemed to be generated in the country where the respective part of the track is situated (e.g. the services are treated as services connected with immovable property), the headquarters would have to issue a separate Lithuanian VAT invoice indicating the Lithuanian VAT payer code for access to the part of the track situated in Lithuania and the supply would be subject to VAT in Lithuania.

Therefore, in our opinion, the implementation of a one-invoice model could be complicated. Such a conclusion is valid for both the one-tier and the two-tier models.

VAT conclusions for the one-tier model

Comparison of VAT implication of three Baltic countries under the one-tier structure:

	Estonia	Latvia	Lithuania
Services between PE and HQ or between two PEs	Services out of scope of VAT (+)	Services should be out of scope of VAT but this needs to be confirmed in written when the taxpayer has been established (+/-)	Services out of scope of VAT (+)
VAT compliance obligations	No differences compared to two-tier structure	No differences compared to two-tier structure	No differences compared to two-tier structure
Input VAT deduction	Yes, as long as connected to taxable supplies of the recipient of service (+)	Yes, as long as all the conditions set by local law are met (+)	Yes, as long as connected to taxable supplies of the recipient of service (+)
Invoicing	Separate invoices by local units (either branch or head-office) in each country for the respective part of track access charge prevent multiple VAT registrations.	Separate invoices by local units (either branch or head-office) in each country for the respective part of track access charge prevent multiple VAT registrations.	Separate invoices by local units (either branch or head-office) in each country for the respective part of track access charge prevent multiple VAT registrations.

Corporate Income tax

Taxation of branches (permanent establishments for tax purposes)

For branches/permanent establishments it has been assumed that the main income will be generated from track access charges to be collected from the Operators.

In Latvia and Lithuania, the general corporate income tax rate is 15%. In Estonia the rate is 21% but it applies only to the distributed part of profit. The retained profits of a permanent establishment are not subject to corporate income tax in Estonia.

Taxation of headquarters

The main difference from the two-tier model is that the headquarters with its branches are considered to be a single legal entity. Branches established in other countries shall be registered as permanent establishments for corporate income tax purposes. For tax purposes, each permanent establishment shall be considered as a separate taxpayer. Purely a one-tier structure would exist in the country where the headquarters are situated (no holding-subsidiary distinction exists).

For the **avoidance of double taxation**, Estonia and Lithuania use a so-called exemption method, which means that any profits allocated to a foreign permanent establishment are excluded from the taxable base of headquarters.

In the case of Latvia, a so-called credit method is used. This means that if the company is headquartered in Latvia, then the whole profit of that company is subject to corporate income tax in Latvia but

any foreign taxes would reduce the payable Latvian corporate income tax. This, however may cause timing issues in relation to Estonia, as the profit allocated to the Estonian permanent establishment is taxable only at the time of profit distribution. For example, if the Estonian permanent establishment distributes its profits 3 years after earning the profit, then the payable Estonian corporate income tax cannot be credited to any Latvian tax.

As the headquarters with its branches is a single legal entity, the potential sale of foreign subsidiaries cannot be an option. Instead, the foreign permanent establishments (or the headquarters) can sell their business.

Thin capitalization regulations are applicable to the headquarters only.

Choice of headquarters locations

Comparison of potential headquarters locations

	Estonian headquarters	Latvian headquarters	Lithuanian headquarters
Taxation of operating profits	EE profits Tax rate: 21% (-) Timing: postponed (+)	EE profits Tax rate: 21% (-) Timing: postponed (+)	EE profits Tax rate: 21% (-) Timing: postponed (+)
	LV profits Tax rate: 15% (+) Timing: immediate (-)	LV profits Tax rate: 15% (+) Timing: immediate (-)	LV profits Tax rate: 15% (+) Timing: immediate (-)
	LT profits Tax rate: 15% (+) Timing: immediate (-)	LT profits Tax rate: 15% (+) Timing: immediate (-)	LT profits Tax rate: 15% (+) Timing: immediate (-)
Taxation in the country of headquarters regarding income allocated to foreign permanent establishments	LV profits: Exemption method (+)	EE profits: Credit method which may cause timing issues with Estonia (-)	EE profits: Exemption method (+)
	LT profits: Exemption method (+)	LT profits: Exemption method (+)	LT profits: Exemption method (+)
Tax cost at the time of profit transfer from the branch to the headquarters	EE: 0% (the same legal entity) (+) LV branch: 0% (+) LT branch: 0% (+)	EE: 21% tax at the time of profit transfer (-) LV branch: 0% (the same legal entity) (+) LT branch: 0% (+)	EE: 21% tax at the time of profit transfer (-) LV branch: 0% (+) LT branch: 0% (the same legal entity) (+)
Tax rate on headquarters other income (e.g. interest, management fees)	21% (-)	15% (+)	15% (+)
Timing of tax payment on headquarters retained other income (i.e. interest, management fees, etc.)	Postponed (+)	Immediately taxable (-)	Immediately taxable (-)

Pricing of internal dealings	Estonia would allow arm's length mark-up internal dealings (+)	Estonia would allow arm's length mark-up internal dealings (+)	Estonia would allow arm's length mark-up internal dealings (+)
	Latvia would allow arm's length mark-up internal dealings- (+)	Latvia would allow arm's length mark-up internal dealings- (+)	Latvia would allow arm's length mark-up internal dealings- (+)
	Lithuania would <u>not</u> allow arm's length mark-up internal dealings which would result in costs for Lithuania (mark-up on service charges and headquarter expenses may not be allowed), however would require to apply mark up in case of the internal dealings resulting in income for Lithuania (-)	Lithuania would <u>not</u> allow arm's length mark-up internal dealings which would result in costs for Lithuania (mark-up on service charges and headquarter expenses may not be allowed), however would require to apply mark up in case of the internal dealings resulting in income for Lithuania (-)	Lithuania would <u>not</u> allow arm's length mark-up internal dealings which would result in costs for Lithuania (mark-up on service charges and headquarter expenses may not be allowed), however would require to apply mark up in case of the internal dealings resulting in income for Lithuania (-)
Thin capitalization regulations (applies only to the headquarters)	Do not exist (+)	Related party debts cannot exceed 4*equity. Interest rate cannot exceed 1.2 times average short-term interest rate. (-)	Related party debts cannot exceed 4*equity, unless there is proof that the loan is arm's length (-)
Cross-border transfer of losses	Could be taken into account indirectly as the loss of foreign branch decreases the accounting profit of the whole company. Reduced profit reduces distributable profit and accordingly the corporate income tax payable. (+)	Very limited (only if the non-resident subsidiary cannot carry its tax losses forward to another tax year). There are also other criteria which must be fulfilled (e.g. taxation periods are the same etc.) (+/-)	As Lithuania applies the exemption method, losses of the Latvian or Estonian PE's cannot be utilized. (-)
Total score:	12	9,5	10

Note: each "+" equals to 1 point; each "+/-" equals to 0,5 points and each "-" equals to 0 points.

Pro's and Con's of the one-tier model

Pro's

- The tax residency country of the single company (the country where the headquarters are situated) may take into account the net result of the three countries. In other words, it may be possible to reduce the taxable profit on the level of headquarters if any of the branches incur losses. In Lithuania, the utilization of the Latvian and Estonian PEs' losses by the Lithuanian headquarters is not allowed, as the exemption method is used.

- From the VAT perspective, this alternative is not considered to have significant favourable arguments, except for the fact that services could be rendered between HQ and PEs without VAT (this has a more beneficial impact to i.e. banks and insurance companies which usually bear significant VAT costs).

Con's

- From the VAT perspective, the PEs of foreign entities have practically the same amount of administrative obligations as an established company.
- An additional non-tax aspect: from a political point of view it may not be acceptable for branch-countries to be headquartered from another country.
- Societas Europaea (SE)

As the establishment of an SE is possible through either a merger (from three separate public limited companies into one SE) or the establishment of a joint holding company (there would be a joint holding company on top of the Estonian, Latvian and Lithuanian public limited companies) then from a taxation perspective, the SE would be a suitable option for both one tier and two tier structures.

The taxation of an SE's profits is based on the same principles as in the case of public limited companies of the country where the registered seat is registered. This means that the tax consequences are identical to the ones described under the scenarios of the two-tier model and the one-tier model.

The main difference is that the SE can change its registered seat from one country to another and thus, change its tax residency. The changing of tax residency should not cause any negative tax implications in Estonia, Latvia or Lithuania if instead of the registered seat, a permanent establishment for tax purposes will remain in that country.

The Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) implementation Act that came into force in **Estonia** as of 10 December 2004 gives different principles for the establishment and management of an SE, but it does not contain any provisions concerning taxation. The consent of the Estonian Tax and Customs Board must be obtained in the case of transferring the registered office of the SE from Estonia to another Member State and also in the case of establishing the SE by a merger where an Estonian public limited company is wound up as the result of the formation of the SE in a foreign country.

In general, the tax consequences of an SE are expected to be identical to the ones described under the scenarios of the two-tier model and the one-tier model.

Please note that there are no provisions in Latvian tax legislation providing specific regulation with this respect. Due to this, the Latvian Tax authorities would not be able to provide any specific explanation either. Therefore, at this stage we cannot outline any specific tax issues related to this scenario apart from the general rules.

In Lithuania, the establishment of an SE through a merger of the companies should be a tax neutral transaction. If the SE represents the joint holding company in a Baltic country with 3 Baltic subsidiaries, comments provided with respect to the two tier structure should be referred to, while if the SE represents a public limited company in a Baltic country with 3 Baltic branches, comments provided with respect to the one tier structure should be considered.

3.9. European Economic Interest Grouping (EEIG)

A European economic interest grouping (EEIG) could be established under Council Regulation (EEC) No 2137/85 of 25 July 1985.

Article 5 of the Council Implementing Regulation number 282/2011 (referring further to the Directive 2006/112/EC article 9 (1) states that a European Economic Interest Grouping (EEIG) which supplies goods or services for consideration to its members or to third parties is a taxable person. Article 9 (1) of the Directive 2006/112 gives the definition of 'Taxable person', which is considered to be any person who independently carries out in any place any economic activity, whatever the purpose or results of that activity.

Taking into account the above provisions, in case an EEIG would be formed, it would be considered as a VAT taxable person if the above conditions are met. Consequently, the VAT treatment of the activities of such an entity would be similar to the ones described earlier above.

From a corporate income tax perspective, the Article 40 of Council Regulation (EEC) No 2137/85 stipulates that the profits or losses resulting from the activities of a grouping shall be taxable only in the hands of its members. Accordingly, such a grouping shall be transparent for income taxation purposes, so that its results are only taxable as profits or benefits derived by its members.

For the purposes of taxation, a grouping is regarded as acting as the agent of its members: its activities are those of its members acting jointly, and each member is regarded as having a share of the property, rights, liabilities and profits of the EEIG. The portion of profits, losses or gains going to each member is determined by the formation contract where this is stated.

There is a Council Regulation (EEC) No 2137/85 Implementation Act that came into force in **Estonia** as of 01 May 2004. Provisions concerning general partnership are to be applied to EEIGs. The said Act does not contain any taxation provisions. Regulation 282/2011 conditions apply directly to Member States and therefore EEIGs are expected to be treated as regular VAT taxable persons when supplying goods or services for consideration.

In practice, the experience with EEIGs in Estonia is non-existent and therefore a further tax analysis would be needed in order to find out the exact tax consequences. The tax matters accompanying an EEIG could be addressed to the Estonian Tax and Customs Board once the respective taxable persons are established and the operational details of the EEIG become clearer.

Please note that there are no provisions in **Latvian** tax legislation providing specific regulation with respect to EEIGs. However, the Latvian law on EEIG stipulates that the operation of an EEIG should be regulated by the same laws as regulating the activities of general partnerships (*pilnsabiedrības*). According to the Corporate Income Tax law, the tax on a respective share of partnership profit is paid by its partners (members). If the partner is a non-resident, a 15% income tax should be withheld by the partnership within 15 days from the moment of declaration of partnership profits.

Please note that it can be argued that a 15% income tax should not apply based on the provisions of the Latvian-Estonian or Latvian-Lithuanian double tax treaties under the condition that the Estonian and Lithuanian partners (members) do not have a permanent establishment in Latvia. If this position is confirmed with the tax authorities, the use of an EEIG may be an efficient vehicle from the corpo-

rate income taxation perspective, ensuring that the income taxes from operations are taxed only in the countries of the EEIG members.

Please note that tax efficiency would depend on the actual legal and operational structure, therefore, the tax treatment should be analysed in more detail when the planned legal and operational structure becomes clearer.

Although **Lithuania** has implemented the EU Regulation on European Economic Interest Grouping (EEIG) Council Regulation (EEC) No 2137/85 by the Law on European Economic Interest Grouping of 22 December 2003, there is no experience with EEIG in **Lithuania**. According to the law, an EEIG is a private legal person and is established from the date of its registration in the Commercial Register.

Since the experience of the three Baltic States regards to EEIGs is very limited, it is difficult to predict the exact tax implications that would accompany the formation of an EEIG. The tax matters should be addressed to the tax authorities of the three countries once the taxable persons are established.

4. FINANCING

4.1. EU Financing

Financing of EU infrastructure projects in 2014-2020

The EU has identified 30 priority infrastructure projects, which were chosen according to their European added value and their contribution to the sustainable development of transport. Their completion - planned for 2020 - will improve the economic efficiency of the European transport system. **One of the 30 priority projects is "Rail Baltic": Warszawa-Kaunas-Riga-Tallinn-Helsinki.**

For the next programming period 2014-2020, the Commission has proposed the creation of a new integrated instrument for investing into EU infrastructure priorities, including the European transport system: the **"Connecting Europe Facility" (CEF)**, which will replace the TEN-T programme.

The creation of the CEF opens a new possibility for financing the Rail Baltic project.

Connecting Europe Facility 2014-2020

The Commission's proposal for CEF budget includes a proposal for €50 billion for the period 2014-2020, of **which €21.7 billion is allocated to the transport sector and an additional €10 billion earmarked in the Cohesion Fund for transport infrastructure.** The Cohesion Fund allocation (€10 billion) would be used to finance transport projects in the Member States eligible for the Cohesion Fund under the **Connecting Europe Facility.**

Applicants: to apply for funding under CEF, one or several Member States, international organisations, joint undertakings, or public or private undertakings or bodies established in the Member States, may submit proposals. For that purpose, proposals may be submitted by entities which do not have a legal personality under the applicable national law, provided that their representatives have the capacity to undertake legal obligations on their behalf.

The funding rates for the field of transport are the following:

- (a) with regard to grants for **studies**, the amount of Union financial aid shall not exceed **50% of the eligible costs**;
- (b) with regard to grants for rail and inland waterways works: the amount of Union financial aid shall **not exceed 20%** of the eligible cost; the funding rate may be increased to 30% for actions addressing bottlenecks; the funding rate may be **increased to 40% for actions concerning cross-border sections**;

Co-financing rates mentioned above may be **increased by up to 10 percentage points** for actions having **cross-sector synergies**, reaching climate mitigation objectives, enhancing climate resilience or reducing the greenhouse gas emissions.

When taking into account all these aspects, the maximum financing rate for rail works may be up to 50%.

Eligibility: under the CEF the following costs are eligible from the date on which the application for aid is submitted:

- The cost of equipment and infrastructure treated as capital expenditure by the beneficiary may be eligible up to its entirety.
- Expenditure related to environmental studies on the protection of the environment and on compliance with the Union acquis may be eligible.

The CEF does not presently finance VAT.

CEF funding earmarked under the Cohesion Fund

The next budgetary period foresees a part of CEF funding in the transport sector under the Cohesion Fund. In total, **€10 billion is earmarked in the Cohesion Fund for transport infrastructure**. This can be spent in the Member States eligible for funding from the Cohesion Fund. Specific calls shall be launched to allocate the budget to projects. When implementing dedicated calls for the CEF, the greatest possible priority shall be given to projects which abide by the national allocations under the Cohesion Fund.

The maximum funding rates shall be for those countries applicable under the Cohesion Fund. The rates are expected to be the same as for the previous programming period (the maximum funding rate is expected to be 85%), but as the budgetary negotiations are presently ongoing, there may be changes to the maximum funding rates.

All other CEF rules apply to the CEF budget earmarked under the Cohesion Fund.

Cohesion Fund 2014-2020

The Cohesion Fund shall support those Member States whose gross national income (GNI) per capita is less than 90% of the average GNI per capita of the EU-27 for the same reference period.

The Member States eligible for funding from the Cohesion Fund in 2013, but whose nominal GNI per capita exceeds 90% of the average GNI per capita of the EU-27 as calculated under the first sub-paragraph, shall receive support from the Cohesion Fund on a transitional and specific basis.

Estonia, Latvia and Lithuania belong to the less developed regions group, where maximum funding rates apply. The maximum funding rates are expected to be the same as for the previous programming period (85%), but as the negotiations are still ongoing the funding rates are not yet agreed upon.

Overview of possible financing mechanisms for the Rail Baltic project

	CEF (EU-wide calls for proposals)	CEF (calls for proposals for Cohesion Fund countries)	Cohesion Fund
Co-Financing	Up to 40%-50% of eligible costs for cross-border projects	Maximum financing rate is expected to be 85% of eligible costs	Maximum financing rate is expected to be 85% of eligible costs
Positive aspects	Cross-border transport projects have higher rate of financing (40%) than other transport projects (20-30%)	High rate of co-financing; additional financing to each Baltic State's Cohesion Fund allocations	High rate of co-financing
Negative aspects	Rate of co-financing is low Not attractive to finance the Rail Baltic project with low co-financing rates	Annual competitive calls for proposals	Politically sensitive decision as the cost of Rail Baltic would use up most of each Baltic State's Cohesion Fund's budget. Not attractive to finance the Rail Baltic project from the Cohesion Fund

The Final Report of the Feasibility Study for Rail Baltic carried out by AECOM estimates that the project implementation period is 13 years (including planning and design, 8 years, and construction, 5 years). The period for the Connecting Europe Facility is 2014-2020, where the final payments have to be made by the end of 2022. This means that the project for Rail Baltic has to be implemented in at least two phases. Each phase has to be well defined with a realistic timeframe and fixed results. As the final payments have to be made by the end of 2022¹⁵, the first phase has to be completed in the first half of 2022.

The second phase of the project would be implemented in the next multiannual financial framework for 2021-2027, where financing possibilities are unclear. Although the availability and terms of the EU co-financing in the next programming period will remain unknown for some time, the cross-border infrastructure projects with regional and EU-wide importance already in implementation are likely to have significant advantage in applying for additional EU funding.

It is recommendable to launch the construction works as soon as possible, preferably earlier than the year 2020 (estimated in the AECOM study) and to complete as much of construction works as possible during the first funding period.

This will help to maximize the amount of EU aid received because:

- the terms of CEF 2014-2020 are valid until the end of 2022, when the final payments have to be made.
- 10% of the overall budget can be spent on the purchase of land. According to the AECOM study, the estimated cost of land is 149 million euros. This means that the budget for phase one of constructing the Rail Baltic should be at least 1,49 billion euros, as then all costs for land would be eligible. If the budget for phase one of the Rail Baltic is less, then only 10% of the budget can be allocated to finance the cost of land and the rest has to be financed from the state budgets.
- the terms for financing the second phase of Rail Baltic are unclear, as preparation for the financial period of 2021-2027 will start in 2018-2019.

¹⁵ According to the latest information discussions are currently ongoing to apply the N+3 rule for the next EU financing period, in which case the final payments could be made until the end of 2023.

The three countries' prime ministers have jointly stated¹⁶ that the EU financing for the project should be allocated outside the national cohesion fund envelopes, and that the EU co-financing intensity should be around 85%. When taking into account the political will and the possible financing options then **the preferred source of financing for all three Baltic Countries is to apply for funding from the CEF earmarked for Cohesion Fund, combining it with PPP, various financial instruments and/or project bonds.**

The following financial instruments/project bonds should be considered:

Project Bond Instrument (pilot phase 2012-2016 is in force). The Pilot Phase of the Project Bond Initiative is designed to involve private capital to deliver EU infrastructure priorities. The PB credit enhancement is designed to improve the credit quality of the senior debt of a project company in order to issue project bonds. The EIB provides the finance facility to a project company in the form of a subordinated loan and / or guarantee. The target investment rating is at least A-, a level expected to attract long term institutional investors (insurance companies and pension funds) Adaptable to all types of PPP payment mechanisms, including availability and user-pay.

Loan Guarantee Instrument (LGTT) is a financial instrument set up and developed jointly by the European Commission and the European Investment Bank (EIB). This new instrument will facilitate private sector involvement in the core European transport infrastructure (Ten-T projects), which often faces difficulties in attracting private-sector funding due to the relatively high levels of revenue risk in a project's early operating stages. It is jointly funded by the EU and the EIB to mitigate traffic dependent risks & cashflows. Currently supporting 6 TEN-T investments worth €11 billion.

Ten-T preparatory measures. As an example, the 2012 Annual Call Priority 3: Support for PPPs and innovative financial instruments. The objective of this priority is to support the screening and the development of projects for suitability to be procured as PPPs and to exploit EU level financial instruments. The expected result will be the creation of an EU level PPP project pipeline within the TEN-T that will

- provide a clear signal to the private sector of the long term public sector commitment to PPP procurement;
- enhance the preparation of projects suitable for PPP procurement;
- ensure the effective and efficient use of EU funds,
- provide upstream support to projects, facilitating access to innovative financial instruments such as the EU project bond initiative (PBI) and LGTT;
- contribute to the success of the pilot phase of the project bond initiative to open the bond market as a source of long term finance for TEN-T projects.

While planning the use of private capital (PPP), various financial instruments and/or the project bonds expertise of the European PPP Expertise Centre (EPEC) could be an asset. EPEC is a joint initiative involving the European Investment Bank (EIB), the European Commission, the Member States of the European Union, Candidate States and certain other States. Lithuania and Latvia are members of the EPEC, while Estonia has not yet applied for membership

¹⁶ Prime Ministers' Council of the Baltic Council of Ministers Joint statement <http://valitsus.ee/UserFiles/valitsus/et/uudised/taustamaterjalid/JS%20final%2010.11.11.pdf>

Concluding, the newest instrument, and thus the one most likely to address the current economic environment and the concerns of the investors, is the project bond instrument. It has the same benefits as LGTT while addressing its shortfalls like short time period and other limitations.

The current state of planning of the Cohesion Fund and the Connecting Europe Facility for the next programming period 2014-2020.

The EU multiannual financial framework for 2014-20 is being discussed and negotiated at the highest level. The negotiations are still ongoing and are expected to end in the beginning of 2013 – then the general budgets and financing rates will be agreed upon.

The European Commission has submitted the position of the Commission Services on the development of the Partnership Agreement and programmes in Estonia, Latvia and Lithuania for the next period 2014-2020, where the Rail Baltic project has been given priority. The Commission points out and urges the Baltic countries to take appropriate action and give financial priority to the railway sector and emphasizes the need to move forward with the Rail Baltic project.

4.2. Project Management Costs

Likely financial contribution

The likely financial contribution is dependent on the selected structure and the financial and economic considerations in the short- and long-term perspectives. These considerations are to an extent contradictory and thus the ultimate decision makers in the form of Governments need to prioritize their objectives.

For example, the selected legal structure could aim at the economic objective of cost minimization. Then the most likely solution would involve outsourcing the tasks and/or the establishment of the PIU. However, the overriding objectives could either be effectiveness, defined as keeping the timeline and securing support from the EU, or efficiency, defined as the optimization of the long-term maintenance costs.

The scope of the current study and limited timeline allows for drawing a broad roadmap on how to proceed with the project. It does not provide an in-depth analysis of different options for reasons previously outlined and taking into account the uniqueness of the project.

Based on the information we have gathered from market participants involved in similar large-scale construction projects in the railway sector, we report our findings in the table below.

Table 1 – Expert assessments on project management cost

	Koidula Border Crossing (EE/RU border)	Ignalina Power plant (estimate)	State controlled asset management company	Private sector rail construction companies		International PPP expert
Project cost	60-70 MEUR	4.6-5.2 bn EUR	In reference to 3.6 bn EUR Rail Baltica project			
Estimated Project Management cost (as % of Project cost)	11%	5-6%	6-9%	5-9%	4-6%	2-4%
Total number of employees involved in project management	20	-	100	50	60	-
Number of permanent employees	10	-	50	25	30	-

It has been suggested by market participants that roughly 70% of these costs will be remuneration of employees and 30% overheads, including marketing. The employee number breakdown assessment is the following:

- 10% Finance related (analysis, bookkeeping)
- 60% Project design related (engineering, design, signaling, maintenance)
- 30% Legal and administration related (legal and administrative work)

Proportions and numbers reported in the previous paragraph were used for running calculations. However, they will highly depend on the set-up of the project management company and the management approach to outsourcing and therefore, should be treated as a guideline for the JV management in order to develop a detailed business plan.

Feasibility Study by AECOM Limited for a Standard Gauge Separate Railway Line within the “Rail Baltica” Corridor through Estonia, Latvia and Lithuania specified the overall project management cost to be 1% of the total construction value or 34 million euros and design and planning fees to be 3% or 102 million euros.

These assumptions were based on AECOM professional judgment from experience of other large scale projects and no specific calculation was performed. Thus, the AECOM benchmark is the range of 1-4% of the total construction value of 3.4 bn. Euros.

In order to derive our project management cost estimate, we started from top down analysis, which specifies the percentage range in relation to construction cost, based on the practice of both international and local market participants in railway sector. The specific cost estimate was calculated by bottom up approach, where functions were staffed with personnel; and overheads, marketing, contingencies and social cost were added.

Based on the data reported above, we set the project management cost at the range of 1-10% and ultimately narrowed it down to 2-5% of the total construction value, because most experts emphasized that the project of this size should allow for economies of scale. We would also like to highlight, that the assessment of local and international experts vary with the former putting a total project management cost much higher (5-10% range).

Thereafter, we have verified the top-down assessment with the bottom-up calculation of the costs benchmarked to the staff and remuneration levels and concluded that the selected range of 2-5% of the construction cost of 3.4 billion euros is appropriate (total capital costs are 3.6 bn. euros, which also include land acquisition costs of 0.2 bn. Euros etc).

Our suggestion is to set project management cost initially at the level of 2.2% of the total construction cost (75 MEUR), and review and amend it periodically during the project timeline of 14 years. Comparing to the AECOM study this is a conservative number.

We would also like to emphasize that even though 75 MEUR represents a significant investment, any errors, miscalculations or delays in project implementation would be much more costly (including safety issues) than investment into appropriate project management capabilities.

The table below reports both the main components of the project management cost and the estimated split over the 14-year implementation period.

Table 2 - Overall breakdown of the cost and schedule of payments

Project management cost	%	'€ million
Remuneration and outsourcing	70%	39
Overheads	27%	15
Marketing	3%	2
Project management cost	100%	56
Contingencies*	+10%	6
Social contributions**	+34%	13
TOTAL PROJECT MANAGEMENT COST		75

Timeline of payments	%	'€ million
First 4 years	21%	16
Second 4 years	41%	31
Third 5 years	38%	28
TOTAL TIMELINE OF PAYMENTS		75

* Applied on project management cost ; **Applied on remuneration and outsourcing

Even though the project might not need an immediate capitalization and various financing scenarios are available, we would like to propose to follow the long-term view and anchor the payments/ capital contributions to each project implementation cycle:

- Phase I (4 years) – Planning¹⁷
- Phase II (4 years) – Design and procurement
- Phase III (5 years) – Construction, testing and final preparation.

For the purposes of our analysis, we use the project management cost of 75 MEUR or 2.2% as the baseline scenario and call it the maximum financing scenario. Additionally, we have defined two alternative reduced financing scenarios medium and minimum (see table 3), based on interviews and information received from Task Force and other involved parties, in order to reflect the current developments and realities.

We would like to highlight that the two alternative reduced financing scenarios contain the significant risk that project management quality will suffer and project goals would be unattained. Besides, these scenarios assume that part of the functions assigned to Rail Baltic Joint Venture will be carried out by civil servants, state institutions, and railway companies. These scenarios contain a risk that they may complicate the project management structure and reduce both the capacity to execute and transparency. However, the Rail Baltic Task Force shall maintain its supervisory role over the Joint Venture due the classical hierarchical system of the EU funds management. In this structure the Joint Venture shall be the beneficiary, whereas the relevant Ministries via Task Force retain their coordinating role as Supervisory Authorities (according to the EU funding system).

¹⁷ Functions of the JV in Phase I defined in clause 2,1 of the Main Report.

Table 3 - Possible financing scenarios, phase I, 2014-2017

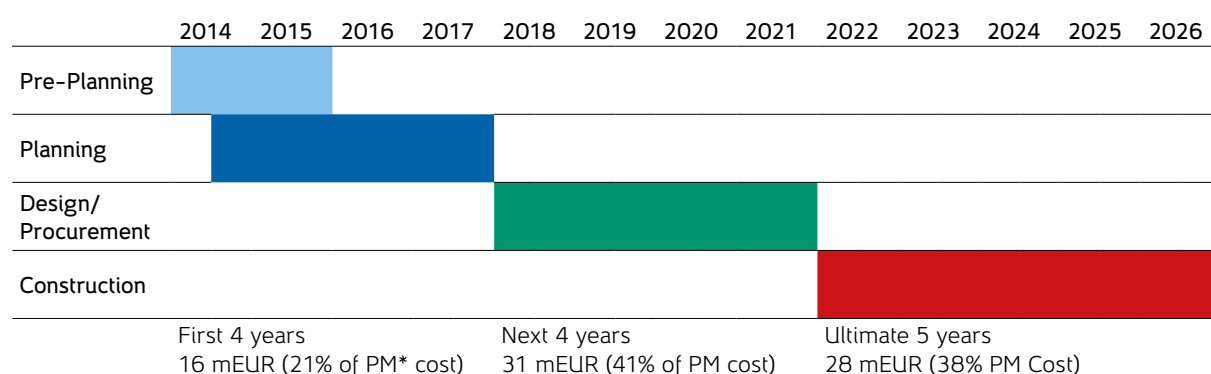
	Do maximum	Do medium	Do minimum
Time period	4 years	4 years	4 years
Average yearly contribution per country	1,34 MEUR	1,03 MEUR	0,65 MEUR
Estimated team size	Finance team 100% (7-8 people)	Finance team 75% (6 people)	Finance team 25% (2 people)
	Administrative 100% (18-21 people)	Administrative 55% (10 people)	Administrative 25% (3-4 people)
	Project design 100% (6-40 people)	Project design 100% (6-40 people)	Project design 50% (6-20 people)
	Management 100% (9 people)	Management 66% (6 people)	Management 50% (4-5 people)
	Supervisory board 100% (6 people)	Supervisory board 50% (3 people)	Supervisory board 50% (3 people)
Functionality	Until the end of 2015, the design functions are to be performed jointly by the Rail Baltic Task Force, the Joint Venture, and various state institutions. Thereafter, the JV is to perform full functionality in terms of the project design and other functions.	Until the end of 2015, the design functions are to be performed jointly by the Rail Baltic Task Force, the Joint Venture, and various state institutions. Thereafter, the JV is to perform full functionality in terms of the project design and reduced functionality in terms of marketing, finance, administrative and support functions.	Until the end of 2015, the design functions are to be performed jointly by the Rail Baltic Task Force, the Joint Venture, and various state institutions. The objective is to establish the Joint Venture (JV) with a functioning management and minimal financial and administrative staff. Additional financial contributions after the first year <u>might be necessary and they shall be based on the analysis of the management team.</u>
	Risks	Even though it represents a significant investment, the contribution might still underestimate the actual project management needs and scope.	Scenario contains a risk of underinvestment, so that the project management quality will suffer and project goals would be unattained.

We have used the following assumptions for the bottom-up calculation of the do maximum scenario on project management cost:

- The permanent number of staff would be 55 (excluding management and supervisory board). The number of staff is indicative and needs to be reviewed by the JV management based on current (future) realities.

- During the peak period either 45 people would be added to payroll or independent contractor will be used by outsourcing certain activities.
- The decision on the precise split between the number of permanent employees and the scope of outsourcing needs to be taken by the JV management team.
- Salaries are based on current market conditions and our best estimates.
- We have ignored the inflationary arguments as AECOM study specified the discount factor at the level of 5,5% and we would not foresee higher long-term inflation.
- We have accounted for potential contingencies in the amount of 10% of Project management costs.
- We have set the tax burden on gross salary to be 34%, representing the higher level of estimated social contributions based on Estonian cost level.
- For project design related jobs, we have taken into account the functions performed by the Rail Baltic Task Force until the end of 2015.
- The Table 5 indicates the AECOM assessment of the preparatory works of the Rail Baltic. After the creation of the Task Force and better coordination achieved, the actual facts are already somewhat different. For instance, design and planning phases are being implemented in parallel, which would probably bring the construction works significantly closer to the present day. However, for the purposes of the long term costs, the AECOM timeline has been used as a base line. The actual costs shall thus to some extent depend on the progress made with preparatory phases. Certainly the cost assessment for the first four years is strictly need based.

Table 4 – Project timeline, AECOM data, adjusted with later start-up

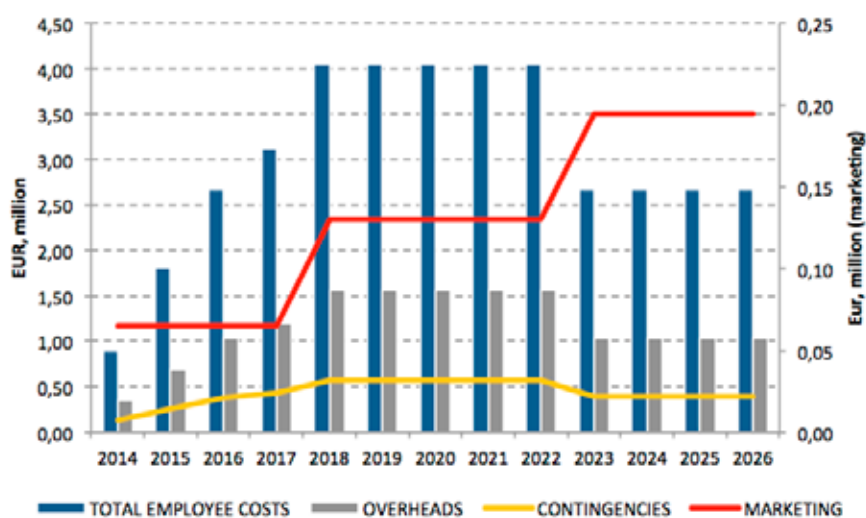


*Project Management

Table 5 – Do maximum scenario cost assessments

€' million	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Total
Finance related Jobs	0,08	0,16	0,16	0,18	0,22	0,22	0,22	0,22	0,22	0,16	0,16	0,16	0,16	2,31
Total nr of employees	3,5	7	7	8	10	10	10	10	10	7	7	7	7	
Legal, admin & marketing	0,21	0,42	0,42	0,48	0,66	0,66	0,66	0,66	0,66	0,42	0,42	0,42	0,42	6,51
Total nr of employees	9	18	18	21	30	30	30	30	30	18	18	18	18	
Project design related	0,11	0,22	1,08	1,45	2,16	2,16	2,16	2,16	2,16	1,08	1,08	1,08	1,08	17,97
Total nr of employees	3	6	30	40	60	60	60	60	60	30	30	30	30	
Supervisory board	0,07	0,14	0,14	0,14	0,14	0,14	0,14	0,14	0,14	0,14	0,14	0,14	0,14	1,80
Nr of members	3	6	6	6	6	6	6	6	6	6	6	6	6	
Management	0,43	0,86	0,86	0,86	0,86	0,86	0,86	0,86	0,86	0,86	0,86	0,86	0,86	10,80
Nr of members	4,5	9	9	9	9	9	9	9	9	9	9	9	9	
TOTAL EMPLOYEE COSTS	0,90	1,81	2,67	3,12	4,04	4,04	4,04	4,04	4,04	2,67	2,67	2,67	2,67	39,39
Overheads	0,35	0,70	1,03	1,20	1,56	1,56	1,56	1,56	1,56	1,03	1,03	1,03	1,03	15,19
Marketing	0,06	0,06	0,06	0,06	0,13	0,13	0,13	0,13	0,13	0,19	0,19	0,19	0,19	1,69
Project management cost	1,32	2,57	3,76	4,38	5,73	5,73	5,73	5,73	5,73	3,89	3,89	3,89	3,89	56,28
Contingencies	0,13	0,26	0,38	0,44	0,57	0,57	0,57	0,57	0,57	0,39	0,39	0,39	0,39	5,63
Social contributions	0,31	0,61	0,91	1,06	1,37	1,37	1,37	1,37	1,37	0,91	0,91	0,91	0,91	13,39
TOTAL PROJECT MANAGEMENT COST	1,75	3,44	5,05	5,88	7,68	7,68	7,68	7,68	7,68	5,19	5,19	5,19	5,19	75,30

Figure 1 - Cost by year



In the two tables below, we report do medium and do minimum scenarios for the phase I period of 2014-17. The following additional assumptions apply to these scenarios:

- Until the end of 2015 most of the design and spatial planning functions are going to be covered by the civil servants and thus less centralised set-up is needed.
- The main functions during this period are firstly, the pre-marketing of the infrastructure to the future clients (both freight and passenger services); secondly, developing the associated (short and long-term) business plan (including traffic forecasts, risk management, market surveys, etc); and thirdly, development of the preliminary cash flow plan and the analysis of the sources of capital for the capital expenditure.
- However, the consultant has not independently verified division of tasks between various institutions in three countries and is relying on the information received from the Task Force.

Table 6 - Do medium cost assessment, phase I, 2014-2017

€' million	2014	2015	2016	2017	Total
Finance related Jobs	0,08	0,14	0,14	0,14	0,51
Total nr of employees	3	6	6	6	
Legal, admin & marketing	0,12	0,25	0,25	0,25	0,86
Total nr of employees	5	10	10	10	
Project design related	0,11	0,22	1,08	1,45	2,85
Total nr of employees	3	6	30	40	
Supervisory board	0,04	0,07	0,07	0,07	0,25
Total nr of employees	1,5	3	3	3	
Management	0,29	0,58	0,58	0,58	2,02
Total nr of employees	3	6	6	6	
TOTAL EMPLOYEE COSTS	0,64	1,25	2,12	2,49	6,49
Overheads	0,25	0,48	0,82	0,96	2,50
Marketing	0,06	0,06	0,06	0,06	0,25
Project management cost	0,94	1,80	3,00	3,51	9,24
Contingencies	0,09	0,18	0,30	0,35	0,92
Social contributions	0,22	0,43	0,72	0,84	2,21
TOTAL PROJECT MANAGEMENT COST	1,25	2,41	4,02	4,70	12,38

Table 7 - Do minimum cost assessment, phase I, 2014-2017

€' million	2014	2015	2016	2017	Total
Finance related Jobs	0,03	0,05	0,05	0,05	0,18
Total nr of employees	1	2	2	2	
Legal, admin & marketing	0,05	0,10	0,10	0,10	0,36
Total nr of employees	2	4	4	4	
Project design related	0,11	0,22	0,54	0,72	1,58
Total nr of employees	3	6	15	20	
Supervisory board	0,04	0,07	0,07	0,07	0,25
Total nr of employees	1,5	3	3	3	
Management	0,24	0,48	0,48	0,48	1,68
Total nr of employees	2,5	5	5	5	
TOTAL EMPLOYEE COSTS	0,47	0,92	1,24	1,42	4,05
Overheads	0,18	0,35	0,48	0,55	1,56
Marketing	0,06	0,06	0,06	0,06	0,23
Project management cost	0,71	1,33	1,78	2,03	5,84
Contingencies	0,07	0,13	0,18	0,20	0,58
Social contributions	0,16	0,31	0,42	0,48	1,38
TOTAL PROJECT MANAGEMENT COST	0,94	1,77	2,38	2,71	7,80

Concluding, the project management cost is estimated at 2.2% of the total construction cost. However, the periodic review and adjustment will be necessary, in order to respond to changing circumstances.

One-step and two-step implementation structures

PIUs* are commonly used to manage the planning and implementation of large capital projects in both developing and developed countries. PIUs are assigned clear authority and accountability for the project. PIUs are commonly dissolved upon the completion of the Project and as a rule are not separate legal entities.

In the Baltic context, they are usually established as part of or an affiliation to the organization of the beneficiary utilizing its relevant know-how and resources.

The main advantage of the PIU is project focus and dissolution upon the completion of the tasks assigned. However, in the context of the current project it has several weaknesses.

Firstly, **considerations of continuance**. The project timeline extends over a decade and thus vital knowledge and know-how might get lost upon dissolution or during the period of project implementation.

Secondly, **we are not aware of any example of international cross-border PIUs**. The management challenges in this environment might be insurmountable.

Thirdly, **PIU needs to draw upon the existing knowledge and know-how of the beneficiary** (donor organization), which can be utilized effectively in achievement of adjacent goals of the organization and project. Even though one might consider the ultimate beneficiary to be a national railroad company, there are multiple issues and risks specified in the interviews with the management of railway companies that would make the transplantation of the PIU into the natural donor/railway company unsuccessful.

Concluding, besides theoretical gains on effectiveness and cost considerations, there are no other major arguments for the support of PIU compared to a longer list of risks and possible failure points.

Pros and cons of different implementation structures

As discussed above, a PIU would have several disadvantages. However, it would not rule out establishing several separate companies or structuring the implementation process into two steps, compared with a unified approach, where one company would implement the project from start to the end.

The following table reports the pros and cons discovered in interviews with market participants and research on similar projects.

*Project Implementation Unit

Table 8 - Pros & Cons of implementation/project management structures

	Pros	Cons
One-Step implementation structure	<ul style="list-style-type: none"> The planning, construction and maintenance is managed by the same entity, thus each stage of the project would be implemented with later stages in mind (therefore the quality of the construction would probably be improved as the project would be designed considering maintenance efficiency). Possibility to build up competence and later export this competence to other projects and countries. The money is spent and generated by the same entity. 	<ul style="list-style-type: none"> Certain people and resources would be involved from start to finish, which could push down efficiency and increase the cost. The competences for the project phases are different, so one will not have a need for the same team after the infrastructure is built. Risk of too much bureaucracy due to centralisation.
Two-step implementation structures	<ul style="list-style-type: none"> When the maintenance and operational considerations are left out of the construction phase, tenders could focus on more competitive pricing. Makes it easier to outsource different tasks to private sector, as they can focus on the part they are most efficient in. 	<ul style="list-style-type: none"> More effort will have to be put in supervising the construction to ensure quality. If the infrastructure is not built with maintenance focus it could imply higher maintenance costs later eating out any gains from lower construction costs. No examples of cross-border PIUs

As specified before, no quantifiable economic arguments were identified in favour of either approach at current stage. None of the market participants were willing to suggest with confidence the supremacy of one or two-step approach. However, analyzing the pros and cons, there was support amongst the market participants for the one-step structure, while the negative aspects were not unanimously agreed upon. Thus, the positive externalities of a one-step structure seem to outweigh the negative cost considerations. More analysis on this matter is provided in paragraph 9 of the Annex.

Evidence gathered from interviews suggests the following options, reported on figures below:

Figure 2 – One-step company set-up

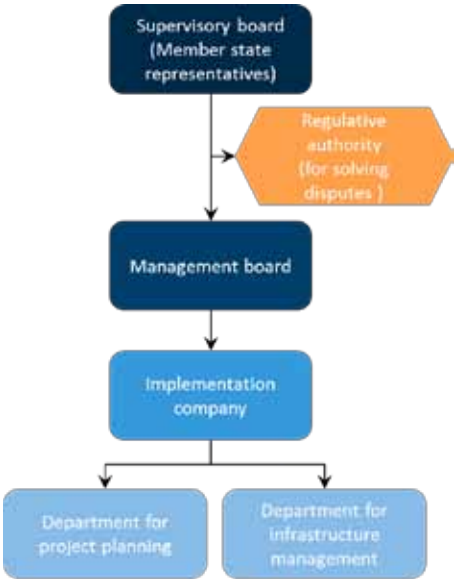
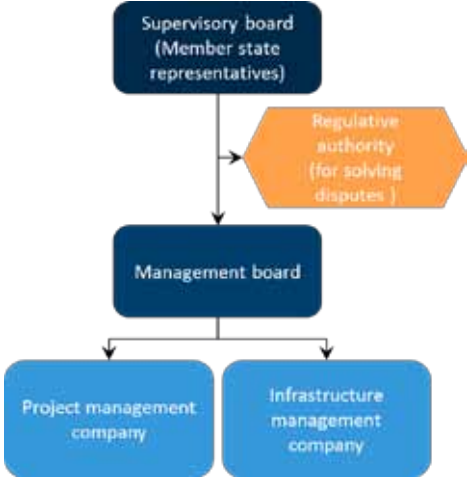


Figure 3 – Two-step company set-up



In the case of a two-step company set-up, there is a difference in timing as the infrastructure management company needs to be established at a later stage.

Conclusions and recommendations

As the detailed analysis of required financial contribution and one- and two-step implementation structures would require longer time frame and project scope than was currently provided to us, we were unable to analyse all of the possible options; however, based on the research conducted the following preliminary conclusions can be made:

- The total financial contribution for project management is estimated at the level of single digit percentages and preliminary calculations put it at 2,2% of the total construction cost or 75 MEUR over the project completion period.
- The estimated range was narrowed down from initial interview based assessment of 1-10% to 2-5%, applied on construction cost of 3,4 bn. euros. Thereafter it was verified by bottom-up calculation to arrive at the preliminary suggestion of 2,2%.
- The split between individual countries should track their contribution into the project and concur with legal set-up. Breakdown by country and years, assuming equal contribution, is presented in the table below. Even though the project might not need an immediate capitalization and various financing scenarios are available, we would like to propose to follow the long-term view and anchor the payments/capital contributions to each project implementation cycle.
- Project management cost needs to be periodically monitored and adjusted if applicable, in order to respond to changing circumstances.
- We would also like to emphasize that even though project management cost represents a significant investment, any errors, miscalculations or delays in project implementation would be much more costly (including safety issues) than investment into appropriate project management capabilities.
- The current information available to us does not support the PIU option.
- The evidence and results on one- or two-step implementation structures are less conclusive, however, the risks related to implementing the project in two or more steps appear to be higher compared to one-step approach and set-up.
- We would propose to consider the establishment of one common Baltic team to manage the implementation despite the specific legal set-up. While initially cumbersome, the Rail Baltica operation as one unit has found support in interviews. Besides, cross-border operational and cultural constraints have been emphasized in case of reference developments (Oeresund, Channel Tunnel, Brenner etc.) as well.

Table 9 - Project management cost breakdown by country

Phase	Total cost ('€ million)	Phase Length (years)	EE	LV	LT
I	16	4	5,4	5,4	5,4
		Yearly cost	1,3	1,3	1,3
II	31	4	10,2	10,2	10,2
III	28	5	9,5	9,5	9,5
Total	75	13	25,1	25,1	25,1

4.3. Private sector financing

The AECOM study sets the estimated total capital cost of the project at 3,6 bn. Euros (incl. land acquisition). The current assessment puts EU financing at 75%-85% of the total. However, there exists uncertainty about the precise amount of EU financing and the missing part (15% and up) has currently not been underwritten.

It is very likely that the project can be implemented only by involving loan on top of EU financing and/or private sector capital. The usual structure in the case of large-scale infrastructure projects needs either a full or partial transfer of the property rights and securitization of cash-flows, to fulfil the requirements of the private sector.

This objective is achieved through Concession-type structures, where Public-Private Partnership (PPP) is the most widely known set-up.

Besides, large scale infrastructure projects are known for overspend in time and cost, and thus additional capital (either public or private) would be needed to fill the gap should such circumstances arise.

On one hand, the private sector participation in financing the project has a reasonably high chance of succeeding. On the other hand, the private sector would normally require a higher yield and in the case of raising the missing 15% to 25%/xx% (assuming 75%-85% EU finance) might prove to be too expensive compared to the possible benefits.

The first choice in these type of circumstances would be to start negotiations with International Financial Institutions EIB (European Investment Bank) and NIB (Nordic Investment Bank) to attract cheaper debt financing, and thereafter to look for additional (private) financing, should any shortfall incur.

4.4. The difference between capital sources and financing structures

In general, capital sources could be classified as public or private. Private capital providers could be split into multiple groups: pension funds, private equity, banks, sovereign wealth funds, specialized private sector companies, construction companies etc. International Financial Institutions (IFI) like European Investment Bank (EIB) and Nordic Investment Bank (NIB) form a third group, which could be referred to as semi-public capital.

As a rule of thumb, public sector carries a sovereign risk and therefore has a lower risk margin than the private sector, which is reflected in lower interest rates. Of course, it ultimately depends on the credit rating and companies could have higher credit ratings than countries. Still, any solution involving private capital is by definition 'more expensive'. While EIB has verbally quoted an interest rate of EURIBOR + 0.9% (90 basis points) margin, then private sector funds (including pension funds) would target at least 4%, plus inflation, per annum.

As specified above, PPP is just a technical solution in the financing structure for the participation of private capital. For example, after setting up a PPP structure, private sector investors could include banks, pension funds, private equity etc. Project bonds and LGTT are just other examples of a technical solution for involving private sector capital.

4.5. Definitions of Concession and PPP

Concession - A service concession arrangement typically involves an operator constructing or developing the asset used to provide the public service or upgrading an existing asset (e.g. by increasing its capacity) and operating and maintaining the asset for a specified period of time. The operator is compensated for its services over the period of the arrangement. The contract is governed by a binding agreement that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. The service concession is binding on the parties involved and obliges the operator to provide the public services on behalf of the public sector entity.

DBFM is a specific type of concession arrangement where the private sector designs, builds and finances an asset and provides facility management or maintenance services under a long-term agreement with the state.

PPP - Means a Public-Private Partnership, specifically an arrangement where a private party delivers infrastructure services under a concession agreement. In a PPP arrangement, the public and private sectors collaborate to deliver public infrastructure projects – such as roads, railways, airports – which typically share the following features:

- a long-term contract between a public contracting authority and a private sector company based on the procurement of services, not assets;
- the transfer of certain project risks to the private sector, notably with regard to designing, building, operating and/or financing the project;
- a focus on the specification of project outputs rather than project inputs, taking into account the whole life cycle implications of the project;
- the application of private financing (often project finance) to underpin the risks transferred to the private sector; and
- payments to the private sector which reflect the services delivered. The PPP Company may be paid either by users through user charges (e.g. motorway tolls), by the Authority (e.g. availability payments, shadow tolls) or by a combination of both (e.g. low user charges together with public operating subsidies)

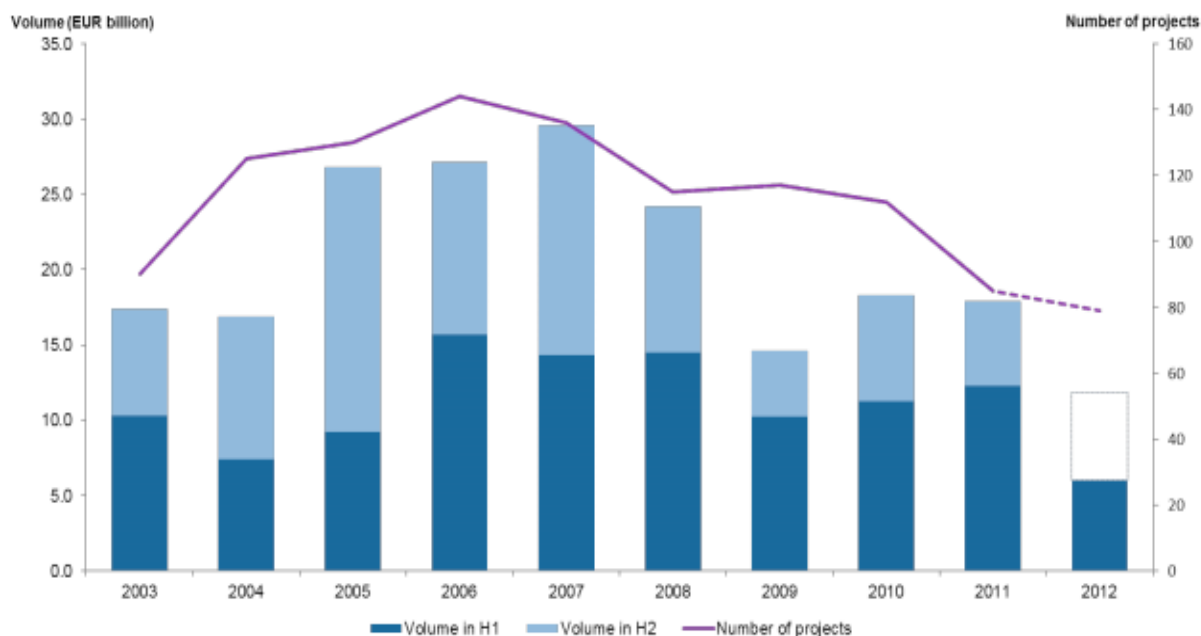
PPP definition from: <http://www.eib.org/epc/resources/guide-to-guidance-en.pdf>

4.6. Overview of PPP and Concession utilisation in similar projects

PPP in 2012

During the first half of 2012, 41 PPP transactions reached a financial close. In the first half of 2011, there were 44 transactions signed, which is not considerably different from 2012. However, these numbers are significantly smaller than the transaction numbers observed over the period 2007 to 2010.

Figure 4 - European PPP Market '03-'12 by volume and no. of projects



When we look at size of the transactions (in 2012, 146 million on average), it is also below the 2011 and 2010 levels.

The transport sector recorded the largest volume of transactions, totalling 2,9 billion euros and roughly 49% of the overall PPP market. A total of 6 transactions were closed in the transport sector - two high-speed railway projects (also mentioned later in our work), two road projects, a port expansion and an urban transport project.

The transaction volumes were at a 10-year low in the first half of 2012. Presumably, this is due to stricter loan requirements and shorter tenures by banks. In addition, the projects have to be economically viable to attract interest from the private sector. However, as the transport sector is the largest volume driver in the PPP market, Rail Baltic has a higher probability for the establishment of a PPP than other sectors.

Source: http://www.eib.org/epec/resources/epec_market_update_h1_2012_en.pdf

Selected examples of PPP projects

We have gathered a list of case studies related to private-public partnerships which could be significant when analysing PPP possibilities for Rail Baltic. This section is divided into two parts: firstly, railway sector related projects and secondly, regional projects. This section provides examples of the typical conditions and duration of PPP deals in Europe.

RAILWAY SECTOR RELATED PROJECTS

High-speed railway between Bretagne and Pays de la Loire - 2012 Jul

The 3,3 billion euro PPP contract for the construction and maintenance of LGV Bretagne-Pays de la Loire was signed by Réseau Ferré de France (national French Rail Network) and Eiffage (French construction company). Under the 25-year contract tendered in 2008, the Eiffage subsidiary Eiffage Rail Express (ERE) will build and maintain the 182 km high speed line between Le Mans and Rennes, plus 32 km of connections with the existing network, including a spur to the Le Mans - Nantes line near Sablé-sur-Sarthe. Construction is expected to take around five years, with preliminary studies running from May 2011 to July 2012 and civil engineering starting at the end of 2012. Completion is envisaged by autumn 2016.

Under the financing agreement, ERE will receive contributions from the local authorities and the RFF during the construction period and will also raise 1 billion euros via a consortium of 12 banks. Once the line opens for operation, the consortium will receive availability payments from the state and the RFF to cover the capital investment and maintenance costs. EIB is to provide 552,5 MEUR towards the construction costs, and Caisse des Dépôts will contribute around 250 MEUR over 20 years.

Source:<http://www.railwaygazette.com/news/single-view/view/lgv-bretagne-ppp-contract-signed.html>

Nîmes Montpellier High Speed Rail project – 2012 Jun

OC'VIA secured financing for 1.83 bn euros Nîmes Montpellier High Speed Rail PPP project. The contract was between Réseau Ferré de France (RFF) and OC'VIA, a company whose shareholders are Bouygues Construction, Colas, SPIE Batignolles, Alstom, Meridiam infrastructure and FIDEPPP. Under the contract, the private partner, OC'VIA, is responsible for funding, designing, building and maintaining the line over a period of 25 years. In return, it will receive public contributions from the local/regional authorities and RFF throughout the construction phase. Subsequently, when the line becomes operational, it will receive investment grants from the State and maintenance and renewal allowances from RFF.

During the construction phase, no less than 11 commercial banks (Bayer LB, BBVA, BTMU, DZ, KFW, HSBC, Mizuno, Natixis, SMBC, Societe Generale, UniCredit) will be putting up nearly 1 billion euros to enable OC'VIA to fund the project. The savings funds managed by the Caisse des Dépôts and the European Investment Bank (EIB) are to handle long-term refinancing operations for the PPP contract holder, backed by RFF guarantee during the operating period. This part of the funding, which represents 80% of total debt during this period, has been underwritten for 521 MEUR by the Caisse des Dépôts and 307 MEUR by the EIB.

Source:<http://www.tfi-news.com/news/item/?n=15528>

Basque Y high-speed rail project in Spain – 2012 Jun

Spanish infrastructure manager Adif has concluded an agreement with the European Investment Bank (EIB) authorizing the first 500 MEUR tranche of a 1 bn euro loan, which will finance the construction of the Basque Y high-speed line.

Spanish Ministry of Public Works and the Department of Transport signed the agreement for financing 4,1 bn euros for the project in April 2006. In November 2007, European Commission for

Transport made a direct investment of 118,5 MEUR in the project. EIB agreed to provide a loan of 1 bn euros for the project, of which 500 MEUR was released in June 2012. The loan will be repaid over a period of 30 years with a grace period of 30 years.

Sources: <http://www.railjournal.com/index.php/high-speed/eib-to-finance-basque-y-project.html?channel=#.UK3r0eSmibM>
<http://www.railway-technology.com/projects/basque-y-high-speed-rail-network/>

High-speed rail between Tours and Bordeaux - 2011 Jun

The 50-year contract, signed between Réseau Ferré de France (RFF) and LISEA, covers the financing, design, construction, operation and maintenance of the South Europe Atlantic high-speed rail between Tours and Bordeaux. It represents a total investment of 7,8 billion euros for Europe's longest high-speed rail ever financed under a public-private partnership.

LISEA's shareholders are VINCI Concessions (leader) and VINCI SA (33.4%), CDC Infrastructure, a wholly owned subsidiary of Caisse des Dépôts (25.4%), SOJAS, a dedicated investment entity (22%), and investment funds managed and advised by AXA Private Equity (19.2%).

The design and civil engineering works included within LISEA's project management have been awarded to COSEA, a consortium of companies led by VINCI Construction which includes Eurovia and VINCI's Energies business line, as well as BEC, NGE, TSO, Ineo, Inexia, Arcadis and Egis Rail. LISEA will be remunerated in the form of traffic-related fees paid by users operating trains capable of travelling on the new HSR.

LISEA is providing 3.8 billion euros of the financing and public subsidies made by the French government, local communities and the European Union for a total amount approaching 3 billion euros plus a contribution from RFF of around 1 billion euros.

Source: <http://www.vinci.com/vinci.nsf/en/press-releases/pages/20110616-1740.htm>

REGIONAL PROJECTS

E18 Koskenkylä–Kotka motorway

The 332 MEUR project involves the design, construction and maintenance (over a 15-years period) of a 53 km motorway. NIB has provided a 14-year-maturity loan totalling 91 MEUR for financing of the E18 Koskenkylä-Kotka motorway. Ramboll is leading the consulting team responsible for the detailed design for construction.

The project will be implemented using the life-cycle model in which the service provider is responsible for the project funding, design, construction, and maintenance during the long agreement period. The life-cycle model is a Finnish application of PPP. The planned construction period for Koskenkylä-Kotka section is 2011–2014.

Portugal Vasco da Gama Bridge

The Vasco da Gama Bridge spans the Tagus River in Parque das Nações in Lisbon. It is the longest bridge in Europe (including viaducts). Construction began on February 1995 and the bridge was opened to traffic on 29 March 1998. Financing was structured via a build-operate-transfer system, a private consortium which received the first 40-year of tolls. The structure of the deal uses a shadow toll scheme for the new bridge and real tolls on the existing bridge. The concessionaires of this

project are - English company Trafalgar Square, French company Campenon Bernard S.A. and five Portuguese companies. The government supports this project with shadow tolls on the new bridge. Hungary M5 motorway

A Build-Operate-Transfer (BOT) concession was signed for the M5 motorway including a 47 km extension. The government has a 40% stake in the consortium with private partners. Features highly successful refinancing and syndication to 24 banks (incl. EBRD).

Poland A2 Motorway

BOT concession for construction, maintenance and management. Financing included private finance with loan guarantee by government, structured as follows: 1) 115 MEUR equity from sponsors; 2) 123 MEUR subordinated debt from sponsors; 3) 235 MEUR senior bank debt, 17-year flexible maturity; 4) Subordinated 358 MEUR zero coupon bond from EIB, 17-yr maturity. An innovative cash sweep: the borrower makes 6-monthly payments into a debt reserve account from excess cash flows to repay early after 13 years.

4.7. Investors in PPP

When talking about the possibility of using PPP, the most likely investors in PPP project should be analysed. The Boston Consulting Group has identified four usual types of potential investors in PPP projects related to infrastructure development.

- **Pure concessionaires** - generally moderate growth companies that earn a large portion of their revenue from the operations of infrastructure concessions. These companies generally have stable finances and they can benefit from the governments' need for the reliable and efficient management of new infrastructure.
- **Construction companies** - both specialized and diversified, have historically been important participants in the short term. However, the high debt requirement will limit the ability of some companies to win infrastructure projects, particularly when talking about large privatizations. With new greenfield projects, the engineering and construction know-how will remain important. This also applies to larger site reuse projects.
- **Private equity funds** - infrastructure-focused PE funds raised 250 billion US dollars from 2000 through 2009, making them a significant force to take into account. PE companies tend to submit aggressive bids and charge higher tariffs.
- **Sovereign wealth funds (SWFs)** - had nearly 3 trillion US dollars under management in 2011 and their investment philosophy requires diversified and long term portfolios. Some of this capital is invested into lower risk long term infrastructure projects in developing countries to hedge for large western economy exposure that is feared in light of the on-going financial crisis. Even though the amount invested is currently small it is showing steady sign of growth.

In addition, global pension funds had about 27,5 trillion US dollars under management in 2011. SWF's and pension funds will be interested in infrastructure investments, but as they are missing the necessary operational competences in the infrastructure business, they will need to partner with specialized companies to compensate for the lack of experience.

4.8. Sentiment of market participants & expert assessments

Based on the interviews conducted with market participants we were assured by lenders and sponsors of infrastructure projects that funding and resources are available, but only for projects that are well conceived, have a reasonably predictable revenue stream, and where risks are manageable.

International financial institutions (IFIs) like the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the Nordic Investment Bank (NIB) would be the recommended partners to consider when planning the financing of the Rail Baltic project. EIB and NIB immediately indicated their strong interest in the project. Our preliminary investigations showed that probability of other IFIs financing the project is much less likely and thus in our Study we concentrated on the EIB and the NIB.

EIB specified that the Rail Baltic project fits with EIB priorities and they would like to support it. The volume of the transaction is large enough to make the transaction interesting and they have a mandate to do projects of this size. They indicated that similar projects with cohesion fund involvement have been done before and EIB has the relevant experience. However, EIB internal rules specify that together with EU funding they can lend up to 90% of the total project cost. Nevertheless, exceptions can be made on a case-by-case basis. EIB and NIB specified their interest in financing this project and both of these IFI's indicated that the most likely form of financing would be a long term loan with 20-40 year maturity with state guarantees to back it.

Acquiring project finance, in terms of loans secured against the future cash flows of the project is more difficult to negotiate as both the construction period and payback period are long. However, EIB pointed out that if the EU Cohesion Fund would be used as sort of a first loss buffer until the construction phase was well under way, then the probability of getting project finance improves. However, the amount of money earmarked for project financing is roughly half of what would be available via direct loans and the cost of this financing would be higher.

If, however, the Cohesion Fund (CEF for the next period) would not be used as an initial loss buffer then the state(s) need to take financial exposure to the project (revenues, costs and risks).

On the matter of project bonds, EIB informed us that it is a new product in their bank and under development. However, our international partners specified that project bonds would require an investment grade rating for the possible instrument from an international credit rating agency and for this the economic viability of the project has to be very strong. Should there be serious interest in using project bonds, the Baltic states should start promoting this project as soon as possible. Building up investor interest and confidence in this project might take a long time and the more the investors know the project, the higher the chance of success.

Indications from private companies suggest that they would require a minimum fixed rate of return of 8%-15% and some form of state/cash flow guarantee. However, it has to be stressed that at the current stage of Rail Baltic development where many issues are still open and no specific answers exist to a number of questions, it is not possible to get specific answers and terms from private companies. The viewpoints of the private sector are best tested on a term-sheet level, where the relevant parties can give specific answers.

The second pillar pension funds in Estonia did not rule out the project and said they could invest into the project. Currently they have roughly 1.5 billion euros under management, so the investment can take up the lower end of single digit percentages (1% equals 15 MEUR) to allow for proper diversification. In Lithuania, second pillar funds have 1.4 billion euros under management and in Latvia around 1.4 billion euros as well. All three countries together have roughly 4.3 billion euros under management and we believe that this kind of a long term project might be an interesting prospect for them. It provides an excellent opportunity to invest into the home market.

International consultants do not perceive this project as a classical PPP project and believe it would be very difficult to attract private sector interest. The only possible way they see it implemented is if the capacity risk is transferred from the private sector over to the public. If this is done through some form of concession, financing might be possible for the operating part and possibly maintenance. However, they pointed out that in order for these projects to be successful the majority ownership and control should always need to stay with the state. Local railway companies mentioned that in Europe similar large infrastructure projects in the railway sector are defined as a rule as public projects and thus they were sceptical of the PPP idea.

4.9. Analysis of different options

The experience from Danish Sund & Baelte suggests that besides PPP and public procurement, a third option called the state guarantee model is available. DBFM tasks are carried out by a SPV, owned by the state and the project is financed almost 100% by debt, raised in the capital market and having an irrevocable state guarantee.

All major bridges in Denmark are built according to this model. It combines both the private sector approach to efficiency, off-balance sheet financing and low financing costs achieved through state guarantee on debt. And the investment will be repaid by users, not tax-payers.

The ultimate input into the decision-making on financing depends not so much on selecting the right structure, but rather on the willingness of the involved parties to bear risks and achieve a return to compensate or minimise risk-taking. All options discussed above would use either IFI financing or private sector capital, but the set-up, structure and risk profile are widely different.

The following pros and cons have to be kept in mind when deciding between public and private financing:

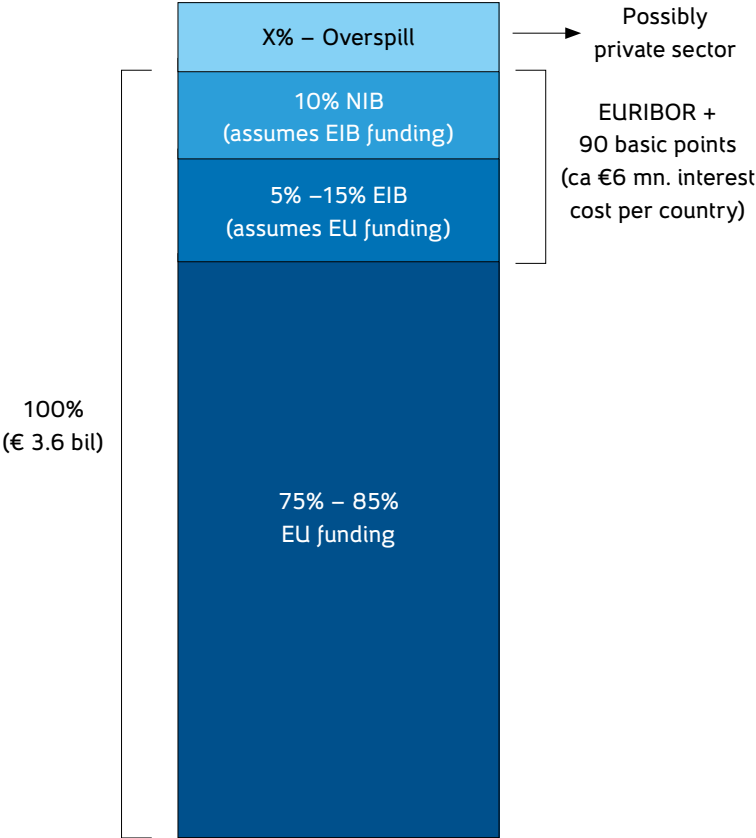
Table 9 - Public Financing vs. Private Financing

	Pros	Cons
Public financing	<ul style="list-style-type: none"> More control over the project and capital flows Probably higher level of EU funding/grants achievable Ultimately cheaper to finance on assumption of achieving the targeted revenues 	<ul style="list-style-type: none"> Pressure on governmental budgets and debt levels – probably could result in higher taxes or political backlash No risk transfer to private sector Limited possibility to use private sector incentive systems
Private financing	<ul style="list-style-type: none"> Less pressure on governmental budgets and debt service (in short-term) Can implement RB at the same time with other projects – no need to prioritize Private sector usually more efficient Large experience and competence pool of international financiers and also developers etc – if well managed, more efficient Investments partly paid for by direct users Concession – eventually the asset will usually be transferred back to the state 	<ul style="list-style-type: none"> Some form of government guarantee probably needed and in case of default the risk might end with government As state guarantees are probably required, it is more beneficial to provide these to IFI's as they provide cheaper financing Difficult and long negotiations with capital providers needed Difficult to find an appropriate structure dependent on investor appetite. Financing is more expensive

It is safe to conclude that the private sector capital is available to finance the project, considering that 75% of construction cost is supported by the EU, which allows for significant risk reduction.

The potential cost-effective financing solution is reported in the Figure 5 below. Assuming at least 75% effective EU finance (even in case of 85% not all costs are eligible), then it could be topped up by 15% of EIB loan adding up to 90%, which could be further elaborated by additional NIB loan reaching 100% of project finance. Only in case of overflows, private or public sector would be called upon. For example, PPP would normally be the more expensive solution and would make sense when either risk transfer or competence based efficiencies are achieved.

Figure 5 - Financing breakdown



Interaction between the JV and the existing RI managers, likely financial impact

Based on the opinions of the industry experts and the AECOM study, the direct technical interaction between the new 1435 mm railway and the existing 1520 mm railway infrastructure will be limited only to certain sections of the track (e.g. central stations and urban areas, extension tracks to cargo terminals, ports, etc), where some of the new sections may be built as double-gauge or existing 1520 mm infrastructure rebuilt to carry rail vehicles of both gauges. In addition also certain entry points could be added to the new infrastructure with access for rail vehicles with gauge-change capabilities.

It is our understanding that the current national railway regulations already allow different gauge tracks to be laid in parallel to facilitate the re-loading of cargo, as is already being utilised on the Lithuanian-Polish border.

We believe that new attractive business opportunities will be created also for the existing national railway infrastructure managers (and their clients), when the new faster north-south railway becomes operational, as it will foster the transit of cargo flows between the presently operational 1520 mm East-West rail corridors and the new North-South European gauge railway.

In the long-term perspective the predicted opening of the permanent Northern sea-route, brought along by the global climate change, may multiply the demand for rail cargo services from the Arctic ports to the European markets in the south of the continent and beyond. The existing East-West railway links, in combination with the new north-south Rail Baltic, should be in a very favourable position to utilise such new business opportunities.

In addition to attracting new cargo flows to the existing railway infrastructure, owned and managed mostly by the national railway companies, the Rail Baltic will offer additional business opportunities for the whole railway-sector of the Baltic region, as the new railway will need a variety of services including railway-specific know-how in design, construction, maintenance, signalling, etc. which the existing RI managers already have or are in a good position to develop further.

Based on the above we can conclude that, unless the existing RI managers will have to undertake direct investments into the construction of the new railway, in the long term the Rail Baltic is likely to have a positive financial impact on the business of the existing railway infrastructure managers.

5. INTERNATIONAL EXPERIENCE

5.1. Øresund Bridge

Background

The Øresund Link is a toll-financed fixed link for rail and road traffic between Kastrup in Denmark and Limhamn in Sweden. It has been constructed as a combined rail and road link consisting of a two-track railway and a four lane motorway between the two cities. The bridge and tunnel were officially opened on 1 July 2000 after five years of construction.

The sole responsibility to finance, construct, own and operate the link lies with the Øresundsbrokon-sortiet (ØSK), a legal entity, which has the exclusive right to collect toll fees. In 1995, the Consortium signed the contracts with Øresund Tunnel Contractors for the tunnel and with Öresund Marine Joint Venture for the dredging and reclamation works. The contract for the high bridge and the approach bridges was awarded to the contractor Sundlink Contractors.

The fixed link for rail and road traffic between Sweden and Denmark is based on a Treaty between the two countries signed on 23 March 1991 (the Treaty)¹⁸. It was agreed in the Treaty that Sweden and Denmark, each in its respective state, shall construct the necessary connections from the Sound link to the existing railway and road networks. Even before the construction of the link ferry services existed between the two countries in this area. The project has a long history. Already in the 19th century plans for closer links in the region were opposed by nationalists in both countries¹⁹. The Danish and Swedish government then carried out investigations and reports in relation to the project in the 1960s and 1970s²⁰. In the proposal that the Swedish government made to Parliament, it was foreseen, that construction should commence in 1993 and the project should be finished by the year 2000.²¹ The project was therefore completed on time. The total costs for the finished project amount to roughly 3,880 million €.²²

Corporate structure

ØSK is a Danish-Swedish stock company jointly owned by A/S Øresund and Svensk-Danska Broforbindelsen SVEDAB AB. It was established on the basis of Art.10 of the Treaty according to which two joint stock companies, each owned by the respective states, shall form a consortium. It is, as a single entity, responsible for planning and other preparations and for the financing, construction and operation of the Sound link. It has to be noted that the consortium is an unregistered organisation, which means that it is registered neither in Denmark or Sweden.²³

A/S Øresund and Svensk-Danska Broforbindelsen SVEDAB AB are respectively owned by the Danish and Swedish states and are responsible for running the respective shore installations in Denmark and Sweden. They shall also be jointly and severally responsible for the consortium's obligations, with mutual liability in equal proportion. A/S Øresund is owned by the Danish state via its parent company Sund & B It Holding A/S. It is notable that Sund & B It Holding A/S is also the par-

¹⁸ Agreement between Sweden and Denmark on a fixed link over the sound, 23 March 1991

¹⁹ Shrubshall, A critical analysis of the Oresund bridge linking Sweden and Denmark, 2007

²⁰ Petterson/ Sundberg/ Khan/ Holmberg , Sweden, Case Study Report, 2010, p.14

²¹ Swedish Government, 1991, Regeringens proposition 1990/91:158 med anledning av ett avtal mellan Sverige och Danmark om en fast förbindelse över Öresund.

²² Petterson/ Sundberg/ Khan/ Holmberg , Sweden, Case Study Report, 2010, p.17

²³ Parsons, Oresund: a legal triumph, European Lawyer, 2000, p.2

ent company of A/S Femern Landanlæg and A/S Storebælt. On the Swedish side SVEDAB AB is owned jointly by the National Rail Administration (Banverket) and the National Road Administration (Vägverket).

Management structure

According to Art.13 of the Treaty the consortiums affairs are to be conducted by a board of directors and a managing director.

The board of directors shall consist of an equal number of members from each company. Decisions shall be taken, unless stipulated otherwise, by simple majority. The two governments shall have full control of the consortiums affairs and its decisions shall be binding on the consortium. A consortium agreement lays down further details regarding the consortium's activity and management.

ØSK consists of five divisions: Property, Operations & Service, Marketing & Sales, Finance & Support and the Treasury.

Financing

The traffic volume across the bridge (for which there were initially high expectations) was below expectations in 2003.²⁴ The numbers have improved since then and in 2009 the project returned a profit.²⁵ Sweden and Denmark had, however, agreed that the activities of the consortium should not require appropriations from the budgets of the respective states. In an additional protocol to the Treaty between the two states it was agreed that no charges should be collected from the two states to guarantee the consortium's loans or other financial obligations. In addition, the railway companies of Sweden and Denmark will pay a flat fee for use of the Sound link railway. The tolls for road traffic are aligned with the price of a crossing by the Helsingborg-Helsingør ferries. It has been reported that this arrangement is due to the Danes wishing to protect partially state owned ferry operators in the northern part of the Öresund.²⁶

As an independent company owned by the two states the consortium is able to borrow money on the capital market to the same rates as the two nations.²⁷ These loans are guaranteed by the two states. The debt amounts to approximately 20 bn Dkk and is expected to be repaid in 2034. Contrary to a public procurement model this state guarantee model does not lead to costs for the state budget. The consortium's initial capital was to be 50 million Dkk, which shall be contributed in cash in equal proportion by the two joint stock companies. The consortium had the task to raise loans for the financing of the Sound link. As regards the operations Article 15 of the Treaty stipulates that the toll charges shall be set by the Consortium. *Netlipse* (Network for the dissemination of knowledge on the management and organisation of large infrastructure projects in Europe) has identified this as a key feature to keep decisions in this regard out of political discussion.²⁸ Through the toll charges the users will pay for the project. This is a difference to a public procurement or PPP model where the tax payer will carry a share of the costs. The Storebælt Fixed Link in Denmark was financed in a similar manner.

²⁴ OECD Territorial Reviews, Öresund Denmark/ Sweden, 2003, p.99

²⁵ Petterson/ Sundberg/ Khan/ Holmberg, Sweden - Case Study Report, 2010, p.18

²⁶ Petterson/ Sundberg/ Khan/ Holmberg, Sweden, Case Study Report, 2010, p.6

²⁷ Petterson/ Sundberg/ Khan/ Holmberg, Sweden, Case Study Report, 2010, p.27

²⁸ Netlipse, Managing large infrastructure projects, 2008, p.231

As regards EU support the construction of the fixed link was a TEN-T (Trans-European Transport Network) Priority Project 11.²⁹ The EU has identified 30 Priority Projects (or axes) on the basis of proposals from the Member States, which were included in the Union guidelines for the development of the TEN-T as projects of European interest. The TEN-T support to the project in the period 1995-2001 was € 127 million.³⁰

This financing model is significantly different from the one chosen for the construction of the Fehmarnbelt between Denmark and Germany.³¹ There the two parties agreed that Denmark shall construct and operate the fixed link across the Fehmarnbelt and shall bear the expenses. In return, Denmark may collect road tolls and fees for using the rail infrastructure from the users of the link. A study from 2003 already came to the conclusion that it would not be possible to finance the Fehmarnbelt Link purely with private means without public subsidies or guarantees.³² In a report from 2009 the German court of Auditors criticised the unclear provisions in the Treaty concerning possible renegotiations in case of substantial cost increases.³³ Already in the Treaty for the Øresund Link Denmark had declared its readiness to work for the construction of a permanent link over the Fehmarnbelt.

Dispute settlement/ resolution

As stipulated by Art.22 of the Treaty, in case of a dispute concerning its interpretation or application, the matter shall be referred to an arbitration board if one of the states so requests. The arbitration board shall consist of three members. Each state shall appoint one member. One member, who shall be the board's chairman and who shall not be a Swedish or Danish citizen or resident, shall be appointed jointly by the States.

Lawyers dealing with the project have pointed to the lack of arbitration and contractual litigation in the course of the project. This was largely due to the fact that the contracts were Design & Build meaning that a large part of the risk was taken on by the contractors.³⁴ The outline of the design was, however, already laid down in Annex 1 to the Treaty between Sweden and Denmark. In this context it is important to note that most of the disputes in construction result from delays and /or disruptions in the execution of the works.³⁵

Crossborder constraints

A case study report on the Øresund Link published in 2010 refers to difficulties caused by diverging approaches to the project in Denmark and Sweden. The involvement of two national political and administrative systems added to the project's complexity.³⁶

In 1995, ØSK signed three contracts for the construction of the tunnel, for the dredging and construction of the artificial island and for the construction of the bridge. Four different companies provide for operation of the rail link. Danish State Railways (DSB) operates trains from Denmark into Sweden and Skånetrafiken is responsible for Øresund trains from Sweden. The Swedish company SJ operates

²⁹ See: http://tentea.ec.europa.eu/en/ten-t_projects/30_priority_projects/priority_project_11/

³⁰ Commission Staff Working Paper - Annexes to the TEN Annual Report for the Year 2001, SEC(2003) 849, p.20

³¹ Agreement between Denmark and Germany on a fixed link across the Fehmarnbelt, 15 December 2008

³² Fehmarnbelt Development Joint Venture (FDJV), Feste Querung des Fehmarnbelt, 2002, p.13

³³ Bericht Bundesrechnungshof, Feste Verbindung über den Fehmarnbelt mit Hinterlandanbindung, 30 April 2009

³⁴ Parsons, Oresund: a legal triumph, European Lawyer, 2000, p.6

³⁵ Genton/ Vermeille, "Soft and hard dispute resolution"- some remarks and practical experiences regarding mega-projects, International Business Law Journal, 1998, 17

³⁶ Petterson/ Sundberg/ Khan/ Holmberg, Sweden, Case Study Report, 2010, p.42

high speed trains from Stockholm to Copenhagen and Railion provides freight trains. As regards the tender procedure for awarding the train traffic to a new operator in 2006, two tender procedures in the two jurisdictions were linked to each other although being subject to different procurement rules.³⁷ This eventually led to a legal dispute before the Gothenburg Administrative Court of Appeal.³⁸

It has been reported that differences to making decisions in Sweden and Denmark have influenced the development of the project and have had implications for the pricing mechanisms.³⁹ In addition, environmental, social and economic concerns had to be balanced. According to a *Netlipse* report the fact that environmental issues were dealt with differently by Swedes and Danes caused complications.⁴⁰ In Denmark all issues on a specific major project are finalised in a separate law while in Sweden specific issues are dealt with by the competent authorities for that subject. The Swedish Water Court exercised a considerable influence during the project.

The Øresund Link is part of a whole strategy for the region. Notably, the Øresund Committee was established in 1993 by the local and regional authorities to aid harmonisation and to prepare a joint strategy for increasing integration in the region.⁴¹

Measures undertaken to mitigate political risks

In general, the Øresund Bridge project benefited from a very long preparation period. The first proper investigations and reports were already carried out years before the actual construction process began. This ensured in-depth preparation especially as regards the significant complexities of the endeavour. The two countries involved in the Øresund project also took the following measures to ensure political agreement and avoid conflict:

- The implementing entity is operated as a joint venture between two state-owned companies, therefore the ultimate control lies with the Danish and Swedish governments. The board of directors is comprised in equal number of Danish and Swedish members. Costs and revenues are split equally. This structure ensured the equal treatment of both participants and thus contributed to the smooth implementation.
- Moreover, the Consortium is responsible for construction and operation, which led to a long-term view of the project and its complexities.
- Environmental opposition was taken into account early on in the project for example by including the railway, which was not the intention from the beginning. It was also very important to balance the economic issues with the environmental concerns. Stakeholder concerns were taken seriously in particular as regards the effects the bridge would have on the marine environment.
- The decision to finance the project without state participation facilitated the political decision making process because negotiations on the stake each party would have to contribute were avoided.
- Political consensus in relation to price setting was reached by including an additional protocol in the agreement stating that the point of reference would be the price level on the ferries.
- The Treaty between the two States sets down the use of an arbitration board in case of disputes if one of the States so requests.
- Throughout the project regional interests were coordinated with the negotiations on national level. In addition, the project was supported by the political vision of a closer integration of the Øresund region and economic benefits for both Malmö and Copenhagen.

³⁷ Busch/ Barlin, The legal framework for cross-border procurement, *Public Procurement Law Review*, 2008, p.1

³⁸ SJ ABv Skånetrafiken (5142-5147-07)

³⁹ Petterson/ Sundberg/ Khan/ Holmberg, Sweden, Case Study Report, 2010, p.5

⁴⁰ Netlipse, *Managing large infrastructure projects*, 2008, p.229

⁴¹ See: <http://www.oresundskomiteen.org/>

Lessons to be learned

The Øresund link shows the importance of the agreement between the participating countries as the foundation of the respective railway project. This relates in particular to the financing arrangements. The fact that the necessary loans taken up by the Consortium were guaranteed by the two States ensured competitive conditions on the market. The risks and benefits of this state guarantee model in the specific scenario have to be compared to the advantages and disadvantages of a public procurement model or a PPP model. The success of the state guarantee model depends on high rated guarantors. It is also worth taking a combination of different models into consideration.

The creation of the Øresund Consortium as an independent agency was very important to enable it to go about its business successfully. In order not to favour one country over the other the implementing unit was set up as a unique unregistered type of entity. Each country is represented equally on the board of directors for the Øresund Consortium and profits and losses are to be shared equally as well. The Governments retained the control of additional expenditures and the budget though.

Diverging approaches in the legal and administrative systems of the two countries led to difficulties even though the project was completed on time. This applied in particular to environmental issues. The Øresund Bridge project is more wide-ranging project of integration for the whole region, for example as regards the harmonisation of tax and labour law. This will ultimately support the project because it facilitates the cross-border movement of Danes and Swedes from one country to the other. The project was helped by the fact that the two regions were already closely linked before the construction of the bridge and that the bridge is linking two population centres in both countries. Therefore local and commuter traffic has contributed to the recent increase in traffic volume.

5.2. Eurotunnel

Background

The Eurotunnel, also referred to as the Channel Tunnel project, creating a connection between England and France via an underground tunnel, represents one of the largest privately funded construction projects ever realised. The Eurotunnel between Folkestone (UK) and Sangatte (France) comprises three tunnels, one large bore rail tunnel in each direction, both linked continuously to a smaller escape, access and services tunnel running between them. The two rail tunnels are single-track rails and are used for trains running in one direction only. The maintenance tunnel is connected to each of the rail-tunnels and serves as a safe haven in case of accidents. In addition, there are four crossover points where trains can switch between the two rail tunnels while maintenance work is being carried out. On both sides of the channel, the terminals have direct access to motorways in order to ensure a fast travel experience.

The project required the cooperation of two national governments, bankers underwriting the funding for the project, numerous contractors, and several regulatory agencies. Further, the construction and engineering of the tunnel required the use of new technology and required significant modifications during the project due to unexpected conditions and changes required by various interested parties. Eurotunnel has a complex structure consisting of two legal entities to meet requirements in the UK and France.

At the project inception, in 1985, the governments of the UK and France together issued an invitation launching the tendering process for the development of the Channel Tunnel. An invitation to promoters was published in the Official Journal of the European Union (OJEU), calling for tenders to develop, finance, construct and operate a fixed link across the Channel between France and the UK, to be financed entirely by private investment. A Franco-British consortium formed by Channel Tunnel Group Limited and France-Manche S.A. was selected as the concessionaire of the tunnel in accordance with the terms of the invitation. The concession agreement for the construction, the financing and operation of the tunnel was initially awarded to the concessionaire for a period of 55 years, until 2051. The concession was subsequently extended until 2086, after which time ownership will revert to the governments of France and the UK. As a condition to extend the concession, between 2052 and 2086 Eurotunnel will pay the governments 40% of its net profit (50% before tax), instead of 25% as initially agreed.

After the award of the concession, the concessionaire entered into a construction contract between with TransManche Link (TML), an Anglo-French consortium responsible for the design and construction of the project. TML is a joint venture between Transmanche Construction in France and Translink in the UK, each of which included five construction companies.

At the same time, an inter-governmental accord (the Treaty of Canterbury) was signed between the French and British governments. The Treaty prepared the concession for the construction and operation of a cross-Channel Fixed Link by private companies and set up an Intergovernmental Commission (IGC), which was responsible for monitoring all matters associated with the construction and operation of the Tunnel on behalf of both governments, together with a safety authority to advise the IGC.

The concession agreement also provided for the appointment of a Maître d’oeuvre (general contractor) at the expense of the concessionaire, to ensure that the works were carried out to the relevant specifications, and to the agreed timetable and cost projections. The maître d’oeuvre was to act not only on behalf of the client, but also on behalf of the IGC, ensuring that the terms of the concession were followed.

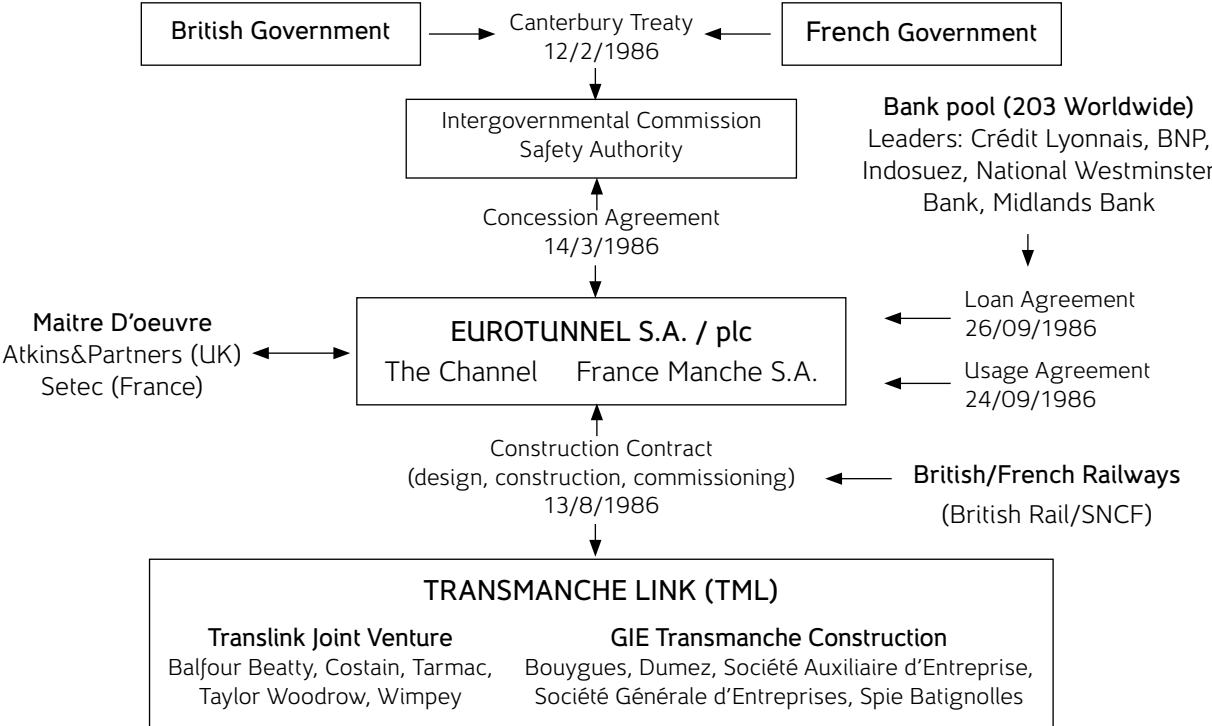
The concession imposed a number of obligations on Eurotunnel, in particular to operate and maintain the system during the concession period, to ensure a steady flow and continuity of traffic through the system and to ensure that traffic may pass through the system with reasonable safety and convenience. The concession also imposed the obligation to finance the system without recourse to government funds or guarantees of a financial or commercial nature.

Project structure

Pursuant to an agreement of 31 August 1996, France-Manche S.A. and The Channel Tunnel Group Ltd. formed both a société en participation under French law as well as a partnership under English law. These are subsidiaries of Eurotunnel SA in France and Eurotunnel plc in the UK, respectively. Eurotunnel Finance SA and Eurotunnel Finance Ltd. are subsidiaries created for taking the responsibility for financing the project. Eurotunnel Developments SA and Eurotunnel Development Ltd. are subsidiaries responsible for property development.

Eurotunnel is a jointly owned and managed legal entity comprising Eurotunnel Plc and Eurotunnel SA. Eurotunnel plc and Eurotunnel S.A. are both listed on the London Stock Exchange and the Euronext in Paris and Brussels, and are traded on all three exchanges as twinned units, whereby Eurotunnel S.A. shares are twinned through a unit subscription with Eurotunnel plc shares. TML, the construction company, is an integrated consortium of two consortia - Transmanche GIE and Translink JV - with a common capital, and distribution of the profits in equal shares. Its overall structure is illustrated in the figure below.

Project organisation



Financing

Article 1 of the inter-governmental accord between France and the UK specified that the construction and operation of the scheme “shall be financed without recourse to government funds or government guarantees of a financial or commercial nature”⁴²

The Eurotunnel project was financed by bank lending and equity in an amount in excess of £10 billion. It has been financed by equity issue and bank loans, credit facilities, provided and syndicated by a total of 225 different banks. The project costs surpassed the initial estimates soon and additional financial sources, in particular new equity and credit facilities, were required. Eurotunnel was obliged to raise several equity offerings to meet the increasing construction costs. The European Investment Bank’s (EIB) participation as a co-financier in the project was a vital sign of European support for the project at a critical moment of the project when equity funding was not sufficient to meet increasing project costs. EIB provided £ 300 million in parallel loans and £1 billion in co-financing facilities.

It is clear that the project did not proceed entirely according to plan. For instance, by 1994 the eventual construction cost was almost double that predicted in 1987. Many of the original traffic and revenue projections proved overly optimistic. By the end of 1999 the share price of the Eurotunnel share had fallen to GBP 0.71, compared with the offer for sale price of (1987) of GBP 3.50. In addition, no dividends had been paid to shareholders over the entire period.

Initially, the expectations about the commercial viability of the Eurotunnel project were generally very high. The initial share price and its development in the first six years reflect this optimism.

Development problems arrived at a rather early stage of construction in the form of delays in the construction programme. These carried a number of adverse implications in terms of the eventual cost of the project, in particular, accumulated financing costs, increased labour costs and unforeseen problems in the works programme requiring costly modifications to equipment. These factors lead to a delayed start to operations (the tunnel opened officially in May 1994, twelve months later than predicted at the time of the sale offering) and therefore a delay in operational revenues arising. At the time of the official opening of the tunnel, a new rights issue of close to 1 billion GBP was made to finance the heavy debt burden accumulated. At this time, the financial projection was that operating cash flows would be sufficient to absorb financing costs. However, the actual revenues from the operation were constantly below projections. The management was strongly criticised for having provided overly optimistic forecasts of the future revenue and financial prospects of the tunnel. Capital costs were severely understated and projected revenues were severely overestimated.

In the period from 2000–2004, revenues, including both transport and non-transport activities, continued to fall short of expectations and in fact fell by 17 per cent. After 2005, Eurotunnel experienced relatively good operational results with yearly growth figures, with significant increases in passenger transport volumes contributing to good results. However, throughout the entire period, Eurotunnel had to service large amounts of debt (which had reached almost € 9 billion in 2007). After a plan by shareholders to exchange part of the debt for equity had failed, the company was placed into bankruptcy protection in 2006. In 2007 a new restructuring plan was approved by shareholders whereby lenders agreed to provide new capital as long term funding, the debt balance being exchanged for equity, and shareholders agreeing to waive perks previously enjoyed (including an unlimited free travel right).

⁴² Graham Winch, *The Channel Tunnel: Le projet du siècle*, p. 6.

Following the restructuring, Eurotunnel was able to generate, for the first time ever, small profits in the years after 2007 and to reimburse parts of its debt. Groupe Eurotunnel S.A., the new entity created after the restructuring, was able to pay the first ever dividend to shareholders and the share price has remained relatively stable until today.

Dispute settlement/ resolution

The inter-governmental accord between France and the UK provided for the establishment of an Intergovernmental Commission (IGC) to supervise the project on behalf of the two governments, particularly with regard to the safety of users, and border, customs, and immigration matters. The IGC consisted of civil servants from France and the UK. Pursuant to the accord, decisions of the IGC were to be taken by agreement between the heads of the British and French delegations. In quality matters, for example, the IGC mandated that in case of differences in the standards of the countries, the higher of the two should prevail. Although this was a good concept in theory, difficulties existed in interpreting differences.

The contract for the construction of the tunnel was an international contract that contained a two-stage provision for the resolution of any disputes that might arise between Eurotunnel (the owners and intended operators of the tunnel) and TML, the consortium of five French and five British construction companies that had agreed to construct the land terminals, bore and equip the tunnels, and provide the necessary rolling stock. At the first stage, any dispute between Eurotunnel and TML was to go to a panel of experts, who had to give a decision within 90 days. If either party disagreed with the Panel's decision, the dispute was to be referred to arbitration in Brussels under the ICC Rules.⁴³

Crossborder constraints

As far as cultural constraints are concerned, Jack K. Lemley, CEO of Transmanche Link from 1989 to 1993, when reflecting on the project, highlighted the importance of cultural matters, communications and contract issues. He stated that there must be one contract, it must be developed and written in one language, and it must be based on one legal system. Further, he stated that it must all contain clearly defined dispute resolution procedures with which all parties are familiar and with which all parties have agreed to abide. He concluded by stating that the key element is communication⁴⁴

Lessons learned

A number of lessons can be drawn from the Eurotunnel project for the Rail Baltic project. Most importantly, it is necessary to establish a sustainable financial planning already from the inception of the project. As the costs for very large infrastructure projects almost invariably get out of control during the construction phase, it is necessary to include risk buffers and include adequate contractual safeguards. The JV contract with the private partner should foresee a flexible mechanism to be able to identify financial difficulties at the earliest moment and to bring together all parties involved (including financial partners) to find pragmatic solutions. The possibility of an inclusion of the EIB in the financing of the project should be clarified at the very beginning, i.e. before the procurement process. In this regard, the potentials for EU project bond financing⁴⁵ should be examined and clarified with the EIB.

⁴³ Redfern, Law and Practice of International Commercial Arbitration 4th edition, p. 344

⁴⁴ Quoted in: Anbari/Giammalvo/Jaffe/Letavec/Merchant: The Chunnel Project (Project Management Institute, Case Studies in Project Management), p. 19/20.

⁴⁵ Cf. EU-EIB Project Bond Initiative: http://ec.europa.eu/economy_finance/financial_operations/investment/eu-ropo_2020/index_en.htm

With regard to the set up, the possibility of an intergovernmental commission as in the Eurotunnel should be considered. This commission, which should act on behalf of the governments of all three countries involved, should be entrusted with monitoring all matters associated with the construction and operation of the infrastructure and a safety authority, advising the intergovernmental commission, could also be set up. With regard to dispute resolution, the parties should agree to submit to arbitration under the ICC Rules. In order to avoid costly and time-consuming translations, one working language (e.g. English) should be agreed upon and for all written documentation the English version of documents should prevail.

5.3. Brenner Base Tunnel

Background

The Brenner Base Tunnel project entails the construction of two single-track train tunnels, one for each direction, and a smaller exploratory tunnel below the Brennerpass to connect Innsbruck (Austria) and Fortezza (Italy) via a high-speed railway link through the Alps. Its sole intended use is that of a railway tunnel. The Brenner Base Tunnel is an integral part of the TEN-T Priority Project 1 Berlin-Palermo, Milan - Bologna, of which 2/3 already have high speed rail capacity (or construction works in relation thereto are currently under way).

The current railway link on the route was constructed from 1859 to 1867 and does not have any high speed rail capacity. Additionally, due to the fact that it leads across the Alps (Brennerpass), rather than underneath, the distance is greater and its high gradient has proved challenging for trains. This is particularly the case for freight trains which require up to three locomotives to climb the pass and on some parts of the route have to reduce their velocity to 50km/h due to the tight bends.

The new tunnel will be flat and only have a minimal gradient. It will be constructed to allow high speed passenger trains of up to 250km/h and freight trains of up to 160km/h and will therefore cut down travel times. Inside the tunnel, a 25 kV - 50 Hz traction power system will be installed and ERMTS (European Rail Traffic Management System) Level II will be the safety system on the route. It is expected that the travel time between Innsbruck and Bolzano will be reduced from currently 2 hours to less than 1 hour. Similarly, travel time between Munich and Verona will go down to ca. 3 hours from currently 5.5 hours.

The tunnel will increase the rail capacity between Austria and Italy and it is hoped that this will aid the already problematic congestion levels of the motorway currently crossing the Brennerpass, which will benefit the environment. It is estimated that the tunnel will have a capacity for up to 400 trains per day, 80% of which will be freight trains. This would triple the freight transport capacity between Austria and Italy from currently 600,000 to 1.8m lorry loads per year.

Most freight transport through the Alps is via the Brennerpass. In 2010, it was calculated that freight transport had increased by two thirds since 1994 and this is expected to increase even further in the future.

First studies regarding possible tunnel projects date back to the 1950s but it was not until 30 April 2004 that the State Treaty was signed by Austria and Italy, obliging both countries to construct the Brenner Base Tunnel. Both countries also agreed in the Treaty to construct the necessary connections from the tunnel to the existing railway network in their respective territories.

The project officially began with the construction of the exploratory tunnel on 4 December 2009 and will be completed in three phases. The first phase (1999 - 2003) included pre-project and first exploratory works. The second phase (2003 - 2013) entails the main project and the building of the exploratory tunnel. The third and final phase, the construction of the main railway tunnels, went under way earlier this year. It is expected that the tunnel will be completed by 2025 and will be operational in 2026. Once completed, the Brenner Base Tunnel with a length of 55km will be the world's second longest railway tunnel (after the Swiss Gotthard Base Tunnel with a length of 57km, which is estimated to be operational from late 2016).

Information available from public sources in relation to maintenance plans after the completion of the Brenner Base Tunnel is scarce. The only reference point in relation to the division of the operation and maintenance costs is the State Treaty, which was signed between Austria and Italy on 30 April 2004. Article 9 (e) stipulates that, subject to any future agreements between the parties, any costs for operating the tunnel will be borne by Austria and Italy in equal parts. We are not aware of any further agreements between Austria and Italy in relation thereto and therefore conclude that this is currently still the intention of the parties.

However, it is likely that further concrete plans will be made between the parties in relation to track management and maintenance closer to the completion of the project. The construction of the main part (Phase III) of the Brenner Base Tunnel only started earlier this year and it is not yet certain when the tunnel will be completed and operational. Official estimates currently expect this to be the case in 2026 but this is already a considerable delay if compared to the original scheduled completion date of 2015, and there may be further delays in the future. Additionally, due to the effects of the financial crisis on the economy in Austria and Italy as well as the failure to attract private sector funding for the tunnel project, the main issue currently faced is the funding of the tunnel itself and the necessary connections in Austria and Italy. Any decisions in relation to the management and maintenance of the tracks are likely to be made and communicated once these initial difficulties are overcome and the completion date of the tunnel can be predicted with more certainty.

Corporate structure

The company at the head of the project is Galleria di Base del Brennero – Brenner Basistunnel SE (BBT SE), which was founded on 16 December 2004. BBT SE was created by the amalgamation of two public companies. Its predecessors were one Austrian (Brenner Basistunnel Aktiengesellschaft) and one Italian public company.

The purpose of the company is the planning and construction of the Brenner Base Tunnel and all necessary connections thereto. BBT SE is completely in the public hand and its shares are distributed equally between Austria and Italy. In Austria, the federal Austrian railway company ÖBB (Österreichische Bundesbahnen) holds the entire 50% as the sole Austrian shareholder. In Italy, TFB (Tunnel Ferroviario del Brennero Holding AG) owns the remaining 50% of the shares. The TFB consists of the following participants: 85.29% RFI (Rete Ferroviaria Italiana – Italian Railways), 6.24% the Autonomous Province of Bolzano, 6.24% the Autonomous Province of Trento, 2.23% the Province of Verona.

It has two registered seats: one in the Austrian city of Innsbruck and the other one in the Italian city of Bolzano. According to the State Treaty the company's main registered seat was Innsbruck until the start of Phase III (construction of the main railway tunnels), with a secondary registered seat in Bolzano. Its registered seat then changed to Bolzano on 1 July 2011, with the company keeping a secondary registered seat in Innsbruck. It was agreed that upon completion of the project the seat would move back to Innsbruck in Austria. Until then, any tenders and procurement processes will now be dealt with under Italian law.

The company form "Societas Europaea" (SE) was chosen due to the multitude of participants in the project and as it was considered especially suitable for big European projects.

BBT SE was founded with a share capital of €10,240,000, divided into 10,240,000 shares with one vote each. Transfer of the shares requires the company's consent, which may be given at the annual

general meeting. Such consent may not be refused if the shares are to be transferred to Austrian or Italian undertakings or individuals which can contribute to the company purpose through their special financial power or technical expertise.

Management structure

BBT SE's Management Board consists of two members, which are appointed for three years each. Their appointment may be renewed.

The company is represented by the two Board Members together or alternatively by one Board Member and a Company Secretary (one of them has to be nominated by Austria, the other one by Italy). The Management Board takes its decisions unanimously.

All those responsible for the project meet every week for detailed discussions regarding the transaction and to consider the progress made, solutions to potential problems and cost efficiencies.

In order to address potential issues with creating a unified project basis between Austria and Italy on which to carry out the necessary project planning and decide on invitations to tender etc. a project guide was drawn up. This is based on the findings of an international group of experts who got together to consider experiences gained from other big projects and used these to prepare recommendations for the Brenner Base Tunnel project.

An Inter-State Commission (CIG) (formerly the Bilateral Commission) was established by the parties and tasked with watching over the development of the different project phases and make recommendations to the Austrian and Italian governments regarding further developments of the construction phases.

BBT SE went to great lengths to make their website transparent and easily accessible. It publishes all current and past tenders for services and construction and information relating thereto on its website (only available in German and Italian)⁴⁶ (newspapers reporting on any public tender also refer to the material on the BBT SE website⁴⁷). Interested companies not only find the tender notifications and results on the website but can also require more information relating to particular tenders in electronic format.

It is possible to apply for construction site visits on the website and the project progress reports are frequently updated.

Financing

The official estimated costs of the project are € 8bn excluding any financing costs. The Brenner Base Tunnel is co-financed by the EU: 50% of the costs for the project planning and the construction of the exploratory tunnel will be borne by the EU. For the construction of the main tunnel the EU is said to co-finance up to 40%. The remaining costs will be borne by Austria and Italy in equal parts. Austria and Italy signed a cooperation agreement in May 2010 to this effect.

Article 9 of the State Treaty envisaged both parties to endeavour to finance the remaining non-EU-co-financed part by way of a public-private partnership (PPP). It also states the parties' intention to

⁴⁶ Website: <http://www.bbt-se.com/index.php?id=22>

⁴⁷ See for example, <http://www.wienerzeitung.at/showpdf/?ID=8915>

share the public part of the PPP model in equal parts. However, these plans failed due to lack of private interest.

The State Treaty also stipulates that after its completion, the running costs for the tunnel are to be borne by both parties in equal parts.

Dispute settlement / resolution

Article 10 of the State Treaty stipulates that any disputes concerning the interpretation or application of the State Treaty are to be solved by the responsible administrations of the contracting parties or by diplomatic means. If the parties cannot reach a solution within six months, the dispute is to be brought before an arbitrator whose decision will be binding. The arbitration tribunal is to consist of two arbitrators, one for each party and BBT SE's CEO.

Crossborder constraints

The most advantageous form of company should be chosen (including its registered seat), e.g. the "Societas Europaea" (SE): - Advantages: cross-border mobility (re registered seat, cross-border mergers), flexibility re applicable law, European legal form (corporate identity); - Potential disadvantages: relatively long registration process.

BBT SE has employees in Innsbruck and Bolzano, the company's two registered seats. The employees work in different languages and therefore all documents and other instructions from the project managers as well as all discussions between all parties involved always need to be conducted both in German and Italian.

Different legal structures in Austria and Italy led to significant differences at the project planning stage. For example, in Italy, a two-step approach was taken. In the first pre-project phase detailed checks of the pre-project as well as environmental studies were carried out in preparation for the main project, resulting in concrete recommendations for the next planning stage. In the second stage, the main project then entailed checking the detailed project agenda for environmental compatibility. This allowed project managers to take into account any environmental costs when preparing the cost estimates. Austria on the other hand evaluated the project in one single step, resulting in practice in environmental issues being considered at a later stage than in Italy. It is not known whether in this case this led to project delays but it is feasible that the coordination of different project time tables from the different project participants can result in project delays as well as difficulties in estimating the project costs.

Due to the involvement of more than one country, it cannot be guaranteed that the project partner will fulfil all of its obligations under the agreement. Constructing the 55-kilometre Brenner Base Tunnel is not the only important part of the project. The tunnel also needs to have rail connections from Fortezza to Bolzano, which will require a further 56 kilometres.

The Brenner Base Tunnel project recognised early on the importance of transparency and easy access to relevant documents and information for affected citizens as well as people involved on the construction side. The people responsible made information relating to geological and water issues, land surveillances, project planning and land affected by the project available online in German, Italian and English through the online portal WebGis⁴⁸. Additionally, as stated above, information relat-

⁴⁸ See <http://gis.bbt-se.com>

ing to current and past tenders is also published on the official website of the Brenner Base Tunnel. Due to the multitude of different players involved, it was at times difficult to assess all potential risks for the project and address these accordingly.

Measures undertaken to mitigate political risks

In order for the cross-border project to run smoothly and in particular, to ensure political consensus at all stages and mitigate any political risks, the two countries adopted the following measures:

- The State Treaty between Austria and Italy stipulates that the project company will have two alternating registered seats, one in each country: During the planning phase, the company was to have its seat in Innsbruck, Austria, and a secondary seat in Bolzano, Italy. During the construction phase, the seat was to be in Bolzano (with a secondary seat in Innsbruck) and during the operation phase, the company's seat is to move back to Innsbruck.
- The project company was founded through the amalgamation of one Austrian and one Italian public company. The purpose of the company is the planning and construction of the Brenner Base Tunnel, and all necessary connections thereto. BBT SE is a public company and its shares are distributed equally between Austria and Italy. Weekly meetings of the persons responsible for the project ensure good and regular communication in relation to the project between the members.
- The State Treaty establishes an Inter-State Commission (ISC) to keep both governments informed in detail about the plans for the various project phases and sets out that any decisions to realise these plans must be made by both governments on the basis of the proposals of the ISC.
- The State Treaty clearly sets out that the ownership of any constructions is determined by the geographical border between the two countries (this also applies to cross-border constructions). Any water and minerals belong to the state on whose territory they were found, independent of who discovered them.
- The State Treaty furthermore stipulates that for any legal tax, employment, social or health issues, the laws of the relevant country shall be applicable.
- In terms of the financing of the project, according to the State Treaty, each country shall be responsible for the infrastructure leading to the tunnel and connecting the same to its rail network. For the tunnel itself, the parties agreed to seek EU co-financing to bear the remaining costs (including operation and maintenance costs after the completion of the tunnel) in equal parts.
- The State Treaty stipulates that in cases of conflicts, any disputes concerning the interpretation or application of the State Treaty are to be solved by the relevant administrations of the contracting parties or by diplomatic means. If the parties cannot reach a solution within six months, the dispute is to be brought before an arbitrator whose decision will be binding. The arbitration tribunal is to consist of two arbitrators, one for each party as well as of the CEO of BBT SE.

Therefore, on the one hand, a project company (BBT SE) with a European identity was set up as a vehicle to ensure efficient cooperation and communication across the two countries' borders. On the other hand, the State Treaty between the two countries ensures that important decisions are made at the individual country-level by the respective governments from time to time and that any rights and obligations arising out of the project remain with the relevant country.

By adopting this project structure, both Austria and Italy therefore tried to anticipate potential cross-border problems and set out rules to mitigate any risks relating thereto. The sustained effort to meet regularly and to make the project as transparent as possible indicates the key role communication plays in big, cross-border projects between the parties involved.

General difficulties

General difficulties in the project are being experienced primarily in relation to costs. It is estimated that the costs will far exceed the official estimations. Official figures still quote €8bn (already up from €6bn in 2010) but other sources expect this to go up to as much as €24bn. More realistic cost estimates are expected after the completion of the exploratory tunnel.

Financing costs have been excluded in the official cost estimates. However, these play an important part in infrastructure projects of this size, especially in light of the global financial crisis. In January 2012, rating agency Standard & Poor's downgraded Austria's credit rating from AAA to AA+ and Italy's from A+ to BBB+, making loans more expensive.

In early 2012 the project plans were reconsidered to address the high costs, and consequently some connections between the two single-track rail tunnels as well as a train overtaking facility were deleted therefrom. This may have negative effects on the safety as well as the capacity in the tunnel once operational.

Further problems have been caused by constant delays. Official estimates now expect the tunnel to be operational in 2026. In 2004, it had been thought that the project would be completed by 2015 (this was then revised to 2020/2022 in 2010). However, other sources believe that delays until 2032 are very likely.

Citizens all along the route are concerned about noise protection and loss of property due to possible constructions of new railway lines with enough capacity to feed the Brenner Base Tunnel.

Lessons learned

The construction of the BBT so far has in particular highlighted the importance of the detailed planning of big and complex cross-border projects. All potential risks need to be assessed and adequately addressed before the project commences so that these can be taken into account in the planning stage and, if appropriate, be addressed in any agreements relating to the project. Cost and time estimates should be as realistic as possible in order for the project financing to be put in place accordingly and to avoid bad publicity.

Possible financing models should be discussed between the parties and the most suitable one for the project should be chosen. If applicable, the relevant industry players should be involved early on in the process to minimise the risk of failing to attract private capital, as was the case for the BBT project.

During the planning and construction stage, one of the key elements is the continuous monitoring of the project. Risks, timetables, national processes and costs relating to the project have to be periodically assessed and, if necessary, the project plans be amended accordingly. This also includes the monitoring of technical innovations and improvements in the relevant industry to ensure that the project is based on the latest technological standards upon its completion.

A further important element throughout the life of the project is the communication and coordination between the different international project participants. Regular meetings of the project company Management Board or other decision-making body should be held and the progress of the project and any risks which affect or are capable of affecting the project be discussed. This is

particularly important where the project participants include parties from different jurisdictions, as national processes required for the successful completion of the project can differ widely and it is essential for the success of the project that all participants are kept continuously informed. Possible difficulties regarding languages should be adequately addressed at the start of the project, for example by determining one or multiple official project languages in which all communication needs to be made available in.

Project communication should also include the involvement of the public. For the BBT project, the visitor centres which were established in the station areas of the cities of Innsbruck (Austria) and Fortezza (Italy) as well as making information relating to the project available on the project's website (including public tenders) has been popular with interested citizens and went some way to ensure transparency of the project processes.

5.4. Railion Denmark

Background

In 2000/2001 the Danish State Railway company Den Selvstaendige Offentlige Virkfoenhed DSB (DSB) came to the conclusion that it was unable to profitably operate a rail cargo business on the Danish rail network. According to Mr Keld Sengeløv, member of the board of DSB at the time, the main reason was that the DSB rail network was somewhat limited, that the total kilometre size of tracks in Denmark was limited, that a substantial amount of rail cargo transport in Denmark was cross-border transport, and that DSB felt that transferring the rail cargo business to Deutsche Bahn AG (DB) would enable Deutsche Bahn to benefit from business of scale, better opportunities for cross-border operations, including locomotives and drivers, and better utilisation of trains and cars. It was expected that cargo trains between Germany and Malmo (Sweden) would be particularly profitable.

DSB and DB agreed to pool their rail cargo businesses with DSB becoming a minority shareholder in Railion GmbH, which was at that time the legal entity, in which Deutsche Bahn AG has concentrated its entire rail cargo business.

As part of the arrangement DSB set up a new legal entity under the name Railion Denmark, to which DSB had to transfer its entire rail cargo business under the name "DSB Gods". After the transfer, the shares in Railion Denmark were sold by DSB to Railion GmbH against shares in Railion GmbH and a cash consideration.

Corporate structure

The rail cargo business of DSB Gods was transferred to a new legal entity Railion Denmark, which was originally established by DSB. The transferred business included transport equipment (locomotives, wagons), machinery, tools and equipment, accounts payable, ongoing obligation, and certain supporting assets (inventory, repair material, etc.), and resulted also in a transfer of all employees to the extent they were not civil servants. With regard to civil servants, such employees were seconded to Railion Denmark on the basis of a separate secondment agreement. After completion of the transfer of the rail cargo business to Railion Denmark, DSB sold its entire share holding in Railion Denmark against transfer of a 2 % shareholding in Railion GmbH (the German subsidiary of Deutsche Bahn AG), which was the main holding vehicle and operational parent company for Deutsche Bahn's rail cargo business) and an additional cash consideration. Railion GmbH was owned by Deutsche Bahn, and NS Group, the Dutch State Railway as minority shareholder. Following such transfer, DB held 92 % of shares in Railion GmbH, DSN 2 % and NS Group 6 %. Subsequently, other parties became shareholders in Railion GmbH as well. Deutsche Bahn AG at that time was (and still is) fully owned by the Federal German Government. DSB was fully owned by the Danish State. Railion subsequently (in 2009) rebranded as "Schenker Rail".

The amount of shareholding DSB received in Railion GmbH was decided on the basis of the value of Railion Denmark, its financial results and future expectations, compared to the existing cargo business of Railion GmbH. Issues like future investment costs were not taken into consideration.

The parties did not consider a European Joint Venture pursuant to Regulation 2157/2001 as such a form was not available at that time. Besides, there was no need for a more international form of legal entity as the parties intended to use a Danish form of legal entity for purposes of Danish labour and employee-participation laws.

Management structure

Railion GmbH was managed by its Board of directors. DSB was not entitled to nominate any director, but it was granted to write and appoint one member to the Supervisory Board of Railion. At that time, when Railion was a limited liability company, it was required to have a Supervisory Board, due to the fact that Railion GmbH had more than 500 employees. In addition, to the business Transfer Agreement and the Sale and Purchase Agreement regarding shares in Railion Denmark against shares in Railion GmbH, agreements between DSB and Railion Denmark were concluded regarding the maintenance of main-line locomotives, pay roll management and track access to enable Railion Denmark to use the entire track network of DSB.

Railion Denmark remained (and still remains) a subsidiary with its own management, based in Copenhagen, which remained largely Danish. Due to language constraints, it was not feasible to insert German management into Railion Denmark, although a coordination committee was formed between Railion Denmark and Railion GmbH for coordination and management of cross-border traffic. Since it was easier to find Danish management personnel with German language skills than the other way round, it was intended to permanently second a number of Railion Denmark staff to Railion GmbH.

Whilst DSB had the right to nominate a member to Railion GmbH's supervisory board it was not intended to grant DSB more influence on the management board of Railion GmbH as the overall size of the Danish rail cargo business was very small.

Financing

Railion Denmark initially had financing needs of approximately Dkk 320 million, and an estimated working capital need of Dkk 100 million. Such amount of working capital, as well as availability of financing lines up to Dkk 320 million were for an interim period guaranteed by DSB. Railion GmbH/Deutsche Bahn undertook to ensure that, as soon as possible, latest 30 days after transfer of Railion Denmark to Railion GmbH, Railion Denmark would receive the required credit facilities with a minimum amount of Dkk 320 million, and ensure that the minimum working capital is always made available to Railion Denmark. Due to the previously loss making situation of the Danish rail's cargo business, it was expected that Railion Denmark would require substantial financial support in the future years, until possible synergies and an expected increase in traffic would make Railion Denmark less dependent on financial support by its new parent company. As an independent company, Railion Denmark would be able to establish its own credit facilities with banks, and borrow money on the capital market. It would also be able to use ownership of assets (mainly locomotives and wagons) as security to borrow money. The agreements did not provide for any state guarantees for Railion Denmark.

Railion Denmark did not plan to acquire any tracks or real estate. Instead, Railion Denmark entered into an access agreement with DSB, which retained ownership of the tracks regarding access to the tracks at standard market conditions that were available to all other rail operators as well.

Dispute settlement/ resolution

The agreements between DSB and Deutsche Bahn provide for all disputes to be decided by arbitration in accordance with the ICC Arbitration Rules. The agreement was governed by Danish law, the reason being that the object of the agreement was DSB's Danish cargo business, so that Denmark had the closest connection.

Cross border constraints

Due to the fact that the track network in Germany was owned by Deutsche Bahn, and the track network in Denmark continued to be owned by DSB, there were no legal impediments restricting cross-border traffic and access to tracks in the respective other country. However, provisions in the employment agreements of civil servants, as well as non-civil servant engine drivers in Denmark restricted Railion Denmark's ability to use Danish locomotive drivers on train routes outside of Denmark, except for direct cross-border traffic to the nearest cargo terminal on the other side of the border. Some practical difficulties existed regarding the use of locomotives in the respective other country, as locomotives would have to require with technical specifications by the relevant railway authority in the other country, in particular, compatibility with signalling and other safety equipment. At that time, only a limited number of locomotives of Railion Denmark had the ability to be used on German tracks. Railion GmbH did not have any locomotive, which was certified for operation on Danish tracks, but it was assumed that Railion GmbH would obtain or modify existing locomotives, and apply for operating permits for use on Danish tracks.

5.5. The Central Commission for Navigation on the Rhine (CCNR)

Further to the examination of comparable cross-border railway projects, in the context of this study we have also identified an existing international organisation that could serve as a structural model for the organisational set-up of a joint regulatory body for the three national governments involved in the Rail Baltic project. This international organisation is the Central Commission for Navigation on the Rhine (CCNR). The CCNR is the oldest European international organisation that is still in force and fully functioning today. Its aim is to guarantee the freedom of navigation on the Rhine river and its tributaries. The CCNR monitors uniform technical regulations (the Rhine system) and fulfils certain policing tasks, guarantees customs treatment and supervises the technical compliance of the ships. For the Rail Baltic project, the set-up and the regulations of the CCNR can be used as an exemplary model with regard to the set-up as a joint regulatory body.

Overview / Function of the CCNR

The CCNR serves as a permanent conference of representatives of its Member States, to ensure the application of the principles of freedom of navigation and equality of treatment of ships of all flags, to draft uniform navigation rules and vessel safety regulations, and to coordinate national engineering projects for maintenance and improvement of the navigability of the Rhine.

The member states of the CCNR are Germany, Belgium, France, the Netherlands, and Switzerland. The European Commission has an observer status in the CCNR. The CCNR dates back to the final act of the 1815 Congress of Vienna. Today, it is based on the so-called Mannheim Act (revised Rhine Navigation Act) of 1868, in its 1963 version. Its main tasks are to ensure the freedom of navigation on the Rhine and its tributaries, and to maintain a uniform legal regime governing navigation along the full length of the river.

The CCNR shall encourage European prosperity by guaranteeing a high level of security for navigation of the Rhine and its environs. The Mannheim Act, although revised several times in its history, still governs the principles of Rhine navigation today.

The Mannheim Convention contains a set of rules that are referred to collectively as “the Rhine scheme”, which cover various aspects of navigation. The guiding principles of the Rhine scheme are freedom of navigation for the ships of all nations, equality of treatment of domestic and foreign vessels, uniform administration and the elimination of all tolls or other fiscal exactions levied solely on the right to navigate. The regulations of the Rhine scheme may cover any aspect concerning the safety and prosperity of navigation on the Rhine and are binding on the CCNR Member States. In relation to the safety of navigation on the Rhine, for instance, the regulations edicted by the CCNR cover, inter alia, technical prescriptions for vessels, regulations on navigating personnel, rules governing traffic conditions (police regulations) and rules governing the transport of dangerous substances.

Mandate and competences of the CCNR

The present mandate of the CCNR foresees a number of functions, with the main function being to ensure the observance of the above-mentioned principles. On the basis of practice over more than a hundred years, the CCNR has two-fold attributions: firstly, it constitutes a standing diplomatic conference within which the representatives of the Member States are able to discuss any matter involving navigation on the Rhine, including revision of the Rhine Convention and the conclusion of

new conventions. Second, it constitutes an international organisation with corresponding attributions. These attributions are three types:

- the adoption of common regulations necessary for the safety of navigation on the Rhine
- the investigation of complaints of failure to comply with either the Mannheim Convention or the various Regulations and measures adopted jointly
- decision-making in respect of appeals against court judgments involving navigation on the Rhine

The CCNR is also competent to investigate any issue involving the promotion of navigation on the Rhine. This attribution is exercised either formally in the form of deliberations adopted by its plenary meeting and its committees, or more informally within the framework of conferences, round-table discussions and other working meetings. Such work may result in various forms of action (recommendation, declaration, memorandum of understanding, etc). Within this framework, the CCNR also carries out studies, drafts documents and publishes information of various kinds, such as statistics and documents on market observation. For the purpose of implementing its competences, the CCNR is recognised as a legal person under international law.

Organisational set-up

The CCNR has its headquarters in Strasbourg. The permanent secretariat employs about fifteen staff, and the organization's annual budget amounts to €1.6 million. The member states make equal contributions to the budget. In the CCNR, the delegation of each member state is composed of four representatives (Commissioners) and two substitutes (Deputy Commissioners).

The Committee resolutions must be made unanimously. Thus, each member state has a right of veto. By rotation, each member state chairs the committee for a period of two years. The Commission passes resolutions unanimously in line with its terms of reference, on the following issues: proposals concerning the prosperity of navigation on the Rhine, adoption of technical and administrative regulations (and their amendments) concerning the safety of vessels and complaints arising from the application of the Mannheim Convention.

The plenary meeting is the CCNR's decision-making body which adopts the Commission's resolutions. Each CCNR Member State has one vote, and decisions are reached unanimously. The meeting is chaired by a representative of the Member States alternately, with a two-year term of office. The CCNR may adopt recommendations by majority vote, but its decisions are obligatory only if approved unanimously. Moreover, the Member States have a period of thirty days within which they may withdraw an affirmative vote.

Plenary meetings of the CCNR are held at least twice a year, as well as extraordinary sessions, when required. They are attended by representatives of the CCNR Member States. Observer States and observer international organisations are invited to attend plenary meetings. Each CCNR Member State may designate four full commissioners and two substitutes. The delegations may also include a delegation secretary and a number of national experts. In certain cases, the plenary meeting has delegated the power to reach decisions on less important issues to its committees. There are about ten committees and about fifteen working parties. Most of the committees comprise at least one full commissioner or substitute commissioner for each Member State and experts designated by them. Meetings are usually held twice a year, but sometimes more frequently. In some cases, the committees' work is prepared by working parties. The composition of the working parties depends on the missions entrusted to them; they may also include external qualified persons. The CCNR assures

administrative continuity and continuous preparation of policy measures through an international secretariat and numerous specialised committees.

Thanks to the close integration of the contributions of the national delegations, the representatives of the industry, the experts and the Secretariat, most of the projects of the committees and working parties are drawn up on the basis of consensus, which makes effective decision-making possible despite the unanimity rule that applies to the plenary meeting.

Procedure to come to decisions

Problems arising from navigation on the Rhine are presented to the CCNR by the national delegations or by international organisations of inland navigation. The plenary session decides either to resolve the matter itself or to refer the problem to a competent committee which, if necessary, works out a solution with the help of experts.

The resolutions are prepared for adoption by the CCNR by competent committees and working groups of experts appointed by the member states. They meet together several times a year.

Judiciary functions

Furthermore, the CCNR also acts as a court of appeal from decisions of courts of first instance in Member States relating to Rhine navigation matters. In the interest of safeguarding a uniform jurisprudence in Rhine navigation matters, the Mannheim Convention foresees the existence of Rhine navigation courts. To this end, the CCNR itself constitutes as a revision chamber, with each Member State sending one presiding judge and another vice judge to the chamber. The revision chamber can be called on after first instance judgements of a Member State's court. The CCNR issues final judgements in affairs that pertain to Rhine navigation. The judgements can be enforced in each Member State.

At the same time, the CCNR has competence to examine and to decide upon complaints resulting from the application of the Mannheim Convention and of the regulations made in accordance with its provisions. These infringement proceedings are not part of the formal judiciary, but are structured as political-diplomatic proceedings. In this regard, only decisions that have been adopted unanimously are considered to be binding.⁴⁹

Lessons for the *Rail Baltic* project

For the Rail Baltic project, the CCNR could serve as a model for a joint regulatory body, both with regard to the establishment of a regulation mechanism (the rules pertaining to the jointly built and jointly administered rail infrastructure) as well as with regard to the organisational set-up.

First, the CCNR and its regulatory scheme (Rhine scheme) could be utilised as a model with regard to the establishment of rules concerning the Rail Baltic infrastructure. The infrastructure, once built, would be subject to the existing EU rail regulatory framework, in particular, the rules on infrastructure capacity allocation and infrastructure charging (Directives 2001/14/EC, and 2007/58/EC). However, in addition to the existing and binding EU rules, the three Member States implementing the Rail Baltic project could agree to setting up a common framework for the use of the common infrastructure in their territory, in particular with a view to the uniform application of the distinct applicable national rules (including those implementing the existing EU rail regulatory framework) in the three countries. In this way, a joint body – set up by the three Rail Baltic States in analogy to the

⁴⁹ *Rittmüller*, 180 Jahre Zentralkommission für die Rheinschifffahrt, Ausw. Dienst 1/96, p. 77[81]

CCNR - could prove to be way to solve the essential issues relating to the use of the rail infrastructure. Instead of setting up different agencies in the three countries to deal with issues related to the use of the infrastructure (e.g. pertaining to equal access, charging, investment, etc.), such a joint body could prove to be a useful and efficient tool to avoid a duplication of resources and diverging rules and judgements.

Second, as regards the set-up of such a joint body, the CCNR presents a useful model on organising the tasks. For example, the rules on equal representation of Member States' representatives in the decision bodies (plenary, committees, appeal chamber) could be used for a Rail Baltic joint regulatory body as well.

5.6. European Rail Networks for Competitive Freight

Pursuant to Regulation No. 913/2010 of the European Parliament and of the Council (Regulation No. 913/2010) requires the Member States to put into operation certain pre-determined international rail freight corridors (the Rail Freight Corridors) consisting of designated railway lines connecting two or more terminals on the territories of the Member States along a principal and diversionary routes, connecting sections and pertinent RI objects.

According to the Regulation No. 913/2010, LT is one of the Member States obliged to put into operation the Rail Freight Corridor No. 8 (Central East West Corridor from Bremerhaven to Kaunas) by 10 November 2015. The Member States not included in pre-designated rail Freight Corridors are required to participate in the establishment of at least one Rail Freight Corridor with its rail-border neighbour, unless its rail network is of gauge different from the main rail network of the EU (i.e. such as EE and LV).

By providing only the basic management structure and minimum operating and financing principles, the Regulation No. 913/2010 enables the Member States considerable level of freedom in implementation of the Rail Freight Corridors. The key elements of operational Rail Freight Corridor are:

- A functioning 2-tier governance structure (the Management Board and the Executive Board, assisted by Advisory Groups);
- Designated railway lines and terminals on the corridor;
- A constantly updated implementation plan and investment plan;
- A “One-Stop Shop” for the railway undertakings for handling requests for capacity;
- Pre-designated capacities (pre-arranged train paths and ad hoc capacities); and harmonised rules for processing capacity requests, capacity allocation and traffic management, whereas the capacity allocation and RIFs shall be arranged in line with the SERA Directive;

The two-tier management system for a Rail Freight Corridor consists of:

- The Executive Board consisting of the representatives of the Member States, primarily tasked with designation of the general objectives of the corridors, supervision and certain functions expressly designated in the Regulation 913/2010, incl. regular reporting to the European Commission;
- The Management Board consisting of the representatives of the IMs and independent bodies tasked with capacity allocation functions, where appropriate, tasked with the operative management functions of the entire corridor and assisted by the advisory groups of terminal managers and RUs. The regulation specifically stresses the possibility of organising the Management Board as an European Interest Group.

5.7. Best practice and recommendations

From the rail projects examined and in addition to the conclusions drawn (lessons learned) from each project, we have identified a number of best practice recommendations which, in our view, are useful tools for the implementation of the Rail Baltic Project:

Risk Assessment

A comprehensive risk assessment is essential for the success of any big infrastructure project in order to consider potential risks at the project planning stage and be able address these accordingly as well as reflect these in the cost analysis. Risk assessment has to go hand-in-hand with well-structured risk management. It is therefore important that the risk analysis is continuously reviewed and kept up-to-date as the project develops. Additionally, employees should be made aware of the risks in order to facilitate better risk monitoring at all levels of the project.

Possible risks include:

- Rail specific and environmental planning risks
- Cost estimation risks
- Tender and public procurement risks
- Contractual risks
- Risks relating to permissions or licences which need to be obtained
- Land acquisition risks
- Financing risks
- Cultural / communication risks
- Construction method and construction risks
- Time table risks
- Risks relating to nature and resources
- Risks relating to a change of the end goal or the project framework

Crucial and relevant issues for setting up the project

In large cross-border infrastructure projects of the scale of the Rail Baltic project, the initial agreement setting up the project has to address all the crucial and relevant issues, in particular:

- the applicable laws for any tax, employment, social or health issues as well as the ownership of any minerals and other natural resources which are found during the course of the project
- the decision-making processes of the project company and generally between the project participants: quorum, unanimous, personal attendance, video conferences etc.
- decisionmaking mechanism to enable all stakeholder states to have their interests represented, on one hand, and overcome the diverging decision-making processes and domestic legal regulations, on the other hand;
- Public relations: direct, continued and transparent contact with citizens is very important for any big project. By way of example, during the second half of the planning permission stage of the Brenner Base Tunnel, the affected public was kept continuously informed through presentations, publications and direct contacts. In addition, information centres were established in the station areas of Innsbruck and Fortezza. There, various models and graphs illustrate the different stages of the project its construction. The information centres also organise visits to the tunnel construction sites, including the yearly "Open Construction Site Day", and give out information regarding the entire TEN-T Priority Project 1 Berlin - Palermo.