

## **THE RESTRUCTURING OF GREEK RAILWAYS**

The new law on rail transport has been voted in Parliament last December. The Law is complementing the European directive on railroad transportation (91/440/EC, 95/18/EC as amended by 2001/12/EC and 2001/13/EC, and the directive 2001/14/EC) which has been introduced into Greek Law by presidential decree 41/2005.

### **A. Main issues**

The law addresses the following main issues:

- a) The restructuring of the OSE Group with the unbundling of activities the assumption of existing debt by the state and the allocation of existing assets among the companies with OSE retaining the fixed network assets and TRAINOSE obtaining the rolling stock. OSE will become the manager of the national railway network infrastructure after merging with the existing manager EDISY. The total employment of OSE is set by law to be 2800 persons. ERGOSE will be responsible for new investment implementation as project managers. GAIAOSE will have possession of the real estate assets that are not related to the main activity but can be commercially developed. TRAINOSE will be the service provider of rail transportation of both people and goods. Furthermore, TRAINOSE will be able to develop coach transportation activities and road transport of goods. Rolling stock owned by OSE will be transferred to TRAINOSE without cost but it may count as a capital increase. TRAINOSE may sign a contract with OSE on the type of services that will offer including the use of stations and other facilities as well as the maintenance of existing rolling stock.
- b) The classification of the rail network in accordance to the state of utilization.
- c) The change of working relations and the transfer of surplus personnel. The Draft Law stipulates that in privatized companies the Board of Directors will have the authority to decide on the structure of the management team and on internal operations regulations. For TRAINOSE the surplus personnel is estimated in the Law at 751

employees 500 of which employed in the main rail activity. TRAINOSE will be operated as a private company if partly privatized.

- d) The establishment of an independent regulator of railroad activities. The Regulator has all the powers required to perform its role and is relatively independent from government interference.

## **B. Implementation process**

The implementation of the new law is likely to follow the same steps as the one on Olympic Airways. In that case the reaction of the unions has been concentrated up to the point of the voting on the law. The only difference is that the government now is unable to offering lucrative offsetting arrangements to those transferred to other organizations. In the case of TRAINOSE when the investor takes over is not expected to face any major disturbances. That will happen 6-12 months later following some tendering process the selection of the preferred bidder and negotiation of contracts. This is exactly what happened with Olympic Airways. After the acquisition by the private investor there was no industrial dispute. There was no union activity even when the new investor decided to merge with his main competitor Aegean Airlines. Therefore, we expect labour unrest to last until the point of transfer of surplus employees to the new umbrella organization which will undertake to distribute the employees to new public sector jobs.

The new law must be seen in conjunction with Presidential Decree (PD) 41/2005. The PD incorporates into Greek law the directives opening up the rail market. Up to now the role of regulator was assigned to the Ministry of Transport. Now with the new law an independent regulator is set up. The Regulator is independent in the sense that it has its own economic resources from a budget line and the decision of its executive officers and board are final subject only to judicial scrutiny. There is no apparent interference by the Ministry of Transport. The only possible line of influence comes from the appointment by the government of its officials.

The establishment of the Regulator is a clear indication that new operators will be accepted into the market. In article 27.2-8 one of the Regulators responsibilities is the granting of permits to operators.

The design of TRAINOSE in the new law and the structure of its privatization point towards a government desire to attract a sister organization such as Deutsche Bahn or SNCF. TRAINOSE retains both the operation of passenger trains and freight trains. However, the law does not specify what happens if later on the investor proposes to disinvest from freight.

In case there is no interest in TRAINOSE the government will redesign the process. That may happen when a privatization advisor is selected and after sounding the market he finds out that there is no real interest. In case the TRAINOSE privatization fails or is modeled in an unsatisfactory way there is always the possibility for an investor to organize a fully independent rail activity asking for a permit on one of the existing routes as it is envisaged in the PD 41/2005.

Up to now the government has succeeded in drastically reducing the cost of operation through closures of unprofitable lines deep wage cuts (mainly in secondary benefits) and fare rises.

### **C. Critical evaluation of the legal framework and the privatization process**

The main weaknesses of the Law are the following:

- Even with management control, a minority stake in TRAINOSE is unlikely to be attractive to third-party investors as the potential rewards may not be adequate to support the inherent financial and operational risks.
- A high risk of political and Trades Union interference through retention by Government of a majority shareholding in TRAINOSE.
- Private Operators unlikely to find Open-Access over main lines or operations at the margins on routes given-up by TRAINOSE attractive.

- No increase in competition and therefore efficiency (cost reduction) and service quality goals may not be achieved.
- No separation of passenger and freight activities
- Direct Award of long-term Public Service Requirement contract to TRAINOSE (necessary to give confidence to the third-party investor) could be open to legal challenge

#### **D. The business plan**

The current operational and financial situation is difficult. With the exception of suburban passenger transport, demand is in decline both for passenger and freight services.

in thousands	2004	2005	2006	2007	2008	2009
PASSENGERS REGIONAL		7968	8093	8503	7559	6043
PASSENGER INTERCITY		1650	1428	1500	1387	1390
PASSENGERS SUBURBAN	1335	2824	4088	6291	7661	7840
FREIGHT (tons)	2968	3058	3884	4817	4253	3627

In passenger services the best part of the network is the PATHEP (Athens – Thessaloniki Corridor) which has the lowest “loss per passenger – km” ratio at 0.06863 as well as significant investments and potential for excellent quality of service. It is also part of the trans-European rail network. The Athens Suburban routes / network provides a “loss per passenger – km” ratio of 0.10287 with significant investments and provides a service of high quality linking Athens with the international airport.

The business plan has been elaborated by the consultants PWC and it is a detailed exercise but it cannot be a firm basis for a private investment analysis. It envisages a return to profitability for TRAINOSE (the rail operator) by the second year of implementation i.e. 2012. In general, total revenues are expected to increase significantly until 2013, due to the new pricelists. Payroll cost will be decreased during the period 2011 – 2013, due to the transfer of a significant number of surplus employees to other State organizations along with the rationalization of other allowances and benefits policy of the organization.

In euro	2010	2011	2012	2013
<b>INCOME</b>	<b>120720363</b>	<b>143909163</b>	<b>154204476</b>	<b>161467457</b>
(SUBSIDY)		50000000	48359089	45264971
<b>EXPENSES</b>	<b>290134566</b>	<b>199868028</b>	<b>203328521</b>	<b>203857790</b>
(PRODUCTION PAYROLL)	80090872	41538479	42129895	40679166
(ADMINISTRATION PAYROLL)	12991575	6982111	7083729	6834462
(MAINTENANCE)	45000000	36795471	37467678	38153330
(ROLLING STOCK HIRE)	33639113	27545100	27545100	27545100
(INFRASTRUCTURE CHARGES)	29287959	24716482	25167276	25627085
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<b>OPERATING RESULTS</b>	<b>164255022</b>	<b>-199684</b>	<b>4994226</b>	<b>8633819</b>

However, throughout the period passenger transport is not achieving profitability. Under a pessimistic scenario passenger transport may lose money if fare increases have an adverse impact on demand for rail. The operational surplus comes from freight services that are already liberalised. Thus, the prospective investor may be faced, in the future, with intense competition from other private operators.

Therefore, the private investor in TRAINOSE, in order to return to financial viability under the pessimistic case, will have to perform the following:

- Further suspension of operating networks
- Suspension of freight activities
- Transfer of additional 300 employees to the Greek state at the second semester 2011
- Reduction of regular salaries by approx. 13%

A private investor has to revise the business plan on a more realistic basis before committing to a privatisation process.

***Dr. S. Travlos - January 2011***