

INDUSTRY FOREFRONT

Russian Real Estate Battle Imperils Global Tube Amp Production

Electro-Harmonix founder Mike Matthews does battle with Russian real estate company in a war he dubs “rock ’n’ roll versus racketeers.”

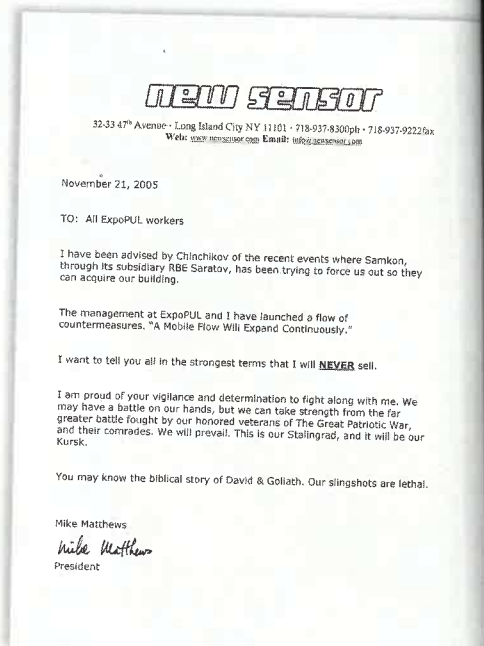
MIKE MATTHEWS IS STEELED for a fight. More than two decades after Electro-Harmonix fell victim to labor racketeers, the maverick manufacturer is fiercely defending the vacuum tube business he has lovingly built over the past 15 years. ExpoPUL, a wholly owned subsidiary of Matthews’ New Sensor Corporation, pro-

duces Sovtek, Electro-Harmonix, Tungsol, Mullard, and Svetlana tubes, which are used in amplifiers made by Fender, Peavey, Mesa Boogie, Crate, Soldano, Korg, Marshall, and many other brands.

The implications for the guitar amplifier industry are potentially enormous. Early responses from some of the many amp manufacturers that depend on the company’s tubes suggest that they are seriously concerned.

According to Matthews, there are only two other much smaller factories in the world still mass-producing vacuum tubes, and ExpoPUL is the only one that designs new types of tubes to meet the needs of its major manufacturer customers.

Matthews’ current adversary is RBE Saratov, a subsidiary of Russian multi-billion-dollar conglomerate Samkon. RBE (Russian Business Estate) is seeking space occupied by ExpoPUL in the Reflektor Industrial Complex, where RBE owns ten other companies. Matthews says he ignored numerous statements by RBE claiming to “want and need” the factory, followed by a veiled threat to



factory director Vladimir Chinchikov to “make big problems for you” if ExpoPUL didn’t vacate the property. When Matthews didn’t immediately respond to a subsequent buyout offer of \$400,000—which was less than he’d paid for the factory seven years earlier—the “big problems” came in the form of a letter informing ExpoPUL that RBE’s power company, Reflektor EnergyKo, would terminate energy flow to ExpoPUL as of December 31, 2005. Other EnergyKo customers in the complex received no notice. Liking RBE’s threat to extortion, in character-

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istic defiance Matthews formally rejected its buyout offer and began forming a defense strategy.

Fortunately for Matthews, in its apparent efforts to force him out, RBE stumbled right out of the blocks. In Russia "energy" is categorized into two classes. "Primary energy," consistent with definitions used in the West, includes electricity, gas and petroleum products used for heating, etc. "Secondary energy" refers to ten different gases including oxygen, hydrogen, nitrogen—and to a far lesser extent seven others and purified water—used as components or for the production of all manner of products such as vacuum tubes. According to Russian law, no utility can cut off a business's electricity. With its larger threat nullified by this law, RBE backtracked, redefining its warnings to stipulate that it had to cut off ExpoPUL's secondary energy to implement badly needed renovations of Reflektor EnergyKo's generating capabilities. Very familiar with those capabilities from his 43 years of working at the plant, Chinchikov challenged the claim. Again, the Reflektor complex's other secondary energy customers were not similarly warned.

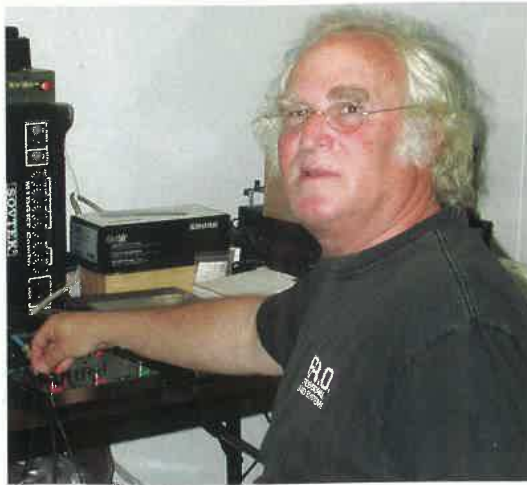
When Matthews rejected RBE's buyout offer as "ridiculous," they responded by cutting off power, threatening his production of vacuum tubes.

Meanwhile, Matthews had filed complaints with the Saratov Arbitration Court and the Russian Anti-Monopoly Commission. On December 10, 2005, the Arbitration Court quickly issued a "very stern" stay, ordering RBE to continue to supply the secondary energy at the current prices until further notice. Also, Russian newspapers began to report on the story, which is of considerable consequence to the local economy and employment picture. "The governor and vice-governor of Saratov are strongly supporting us," says Matthews. "They don't want to see our 830 employees on the streets, out of work, and they don't

want the Saratov region to be perceived as a bad risk for international investors.” He also noted that on December 12 the mayor of Saratov, who reportedly has ties with RBE, resigned from office. It’s not known whether his departure is related to the New Sensor-RBE dispute.

RBE failed to show up for the first scheduled hearing by the Anti-Monopoly Commission. At a rescheduled hearing the Commission ruled in favor of ExpoPUL and New Sensor, ensuring at least six more months of uninterrupted operation. Also, as this issue was going to press, Matthews was anticipating assistance from the U.S. ambassador to the Russian Embassy, and the office of New York Governor George Pataki confirmed that it would contact a broad range of U.S. and Russian government officials on New Sensor’s behalf.

Matthews is best known for his groundbreaking Electro-Harmonix effects pedals such as the LPB-1 power booster, Big Muff fuzz, and more recently the English Muff’n Overdrive,



“THIS WILL BE OUR STALINGRAD!” New Sensor’s Mike Matthews rallies his employees in his fight with a Russian real estate firm.

POG (Polyphonic Octave Generator), and Flanger Hoax. In 1982 his bruising battle with “labor racketeers” and other challenges bankrupted Electro-Harmonix. Six years later he launched New Sensor Corporation and began importing vacuum tubes from three factories in Russia. He regained ownership of the Electro-Harmonix trademark in

1991 and began manufacturing three E-H pedals in Russia that still complement the vast line of pedals made at the company’s main New York production facility. As with the reborn Electro-Harmonix, Sovtek’s business grew, and in 1999 Matthews bought the Reflektor factory outright. Today it produces tubes for many of the world’s top amplifier makers.

Despite the favorable ruling from the Saratov Arbitration Court and apparent support from some government officials, Matthews acknowledges, “The Russian legal system is very complex. It’s very easy [for litigants] to appeal to a different court and, depending on that court’s political and economic alliances, win a

reversal. So for us the ballgame is far from over.” However, he has also received encouragement and tangible support from significant industry players. Hartley Peavey sent a letter of support to Vladimir Putin appointee Alexander Kononov, presidential representative for the Volga Federal District, which surrounds the Saratov region Peavey wrote glowingly of his relationship with Matthews and Sovtek tubes, which he called “the best in the world.” And Steve Grinrod, managing director of Vox Amplification, wrote a letter to Rashid Nurgaliev, the Moscow minister of internal affairs. Grinrod testified to Vox’s reliance on Sovtek tubes to create the classic Vox sound that traces back to the debut of the Rolling Stones and the Beatles. Other letters to various government officials have been sent by the president of Fender and the chairman of Korg Japan.

The consequences of this dispute are conceivably great and wide-ranging. For ExpoPUL’s 830 employees, a win by RBE could take away their livelihood. For New Sensor’s Sovtek division, which accounted for more than half of the company’s \$17.4 million in 2005 revenue, the stakes are equally dire, though Matthews has already begun formulating backup plans. “If they do manage to cut off our secondary energy,” he explains, “we could operate temporarily by using tanks of gas, but it would require that we haul in 67 tanks of gas every day. Because of safety concerns and other issues, our production would be reduced from 13 production

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lines to a double shift of two production lines. In other words, we'd only be able to produce 4/13 of our current levels."

A longer-range alternative would be for ExpoPUL to purchase its own secondary energy equipment. In support of this option, New Sensor bought a building foundation that is adjacent to ExpoPUL—but not owned RBE. "That facility would be very convenient for housing new energy equipment," says Matthews, "and we've located the equipment to generate the main gases we need—oxygen, hydrogen, and nitrogen—but it would take six months or

longer to install it and train the factory workers how to run it. Also, the new equipment would cost \$1.6 million, which would be a pretty stiff price if our production volume is reduced by any kind of shutdown."

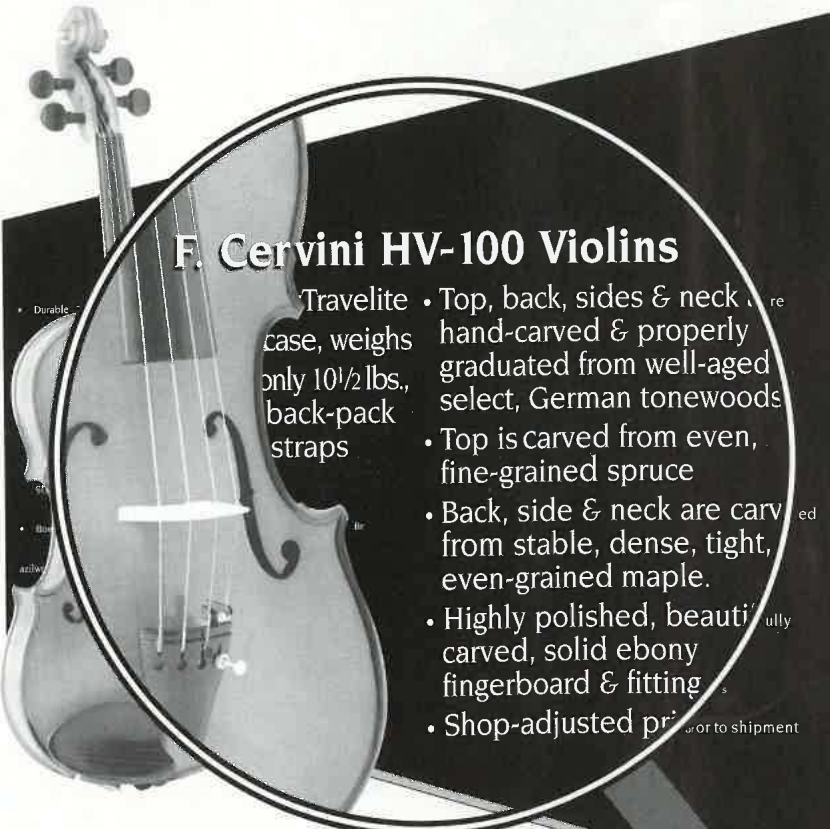
But no one is counting Mike Matthews out. "Anyone who knows me from my past knows that when I'm confronted by racketeers, I'm going to battle them with all my creative might to prevail. Hundreds of thousands of rock 'n' roll musicians depend on these tubes. I'm not going to let them down."



THE EXPOPUL FACTORY in the city of Saratov, Russia, manufactures some three million vacuum tubes every year.


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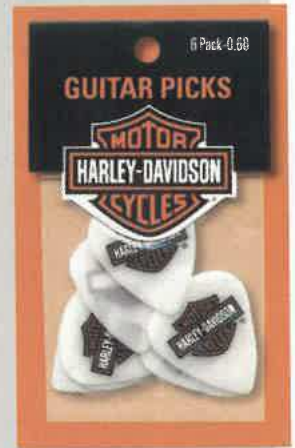
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