

INVESTMENT GUARANTEES

Cover for Capital Investments is still important today - a Field Report

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Political borders are no longer barriers, the economic integration is growing in line with globalization, and cross-border investments have become daily practice. Despite this dynamic development, risks for investments abroad persist and can only be covered under appropriate schemes. The following story underlines this:

The joint stock company ALSTOM Sverdlovsk Elektromechanical Company (short: ZAO „ALSTOM SEMS“, Jekaterinburg, Russian Federation) is a medium-size company with approx. 500 employees at present and a turnover of about EUR 13 million. The core business of the enterprise is the development, production and distribution of medium voltage switchgear systems and instruments for the power distribution. Chief customers are industrial firms, airports, the oil and gas industry, hospitals, and power supply enterprises.

The company ZAO „ALSTOM SEMS“ was founded on 23 August 1994 as a joint venture of a German subsidiary of today's ALSTOM-Group and the staff of „TOO SEMS“, which had been privatized in 1990. The share capital was contributed by the two shareholders one half each, the German shareholder contributing cash and the Russian shareholder (staff) making available business assets. In 1990 already, the staff had bought the assets of the former state enterprise from the Ministry of Property of the region Swerdlowsk. When setting up the joint venture today's ALSTOM had its investment in Jekaterinburg covered by an investment guarantee of the German Government. The joint venture performed well; in 1998 a capital increase became necessary to extend the production plant and renovate the existing offices. The additional share capital was provided solely by the German shareholder, from that on ALSTOM has owned 98% of the share capital and the Russian staff of the company only 2%. This capital increase was also guaranteed by the German Government by way of supplementing the investment guarantee.

Subsequently business could again be expanded. The marketing of the products manufactured in Jekaterinburg according to German standards and on the basis of the technology consistently applied in the ALSTOM group, could be extended

to the entire Russian territory. This positive development clearly showed that the joint venture would shortly be profitable and the resulting profit would be distributed to the shareholders.

On 29 December 2000 the Public Prosecutor's Department of the Swerdlowsk region, initialized by a regional administrative authority of the Swerdlowsk region, filed suit at the arbitration court against ZAO „ALSTOM SEMS“. The objective of this lawsuit was to invalidate the privatization of the business assets in 1990, which the Russian shareholders had brought into the joint venture in 1994, and by this to restore these business assets to the state. These assets - i.e. all assets of the plant that had existed in 1990 - are essential for a manufacturing plant. The reassignment to the state was to apply among other things to all buildings including the factory building (combined with ZAO „ALSTOM SEMS“'s usage rights of the property), essential elements of the infrastructure like the transformer station, which is indispensable for the internal power supply, the sewage pipe system and the telecommunication system as well as the bulk of existing machines. A removal of these objects would lead to the closure of the plant, despite the fact that ALSTOM had made considerable investments in new machines and buildings since 1994, and, moreover, without the "old" machines and buildings a regular production process could not be guaranteed.

In the period between 25 January 2001 and 14 April 2002 altogether five court hearings in Jektaterinburg took place. Twice the case went through the various stages of appeal, first the regional administrative authority prevailed and after that ZAO „ALSTOM SEMS“ won the case.

Parallel to the court proceedings criminal subjects were trying to effect the reassignment of the assets with legally intolerable means and the strategy to intimidate ALSTOM's local management. Various enforcement attempts resembled raids, where bailiffs with armed support troops invaded the plant und threatened local staff as well as staff delegated from Germany. The plant security officers of ZAO „ALSTOM SEMS“ were reinforced by external security guards and the managing staff was provided with personal protection. These raids remained unsuccessful because staff and management jointly warded off the attacks and refused to hand over the assets and because the Moscovian lawyer hired by ALSTOM, who was present there all the time, was able to continuously counter the attempts of enforcement with filing interim injunctions.

Immediately after the service of the writ against ZAO „ALSTOM SEMS“ PwC had been informed about the imminent development and the risks involved eventually threatening to end up as an event of de facto expropriation, ALSTOM, PwC, the German Ministries concerned, the German Embassy in Moscow as well as eligible Russian government authorities cooperated to ensure political support in this conflict.

All those who are familiar with the situation in Russia confirmed that the proceedings initiated by the prosecuting party in Jekaterinburg exemplify that in case of success such methods might splay to the whole Russian territory. The representatives of the Federal Russian authorities have more or less openly taken sides with ALSTOM SEMS. However, they uttered their fear that this lawsuit and the resulting court proceedings will, in case of success, severely damage Russia's reputation. Even though remarkable political support of the Central Government could be observed, it has to be conceded that Moscow was not able to exert sufficient influence on the regional administrative authority in Jekaterinburg, which in this matter is not subject to directives, to make them end these proceedings.

Against this background the case developed an macroeconomic political explosiveness: if ALSTOM could prevent the de facto expropriation, this would act as a signal for other German-Russian joint projects and would certainly cause political consequences in Jekaterinburg and stabilize the investment relations between the two countries. If the administrative authority of the region Swerdlowsk had been able to enforce its claim, a concrete loss would have resulted and an indemnification would have been claimed under the existing guarantee, and in addition other cases would have been staged in the same way. In so far it was of vital importance to counter the criminal attacks with all possible means. ALSTOM has not spared any costs and used all possibilities under Russian law to defend themselves against measures that might lead to expropriation.

With the third-instance decision of 16 April 2002 the court in Jekaterinburg dismissed the action of the administrative authority of the Swerdlowsk region to reassign the assets privatized in 1990.