



- [Log in to The Deal Pipeline](#)
- [Subscribe to The Deal magazine](#)
- [Products & services](#)

TheDeal Magazine

Voice of the deal economy

- Twitter
- Free newsletter
- RSS feed

— BANKRUPTCY —

Self-help

By Matt Miller

[SHARE](#) [E-MAIL](#) [DISCUSSION \(1\)](#) [PRINT STORY](#)

Published June 5, 2009 at 11:55 AM

EXECUTIVE SUMMARY

- In Germany, self-administration is comparable to U.S.-style debtor in possession.
- German society favors restructuring and rehabilitation.
- Germany may now try self-administration; companies and courts will be more predisposed to sign off.

Search

[« PREVIOUS STORY](#) [HOME](#) [NEXT STORY »](#)

Retailing in Germany is in a deep funk. More and more retail chains are going bust as unemployment rises, consumers cut back on spending and distressed banks refuse to lend more money. **Woolworth Deutschland GmbH & Co. KG** went into preliminary receivership in April; many stores are expected to shut down. **Arcandor AG**, one of Germany's two biggest department stores, is desperately trying to **stay afloat**, begging the government for a billion-dollar bailout. (The German parliament could decide June 9.) The **administrator** for a smaller department store chain called **Hertie GmbH** announced May 20 that the century-old retailer would be liquidated.



A recent **successful exit** from insolvency of **SinnLeffers GmbH**, now a chain of 22 stores and once a subsidiary of Arcandor predecessor company KarstadtQuelle AG, offers a rare bit of good news in this harsh environment. It shows that German insolvency can effect a U.S.-style debtor-in-possession with beneficial results, despite some of the toughest regulations in the world on director liability and both a public and a judiciary skeptical of allowing management to stay in place.

[Continue reading below](#)

PERSPECTIVE
IS NOT JUST
A MATTER OF
WHAT YOU SEE



Explore The Deal's

- Products**
- Services**
- [The Deal Pipeline](#)
- [The Deal magazine](#)
- [Corporate Pipeline](#)
- [The Deal Events](#)
- [Advertising](#)
- [Custom Media](#)
- [Reprints](#)
- [Customer Service](#)

[Learn more](#)



Also From The Deal.com

- [The Magazine](#)
- [Dealscape](#)
- [Corporate Dealmaker](#)
- [Deal Video](#)



- Proper arrangements
- The future and other problems
- That worrying wall of debt
- The new normal
- Honey, I shrunk the VCs



[foleyhoag.com](#)

BUT HOW
YOU SEE IT.

Attorney advertising. Prior results do not guarantee a similar outcome.

Last month, SinnLeffers came out of insolvency substantially slimmed down but otherwise intact. That's quite a victory, considering that since the financial crisis last September, most German insolvencies have led to liquidations.

With SinnLeffers, the whole exercise took less than a year, which in a German insolvency timetable is blazingly fast. More than two-thirds of the employees kept their jobs.

"This is a success story," says Annerose Tashiro, an Achern, Germany-based lawyer at **Schultze & Braun GmbH**, the restructuring firm responsible for the SinnLeffers self-administration. "As of now, there should be a better reception, since we can prove [self-administration] works and works proficiently."

However successful, this doesn't mean a Chapter 11-style debtor-in-possession insolvency will now sweep through Germany, according to several legal specialists in German restructuring. For the foreseeable future, self-administered insolvent companies will remain relatively rare, for reasons that range from court preferences and public perception to creditor rights. "Courts are still quite reluctant to have a company in the hands of people who ran it into the ground," says Andreas Böhme, counsel in **King & Spalding LLP's** Frankfurt office. "Companies routinely apply for self-administration, and just as routinely, courts turn them down."

In Germany, insolvencies are the domain of a special chamber of commercial court. As Martin Rolf Trayer, a lawyer with the Frankfurt office of **Faegre & Benson LLP**, explains, insolvency judges in Germany have enormous latitude in deciding which administrator gets the call. "It's in the court's discretion who is given the mandate for administration," Trayer says.

Volker Beissenhertz, also a Schultze & Braun attorney, believes there will be more self-administration cases but that it may take another five to 10 years to really gain momentum.

"This can be seen as a trend, perhaps not in terms of a particular head count, but what can happen in [the future]," says Beissenhertz, who was responsible for the back-office coordination of the administration.

Under the terms of the SinnLeffers restructuring, pre-insolvency shareholder **Deutsche Industrie-Holding GmbH**, or DIH, retained ownership, but lost about €100 million (\$139 million) in outstanding loans it had extended to the company. DIH purchased the chain in 2005 along with a Palm Beach, Fla., private equity firm, **HMD Partners**.

In June 2008 DIH bought out its partner. Neither the original sale price nor the subsequent acquisition cost was ever made public. DIH is a Frankfurt private equity firm that specializes in middle-market, distressed companies.

SinnLeffers and Hertie were at one time both owned by the troubled European department store and mail-order conglomerate KarstadtQuelle. Much as **Macy's Inc.** subsumed various brands into its name after acquisition, so, too, did KarstadtQuelle attempt to gobble up in the 1990s all sorts of department store and apparel chains and turn them into one retail behemoth. For example, Hertie, a group of smaller department stores, was rechristened Karstadt Kompakt GmbH & Co KG.

The aggressive expansion strategy didn't work. In 2005, KarstadtQuelle teetered on insolvency. To stay afloat, it had to unload four of its acquired chains.

No acquirer succeeded in a successful turnaround of the various properties. As the economy soured, all four retail entities filed for insolvency. Apparel retailer Wehmeyer GmbH & Co. KG filed last July, as did Hertie. SinnLeffers filed a month later. Men's clothes chain **Pohland-Herrenkleidung GmbH & Co. KG** filed in March.

Pohland is still in preliminary administration. In December, apparel sourcing company **Techno Lifestyle GmbH & Co. KG** acquired Wehmeyer, a 43-store chain, out of administration for an undisclosed amount. Techno Lifestyle managing director Rajive Ranjan told an Indian newspaper that his company would invest €15 million into expansion and open a branch of Wehmeyer in his native India next year.

Hertie failed to find any such savior. On May 20, the court-appointed administrator for Hertie announced all 54 stores would be shuttered. More than 80% of the creditors voted for liquidation, which came after negotiations broke down between potential new investors and the old owner, a distressed U.K. investment fund that also holds the leases to the properties. The British property and financial investment company, **Dawnay, Day International Ltd.**, is also **in receivership**.

Hertie's administrator, **White & Case LLP** partner Biner Bähr, faults Dawnay Day for poor operational management while in charge and intransigence during restructuring negotiations.

"They were financial investors [interested] in property. They didn't have the expertise for running a retail business," Bähr says.

Hilco UK Ltd., a subsidiary of the U.S.-based **Hilco Group**, was a 15% minority shareholder in Hertie. "They were supposed to bring retail expertise, but they failed also," he says.

The Düsseldorf-based lawyer, one of Germany's best-known insolvency administrators, added that reduced rentals were absolutely essential for continued operation. Potential investors "needed new lease contracts. They couldn't possibly run the business with the old ones."

According to Bähr, Dawnay Day also failed to consider a critical element of German insolvency law. Under normal circumstances, the landlord would have priority as a creditor. But in this case, the landlord is also the shareholder. So rights are subordinated, even though the operating company and the property companies may be separately incorporated. "That was a crucial point of law," says Bähr, which Dawnay Day representatives didn't appear to understand. "Let's call it a clash of cultures."

SinnLeffers avoided being broken up, although it didn't escape some contraction. It applied for insolvency in August 2008. While in administration, the chain cut 22 of 47 stores. Roughly 1,300 workers, or about 35% of the workforce, lost their jobs.

German societal dictates lean heavily toward corporate restructuring and rehabilitation whenever possible. "Liquidation is a second choice to restructuring. It has always been and will always be," says Detlef Hass, a Munich-based partner at **Lovells LLP**. "A majority of insolvencies are small businesses, and a majority of those result in liquidation. A normal-sized business would not be liquidated as long as there was a chance to be restructured." However, there's a paradox at work. Society may favor restructuring, but directors must contend with enormous legal pressure to file for insolvency administration.

They can face both civil and criminal liability if they allow a corporation to continue operating while insolvent.

Under the law, directors have just 21 days to declare the company insolvent if they determine the company is illiquid. Until last November, directors also were required to file if they determined that debts are greater than assets if liquidated, the so-called balance sheet test. The law was amended to make the determination less absolute. Directors could be exempt from filing if they determine that the outweighing of the asset value by debt is a temporary phenomenon and the company will remain liquid for the next 18 to 24 months.

That gives directors some latitude. But lawyers say corporate officers will still likely err on the side of caution to avoid any potential liability.

Under German law, insolvency is a two-step process. After directors declare their company insolvent, the court appoints a provisional administrator, a process that could take three to six months. That individual is a specialized lawyer drawn from a small list supplied to each court.

During the preliminary period, an administrator attempts to determine what course insolvency should take. There is some breathing room. The state pays the wages of workers for up to 90 days. It's one of the most generous interpretations in Europe of a European Union directive mandating some kind of government assistance for workers of newly insolvent companies.

"If you don't have to pay for 4,000 employees, you can really make money. You can't not make money," Beissenhertz says.

The actual insolvency kicks in, usually after three months, but sometimes longer, depending on the size and complexity of the company.

Typically, the provisional administrator also becomes permanent, with wide-ranging powers over the company and its future. "It's much more like a manager's job," Trayer says.

However, the administrator can also pretty much dictate what course of action to take. "Insolvency allows administrators to liquidate, run or sell the company," says Hass. "That's the beauty. It can be a tailor-made proceeding."

In the case of SinnLeffers, a district court in Hagen, Germany, appointed Horst Piepenburg provisional administrator. Düsseldorf-based Piepenburg is one of the country's most experienced administrators. He has worked more than 1,000 insolvency cases, including Babcock Borsig AG and companies related to the **Axel Springer AG** group.

A few months before the provisional insolvency, however, SinnLeffers had hired Schultze & Braun, the country's largest specialist restructuring firm, to consult on restructuring options. One Schultze & Braun partner, Detlef Specovius, functioned as a chief

restructuring officer and assumed the title of managing director in August. The plan, says Beissenhirtz, was for Specovius and Schultze & Braun to lead the company toward self-administration.

Piepenburg agreed with the self-administration arrangement. The court approved the proposal on Nov. 1. Piepenburg became a trustee, with supervisory powers. Specovius became self-administrator, while other management remained in place.

His firm filed a plan to the court in December. The court approved the plan, as did creditors, in March. After a mandatory appeal period, the court formally discharged the insolvency on May 4.

SinnLeffers benefited from some special circumstances. That included a simple share structure and only one major creditor.

Under German law, shareholders must approve any restructuring plan. As the sole shareholder, DIH was obviously on board. DIH also was the only creditor, save some trade creditors, which were paid off in full under the plan.

Under German law, suppliers have the right to regain their goods even in an insolvency if they aren't fully paid, says Tashiro, who heads Schultze & Braun's cross-border insolvency and restructuring group. An administrator has the right to either assume or reject all other contracts.

Since DIH agreed to forgo its entire loan, there were no creditor disputes, which could have derailed the plan. "If this were an LBO and there were 70 banks, you'd go crazy trying to do a business rescue," Beissenhirtz says.

One reason the notion of a SinnLeffers self-administration gained traction, Beissenhirtz believes, is that neither the judge nor the wider public blamed management for the company's woes. Instead, there was an understanding that DIH inherited problems from KarstadtQuelle.

"Management came to power in 2005 and tried to rescue the company ever since," he says.

By contrast, management is normally considered a major part of the problem and immediately removed in most German insolvencies.

What's more, many administrators are loath to cede power.

These circumstances are not easily replicated. While self-administration has been legally possible since the country's insolvency laws were updated a decade ago, few cases have been logged.

Even then, it's not exactly the same as an American debtor-in-possession. "Just looking at the black-and-white law, management can stay in place," says Hass. "In reality, management gets a chief restructuring officer-type in place who essentially acts as a CEO.

"Then the courts might appoint him as administrator."

Particulars of the SinnLeffers case notwithstanding, Tashiro believes other companies and other turnaround specialists in Germany will now be tempted to at least try self-administration, and companies and courts alike will be more predisposed to sign off on the process.

"It gives me confidence," she says.

"Those who have a good understanding of the way it works will be supportive. Those who never liked the concept will not support it. This won't change their minds."

Self-administration is a "pretty Germanic clone" of American debtor-in-possession, and "it's complex," adds Kolja von Bismarck, a Frankfurt-based partner at **Clifford Chance LLP**, speaking at a Turnaround Management Association Webinar, or Web seminar.

But "it works."

Tags

- [Arcandor](#)
- [Axel Springer](#)
- [bankruptcy](#)
- [Dawnay Day](#)
- [Deutsche Industrie-Holding](#)
- [Germany](#)
- [Hertie](#)
- [Hilco Group](#)
- [HMD Partners](#)
- [Macy's](#)
- [Pohland-Herrenkleidung](#)
- [SinnLeffers](#)
- [Techno Lifestyle](#)
- [Woolworth Deutschland](#)

Comments

From: dave,

Mr Bahr was simply dragging out his process with the stores and pretending someone would buy the dog of the business in the hope he could get his hands on the property companies too and thus increase his fees. He failed and is now blaming everyone but himself.

POSTED ON: JUNE 6, 2009 1:07 AM

Post a comment

Name:

Email Address:

URL:

Remember personal info?

Comments: (you may use HTML tags for style)



Please only click "Post" once. It may take a few moments to process.

Post

TheDeal.com

About Us
Contact Us
Products & Services
Advertise
Newsroom
Sitemap

Dealscape

M&A
Private capital
Bankruptcy
Law & regulation
Technology
Deal international

Magazine

Features
Insights
Dealwatch
Dealmakers
Community
The Magazine

Corporate Dealmaker

Topics
Events
Resource Center
Magazine

Deal Events

The Deal Economy 2010
TMA/The Deal's Distressed
Investing Conference
Healthcare Dealmaking
Symposium

Deal Video

Inside The Deal
Behind The Money