Privatization Contracts with the German Treuhandanstalt: An Insiders’ Guide†

The German “Treuhandanstalt” (literally translated, “Trustee Agency” and hereafter referred to as Treuhandanstalt, Treuhand, or THA) was established to perform a massive, historical, and unexpected task. It is the independent agency of the German Government entrusted with the job of helping convert the command economy of former East Germany into a modern, social market economy.

In order to understand the Treuhand, a brief history is necessary. The Treuhand’s precursor was established in March 1990 under the last Communist regime in East Germany. The Treuhand as we now know it was first empowered in July 1990 under the terms of the Treuhandgesetz. On its creation, the Treuhand overnight became the largest holding-type company in the world. It immediately took legal title to all the companies that previously had belonged to the state of East Germany and assumed the responsibility for their interim administration and

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†This contribution is an account of the personal views of the authors and is not intended as a statement of the official position of the Treuhandanstalt regarding the matters discussed herein. The EditorialReviewer for the article was Klaus Peter Berger.

rapid privatization. The Treuhand began its task on July 1, 1990, with a staff of about 200 mostly East German employees and a portfolio containing over 12,500 companies (after spin-offs), plus over 20,000 restaurants and retail stores. Many of the 12,500 original Treuhand companies included diverse and unrelated activities under one corporate umbrella; they are estimated to have comprised something like 35,000 individual economic entities. When the Treuhand was first called into being, its portfolio companies employed over four million employees. History had not given anyone much time to ready East Germany for market.

Since July 1990 the Treuhand has made impressive progress. All 20,000 restaurants and retail stores are now in private hands. As of September 1992, about 8,500 companies or parts of companies have been privatized and are now being managed by the entrepreneurial owners who took them over. From January through September 1992, companies were being sold at the rate of approximately twenty per day. Close to 500 companies, with approximately 9 percent of total employee count, have been sold to foreign investors, who, from the beginning, have been eligible to purchase 100 percent of a company and are eligible for all the incentives offered to West German firms.

The Treuhand itself built up rapidly from a handful of people with bad phone connections to a functioning institution of around 4,000 employees plus 800 full-time consultants. These people are divided approximately equally between the central office in Berlin and the fifteen branch offices distributed among the major cities of the new federal states. The Treuhand has become a large organization, but, it is hoped, not for long. Its explicit goal is to sell its portfolio and put itself out of business as quickly and responsibly as possible, a job it is completing with remarkable speed.

Given the uniqueness of the historical circumstances that brought the Treuhand into being, the Treuhand itself has developed into a unique institution with a set of goals, procedures, problems, and opportunities peculiarly its own. This article discusses how the uniqueness of the Treuhand and the current circumstances in the former German Democratic Republic (GDR) affect the process of purchasing a Treuhand company. Part I provides an overview of the Treuhand's functions and considers some peculiarities regarding the negotiation of acquisition contracts with the Treuhandanstalt. This part of the discussion is business-oriented, geared to the concerns of investors first approaching the organization. Part II then details particularly important, recurring possibilities of arrangements and clauses in contracts that may grow from the peculiarities outlined in part I. Here the discussion is of possible contract terms and is legally oriented. Part III concludes that the Treuhandanstalt's experiences can provide valuable lessons to other former Communist countries in their efforts to privatize their economies.

The article was written with several main objectives in mind. First, the authors (one a former and one a current Treuhandanstalt employee) find their personal experiences in this unusual time and place fascinating, and hope that others might share their interest. Second, the article is intended to help those who want to approach the Treuhandanstalt to understand the institution better, thereby helping
professionals to learn more about how to take advantage of the historically unique chances the Treuhand offers. The Treuhand is actively trying to encourage greater involvement by non-German investors, and this article is intended to increase the transparency of the process by sharing some "insiders' " reflections on it. Third, during its brief existence, the Treuhand has been the object of great criticism, some of it well founded, some of it reflecting a lack of understanding of the organization and how it must work. The organization is a large, complex, and improvised attempt to solve a massive and convoluted set of problems. It is an adolescent bureaucracy, born of chaos and destined to be phased out without ever functioning normally. It is a human creation, whipped together quickly and then put under extreme pressure without time to prepare. Business as usual cannot be expected. Though the Treuhand is far from perfect, in historical retrospect it and its accomplishments may well be judged more kindly than is now the case.

Last but not least, although the THA itself is unique, the problems that it has had to address have analogues in every former command economy. Given its special conditions, Germany was forced and able to proceed faster and further with its privatization program than any other country. Through the establishment of groups such as the Treuhand Ost Beratung GmbH (Treuhand East Consulting Company) and the Treuhand Alumni Club, an effort is being made to ensure that the Treuhand's collective experience of the past two years can, in some small measure, be passed on further. It is hoped that this article, written in the world's most widely understood language, will support the Treuhand's efforts in this direction. Long after the bulk of the German privatization campaign is over, other countries will be struggling with theirs. This guide to the inner workings of a successful pioneer may aid and encourage them in their task. They are not the first, and they are not alone.

I. Treuhandanstalt Peculiarities

The process of buying corporations in the former GDR differs greatly from that of buying an established company in the old West German federal states or in other capitalist economies. The Treuhand's companies were not built like capitalist companies and the Treuhand is not at all like a normal, profit-motivated seller.

Under East German communism, the business class was effectively banned and decision-making was heavily centralized. At the individual level, GDR companies were thus largely production facilities operating according to a central plan. They had little need to develop in-house capabilities in marketing, finance, financial controlling, strategic planning, or law, and they are now suffering accordingly. GDR companies were formed to suit one system. Then, virtually overnight, the system vanished, leaving them to cope with the sudden shock of the introduction of the market economy. With legal and economic unification, local East German markets were immediately opened to fierce competition, both from West German and from other international suppliers. Most of the costs and the rules of doing business changed drastically. East German consumers for the first time had hard,
convertible currency with which to buy long-coveted western goods, and the hard-pressed trading partners of East German companies had to pay for products in scarce deutsche marks (DM). The combination of shocks would have tried even the most competent western managers, let alone managers trained only in a predictable, if scarcity-plagued, world of overwhelming state control.

A. SOCIAL CRITERIA IN TREUHANDANSTALT SALES

When making a decision between competing bidders for a company, THA takes into account not only the typical sales criteria (maximum profit yield at a minimum of contractual risk) but also a range of "soft" concerns reflecting the social, employment, business structure, and industrial policies of the German Government. The Treuhand has no desire to "take the money and run." Instead it looks to the mid- to long-term commitment and credibility of each potential purchaser to ensure that THA institutional goals are reached. These concerns are basically foreign to any private seller. The range of issues that the Treuhand insists on keeping on the table may often confuse or frustrate negotiating partners who do not understand or agree with the Treuhand or its motivations.

Even if one potential investor offers a higher purchase price for a company, the prize may go to a bidder offering less money but more guaranteed jobs, or to a smaller bidder offering less money, but fewer oligopolistic ties. Bidders incessantly appeal to this "social conscience" in order to justify demands for a reduction in purchase price. Though the impact of such nonprice factors on THA decision-making is substantial, the exact weight to be given to the various factors cannot be precisely foreseen. THA has no set formula for valuing companies or competing bids. Each case is decided on its own merits. In its first two years, the Treuhand recorded sales proceeds for its companies of 35.2 billion DM and total investment guarantees of 125.3 billion DM plus 30 billion for modernization of company-owned heating and power plants, a 5:1 ratio that indicates how seriously the Treuhand values investment guarantees, and how much in sales proceeds it will sacrifice to get them.

Because of the long-term and broad-ranging perspective of the Treuhand, bidders are almost invariably requested to submit a business plan that describes their intentions for the company. This plan generally should include not just the purchase price, but a thorough discussion of how the bidder intends to address the Treuhand's social concerns. The plan should thus consider the expected level of investment, both in fixed assets and in human capital, the projected employment over the next several years, and a description of how the bidder plans otherwise to develop the company, its production, and its markets.

B. TREUHANDANSTALT'S NEGOTIATING "PERSONALITY"

1. Seller's Motivation

The combination of systemic shocks described above virtually ensured that Treuhand companies would lose more money and need more help than anyone
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could have imagined in the first euphoria after the fall of the Wall. Once communism's hermetic seal was broken, it became clear that many East German companies were quickly wasting assets. Some companies, especially in growth industries, have been able to make an effective switch into the market economy while still owned by the Treuhand. All are trying. The Treuhand has spent billions to bring its companies into a standardized legal and accounting format, to help managers develop business plans, and to restructure companies to respond to market conditions.

At the same time, not all firms can adjust effectively to current conditions, even with the help of armies of consultants and newly hired managers. Company managements, all too often, though understandably, respond with paralysis—looking to the Treuhand to provide them with the next five-year plan, or better yet, with a new owner. The paralysis is often compounded because the Treuhand, itself a stop-gap solution, is not normally able to make substantial new investments in plant, preferring instead to leave that to the new owners. Without new owners with the incentive and ability to provide the missing ingredients that neither the Treuhand, nor its consultants, nor its portfolio companies can provide, the situation for many individual companies tends only to worsen over time. Treuhand negotiation teams are acutely aware of the time pressure under which they must close sales.

The THA has "deep pockets" and does not need sales revenues to continue its operations. While private sellers normally need sales proceeds to attain a particular goal—to repay stockholders, satisfy debts, invest elsewhere—this is not the case for the Treuhand. Sales proceeds are returned to a central account and disappear from the view or control of those responsible for the sale.

In the usual context, the seller's emotional connections often play a central, if hidden, role in negotiations. The THA negotiation teams will normally have little emotional connection to the companies that they are selling. Those people who do care, the senior managers who have invested decades in a firm, are relegated to a fairly minor role in the sales process and their feelings are regarded as peripheral. Though harsh, the reality is that they are used for information and, if willing, to further the sale, but they do not control negotiations or make the final decision. That rests with the often young Treuhand negotiator on whose desk the file just landed.

The result is that THA negotiators tend not to adopt overly aggressive purchase price demands and negotiating strategies. They also are often prepared to grant more favorable terms if prospective purchasers can factually substantiate claimed shortcomings of the enterprise. This attitude is not surprising given that the THA's ultimate goal is to create the groundwork for a healthy economy in the former GDR. Leaving investors some margin to build a solid business is seen to be in the general societal interest. Nevertheless, though they may lack a seller's normal human greed, THA negotiators—whether out of personal, professional, and moral standards, or out of need to satisfy the ever-increasing demands of internal contract

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review staff—will try to avoid "underselling" a company. All proposed sales for less than net book value must be internally justified in writing.

2. Staffing Stress Points to Remember

When the Treuhand began its moral equivalent of war, virtually no steps had been taken to ready it for battle. Though it may look deceptively permanent, the Treuhand has very little in common with an ordinary government ministry established to handle the day-to-day business of a more or less orderly world. It is a large "hit squad," called together quickly to respond to a crisis hard to comprehend in its scope and depth.

The urgent need to establish a Treuhand created many unexpected and some unique staffing problems. The Treuhand had to staff up quickly at a time when the job market for professionals with the experience and ability required to sell Treuhand-owned companies was extremely tight. It offered midterm assignments, brutally long working hours, and an unformed structure in a country where long-term security, leisure time, and order are highly cherished. Insofar as the qualified workers were largely from former West Germany, the Treuhand also had to entice managers to move, and often to live for months in hotels. Given both the German housing shortage and a cultural propensity to stay put, this was a much harder proposition in Germany than it would be in the United States.

Initially, salaries and benefits for midlevel managers substantially exceeded West German norms, a necessary inducement to attract competent staff. While the money was important, what the Treuhand could also offer was a never-to-be repeated challenge, where one could quickly assume responsibility, gather experience, and make contacts impossible in the normal, hierarchical world of German business. Many responded to the call and the Treuhand has become an "in" place to work for ambitious young professionals.

Persuading more seasoned managers to leave their existing positions and work at the Treuhand has proven more difficult than getting younger staff members. During the first year or so of its existence, many senior managers were seconded from large corporations. They agreed to lend staff to the Treuhand for a limited period, out of motivations that normally included an uncertain mix of patriotism and self-interest. The vast bulk of these seconded managers successfully avoided conflicts of interest, and many of the Treuhand's positive achievements, especially during its first eighteen months, would have been impossible without them. These seconded managers are generally and gradually being replaced by full-time staff members. A number of other Treuhand senior managers are life-tenured West German bureaucrats on loan from their respective ministries. A third group of senior managers, including some of the very best professionals at the THA, comprises people near the end of their careers or coaxed out of retirement to help turn the unification of Germany into a reality.

Staff changes are frequent as seconded managers return to their permanent jobs
and ongoing internal reshuffling leads to reallocation of work. The organization is gradually settling into a routine, but it will never be as stable as normal ministries. If negotiations are protracted, staff changes can and often do lead to delays and difficulties.

Negotiators are well advised to keep in mind the stresses under which their THA counterparts must work. Though the organization is large, in many areas it has been seriously understaffed. In a common scenario in the central offices, one might find a junior manager in his or her mid-thirties with several years’ work experience in a major bank, consulting firm, or law firm who is responsible for selling ten to twenty companies that may have had an aggregate of well over 5,000 employees. In the various Treuhand branch offices the junior manager will be responsible for more firms, but a lower employee count. The junior manager (who may not even appear on the organizational chart) could report to a senior manager in his or her late thirties or early forties, who is supervising six or eight junior managers, all with comparable work loads. The entire section might share one, or if it is lucky, two secretaries. Each section reports to a director, who is responsible for a number of such sections. Prime negotiating partners are thus often less experienced and less closely supervised than one might hope. The system is working, but never quite as well as anyone would like. For would-be purchasers, patience, persistence, politeness, and a good sense of when—and when not to—try to have supervisors drawn into the process, are often crucial keys to successful negotiation.

As the Treuhand sells an ever-larger portion of its portfolio, however, the work load for individual managers and sections is correspondingly decreasing. The processes for selling companies are becoming routinized and subject to tighter internal review. Though pressure to sell companies remains intense, there is more time to spend on each sale. The pioneer days are over. The better-trained Treuhand teams are now more likely to be capable of managing a consistent and adequate quality sales process than was previously the case. In addition, the Treuhand has developed a large internal controlling staff that plays an increasingly active role in negotiations. Approval of controlling staff has become a prerequisite for most sales. To get that approval, the salespeople must convince the controlling staff that the deal makes sense and was reached by following the rules.

As the Treuhand proceeds with its work, staff members are increasingly threatened with selling themselves out of their jobs. The Treuhand has announced initial staffing cuts in 1993, with deeper cuts in succeeding years. The smaller branch offices are beginning to close, as are some of the smaller industry branches. To avoid surprises, prospective investors should ask about the life expectancy of the particular section responsible for the company they want, as well as about the future plans of their main negotiating partners. Surprisingly, though, the pace of privatization does not seem to have slowed as the number of companies to sell has shrunk. As a deadline nears for closing a particular area, the sales pace may...
actually increase as section leaders and directors push to get their promised success bonuses.

3. Due Diligence and Superior Knowledge of the Purchaser

In normal acquisition contracts, sellers know what they are selling far better than buyers know what they are buying. A seller's superior knowledge usually results from long years of management experience, sometimes dating back to the foundation of the enterprise. As a rule, a purchaser has only a limited opportunity to become familiar with the target by means of inspections, presentation of certain documents, tests, or consultations with the management. Not infrequently, a seller will deliberately restrict a potential purchaser's access to information.

The THA operates in a different world. In the initial days of the Treuhand's existence, negotiation teams often had little or no information about the companies they were selling before they entered negotiations. The information flow to negotiation teams has improved drastically over the past two years as consultants have produced reams of reports and Treuhand staff members have had a chance to get a sense of the companies within their areas of responsibility. Despite these improvements, prospective purchasers often understand the companies far better than the THA sellers. Potential buyers who are new to the THA context are incredulous when they relay company information previously unknown to the THA sales teams. Nevertheless, such a situation frequently occurs, and the information is usually appreciated.

Though many THA negotiators, particularly in the industry-organized THA central offices, have solid industry knowledge, not all do. Even those who do may not fully understand the niches in which a particular firm operates. Prospective purchasers who share some of their branch-specific knowledge with THA negotiators not only quickly learn what their partners know, they also help develop the Treuhand negotiators' confidence that they are the sort of serious investors the THA wants.

The uneven distribution of knowledge about the target typically forces the Treuhand to place unusual importance on a variety of expert opinion that it commissions to help its decision-making. Given the lack of other reliable information about individual companies, the Treuhand often finds it difficult to justify deviating from the findings of its appointed experts.

The Treuhand's most obvious source of data about individual companies is firm management. Though this source is critical, it is for several reasons not always as reliable or forthcoming as the THA would like. The Treuhand has had the unenviable job of having to dismiss over 1.5 million employees from its portfolio companies in order to trim work forces down to a point where firms might interest potential buyers. Companies frequently have the impression that the Treuhand, as the super-owner, is the source of all their problems—rather than the inheritor of them. Since companies have been under Treuhand management, THA staff members have normally not had the time, continuity, or context to develop trusting
relationships with the managers of the companies in their charge. This then leads to miscommunication on essential points and blocking of information flow to the THA.

Potential purchasers have a much simpler relationship to company management. While the Treuhand plays the role of the short-term "heavy," potential purchasers can present themselves as long-term saviors. They would often have had past competition or delivery relations with target firms, which would have provided them with accurate and detailed insights into the company before they approached the THA as potential purchasers. Company managers often inwardly go over to the side of the purchaser, whom they expect to continue the business successfully and keep them employed. Though the managers of Treuhand companies are liable to honor their fiduciary duties to the THA, concepts about avoidance of conflicts have not had long to take root in the minds of many former East German managers. The process continues of clarifying, tightening, and enforcing the ground rules governing how THA company managers need to deal with prospective purchasers. Much progress has been made, but the fundamental tensions between THA and management remain, which are sometimes used, legally or not, to a purchaser's benefit.

During the early stages of the Treuhand's history, not infrequently the prospective purchaser had (usually unbeknownst to the THA) already taken over the management in an informal way. East German managers would welcome West German "big brother" companies, permitting them to remove employees, rebuild production facilities, and in some cases make considerable investments (often without legal basis—the naiveté was not purely limited to the East Germans), even before the start of any negotiations. Likewise, often without asking for THA's approval, panicked firm managers would give complete access to the company and all available information on it to anyone who appeared to be a prospective investor. Information thus released has been misused more than once. Prospective purchasers have been known to go so far as to exert influence on the selection of the auditor and on other experts and the preparation of the DM opening balance sheet.

Treuhand company managers are now under strict instructions to get THA approval before permitting potential purchasers access to the company and its documents. The THA frequently conditions its approval on the signing of confidence agreements. Once this approval is given, prospective purchasers generally have free access to all the firm's data. Normally, they can afford to spend far more time reviewing it than can their THA counterparts.

An individual THA company manager may have personal reasons for blocking access to data, such as having proposed his own management buy-out scheme and not wanting to have his scheme supplanted by the prospective purchaser, or having a strong preference—for whatever reason—for one candidate. If a prospective purchaser suspects that data are not forthcoming because of such a possible conflict, the prospective purchaser should request that the responsible THA seller
try to resolve the access problem. Potential purchasers suffering from due diligence logjams should not assume that either the THA seller or the entire company management team shares the self-interest of the blocking company manager.

The quality of the data uncovered in due diligence is, of course, widely variable. Though some companies may be able to present potential purchasers with records quite comparable to what one would find in well-managed western companies, that is not always the case. Again, with persistence and the normally forthcoming cooperation of management, most purchasers are able to build a reasonably complete picture of the company.

D. FACTORS SIMPLIFYING ACQUISITION CONTRACTS

Several different forces are at play that result in THA acquisition contracts being much shorter and simpler than "normal" acquisition contracts.

1. Relative Irrelevance of Company History

Privatization almost always involves a far-reaching new beginning for former state enterprises. Treuhand-owned companies are often viewed by purchasers as a kernel, from which future product development and market entry will grow. Treuhand companies can offer potential purchasers four main advantages: a stable supply of highly trained workers who will work, at least for now, at a discount from West German wages; additional (if imperfect) production capacity at a reasonable price; European Community-based real property in which to operate; and the remnants of an old distribution system and beginnings of a new one. Frequently, new owners will use the company purchased as a vehicle to produce new products with new technologies, to be sold through newly created distribution systems in new markets. Given that the future will inevitably look very different from the past, the history of individual companies is often of limited interest to purchasers—other than as a possible link to opening eastern markets. Many of the normal mergers and acquisitions representations and warranties regarding the history of the company and performance data of the past thus become superfluous. Without risk to the purchaser, much of the usual "laundry list" can be reduced dramatically.

2. Simplicity of Communist Companies

Due to the centrally planned economy, GDR state-owned firms had comparatively simple outside relationships. They were pure production and distribution facilities, with little or no responsibility for marketing or finance. The complex contracts found in capitalist countries were unknown in Communist GDR. Insofar as a company has mortgages and other encumbrances against land, factoring agreements, complex stock ownership and option structures, and the like, they are probably of recent origin. Patents and trademarks play a part in only limited cases. The relative simplicity of this system of contracts and legal rights often
saves the purchaser much worry. Recent contracts need to be checked carefully, as do old contracts with foreign trade companies, but the checklist is likely to be short. Legally, most THA companies, even the large ones, are very basic entities.

Precurrency-reform loans, for example, typically were debt either to the state bank or to a state-owned foreign trading company. In either case, this debt would have been refinanced by the responsible successor agency as part of a package in which billions of marks of such debt was refinanced. The terms of the refinancing at the individual company level would be standard and simple. In the former GDR, huge amounts of debt were loaded onto the balance sheets of individual firms so that the state could claim that it ran no deficit. Predictably, the debt numbers bore little relation to any money ever seen by the company managers. Potential purchasers occasionally misinterpret the bloated debt figures as a sign of something foul at the individual company level. In fact, the incompetence and corruption took place far higher in the system, to the outrage of individual firm managers, who then had to carry the burden.

3. "As Is, Where Is" Sales

Given its limited knowledge, the Treuhand is normally reluctant to give any but the most basic representations and warranties about its companies. For non-German purchasers, especially for potential purchasers coming from the United States, the Treuhand’s unwillingness to give the customary representations and warranties poses a substantial stumbling block in negotiations. Though western German contracts have been gradually bloating as American-style clauses are imported, German mergers and acquisitions contracts are lean by U.S. standards. Treuhand contracts are leaner still. To those used to allocating transactional risk precisely by lengthy and hotly negotiated catalogues, the Treuhand’s typically meager offerings may seem to offer an impossibly low degree of comfort.

The problem can become especially acute when the German subsidiaries of non-German companies try to convince management at the head office that a transaction is sound and fair. To overlawyered American eyes, the THA contract looks too short to be prudent. The head office representatives who appear briefly in Germany for a day or two of negotiations often cannot satisfy themselves that their German representatives have done enough due diligence to justify the exceptional step of waiving the normal protections. The Treuhand representatives cannot give additional comfort, especially if the potential purchaser knows far better than they the actual risks involved. The result can be a deadlock that benefits no one.

Rather than insisting on the usual protections—thereby not only straining relations, but also risking losing what could be a good deal—potential purchasers of Treuhand companies are well advised to drop their usual preconceptions and adopt their negotiating strategy to the exceptional reality. The Treuhand is much more like the harried clerk in the closing sale of a second-hand shop, than the genteel owner of a fancy boutique. Shrewd buyers should behave accordingly: check the merchandise thoroughly, push hard on the few points that matter, and aim for the
quickest closing possible, before getting leapfrogged by someone who knows the ropes and accepts the process for what it is.

The Treuhand is selling some remarkable bargains, but they do not come with ribbons and bows. Potential buyers should take the time in the company itself to do the basic research they need to feel comfortable in selling the deal effectively to the board back home. If their study does not bring comfort, they should not agonize. They should make an offer that reflects the degree of comfort as of the deadline. If that fails, they should move quickly onto the next deal, using what they learned in the last one. The sale is going fast, and waiting is rarely a good strategy. If the potential buyer eventually decides to wait to buy a firm from a private seller in the secondary market, after a turnaround has begun, the price will probably be much higher than the Treuhand offer.

II. Particular Clauses in Contracts

A. Employment Clauses

Given the ongoing structural crisis in the former GDR and the scale of the effort needed even to begin to bring it under control, the urgency of the Treuhand’s need to maintain and create jobs cannot be overestimated. The Treuhand does not just pay lip service to the goal of employment, it forgoes substantial potential gain in the sale of its enterprises to ensure future jobs. Given this institutional emphasis, it is not surprising that contracts normally include an agreed number of full-time equivalent jobs that will be maintained for an agreed period of time. If this target number is not reached, the purchase price will be increased subsequently, or the purchaser will have to pay a penalty. Employment clauses are frequent. Though legally simple, they are of great importance to both sides.

The Treuhand negotiates to have penalties set at a level that ensures that the agreed employment levels are maintained. Frequently, the penalty approaches the cost of keeping an employee on staff.

Investors normally make little progress when they try to build loopholes into employment clauses by inserting broad “conditions beyond the purchaser’s control” language. The Treuhand generally expects that the penalties for failure to maintain agreed employment levels will be paid regardless of the grounds for the failure. Especially unwelcome is buyer-proposed language that attempts to make unexpected market conditions a trigger to escape the penalty. The world of market risks is, after all, the jungle in which entrepreneurs make their gains. To a greater or lesser extent (with pure real estate transactions being a notable exception), the THA has granted price concessions in exchange for employment promises. The Treuhand trades so much against the quality of the investor and its belief in the investor’s business plan that it regards it as only just to ask for those concessions back in the form of a penalty, if the promises that prompted the concessions are not kept. Long after the privatization of the Treuhand’s companies is complete, a THA staff will remain to supervise all forward-looking contract clauses.

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B. INVESTMENT CLAUSES

Because the Treuhand must play a catalytic role in the rebuilding of East Germany, it pays close attention to the amount and kind of investment to which a particular purchaser commits to itself. Binding investment promises from solid purchasers are an anchor for the future. They offer hope of survival to business enterprises and help arrest the trend to deindustrialization of the former GDR.

Investment clauses use the same technique as employment clauses to ensure that the purchaser makes certain investments in the target company. Agreements commonly specify both the amount to be invested in the target and the time period during which the investment must remain invested. Though employment obligations may be fairly easily defined, defining "investment" can pose problems. Depending on the objective, such clauses can range from broad definitions of total investment goals before a certain deadline, thus leaving an investor wide discretion over the specific types of investment and their financing, to precise specifications of actual investment measures to be undertaken, their financing, and their timing. If the agreed investment is not made, contractual penalties must be paid, often equal to 50 percent or more of the investment not made.

Many purchasers of THA companies are able to put together financing packages that enable them to make the required investments with a substantially smaller outlay of their own capital than would be necessary under more normal circumstances. The numerous government incentive programs, if used fully, can repay up to 50 percent of the costs of new investment and help finance the remainder at favorable terms. Also, because the Treuhand is willing to trade purchase price against other guarantees, it frequently happens that a company, as a going concern, will be sold for less than the value of its parts. This often substantial unencumbered asset value can be used to secure debt to make the required investments. Given that many investors in these conditions put little down to get more than they paid for, investment clauses can restrict creative leveraging and require investors to put their own risk capital into the company purchased. For the Treuhand, this extra link tying the investor to the object can be especially important where the actual purchase price is small.

An indication of the weight the Treuhand gives such clauses is that as of the end of July 1992 Treuhand sales contracts contained investment guarantees totalling 120 billion DM while the Treuhand realized only 21 billion DM in sales proceeds. It is hoped that this investment will encourage more new investment, thus having a multiplier effect throughout the economy.

C. SPECULATION AND ASSET-STRIPPING CLAUSES

Speculation clauses enable the Treuhand to enforce a bidder’s original statements of intent about the company purchased. Their goal is to stop the destruction of a company by a purchaser who wants to tear out the surplus value lying within, when the company was sold on the understanding that the purchaser was to
continue it. If the purchaser resells a company at a gain to a second buyer, the 
THA should normally have no reason to recoup that gain as long as the second 
buyer continues to run the company in accordance with the social criteria argued 
for by the original purchaser and the THA. Speculation clauses provide for a 
revaluation in case of any resale, lease, or use of real estate deviating from the 
agreed purpose. Their time frame of five to fifteen years is longer than that of 
a typical revaluation clause. Speculation clauses are not intended to return windfall 
real estate gains, but to increase the purchase price subsequently only if the 
social target aimed at by THA has not been realized. In their preventive effect, 
speculation clauses are the functional equivalents of business continuation, em-
ployment, and investment clauses explained below.

Speculation clauses are drafted similarly to the revaluation clauses described 
above, but with a different thrust. Defining and agreeing on the event of specula-
tion or asset-stripping is frequently complex. Purchasers seek to have "specula-
tion" defined narrowly so that the revaluation right of the THA only arises for 
a clear failure to fulfill the contractual purpose. The Treuhand seeks to define 
"speculation" broadly to provide it (and more importantly, the workers and 
towns that the THA is trying to protect) with real protection against clever evasion. 
To satisfy purchasers' legitimate interests, it may be necessary to exempt 
financing-driven "sale and lease back" procedures or corporate reorganizations 
or sales that do not undermine the THA's contractual goals.

In lieu of a revaluation right, the THA may sometimes agree to retain a right 
to the return of the property in the event of speculation, if necessary secured by 
registration of a transfer deed. As a third alternative, a "surplus levy" may be 
imposed based on the actual resale price. This third option may spare the purchaser 
the risk of having to pay on the basis of a revaluation by neutral experts, which 
value may exceed the realized resale price. In order to prevent an intermediate 
sale at a manipulated low price, the THA then reserves either a right of first 
refusal or to impute a fair market resale price. If a dispute arises, this market price 
may, after all, have to be determined by an expert.

D. BUSINESS CONTINUATION CLAUSES

Business continuation clauses largely overlap with speculation clauses and 
occasionally fuse completely. Technically, however, they are drafted slightly 
differently because their triggering event is the shutdown or modification of the 
existing plant, regardless of any speculative sale of real estate. In general, business 
continuation clauses are not used as often as speculation clauses. The Treuhand's 
motivation for requiring business continuation clauses is comparable to its reasons 
for requiring speculation clauses and the other terms it negotiates to realize its 
social goals.

In a number of instances the Treuhand has insisted on such a clause when the 
company was clearly worth more "dead than alive," but the Treuhand wanted
to continue it for its own broader reasons. In one extreme case involving a purchase by an American multinational company, the Treuhand was selling a completely new industrial facility that had been commissioned in the final days of the GDR. The multimillion dollar bill came due after currency reform and after the company responsible for its payment had become a Treuhand-owned GmbH. The facility, a grandiose showpiece of GDR autarchy, was overbuilt and oversized for market needs. Its massive halls appeared designed to withstand military attack. The Treuhand faced the choice of permitting the company to go bankrupt and then selling its parts, or trying to find a buyer for the entire business, "gold doorknobs" and all. If the company had gone bankrupt, the Treuhand would have further weakened an already economically weak area. Since many of the creditors of the company were themselves Treuhand-owned firms, permitting bankruptcy and repudiation of the company's debts would have caused a ripple effect of payment problems in a substantial number of THA companies. The simplest and ultimately cheapest solution for the THA was thus deemed to be to pay the bill for "gold doorknobs," then sell the company for a price reflecting the actual market worth of the facility and to require the buyer to continue the business in operation. If the buyer fails to continue the business, it will have to pay a penalty initially substantial and decreasing in stages over the first six years after the purchase.

E. REVALUATION CLAUSES FOR REAL ESTATE

The THA and the purchaser often agree to have expert appraisers revalue real estate for a second time after a period of two, three, or five years. If the real estate's value has increased since the sale, the purchase price is adjusted subsequently. Revaluation clauses take effect regardless of the purchaser's use of the real estate. They are not sanctions for failure to meet obligations, which are discussed later in this article.

Though this kind of provision sounds potentially unfair, it is necessitated by the odd market conditions in the former GDR. Because of the absence of an established real estate market, the parties often cannot know what a piece of real estate is really worth. This lack of knowledge frequently yields a hidden windfall gain for purchasers, even as of the closing of a contract. Thus, for a limited period of time, increases in value due to developments of the real estate market after contract conclusion are to be returned to the THA.

Revaluation clauses raise numerous technical problems that can be resolved by a range of alternatives. A threshold question is whether a clause should apply only to land or also to buildings. To decide, the THA assesses the quality of the building substance, the relative values of the buildings and the land, and the location and size of the real estate. The criteria used to revalue property have to be identical to those used to determine its initial worth. Value increases due to investments made by the purchaser are measured and netted out.

Potential purchasers sometimes fear such clauses as imposing unknown and
uncontrollable future risks. A number of solutions help reduce the purchaser's risk, while assuring the THA its fair share of the newly established market value. "Lids" can be agreed as maximum permissible increases either in percent or in absolute square meter prices. A minimum can be set, so that only increases of more than an agreed percentage or set value will be returned to the THA. The THA may in some cases agree to share the windfall gain with the purchaser according to a preset formula. Liquidity problems can be allayed, if need be, by THA grants of reasonable respites for payment on reevaluation, or by other comparable arrangements.

Since revaluation clause claims will only be made if a higher property value is subsequently established, such clauses will, in the final analysis, be neutral in balance sheet effect. As the real estate markets in the former GDR have become more established and market values more certain, the need for revaluation clauses has decreased. They are thus increasingly less likely to be required in THA contracts.

F. Purchase Price, Respite for Payment, and Guarantees

THA privatization contracts resemble normal acquisition contracts in the payment obligations of the purchaser. As a rule, THA only transfers title in exchange for payment of the purchase price. If it grants a respite for payment, it requires guarantees. Any attempts by a purchaser to make the THA put part of the payment at risk (for instance, by having the payor be a newly founded shell company) are usually not successful. Delaying payment does not normally reduce the effective purchase price since market interest rates have to be paid for outstanding balances. In order to simplify matters, many purchasers pay in advance of formal transfer of ownership. In real estate sales, for example, the purchase price often is to be paid at notarization and not when the transfer is registered in the land records. The buyer risks little in trusting the Treuhand to carry through with the deal.

G. Unknown Risks and Reserves for Potential Liabilities

When former state-owned enterprises first were brought under the THA's jurisdiction, each company was established in a corporate form recognized under German law (GmbH or AG). Each had to file an "Initial DM Balance Sheet," giving a first snapshot of the status of the company as of July 1, 1990, in terms of the newly instituted currency. East German companies had organized their bookkeeping toward reporting to the central planning agency, had never been audited according to western standards, and had never worked under DM cost structures. Bringing the books into a standardized form took thousands of billable hours of accountants and lawyers and was a learning experience for all involved. Nevertheless, it was a crucial first step toward getting the legal structure and
accounts of Treuhand-owned companies to follow a comprehensible, useful format. As the auditors quickly reviewed thousands of companies, they frequently found it necessary to set aside substantial amounts as reserves for potential liabilities. Auditors, being a cautious class, especially in unfamiliar surroundings, the initial reserves were often much larger than they needed to be.

If the THA company's balance sheet discloses potential liabilities, two possible arrangements are used. If the likelihood of occurrence appears rather remote, the original sale price is not reduced, but the THA promises to pay up to the reserved amount if the risk is later realized. If the risk seems quite likely to occur, the original sales price is decreased accordingly, often by decreasing the net asset value. If the feared event does not take place within a certain period of time (and the reserved amount thus is not used), the buyer pays the THA a subsequent increase in purchase price. In this case, the subsequent increase in purchase price often is detached from the "disposition" of the reserve in terms of account balancing. In order to guarantee an appropriate use of the reserved amount, the THA normally retains the right to codetermination for a specified period. It may also offer the purchaser an incentive to act in a way to minimize use of the reserve, such as by sharing 25 percent of the reserved amount not used.

Reserve clauses are a handy tool for both the THA and its purchasers. Rather than allowing negotiations to fail because of potential risks such clauses offer a way to reach a fair settlement with minimum negotiating. Over time, as the various risks first uncovered in the DM opening balance sheets have or have not come to pass, the need for such reserve clauses has gradually declined to a level similar to that expected in the usual course of business.

H. DIFFiculties with Basic Seller's Representations

The factors leading to the Treuhand's need to give only short and very simple seller's representations and warranties have already been discussed. Frequently the Treuhand's warranties are limited to three points: (1) the existence of the company; (2) the holding of shares by the seller; and finally, (3) the company's title to its real estate. Even these basic representations, which in all fairness a buyer should be able to expect, can give rise to substantial legal problems and may only be given by the Treuhand after painstaking review. When these basic representations prove problematic, investors' worst fears may surface. This uncertainty is aggravated in the case of those investors who come from afar, plan to leave soon, and are not aware of how common and solvable (albeit aggravating) the problems are. Since the Treuhand itself may not uncover its inability to give a representation until it has been asked to do so, the timing of the discovery (for instance, immediately before final contract negotiations are due to begin) may be especially unsettling. Under these circumstances, the investor is advised to proceed to other points in the negotiations on the assumption that a reasonable solution
will eventually surface. The Treuhand is not trying to sell something it does not have. It is merely trying to operate in a context in which one legal and economic system has been imperfectly grafted onto an entirely different one.

To take one example, there are a number of grounds why it might be difficult for the Treuhand to give a clean opinion regarding title to real estate (other than possible restitution claims, which are discussed in more detail below). Under the Communist regime in the GDR, the vast majority of land and buildings were held as "people's property." That ownership was reflected in the GDR land records. In theory, people's property belonged to everybody. In making the transition back to a system based on private, rather than people's, property, the question was presented—to be resolved over and over—which land and buildings should be reflected in the land records as belonging to which newly formed corporation? The Treuhand Act's solution was to follow the ownership lines established under the GDR legal principle of "holder of right" (Rechtsträgerschaft). Individual "People's Owned Companies" (Volkseigene Betriebe or VEB) were usually noted in the land records as the holders of right to the property they used. The THA-owned stock company that was the legal successor to a VEB, by the formal working of the Treuhand Act, assumed those rights.

Problems quickly arose because the legal niceties required to establish the rights of holders of right were often imperfectly followed. The initial solution in the Treuhand Act soon uncovered myriad individual cases where strict application led to senseless and contrary results. A later amendment to the Treuhand Act yielded some clarity. What no amendment to the Act could accomplish was to bring order into land records. Land record offices that had been neglected for forty years were immediately called on to respond to an entirely new set of circumstances. The resulting breakdown in the recording system is only gradually being sorted out, as overwhelmed offices throughout former East Germany work through their backlogs. Thus, in order for the Treuhand to be able to give a standard representation as to title, it frequently proves necessary to do additional research or to put land records offices under pressure to respond in a timely manner. Comparable problems can arise in regard to representations about the formation of the company or the Treuhand's ownership of shares.

I. ECOLOGICAL DAMAGE CLAUSES

1. Environmental Damage—Background Issues

Prospective purchasers looking at their first acquisition on the other side of the Wall may be inclined to panic when the issue of environmental damage first comes up. The panic is rarely necessary. Until 1945, East and West Germany were one, and the same standards applied. During the golden years of the West German

2. 5 Durchführungsverordnung zum Treuhandgesetz [5th Executory Ordinance to Treuhandgesetz] of Sept. 12, 1990, GB1. I at 1466.
Wirtschaftswunder, or economic miracle, in the 1950s and 1960s, environmental protections were none too stringent. Only in the 1970s did the environmental paths of East and West Germany first markedly diverge. While West Germany increasingly developed and enforced environmental legislation, the former GDR continued its old routine. Resources were, after all, scarce and environmental protection was secondary to survival of the communist economic system.

Some of the sights and smells in East Germany may remind one strongly of industrialized New Jersey or Dortmund in the early 1960s and extreme pockets may even resemble Pittsburgh of the same era. But those anticipating a countryside virtually destroyed by pollution are overly pessimistic. Environmental risk can be assessed, likely cleanup costs measured, and a manageable allocation of risk agreed upon. What a prospective purchaser has to bear in mind, however, is that 1990 West German environmental laws (with some important, and for investors favorable, exceptions) were imposed on an industrial society operating under 1950s environmental sensitivities.

2. Safe Harbor Rules Under the General Environmental Act (Umweltrahmengesetz)

Though environmental issues should not be overly mystified, clearly there are concerns to address when buying an industrial facility that meets 1950s standards when 1990s rules apply. In partial response the lawmakers, under the General Environmental Act, granted a limited safe harbor exemption from current standards in the new federal states only. This exemption enabled the governments of the various new states to release company purchasers from cleanup responsibilities they would otherwise have had for environmental damage that occurred prior to June 30, 1990. This safe harbor window closed on March 28, 1992, but before it closed a great many Treuhand-owned companies filed timely applications for the safe harbor.

The experiences of individual companies in applying for this safe harbor and in having the application accepted have to date been mixed. The requirements for and the legal consequences of such environmental releases are far from clear. Likewise, it is unclear if full environmental studies need to be submitted with a safe harbor application and, if so and if the application is later rejected, whether the same study can be used to prosecute the applicant for environmental cleanup. Currently close to 2,000 known applications for safe harbor releases are pending on which no decision has been made. The impasse is only likely to be resolved when the financially strapped new states and the federal government are able to negotiate a settlement regarding payment of required cleanup costs on the properties for which the new owners have been granted environmental releases.

3. Contractual Distribution of Environmental Risks

Within certain guidelines set forth by the Federal Finance Ministry, the Treuhand is fundamentally prepared to share with its purchasers the costs of making
a site meet minimal, legally required environmental standards. The Treuhand is not, however, prepared to assume consequential damages or damages whose amount depends on the future activity of the purchaser. As the owner of its companies, the Treuhand does not have direct, unlimited liability to pay for their cleanup costs. If the cost of the potential cleanup clearly exceeds the Treuhand’s economic interest in a company, the Treuhand has the option of placing the company in bankruptcy and avoiding any obligation for cleanup costs greater than its equity in the company. The existence of this option places an upper limit on the Treuhand’s willingness to negotiate terms.

The allocation of risk for cleanup costs may follow a wide variety of formats and be tailored to reflect the particular risks of most concern. An often used option is to establish a base cleanup amount for which the purchaser bears sole liability, an intermediate cost amount to be shared in some ratio between the Treuhand and the purchaser, and a remainder to be borne by the THA or the purchaser alone. Those risks that have been verified by expert study prior to the closing may be allocated according to one method, and as yet unknown risks according to a second method. The parties might agree to allocate costs of specific cleanup problems differently, so that, for instance, the Treuhand would share costs for cleanup of old oil, but costs of asbestos removal might be the purchaser’s sole responsibility.

The Treuhand only helps to pay for cost-effective cleanup and normally retains the right to review and approve plans and budgets to avoid unjustifiably large expenses. In addition, the Treuhand limits its help by paying only for those costs required to make the particular, contemplated use comply with applicable standards. Thus, if part of a site is to be paved over for traffic and not used for a building, the THA refuses to pay for anything beyond the cleanup needed to enable that site to meet the less stringent guidelines for paved areas.

In the event of serious questions about possible cleanup risks, professional environmental studies normally play a central role in Treuhand contracts, as they do when companies are bought and sold in other more normal contexts. The studies help the parties assess and control the major feared possible risks by scientific tests before any acquisition contract is concluded. Such tests prior to contract conclusion are often stipulated by the THA, which is not prepared to take on contractual cleanup obligations without having a sense of their potential scope.

4. "Green Field" Threat

In order to force the Treuhand to accept a greater portion of cleanup costs, potential purchasers may threaten to bypass environmental problems with one site by building a new facility on a "green field" site in the area—taking the key employees and starting afresh. Because of its nature as a governmental super-owner and super-seller, this threat does not scare the Treuhand as much as it might a private seller of a single environmentally damaged property. The THA is not so wedded to any particular location that it is prepared to pay to reconstruct all properties at public expense until they are suitable for their intended purpose or
suitable to continue an existing use. If a new “green field” investment is more appropriate than spending millions to make an old industrial site usable, the Treuhand might decide to offer one of its many other sites to a purchaser. The Treuhand would then either sell the damaged site for a use that would not require so much cleanup, or retain the site and clean it only to the extent of removing urgent threats to public safety.

5. Treuhand Guarantee of Cleanup Costs

If a purchaser is buying assets from a Treuhand-owned company rather than stock in the company from the Treuhand itself, THA approval of the contract may be required, but the Treuhand itself does not become a party to the contract and normally assumes no direct liability under its terms. Given that many THA companies have poor credit standing and may even be on the brink of liquidation or bankruptcy, purchasers of assets may ask the Treuhand to guarantee any future environmental risk-sharing obligations undertaken by the Treuhand-owned company. Increasingly, the Treuhand only grants such a guarantee in exchange for direct payment to it of what amounts to an insurance premium for assuming a legal liability it would not otherwise have had.

J. Restitution Claims

1. Background

As discussed above, the analysis and resolution of environmental damage issues in Treuhand contracts do not differ drastically from those in other contexts. The same cannot be said for dealing with restitution claims. Such claims arise from the transitional legal peculiarities in the former GDR and they are unique to this place and time. The Unification Contract between West and East Germany established the principle that people who had lost their properties in various waves of Nazi and post-1949 communist nationalizations had a right to its return (Vermögensgesetz or Property Act). Only as a secondary alternative to this right of return would they have a right to monetary compensation.

Restitution claims may be filed for the return of real property, businesses, and other identifiable assets such as bonds and bank accounts. They are a central concern in the selling of many THA-owned enterprises. In practice, this general principle of “return before compensation” has proven one of the greatest sources of uncertainty and confusion for investors.

All restitution claims must be filed in property offices (Vermögensämter), which were newly formed for the task of handling such claims. The filing of such a claim triggers a ban on the disposition of the asset against which the claim has been filed. The scope of the ban depends on the kind of asset. A restitution claim for a “business” bans the sale not only of the shares reflecting ownership of the business, but of all assets belonging to the company essential to the continuance of its business. Although the issue is not yet statutorily regulated, it is current
accepted practice that a restitution claim for real property belonging to a company merely bans the sale of the specific parcel against which the claim has been made. The shares in the company owning the claimed parcel may still be sold, though the parcel itself will remain subject to the claim.

2. Methods to Lift Ban on Sale

Before the Treuhand can sell any shares or real property, it must determine whether any restitution claims have been filed with the responsible property office. If they have, the THA must analyze whether the claims have been made against a “business” or against real property. On the basis of this analysis, the THA can determine whether the planned transaction is possible immediately, or whether it must use one of the following methods to set aside the ban on sales.

a. By Agreement

The simplest way to remove the threat of restitution claims is to enter a contract with the claimants whereby they release their claim to restitution in exchange for compensation out of the sales proceeds. The Treuhand and the bidder can approach the claimants jointly and negotiate a settlement with them that will enable the purchaser to proceed with the acquisition—and later investments in it—with a minimum of concern about potential restitution.

b. By Proceeding Under the Investment Priority Act of July 14, 1992 (Investitionsvorrangsgesetz)

A partial statutory solution to the strict application of the “restitution before compensation” rule for businesses and properties is included in the Investment Priority Act. By using the proceeding under the Investment Priority Act, a special section of the legal department of the THA can set aside the ban on sale by granting potential purchasers an “Investment Preference Decision” (Investitionsvorrangbescheid). The Treuhand can issue such a decision only when the investing company commits itself to undertake specific, written investment measures and agrees to return the assets against which the claim has been filed if it does not make the agreed investment. Restitution claimants have a right to participate in Investment Priority Act proceedings and propose their own, alternative investment plans. The Treuhand grants an Investment Preference Decision only when the investor’s proposed investment and the investor’s ability to carry it out substantially exceed those of the restitution claimants. In practice, that restitution claimants (often groups of heirs, the individual members of which have widely different goals and abilities to carry them out), frequently are unable to come up with credible or competitive investment plans within the time period required. The Treuhand can then grant the Investment Preference Decision without further delay.

c. Appeal Rights

Restitution claimants have a legal right to protest the granting of an Investment Preference Decision in court, theoretically giving them the chance to block a privatization with years of litigation. Practically, this litigation course has seldom been taken. When it has, the cases primarily have involved first-class, downtown Berlin real estate. Litigation involving factories has been even less common, and those few cases have been pursued by claimants with less diligence.

d. Unjustified Restitution Claimants

Another way to set aside the ban on sales is to seek a decision from the responsible property office that the restitution claim in question is unjustified. For example, claimants who lost their property between 1945 and 1949 have no rights to restitution; and claimants for less than 50 percent of the shares of a seized company have no such right. Claimants seeking the return of a business are also blocked when the current company bears little resemblance to the company that was seized, or when the company has been shut and is unlikely to be brought back into operation. On a case-by-case basis, the property office can thus decide to lift the ban on sales and void the restitution claim. In extreme cases, where the restitution claim is clearly groundless, the Treuhand has the discretion to sell property subject to the claim without waiting for the decision of the property office.

3. Closing the Deal—Despite Claims

The Treuhand has two basic ways to transfer a company subject to restitution claims. The first choice is to resolve the restitution claims prior to transfer of the company (following the procedures described above to their end) and to draft an outright sales contract reflecting the requirements of the procedure followed. Unfortunately, this clearly preferable solution is not always practicable when the Treuhand is under pressure to sell companies and buyers are anxious to take them over.

Frequently, the second option must be followed and contracts closed despite uncertainty presented by still-unresolved restitution claims. In this event, the Treuhand may agree to a sale that is complete except for the later satisfaction of the condition precedent that the restitution claims have to be settled within a specified time period according to one of the several methods outlined above. Once the restitution claims are settled, the formal transfer then takes place automatically. During the interim period, the Treuhand delivers operating control of the company to the purchaser, but may retain at least partial responsibility for interim losses. Since one cannot be expected to invest heavily in a property one does not own, the deadline for any contractual investment commitments will be extended until the interim period is over.

As previously discussed, in share deals where a restitution claim has been raised against property belonging to the company, the sale of the business can proceed
without ban, but subject to the claim. Many such transactions have been closed
with the following being agreed between the purchaser and the THA:

The Treuhand undertakes to use its best efforts to attempt to have the restitution
claim reduced to a claim for compensation; if a restitution claim succeeds after
the share transfer has been completed, the Treuhand agrees to pay the share
purchaser the then-current book value of the property reclaimed; the paid-in
capital of the THA-sold company thus remains unchanged by the property return.
If the return of the property dooms the enterprise as a whole, this risk cannot be
entirely eliminated or compensated by such a solution. The Treuhand then nor-
mally agrees to permit the purchaser to void the contract in exchange for return
of the original purchase price. The Treuhand does not offer further compensation
or consequential damages. In some circumstances, however, the investor may be
able to get compensation from the successful restitution claimant.

K. FINANCIAL RELATIONS BETWEEN THE THA AND
ITS COMPANIES IN SHARE DEALS

1. Compensation Claims Under Deutsch Mark
Opening Balance Law (DM Bilanzgesetz or DMBiG)4

In addition to the relation between a stockholder and its enterprise, the Treuhand
has numerous further legal and financial ties to its portfolio companies. The
Treuhand’s goal in selling a firm is to release itself of all these ties. A few of the
Treuhand’s legal obligations as owner are remnants of the communist social order,
in which individual companies played a highly paternalistic role towards their
workers. Others arose during the transitional period of Treuhand management,
and others reflect the Treuhand’s continued need to heavily subsidize its portfolio
companies.

Section 24 of the DMBiG provided Treuhand-owned companies with a “com-
pensating balance claim” (Ausgleichsanspruch) to protect them against the conse-
quences of possible overindebtedness as of July 1, 1991. These claims were made
against the THA, and the THA then had the opportunity, for a certain period after
a company’s DM opening balance sheet was approved, to decide whether or not
to recognize them. THA paid the claims that it recognized, thereby saving the
company from a forced bankruptcy filing. Claims of companies deemed not
salvageable were denied, thus forcing the company to file for bankruptcy. In the
context of the sale of shares in a company, it is prudent to clarify whether or not
the company has had a compensating balance claim and how it was resolved.

2. Old Debts

As discussed above, the communist economic system imposed substantial debts
on the balance sheets of individual companies. The creditor for these debts was

4. Gesetz über die Eröffnungsbilanz in deutscher Mark und die Kapitalneufestsetzung (DM-
normally either the State Bank of the GDR or a state foreign trade company. In the context of the unification process, many of these old debts were refinanced and transformed into real, though indirect debts of individual Treuhand-owned companies to western, primarily former West German, commercial banks. In the context of privatization, the treatment of old debt needs to be resolved. Insofar as old debts are released or assumed by the THA at sale, this naturally is reflected in stockholders’ equity and in the sale price.

3. **Guarantees of Liquidity Credits**

In order to ensure the liquidity of its portfolio companies during the first shock of their transition to the market economy, the Treuhand was forced to guarantee billions in DM worth of liquidity credits that private banks extended to its companies. When selling companies, the THA seeks either to have the liquidity credit guarantee assumed by the purchaser or to have the underlying debt repaid. The resolution must be negotiated in each case.

4. **Unknown Assets**

The Treuhand frequently is not aware of all of the assets owned by its portfolio companies. The company may, for example, have undisclosed shares in other companies, real estate, or valuable trademarks, the value of which is not reflected in the purchase price. In order to avoid a windfall gain to the purchaser, the Treuhand frequently thus negotiates protective clauses requiring the purchaser to return to or purchase from the THA later-discovered property not accurately reflected in the company’s financial statements at the time of sale. Insofar as this solution presents problems under laws regarding the legally required nominal capital of public stock companies, it is often advisable to style such possible future payments or transfers as subsequent purchase price adjustments.

III. Conclusion

The Treuhandanstalt has, during the course of its brief existence, become a reasonably well-functioning mergers and acquisitions factory. It mass produces company sales with a view to maximizing future growth. The conditions of the sale are without historical precedent; but with communism in ruins, they are not unique. Other countries now faced with the challenge of rebuilding might consider some of the decisions which Germany made, which then made it possible for a sale on this scale, with this careful attention to the future, to occur.

The German commitment to the privatization process has never been in doubt. The specific legal framework of unification was hastily constructed and is being gradually refined, but the German Government has never wavered about whether the sales should happen. The Treuhand has instituted a legal and accounting framework and has developed fairly well-standardized and generally agreed procedures. Overall, the Treuhand has established a way of doing business and now

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has many experts trained in it and in helping investors through it. After the few initial pioneering months, standard methods of control were introduced to guard against conflicts of interest and to ensure that the Treuhand guidelines were being followed. Assets were sold for low prices in exchange for reasonable future commitments, and the response, both from German and non-German investors, has been remarkable.

No organization that assumed the Treuhand's tasks could be popular. Wisely, the Treuhand was given the political independence to reach its goals. In order to make its companies marketable, the Treuhand had to lay off hundreds of thousands of workers, including hundreds of company leaders who had colluded with the secret police. It has had to put over 1,800 companies in liquidation. By creating a powerful, centralized holding, capable of making decisions tough enough to reflect the reality, mass company sales were made possible. The Treuhand does the dirty work, so that every investor can be a white knight. Countries that do not exert such controls may find themselves bled dry by the demands of inefficient state enterprises. Trying to leave those messy tasks to investors will save short-term political problems, but probably hinder long-term economic growth. Each country will have to make its own calculations and compromises. A German-style Treuhand is certainly effective, but undiluted, its medicine may be too bitter for new governments to swallow. The open question is how much of its lessons and expertise can be translated into other contexts.

A little over two years after beginning its task, ownership of most of the industrial plant of an entire country has changed hands. Critics charge that the Treuhand is succeeding only in an unprecedented giveaway of national treasures to neo-colonialists. The criticism is harsh and ignores the 1,700 companies sold to former GDR citizens. The criticism also takes no account of the tremendous expense of maintaining national treasures that under chanted conditions have become national dinosaurs. Time will tell whether the course chosen was the best one. It seems clear, however, that the former GDR, after an especially rough start, has a more solid foundation for growth than that found in many of its former socialist friendship states. The Treuhand has done what it can to build that foundation.

In a very short period, the Treuhand helped create conditions under which thousands of investors took the plunge of major, long-term commitments into once-hostile waters. Compared to the former GDR, other formerly communist nations have low costs, soft currencies, and mostly captive domestic markets. If these countries of the former East Bloc do not quickly set up their own structures to encourage entrepreneurial risk-taking, the capital needed to rebuild their economies will not be mobilized and their situation can only worsen. Other nations will clearly not be able to afford all the Treuhand's luxuries, but they would be well advised to take what they can use and afford from its experience. There is much worth studying and some worth adopting.