

Philipp Holzmann AG – insolvency of a construction giant

Winding up an insolvent global group presents wholly new tasks for the insolvency administrator

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At a glance

- Insolvency proceedings on the scale of those against Philipp Holzmann AG cannot be instituted in the conventional way and require innovative approaches.
- Handling such major proceedings ultimately leads to the structure of the insolvency administration coming to resemble the management structure of a large company and generates a need to form a number of ‘specialist departments’ for the administration. Furthermore, proceedings will only be successful where the insolvency specialists are joined by other technical experts working as an interdisciplinary team.
- If during insolvency proceedings certain activities of the insolvency administrator are performed in the interests of individual groups of creditors, it makes sense for these tasks to be transferred to a subsidiary of the assets involved in insolvency proceedings, using this form of outsourcing to guarantee more effectiveness as well as transparency for all creditors.
- In the Holzmann proceedings specifically, the entry into force of the EC Insolvency Regulation considerably simplified the cross-border activities of the insolvency administrator and often helped provide prompt solutions to problems.
- Although it is provided for in the Regulation, experience gained from the proceedings against the assets of Holzmann has made it an unattractive prospect for German insolvency administrators to institute secondary insolvency proceedings in those EU Member States in which a company’s branches are located.

Introduction

With the ‘largest bankruptcy of 2002’, Germany has become the European champion in terms of revenues figures. Taking into account its most recent annual revenues of 6.4 billion euros, the insolvency of Philipp Holzmann AG (‘Holzmann’) might well be the largest insolvency to have taken place throughout the whole of Europe in 2002. At the same time, insolvency proceedings against the assets of Holzmann can be seen as the first German proceedings to be carried out in line with the EC Regulation on Insolvency Proceedings (No 1346/2000), being opened only one day after the Regulation came into force.

Facts and figures

Holzmann first filed for bankruptcy in 1999. This could easily have led to the insolvency of the long-standing company, had it not been possible to conclude a rescue deal with its creditor banks, including all the leading German financial institutions, shortly after bankruptcy was filed – thanks, in particular, to extraordinary political pressure and not least to intervention by Federal Chancellor Gerhard Schroeder. The fact that this political intervention was fiercely criticised by many can only be understood in terms of the specific history of this time-honoured company.

History

Holzmann belonged to the group of large-scale companies referred to as ‘Germany plc’. The rule in Germany up until recently was that all large group companies were in some way connected by means of cross-shareholdings. This was also true in the case of Holzmann, whose major shareholder since 1873 had been Deutsche Bank AG. It was precisely this system of Germany plc that made the prospect of one of the country’s top companies going bust apparently impossible. As a result, it came as a massive shock in Germany when one of the flagships of the economy went into insolvency.

Holzmann was established in 1849 by the former miller Johann Philipp Holzmann, exactly 150 years before the company first filed for bankruptcy. The company initially established itself as a large regional construction company over the course of industrialisation, which also saw the city of Frankfurt gradually evolve into a major commercial centre. The conversion to a public limited company in 1917 was the logical outcome of the company’s steady growth. The first large-scale overseas projects were already underway by the end of the 19th century – such as the Central Station in Amsterdam and construction on the so-called ‘Baghdad Railway’ – after the first large and prestigious projects had already been carried out in Germany – including the Hamburg Town Hall, the Reichstag building in Berlin and the Frankfurt Opera House.

Expansion in overseas business was stepped up in the 1920s, especially in South America, with, for example, the construction of the Buenos Aires Metro. Following the ‘aryanisation’ of the Executive Board, the company also found itself involved in Nazi building projects, such as the construction of the ‘Siegfried Line’. Milestones in the company’s most recent development jump to 1979 with the takeover of US construction giant JA Jones and Lockwood Greene, constructor of the Petronas Towers in Kuala Lumpur.

Holzmann figures

The steadily growing global player employed more than 23,000 staff worldwide in the years leading up to its insolvency, more than 3,000 of whom were employees at the German AG. Up to 600 companies were consolidated in the group and, in turn, divided into individual groups such as the Imbau Group, the HSG Group and, particularly in the USA, the JA Jones Group. The group was ultimately generating annual revenues of 6.3 billion euros. These are mainly attributable to the four basic divisions of general construction (developing and constructing office buildings, shopping centres, hotels, schools, power stations etc); infrastructure construction (planning and development of large-scale infrastructure projects, such as bridges, stretches of railway, airfields, harbours and tunnels); industrial facility construction (process and facility planning, as well as project management for all areas of industry, eg automotive chemicals, aerospace etc); and the services division covering 'all areas of construction' (general facility management, maintenance and inspection etc).

In light of the construction industry crisis that had already been looming for some time in Germany, Holzmann made concerted efforts to retain its market position by developing its own construction projects, which were also marketed and leased by the company itself. With losses of DM1.7 billion, it was precisely these construction projects that turned out to be the fundamental cause of the company's insolvency.

The preliminary proceeding – survey and surprise

Following the disclosure of poor figures for 2001, the banks involved in the rescue initiated in 1999 decided to freeze Holzmann's credit lines in March 2002. On 21 March 2002, after the collapse of last-ditch negotiations with creditors, the Executive Board saw no alternative but to return to the insolvency court. This time there was no government intervention. On the same day, Mr Ottmar Hermann, lawyer, auditor and tax advisor, was appointed preliminary insolvency administrator by the insolvency court of the Frankfurt am Main district court, which also ordered preliminary insolvency administration.

Maintain the overview!

On the basis that Mr Hermann had already acted as preliminary insolvency administrator for a brief period in November 1999 during the opening of insolvency proceedings against Holzmann that were subsequently abandoned, and given that the possibility of insolvency proceedings had already been a major topic of media discussion for some days before bankruptcy was filed on 21 March, the preliminary insolvency administrator was able to set up a insolvency team during the days leading up to the actual filing date, in order to be able to approach the sizeable task in a structured manner from the start. Thus, on the very next morning after filing for insolvency, a crowd comprising more than ten lawyers and other insolvency experts made its way to the headquarters of Holzmann.

The first item on the agenda was a short meeting with the Executive Board, after which employee representatives were immediately included in the preliminary insolvency administration. Then, the individual members of the first insolvency team set about visiting the different departments of the group's headquarters. Amongst other things, it was planned that the management previously responsible for the different areas (ie overseas department, domestic construction business, treasury etc) would each be designated an insolvency specialist. This took place in line with the legal parameters of the German Insolvency Code (*Insolvenzordnung* – InsO), which typically provides for the appointment of a preliminary insolvency administrator with reservation of consent as part of the preliminary insolvency administration. This means that the previous management of a debtor company is no longer permitted to make any independent asset decisions but now requires the consent of the insolvency administrator. The preliminary insolvency administrator is also prohibited from taking decisions independently of the management. Debtors are often told to think of the preliminary insolvency administrator as the current manager's 'Siamese twin'. This meant that the opening days of the preliminary insolvency administration at Holzmann were marked by efforts to quickly gain an overview of the essential business and likely problems. For example, the author party had the task of co-ordinating incoming post and facsimiles, which meant confronting a ten-metre mountain of paper every day! This involved separating the important from the trivial, passing information on to the correct contacts, and thereby maintaining an overview of all the related procedures.

It soon became clear that it would be extremely difficult to attain this sort of overview. The managers responsible for the administration of group companies, for example, were not able to state definitively which or how many subsidiaries belonged to the global Philipp Holzmann Group. The team of the insolvency administrator subsequently went about preparing corresponding overviews themselves, firstly by hand and then on automatically created 'wallpaper'. A thoroughly comprehensive overview of the participations business was made available after three weeks – to the amazement of the responsible managers, as this had never been available at Holzmann in previous years. The figures reported by the branches to headquarters via the main branch office also soon turned out to be inconsistent and often non-comprehensible. This meant that the preliminary insolvency administrator had to set up its own reporting system, right down to branch level, in order to obtain more or less reliable figures for the relevant ongoing construction projects.

Construction work continued by engaging regional administrators¹

Winding up insolvent construction companies is not one of the preferred proceedings for insolvency administrators in Germany. There are a large number of prevailing legal problems in this area, resulting in particular from the realities of the German construction industry and the legal framework of the Insolvency Code. In the case of Holzmann, however, the most pressing problem in the preliminary insolvency administration was safeguarding the continuation of ongoing construction projects, which ultimately constitute the true value of a construction company. Contractors often

tend to hastily send letters of termination, and suppliers tend to discontinue all deliveries, directly after insolvency proceedings have been filed. Employees also tend to leave the company. In order to avert the collapse of the building activity of Holzmann across all of Germany, and also to make his presence felt on the ground, the preliminary insolvency administrator proceeded on a route totally unprecedented for the German insolvency practice. As a result, the preliminary insolvency administrator furnished experienced insolvency experts at each of the 17 main Holzmann sites with corresponding powers, so as to directly represent the interests of the preliminary insolvency administrator and those of the creditors at the branch. Thus, only a few days after the filing date, every large construction project in Germany had its own on-site contact partner from the preliminary insolvency administrator, to enter into dialogue with the contractors, employees and suppliers concerned on the possibilities of continuing building works. At the same time, it was the job of the regional administrators to make a selection between cash-positive and cash-negative construction sites, so that the preliminary insolvency administrator would have access to reliable information in this matter and could therefore base his decision on a solid foundation.

Proceedings opened

From the very outset, no German party had shown any significant interest in the domestic construction business, (ie Holzmann's main business in Germany). This was not too surprising given that Holzmann's major competitors, Hochtief and Bilfinger & Berger, for example, were more concerned about a shakeout than acquiring their rival Holzmann. As a result, only foreign investors came into consideration as prospective bidders for the domestic construction business. Although a large number of negotiations were held with well-known foreign companies, these also came to nothing – not least due to the poor economic state of the German construction industry. This meant that shortly after insolvency proceedings were opened, it already seemed likely that the main task of the insolvency administration would be the winding up of the company.

Domestic construction business

The key operational task of the liquidation was the winding up of Holzmann's domestic construction sites. These were executed both by the company itself and in the form of joint ventures with other large and small construction companies.

The insolvency administration's investigation revealed that, at the time of filing for insolvency, 587 construction sites within Germany were operated by the AG. All these construction projects then had to be analysed, examined and evaluated by former company employees and insolvency specialists. If it was possible to continue 350 of these construction sites during the preliminary proceedings, 157 sites were then continued by the administrator at the opening of proceedings. It should be noted at this point, that, under German insolvency law and from the perspective of the insolvency administrator, the continuation of construction projects beyond the opening of insolvency proceedings gives rise to legal and thus also financial risks, resulting

from the so-called 'performance option' (*Erfüllungswahl*) given in the Insolvency Code regulations. The simple continuation of contracts beyond the start of insolvency proceedings in effect means that substantiated and maybe only partially-known risks associated with construction projects also become liabilities of the insolvent estate before the opening of proceedings and have to be satisfied from the estate by the administrator. For this reason, it was first of all necessary to analyse the cash-positive construction sites.

At sites where, according to the analysis, continuation would serve the interests of the estate, separate negotiations had to be held with each of the developers so that work could continue on the basis of completely new contracts. This is why continuation of each of the existing contracts was deemed too much of a risk.

In terms of construction projects that had been operated by partnerships, numbering 570 in Germany, it was no longer possible for them to be continued after the start of insolvency proceedings. As a result, all partnership relationships with Holzmann were terminated by partnership partners or were terminated automatically under the partnership agreements, as at the opening of proceedings. There are still a large number of legal and substantive problems to solve in this area. Given the specific conditions of insolvency law, and the right to contest transactions in insolvency proceedings, the determination of the settlement claim in favour of the insolvent estate is a highly contentious issue between the insolvency administration and partners from the partnerships. It is therefore believed that set-offs at the expense of the insolvent estate, shortly before and after filing for insolvency, are impossible under German insolvency law. Setting proper levels of performance does, however, represent a real challenge – dealt with by the insolvency administration to the extent that many engineers are still employed today. As regards legal problems, however, the German courts are expected to produce leading decisions that may also have an impact on the legal practice in the German construction industry in the area of partnerships.

Given that it was impossible to find an overall investor for the domestic construction business, a number of solutions – primarily in the interests of employees – were ultimately found at the regional level. Individual agreements were therefore concluded with local construction companies, stipulating that, wherever they took on the employees working in the corresponding branches, they would continue the Holzmann construction projects. Generally speaking, it has been possible to save around 55 per cent of the previous posts at Holzmann in Germany to date, which is all the more encouraging bearing in mind that between 1995 and 1999, more than 40 per cent of jobs in the German construction industry on the whole were lost.

1.5 billion bank guarantees

Of course, Holzmann also had to furnish its partners and other parties involved in construction projects with a large number of warranty and performance bonds, and other guarantees for its many construction projects and partnerships. Overall, the insolvency administrator's investigations revealed that more than 6,350 different guarantees were issued, which – at the start of insolvency proceedings – constituted total risk in excess of 1.8 billion euros for the guarantors of the group.

Guarantees from subcontractors issued in favour of Holzmann accounted for a number in excess of 30,000.

As experience in Germany up until now has shown, insolvencies of construction companies, in particular, frequently result in developers or other former business partners drawing on guarantees without good cause – as they consider insolvency administrators unlikely to be able to carry out competent, informed examinations into the reasons held for utilising guarantees. It was, however, possible to adopt a very specific approach to this challenge, owing to the huge amounts of Holzmann bank guarantees. On this note, the insolvency administration or insolvent estate formed its own subsidiary, ‘p.e.o.s. GmbH’, which took on, in particular, former Holzmann engineers and construction office staff as specialists. The key task for this company was then to examine the justification for drawing on each of these guarantees. This means that the company generates most of its income from premiums for the prevention of the unauthorised utilisation of guarantees. Since then, total guarantees for the company have already been reduced by half as a result of this task force’s remit in preventing the unauthorised utilisation of guarantees. Overall, around 80 per cent of unauthorised utilisations, which would otherwise have been charged to the guarantors, were successfully averted. In addition, the administration of subcontractor guarantees and, where applicable, claims against subcontractors, represents a further area of this company’s operations. The company also supported the insolvency administration in collecting receivables, meaning that the 160.8 million euros in open receivables at the time of filing for bankruptcy had already been reduced by one half within one and a half years.

Overseas projects – examples in the Netherlands and the BVI

Winding up Holzmann’s overseas projects was also an exciting process. For example, large-scale infrastructure projects had been carried out in the Netherlands and also in London (Channel Tunnel rail link) via the main branch office in Düsseldorf. More than 250 Holzmann employees were still active at the six large-scale joint venture projects in the Netherlands at the time of filing for bankruptcy. Filing for insolvency did, however, lead to the immediate termination of participation in the joint ventures in the Netherlands. This was all the more regrettable as many of these projects had real potential for generating major profits. Negotiations with joint venture partners, however, succeeded in retaining employees to work until the end of Holzmann’s activities on the sites. This safeguarded the smooth continuation of construction projects, as Holzmann employees could then be assigned to highly specialised machines and similarly skilled tasks. Furthermore, their jobs were secure for at least the following few months. A large number of employees have since been taken on by the remaining joint venture partners in the Netherlands.

The Netherlands has also clearly demonstrated the benefits of applying the EC Insolvency Regulation. For example, numerous attachments had already been levied against Holzmann in the insolvency proceedings, in particular on receivables from the profitable joint ventures. The German Insolvency Code, however, provides that

attachments carried out in the month prior to or following the filing for bankruptcy which impair the creditors as a whole automatically become invalid. Given that German insolvency law prevails in such matters, as clarified on the strength of the EC Regulation, these attachment measures could simply be eliminated as a diversion tactic. The Regulation therefore helped in ensuring that the insolvent estate was not reduced to the benefit of overreager individual creditors.

In contrast to the Netherlands, there was no clarifying international regulation of this kind in the British Virgin Islands (‘BVI’) which could be resorted to in relation to attachment measures. A single subcontractor had been making attachments to the bank account still maintained, as well as the equipment still available, in the BVI. To this extent, separate – and ultimately successful – legal action had to be taken against this subcontractor. This allowed the Eastern Supreme Court of the BVI to be convinced that the insolvency proceedings against the assets of Holzmann should receive international recognition, as German law provides for the principle of reciprocity and both encourages and guarantees the international recognition of insolvency proceedings. As a result, the Eastern Supreme Court passed a corresponding resolution stating that German insolvency proceedings shall also be recognised in the BVI, and that attachments into the assets of the insolvent estate are invalid following the start of insolvency proceedings.

The insolvency proceedings also involved examining whether or not to institute secondary insolvency proceedings in the EU Member States where establishments (in accordance with the definition given in the EC Regulation) are located in the interests of the creditors. It is important to note, however, that German insolvency law does not provide for preferential rights for individual groups of creditors. Instead, all creditors are treated equally in terms of the satisfaction of their claims. It could, however, be the case that such rights would have entitled individual creditors to preferential satisfaction in the foreign Member States involved. For this reason, the approach was taken that the initiation of secondary insolvency proceedings would not be in the interest of all of the creditors. Rather, any petition for secondary proceedings could result in liability claims of the German insolvency administrator. This is because the insolvent estate realised in the Member State in question could be fully absorbed in the secondary insolvency proceedings and would only have been available to individual creditors, meaning that no distributions would have been able to be made to the German insolvent estate. In light of the above, it remains to be seen whether or not secondary insolvency proceedings could constitute a viable option from the point of view of a German insolvency administrator / German creditor.

Administration and disposal of the subsidiaries

As a result of the insolvency of the Imbau Group and the Chapter 11 proceedings of the JA Jones Group, but also due to the disposal of HSG and Deutsche Asphalt-Gruppe, a substantial proportion of Holzmann’s investment portfolio had already been deducted from the estate or disposed of. However, the company still had around 200 shareholdings in Germany. Gathering the key information on these companies

has often involved painstaking work. Many of the companies have already been liquidated or sold off to interested parties. Nonetheless, even this area offered plenty of surprises. One drawer, for example, contained shares in a Nigerian public limited company.

‘Seek and ye shall find’

All the same, such surprises have, to date, proved to be in no shortage in the Holzmann insolvency proceedings. An inconspicuous office, for example, turned out to be hiding the historical spade used by the German Kaiser and the Turkish Sultan in the historic ground-breaking ceremony for the Baghdad Railway. Fittingly enough, the floor of this office also flaunted the very carpet on which the historic contract for

this Holzmann construction project was signed. So even today, the more than 100-strong insolvency administration team in the proceedings against the assets of Philipp Holzmann AG are guided by the principle of ‘seek and ye shall find’!

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NOTE

1. ‘Regional administrator’ (*Regionalverwalter*) is not an official term. German law only provides for an ‘insolvency administrator’ – ‘regional administrator’ is a term we have coined ourselves. This means an agent of the insolvency administrator, who is vested with all rights and obligations of the insolvency administrator within one region.