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## The Treuhandanstalt, privatization and the role of the courts

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**discussion paper**

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**The Treuhandanstalt, Privatization  
and the Role of the Courts**

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## **Abstract**

The paper considers how the Treuhandanstalt's legal identity as both a public and private entity helps to explain the process of privatization or creation of property by the state after 1989. I argue the agency did not easily fit within the rigid categories of the German legal system. Moreover, its hybrid status limited the degree to which individuals or groups could make use of the courts to hold the agency accountable. As neither a fully public nor fully private entity, the agency's status successfully circumvented a number of traditional forms of control that exist in both public and private agencies in Germany. As a result, privatization was defined in a very narrow neo-liberal sense despite what one would predict from the standard accounts of the German Model.

## **Zusammenfassung**

In dem Papier wird der Frage nachgegangen, wie die rechtliche Konstruktion der Treuhandanstalt als einer sowohl staatlichen wie privaten Einrichtung dazu herangezogen werden kann, um den Prozeß der Privatisierung wie der Schaffung von Privateigentum durch den Staat nach 1989 zu erklären. Es wird die Meinung vertreten, daß diese Organisationsform nur schwer in die strikten Kategorien des deutschen Rechtssystems paßte. Darüberhinaus hat dieser hybride Status die Möglichkeiten für Einzel- wie für Rechtspersonen eingeschränkt, die Treuhand vor Gericht zu belangen. Als weder „richtig“ staatliche noch „richtig“ private Einrichtung konnten die normalerweise üblichen Formen staatlicher wie privater Kontrolle erfolgreich umgangen werden. Daraus ist zu folgern, daß die Privatisierung - im Gegensatz zu den Standards des „Modell Deutschland“ - in einem engen neoliberalen Sinne verstanden und praktiziert wurde.

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The Treuhandanstalt . . . is a large "hit squad."  
(Wächter 1993).

## 1. The Puzzle

How does a government voluntarily decrease its span of control during fiscal and economic crisis? More specifically, how do governments privatize state holdings? Conventional wisdom in the public management and privatization literature<sup>1</sup> tells us that the management of such enormous tasks is done poorly, and that government strategy is likely to be inefficient.<sup>2</sup>

Work in comparative political economy also suggests that important policies that affect large and well-organized societal interests are likely to be inefficient.<sup>3</sup> Interest group politics in the United States, for example, often generates poor outcomes due to the openness of the political system. Actors are able to strategically exit the decision-making process and thereby contribute to extremely low levels of trust (Badaracco 1985; Brickman 1985). In contrast, the closed consensus-based politics among corporatist political systems, such as Germany's, is characterized by a reduction of exit options and has perhaps a higher level of trust (Katzenstein 1987). However, such a system is likely to function in a much slower and deliberate fashion than the open system. Policies may, therefore, turn out to be more accommodating than efficient (Albert 1993; Thurow 1992).

Given these expectations in the public administration and political economy literature about the effectiveness of public agencies, it is particularly interesting to consider the German agency charged with the task of converting the former East German planned economy into a form compatible with a social market economy. The agency's privatization of hundreds of billions of assets following collapse of the Berlin Wall in 1989 demonstrates the importance of an agency's legal status as an independent factor influencing the types of controls and accountability exerted upon the agency. This paper describes how attention to the legal process helps to explain the THA's process of privatization.

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<sup>1</sup>For general sampling see (Kettl 1993; Warwick 1975; Otter 1995; Drucker 1969; Gaebler 1992).

<sup>2</sup>Borrowing from Etzioni (Etzioni 1964, 8) I distinguish efficiency from effectiveness. The former refers to the relation between a certain activity and the costs of its execution, where as the latter concerns the goal achievement of the organization. For some of the best argued work see (Friedman 1962) and (Tullock 1965). For a good recent empirical study see (Dutch 1991).

<sup>3</sup> For a theoretical overview of the differences see the chapters in (Berger 1981) and the article by (Wilson 1983).

The Treuhandanstalt (translated "Trustee Agency" and, hereafter, referred to as the "THA") began with no organization, structure or blueprint. Its leaders argued for a "learning by doing" approach. Yet, it was immediately instilled with tremendous power and authority. Its actions impacted not simply the 4 million workers employed in THA-owned firms<sup>4</sup> but the firms' competitors in the West, environmentalists, state governments, local governments, union members, and hundreds of different clubs and organizations across the country. Even with planning and preparation such a task would be daunting for any organization. Yet, to the astonishment of its critics and supporters, the THA largely completed the task of privatization before closing its operation in 1994. A single agency managed in four years to transfer into private hands what had been the 15th largest economy in the world. At a time when politicians in all advanced industrial countries are extremely concerned with the growth, effectiveness and self-preserving tendencies of public bureaucracies, the THA offers an important case study.

The shock and euphoria that accompanied unification may help to explain the Treuhand's initial trajectory of rapid privatization with little state intervention. However, it is remarkable that the agency was able to largely remain on course throughout its existence. Rational choice explanations in political economy or public administration concerning the development of bureaucracies offer little help in understanding this phenomena. Such theories predict that governments are likely to become overbloated and inflexible in order to serve the electoral interests of politicians as well as the interests of powerful societal interest groups (Tullock 1965). Rational and public choice scholarship also suggests that competition and distrust among interest groups leads to sub-optimal outcomes (Fiorina 1979). And, finally the natural interests of bureaucrats to increase their budgets and span of control inevitably leads to a perpetually inefficient and self-sustaining bureaucracy (Niskanen 1971). As a result, one would expect the THA to quickly become victim to interest group fighting. Alternatively the neo-corporatist literature on the "German Model" would also predict that the German agency would operate much more slowly though perhaps not inefficiently (see the essays in Markovits (1982)). Such theories suggest that governance structure of regulation in Germany is composed of a number of well-organized interests whose participation in the process is institutionalized. One would thus predict that the process of privatization between 1989 and 1994 would at least resemble previous cases of privatization in West Germany: that is, more deliberate and incorporate many more interests in institutionalized settings.<sup>5</sup>

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<sup>4</sup> Firms consist largely of former East German large conglomerates ("*Kombinaten*") of smaller businesses translated literally "people-owned firms" ("*Volkseigene Betriebe*").

<sup>5</sup> For one the best historical accounts of this see Shonfield's chapters on Germany (Shonfield 1969). Claus Offe, Philippe Schmitter and Wolfgang Streeck have also written extensively on the topic.

In contrast to both the neo-corporatist and rational choice literature, however, what one sees is the opposite: the agency adopts a very narrow notion of privatization and is able to maintain its course until the end. The agency succeeds in privatizing rapidly and making itself redundant in a relatively short time.

## 1.1 The Importance of an Agency's Legal Character

One important solution to this puzzle is the legal character of the agency. Despite the close historic relationship between law and public administration, legal identity is a relatively underdeveloped topic in the broad policy literature on the THA. Although the German legal literature served as a forum for debate between 1990 and 1994, the debates centered on the substantive legal position of the THA with little emphasis on the policy implications that derived from the agency's legal character. Moreover, the German legal literature largely overlooked procedural aspects of the agency's legal identity. By procedural I refer to the rules and practices in administrative and civil courts that inform how an entity like the THA is controlled and by whom. I argue below that procedural law is an important component in understanding the agency's autonomy.

Why focus on these detailed German legal debates? In his discussion of bureaucracy Weber (1968, 24) makes a distinction between two types of rationality: instrumental ("*zweckrational*") and goal-rational. The former reflects a concern for the efficiency of the process by trying to determine the best method of completing a given part of a larger task. Alternatively, with goal-rational or substantive rationality, an individual strives to evaluate in one composite calculus the goals, means, and possible secondary consequences of her actions. An analysis of the legal character provides a better understanding of the THA's instrumental rationality. It provides a map of the legal constraints and parameters within which policy makers operate. Such an analysis highlights the idea that public agencies do not exist in a vacuum but are institutions embedded in social frameworks governed by complicated legal systems.

## 1.2 The Argument

The Treuhandanstalt's legal identity as both a public and private legal entity helps to explain the process of privatization or creation of property by the state after 1989. As neither a fully public nor fully private entity, the agency's status successfully circumvented a number of traditional forms of control that exist in both public and private agencies in Germany. As a result, privatization was

defined in a very narrow neo-liberal sense despite what one would predict from the standard accounts of the German Model.

Three important features distinguish the public sector accountability and control in Germany. First, the majority of public administration is delegated to local and state levels. The decentralization of the state's activities insures that implementation of policy is tailored to the specific needs of the region and by those with knowledge about the area. Citizens, in turn, are able to hold either local or state level officials accountable who, in turn, place pressure on representatives in parliament.<sup>6</sup>

Second, the participation of well-organized interested is institutionalized in the policy process. This is most evident in wage-policy where centralized industrial unions, business associations and government work out policies in a very formalized process.<sup>7</sup> Although one should exercise caution about over-romanticizing these relationships, it often nevertheless means: 1) that those affected by a public policy such as unions, state governments and para-public organizations are often included in the decision making and oversight process; 2) their ability to leave the process is limited; and 3) decisions are made by consensus. Following an often time-consuming and laborious process, opposing interests achieve a compromise or no policy is made. Importantly, through the institutionalization, parties share a stake in making sure the policy works.

Finally, a third characteristic of the German Model is an administrative and civil legal system based on "a rule of law." Germany's legal culture embodied in the concept of the "*Rechtsstaat*" means that the state is not simply an enforcer of laws but also the independent arbiter of the public interest. The system embodies the separation of politics and administration that Luther Gulick, Woodrow Wilson and Frank Goodnow advocated in the United States a century earlier. The material expression of the *Rechtsstaat* is the development of Germany's Basic Law<sup>8</sup> and Constitutional Court (Smith 1979, 186-88; Dyson 1992, 87). Judges' ruling are based on the application of specific cases to the law[s] rather than on the concept of *stare decisis*. Similarly, bureaucrats -- as agents of the state -- also enjoy a great deal of autonomy in the application of specific cases to the laws.

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<sup>6</sup> A classic example of this in action is the recent change in Germany's Asylum Law. Until two years ago the country had one of the most liberal constitutional guarantees of asylum in the world. However, after local and state institutions complained bitterly that they were being taken advantage of, the law was changed and made relatively restrictive (Cassell 1994).

<sup>7</sup> It is important to note that not all affected interests are incorporated. Moreover, the degree to which all parties are brought together varies by sector. Nevertheless, the general German corporatist model has a set of actors such as state governments in the Bundesrat actively involved in the development of federal policies which the states in turn must implement.

<sup>8</sup> Also known in German as the *Grundgesetz* or G.G..



The following paper addresses the third feature, namely the Treuhand's position in Germany's *Rechtsstaat*.<sup>9</sup> The agency does not easily fit within the rigid categories of the German legal system. It is given a hybrid status which limits the degree to which individuals or groups can make use of the courts to hold the agency accountable. An understanding of the legal status helps to explain how the agency is able to operate more freely than either public or private entities despite expectations concerning the influence of external pressures created by the agency's actions.

Such a freedom steers the agency into the waters between Scylla and Charybda: it offers the great potential for innovation while posing the equally great threat of loss of control and accountability. The focus of this paper is on the way in which the legal character opens up opportunities for both alternatives. While I focus only on the THA the contribution is intended to extend more broadly to the conditions under which radical institutional innovation can occur. The paper demonstrates that when public or private actors fall outside of the standard legal categories of German law, an opportunity is created to act in very different ways than what one would be predict from standard assumptions about the German Model (Casper 1995).

### 1.3 Outline of Paper

The following continues in Section II, with an historical description of the Treuhandanstalt's development. The purpose is it provide the necessary background with which to understand how the agency's instrumental rationality was defined during its genesis (Section III). In Section IV I then describe the THA's legal character in terms of the transfer of assets to the private sector and the management of firms prior to their sale. The aim is to then link the legal discussion back to the THA's instrumental rationality. Section V concludes the paper with statements about how substantive and procedural aspects of the THA's legal identity impact the policy making process.

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<sup>9</sup> The application of features one and two to the Treuhandanstalt were partly addressed in an earlier paper (Cassell 1996).

## 2. The Treuhandanstalt: a brief history<sup>10</sup>

The legal development of the Treuhandanstalt occurred in three stages that correspond with three important laws (Kloefper 1996). The stages are not neat junctures but tend to overlap one another. The first phase began on March 1, 1990, with the German Democratic Republic government's passage of the law<sup>11</sup> creating the "Anstalt zur treuhändische Verwaltung des Volkseigentums (Treuhandanstalt)" and a Conversion Ordinance<sup>12</sup> that provided for the conversion of communist economic units into organizational structures under private law.<sup>13</sup> Once converted into private assets, the Treuhandanstalt became the sole owner in most cases.

The agency's lengthy title reflects the tenor of its initial mandate: to act as trustee of the East German public holdings during the transition to a more market-oriented system. The emphasis in the original text of the March 1 law was less on privatization than on the administration of assets in the interest of East Germans. There was a strong concern among those who had brought down the East German totalitarian regime that West German speculators would soon cross the border and take advantage of East Germany's vulnerable position (see Kemmler 1994; Schröder 1993; Kloefper 1996). In line with the GDR reformers' antipathy toward a centralized government apparatus, reformers in the Volkskammer envisioned the THA as a decentralized agency organized around a central office in Berlin and 15 regional offices whose jurisdictions corresponded with the GDR's 15 sub-national governmental units or "*Bezirke*". The participants of the Round Table discussions, which gave birth to the concept of the THA, attempted to create an alternative to East and West Germany's political and economic systems. They hoped a decentralized organization would allow the agency to operate in the most efficient manner even as it protected East German interests.<sup>14</sup>

The second phase of the THA's development began with the victory of the conservative Christian Democratic Party in East Germany's first (and last) free

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<sup>10</sup>There are numerous accounts of the Treuhand's development. Some are more critical than others. For several excellent accounts of the development of the Treuhand during this early period, covering a range of perspectives see (Kemmler 1994; Wächter 1993; Seibel 1992; Priewe 1993; Schröder 1993).

<sup>11</sup>Law is entitled, "Beschluss zur Gruendung der Anstalt zur treuhaendischen Verwaltung des Volkseigentums" Gesetzblatt der DDR 1990 I.

<sup>12</sup>Ordinance on the conversion of state-owned industrial combines, companies, and organization into joint-stock companies. Gesezblatt I, 107 [1 March 1990].

<sup>13</sup>The conversion ordinance sets into motion the transformation of East Germany's Volkseigene Betriebe and Kombinanten into limited partnership firms (Gesellschaften mit beschränkte Haftung, "GmbH") or stockholding companies (Aktiengesellschaft) respectively. For details of how this was done see (Elsner 1990), (Rosener 1990) and (Horn 1991).

<sup>14</sup>For a good account of the Round Table and its focus on the Treuhandanstalt see (Rose 1990).

election on March 18, 1990 and the subsequent appointment of Lothar de Maizière as Minister President of East Germany. De Maizière and his cabinet, in contrast to participants of the Round Table discussions, worked to shift the Treuhand's strategy and structure toward a more clearly market-oriented outcome with goal of privatization at the forefront. With a conservative Volkskammer to support him, De Maizière succeeded in passing the "Gesetz zur Privatisierung und Reorganisation des volkseigenen Vermögens" (Law of the Privatization and Reorganization of Publicly-owned Assets, hereafter, referred to as the "THG") on June 17, 1990.<sup>15</sup> The new law voided the earlier law and -- along with five Implementation Ordinances<sup>16</sup> -- reformulated the THA's responsibilities and structure.

Even the title suggests a very different agency. The preamble of the new law mandated the THA to transfer public assets to private legal entities or natural persons as swiftly as possible and, to the greatest possible extent, by selling them. The new law also called for a restructuring of the agency into four private stock-holding companies ("*Aktiengesellschaften*" or AGs) to insure that the task of privatization would not be jeopardized or slowed down by political influence. In their explanation for why the stock-holding company form was adopted Fischer and Schröder (1993, 33) note simply, "AG's were considered to be more flexible and more able to take actions than institutions under public law." The second phase is thus characterized by a reorientation and restructuring of the agency toward the goal of privatization.

A third phase of the THA's development began in the summer of 1990 and concluded with the Unification Treaty that took effect October 3, 1990. During this period West German government and business leaders significantly extended their influence over the Treuhandanstalt. The question was no longer whether East and West Germany would unite but rather the terms and conditions under which unification would occur. The Kohl government in Bonn wanted to make certain it was not saddled with the long term responsibility of restructuring the eastern states. The strategy of the conservative majority in the West German parliament (CSU/CDU/FDP) reflected a neo-liberal orientation that emphasized minimal state involvement and private markets as the solution to redevelopment of the east.<sup>17</sup>

West Germany's influence on the THA is apparent during this period in at least two ways. On July 15, 1990 Detlev Rohwedder, the second president of

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<sup>15</sup>Gesetzblatt I, 300 (17 June 1990).

<sup>16</sup>1st Implementation Ordinance to the THG (15 August 1990), Gesetzblatt der DDR I, 1076; 2nd Implementation Ordinance to the THG (22 August 1990), Gesetzblatt der DDR I, 1260; 3rd Implementation Ordinance to the THG (29 August 1990), Gesetzblatt der DDR I, 1333; 4th Implementation Ordinance to the THG (12 September 1990), Gesetzblatt der DDR I, 1465; 5th Implementation Ordinance to the THG (12 September 1990) Gesetzblatt DDRI, 1466.

<sup>17</sup> For a good account of the economics see (Sinn 1992).

the THA and former executive at Hoesch AG in Dortmund, succeeded in establishing a "western business majority" on the Executive Committee of the THA. That is, Rohwedder succeeded in insuring that a majority on the executive board of the THA would be western business leaders with experience in either firm restructuring or privatization. Moreover, these were business leaders with a strong personal stake in East Germany's transformation.<sup>18</sup> Kemmler (1994, 197) notes that De Maizière's initial concept was to have the committee divided equally between east and west Germans to insure that "half understood where we had been and half where we were going."

A second show of West German influence occurred in the structure of the agency. In what Wolfgang Seibel describes as a "coup," Rohwedder unilaterally disregarded the THG's mandate of the stock company model and opted to go with a centralized and highly autonomous agency under public law (Seibel 1996). "Life comes first and then the legal paragraphs" ("*Erst komme das Leben, dann die Paragraphen*") explained Rowedder in a speech before the Volkskammer in September 1990. Numerous explanations have been given for this move. Some suggest that the stock-holding company model was simply not feasible or practical given the nature of corporate law in Germany.<sup>19</sup> Rohwedder argued that the process of transforming the agency into stock-holding companies would lose too much time in setting up the institutions. Others point to the strong influence of labor on stock-holding company boards (through Germany's co-determination laws) as explanation for Rohwedder's reluctance. A THA employee, who began his tenure in the agency in mid-1991 in Dresden and still works in the agency's internal controlling department, recalls very clearly Rohwedder's decision:<sup>20</sup> "In the beginning the Treuhand law stated the agency was to form into four stock-holding companies. Thank God Rohwedder did not form the the stock-holding companies. It would have meant the unions and the SPD would have been involved in the process. Unions and the SPD were more interested in restructuring than privatizing. If the stock-holding companies had been formed the THA would still be around today."

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<sup>18</sup> For instance, (Suhr 1991, 87) notes that Rohwedder's first executive committee meeting consisted of the following members: Hans-Olaf Henkel, President (*Vorsitzender*) of IBM; Claus Köhler, Director of the Deutsche Bundesbank; André Leysen, executive committee president of AGFA Gavaert; Frank Niethammer, Head of AIGV AG; Klaus Piltz, CEO of VEBA AG, Horst Pastuszek, on the managing committee of Tchibo Holding, and Jochen van Tilburg, CEO of Grundig.

<sup>19</sup> This point was made to me by numerous German Bundestag Parliamentarians who served on the Treuhand oversight committees from both the SPD and the CDU parties.

<sup>20</sup> The interviewee was one of the young employees hired straight out of college to work in administration and management of firms (*Begleitung und Beteiligung*) at the regional office in Dresden. He now works in the central office performing audits on firms and the Treuhand successor organization the Bundesanstalt fuer vereinigungsbedingte Sonderaufgaben (BvS).

Whatever the reason, the move clearly reflected an increase in control by West German business and government leaders.<sup>21</sup>

The Unification Treaty solidified the West German government's control over the Treuhand. The Treaty established the Treuhand as a federal trust agency (Bundesunmittelbare Anstalt des öffentlichen Rechts § 25.Abs.1 Satz 2 EV). Much like an American "public corporation," the "Anstalt" designation gave the agency more administrative independence than is typical for federal or state bureaucracies in Germany.<sup>22</sup> Nevertheless, the Treuhandhandanstalt became a federal public entity whose mandate was spelled out in the Treuhand Act and the Unification Treaty. The mandates included:

- privatization through the sale of either whole or partial firms as swiftly as possible;<sup>23</sup>
- securing the competitiveness and efficiency of firms and other market structures through restructuring and investment;<sup>24</sup>
- closure of firms not capable of being restructured and the subsequent sale of firm assets in bankruptcy proceedings.<sup>25</sup>

As the short list illustrates, the THA became the primary government institution in the redevelopment of the eastern states' economies.<sup>26</sup>

With an understanding of the THA's early development one can begin to appreciate the instrumental rationality that informs the process of privatization. The following section describes how privatization or the creation of property is

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<sup>21</sup>The minority report of a Parliamentary Investigatory Committee also concluded that West German government officials were actively involved prior to unification in insuring that the THA's reconstruction efforts be kept to a minimum and that the influence of unions and parliament on the agency's activities also be constrained to a minimum [Treuhandanstalt, 1995 #238, Vol. 14, p.120].

<sup>22</sup>In particular, a central component of this autonomy is that an "Anstalt" may adopt its own particular system of governance. The Treuhandanstalt adopted the governance structure of a private holding. Another Anstalt, the Bundesanstalt für Arbeit, uses a different governing structure that incorporates much broader representation. For several excellent discussions of the history of public trustee agencies in Germany see (Krebs, 1985) and (Rüfner, 1985). The THA's federal status is also unique in Germany where -- with exception of the Bundesbank and Bundesbahn -- most administrative tasks are done by state and local governments.

<sup>23</sup>Preamble of the THG

<sup>24</sup>§ 2 section 6 THG. This is, however, specifically not seen by the agency or the executive as a general economic mandate or mandate to pursue regional economy policy [Wild, 1991 #126].

<sup>25</sup>§ 8 section 1 THG

<sup>26</sup>For a more complete list see (Kloefper 1996, pp. 49-54) and (Wächter 1993).

defined by the THA. It also develops a schema that helps to understand what exactly was at stake in the process.

### **3. Privatization: narrow but costly**

The most important question in 1990 concerned the content of privatization and the types of control and influence. A crucial consideration is that at the time most observers expected East Germany's assets to be worth anywhere from 600 billion<sup>27</sup> to a trillion German Marks.<sup>28</sup> Government officials at the state and national level assumed that unification could be bought with East Germany's assets (Suhr 1991). In November 1990, for example, Helmut Kohl emphasized in a televised speech that no one would suffer in eastern Germany from the introduction of the market economy and no additional taxes would be necessary to finance German unity (Kohl 1990; Krumrey 1992, 74). Kohl's statement was partly political rhetoric but was also based in part on the premise that the sale of East Germany's economy would more than pay for the process of unification. In the end, because of a collapse of east European markets and a complete over-estimation of the value of firms, the bill for the privatization effort will certainly exceed 300 billion marks (approximately \$250 billion). Nevertheless, it is important to keep in mind that in 1990, the debates about the control and policy of the Treuhand were based on an enormous false sense of worth.

The debates over the Treuhand and its policy are complex and cover a wide range of different asset types and industrial sectors. A number of authors have delved into different aspects of the agency's policies toward various sectors.<sup>29</sup> To make sense of the larger debates at the time the Treuhand was taking form, it is useful to simplify matters somewhat. I think of instrumental rationality, that is the logic of the process of privatization, in terms of two variables: control and policy. Each consists of a narrow or a broad dimension. Control could be placed in the hands of a very small number of interests or shared among a broad section of the population. Correspondingly privatization can be defined: in very narrow terms, whereby the state's strategy is to transfer assets to the private sector as quickly as possible in order to allow market forces to take hold; or in broad terms with a more involved state and property defined in more complex ways that help assist the state in directly attempting to develop a regional economy (Salzgitter AG, Deutsche Industrie Anlagen

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<sup>27</sup>Detlev Rohwedder stated in October 1990 with confidence, "Der ganze Salat ist 600 milliarden wert" ("The whole salad is worth 600 billion") (Wehner 1991, 28; Czada 1994).

<sup>28</sup>Estimated by the Modrow government in 1989.

<sup>29</sup> For various studies see (Griffen 1994; Deeg 1993; Carlin 1994).

Gesellschaft (DIAG), Volkswagen, Lufthansa). The matrix below illustrates the alternatives.

		<b>Control</b>	
		Broad	Narrow
<b>Policy</b>	Broad	1	2
	Narrow	3	4

In 1990, many argued that control<sup>30</sup> should be shared among a broad range of actors. Suggestions along these lines included the creation of mini-Treuhand in each state government. The Treuhand Act passed in June 1990, calls for the creation of four stock-holding companies. Unions and States also called for greater participation. The organizational structure prior to the second Treuhand Act was a loosely linked decentralized agency with assets divided among the 15 governmental units of East Germany. All of these reflect a broadening of control and influence.

In contrast, West German government and western business leaders pressed for a much narrower set of controls with clear lines of authority. They argued that the process of privatization would become excessively politicized unless control could be kept centralized and limited to a few select individuals.

In addition to control, there was also a debate over the policy of privatization.<sup>31</sup> Numerous groups and scholars in 1990 called for the Treuhandanstalt to recognize its position as the most important instrument for the reconstruction and redevelopment of East Germany (Engholm 1991; PDS 1994; Sinn 1992; Scheifele 1991). They argued that the Treuhand must accept its role and develop strategies for the improvement of regional economies rather than focussing solely on individual privatizations. Conservative and Liberal Party members countered that a broad notion of privatization was unrealistic, inefficient and extremely time-consuming. The Treuhand, conservatives argued, must concentrate singularly on transferring public holdings to the private sectors as quickly as possible. The market mantra

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<sup>30</sup>I use the term "control" as the direct influence over policy.

<sup>31</sup>(Jens 1993)describes the debate as between gradualism and shock therapy.

echoed in Bonn and in the West German business community was "Privatization is the best form of reconstruction."<sup>32</sup>

In theory each of the four boxes were possible, in practice only 1 and 4 were likely in 1990. A broad control of the process would have made it extremely difficult to insure that privatization take on a very limited neo-liberal market form. While box Number 2, a narrow policy influence and broad definition of privatization, was possible, it had few supporters. Public debates in 1990 centered around boxes 1 and 4: would the THA be the instrument for redeveloping East Germany which would require a longer term involvement by the state<sup>33</sup> or would it take the neo-liberal path of quick privatization with minimal state involvement?

The agency's initial trajectory was, in part, solved by its legal designation in October 1990 with the development of the Unification Treaty. Article 25 of the Unification Treaty establishes the THA as a trustee agency subordinate to the Ministry of Finance<sup>34</sup> headed by Theo Waigel, member of Bavaria's conservative Christian Socialist Union party. Waigel was a strong advocate for the neo-liberal version of privatization. He argued the agency must maintain the narrow course of privatization in its action and public rhetoric.<sup>35</sup> An official statement from the Kohl government captures the narrow construction of privatization: "The Treuhand does not practice any active regional or structural politics. The regional and social effects from our privatization of firms are made with the close consideration of the interests of federal and state governments"<sup>36</sup> (Bundesregierung 1992, 8). The statement points out that although the Kohl government recognized that its actions had regional effects for segments of the economy, the agency was to eschew any suggestion of direct responsibility for "structural politics" in the East. Regional and structural politics is the domain of state governments. The fate of particular THA firms, in turn, was to be based on the dynamics of the market coupled with the abilities and skills of the buyers or the management in the firms themselves. The THA's strategy was to keep a careful distance from its subsidiary firms, stressing the necessity for firms to make it on their own in the new market environment.

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<sup>32</sup>"Privatisierung ist die beste Sanierung." This phrase is attributed to Detlev Rohwedder (FAZ 19 Dec. 1991, 13).

<sup>33</sup>Position of the opposition parties, the Social Democratic Party, PDS and Green Party.

<sup>34</sup>The Ministry of Finance bears the primary legal and policy responsibility for the agency. The Ministry of Economics may give guidance on the THA's policy issues but is not the legal overseer.

<sup>35</sup> Seibel, in fact, argues convincingly that the federal government used the THA as a scapegoat or lightning rod to take the heat for the narrow privatization policies (Seibel 1992).

<sup>36</sup> Translation by the author. The original reads: "Die Treuhandanstalt betreibt keine aktive Regional- und Strukturpolitik. Die regionalen und sozialen Auswirkungen der Unternehmensprivatisierung werden in enger Abstimmung mit Bund und Laendern . . . jedoch berücksichtigt."



Interestingly, after the Unification Treaty was signed, unions and state governments were incorporated into the decision-making process at the federal<sup>37</sup> and regional level.<sup>38</sup> However, the THA (with the federal government at its back) never relinquished control of the privatization process. The THA's strategy was to retain control and maintain its course by extending side-payments and concessions to unions<sup>39</sup> and state government leaders<sup>40</sup> at various points in response to external pressures (Wieczorek 1992).<sup>41</sup>

In sum, the Treuhandanstalt evolved from an agency charged with administering East German assets in the interest of East Germans to a sales agency with enormous autonomy in achieving a very narrow neo-liberal notion of privatization. In the end -- after four and half years -- the THA paid a great deal to remain in box No. 4. Among the subsidies spent by the THA includes more than 100 billion marks just for the wages of employees in firms which were not able to be privatized right away (Czada 1994, 218).<sup>42</sup> With the exception of several large politically sensitive industries, such as chemical, steel and ship building, the agency's unwavering strategy throughout its existence was to give limited-term financial assistance to assets determined viable until they could be sold to private investors. Assets determined to be non-viable were shut down and placed in a liquidation process. When it began its operation 4 million people worked for approximately 13,000 Treuhand firms comprising over half the East German work force. Within a year over 2 million employees had been laid off (Wahse 1994; Czada 1994).

The shock of unification and weakness of state governments in the East (Seibel 1994) may help explain the Kohl government's ability to place the THA in Box No. 4 initially. What is remarkable, however, is that the agency did not drift into Box No. 1 over time as governmental institutions began to develop, deindustrialization spread and unemployment began to increase rapidly.

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<sup>37</sup> Following unification, three union representatives and each of the five ministers of the former-East German state governments are given seats on the Treuhandanstalt's Executive Committee. There are also committees set up at each of the THA's regional offices that include members of labor.

<sup>38</sup>The Treuhand's regional offices also had "Wirtschaftsbeiräte" (economics councils) associated with them which would be advise by the Treuhand about upcoming privatization decisions or problem privatizations.

<sup>39</sup>Interviews with the leadership of IG Metall and IG Chemie confirm this point. In response to several well-publicized strikes, the THA agreed to invest in make-work and training programs ("*Arbeitsbeschaffungsmaßnahmen*" ABM and ABS) as well an increase in the social plans implemented after employees were layed-off (Rabe 1995).

<sup>40</sup>Interviews with state government leadership in Brandenburg confirms this points. State governments such as Sachsen succeeded in pressuring the Treuhand to participate in restructuring programs (Kern 1993), as well as, committing the agency to "save" certain industries such as steel, ship building and chemicals.

<sup>41</sup> For a description see (Lichtblau 1993) and (Petra Naujoks 1992).

<sup>42</sup> For a good account of the finances see (Lichtblau 1993).

From 1990 until Birgit Breuel (successor to Rohwedder) symbolically pulled off the sign outside the THA's headquarters of the Leipziger Straße building in 1994 the agency was able to essentially remain on course.<sup>43</sup> Tables 1 gives an overview of the THA's inventory over time.

Table 1: Cumulative Treuhand activity from 1990 to 1994.

	12/31/9	12/31/9	12/31/9	12/31/9	12/31/9
Privatizations (includes partial)	681	4683	11043	13643	15102
Remaining Privatizations	7648	5811	2575	951	192
Employment guarantees (1000)	255	930	1400	1490	1510
Investment guarantees (DM billion)	50	114	170	187	211

Source: Treuhandanstalt Year-end Reports

On December 31, 1994 -- four years after starting from scratch -- the THA shut down having liquidated or sold 95 percent of its portfolio. The agency either sold or placed in liquidation more than 13,000 firms. Millions of acres of land and real estate were sold or turned over to local and state governments. The federal government collected more than DM 50 million from the sale of firms and secured more than DM 200 billion in investment and 1.5 million jobs from private investors.

The following suggests how the legal position contributed independently to this process of privatization.

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<sup>43</sup>This is a controversial point. A number of scholars have suggested that the THA changed course in 1992 and began to favor reorganization over privatization. The evidence to support this is weak however. The development of the Management Company Limited Partnerships (MgKGs) was in line with the THA initial strategy of quick privatization. From the point of view of the THA, once an asset was transferred to a MgKG it was considered sold and off the books of the Treuhand. Restructuring programs such as ATLAS in Sachsen-Anhalt or the subsidization of the chemical industry in Bitterfeld were developed because of political pressure from the outside. The THA was successful in isolating those initiatives from its general policy. An assistant to the executive committee stated in an interview: "The Treuhand never changed its policy of quick privatization. There was never a change in course. Breuel was pressured to spend more on restructuring. In response she shifted some of the money that had previously gone to subsidize an investor and, just before the sale, shifted it to the firm in order to appear to be spending more money on the restructuring. But in reality the policy that investors who buy the property should be the ones making the restructuring decisions never changed: the money was still paid to the investor at the point of sale." A recently complete dissertation on the topic of the Management KGs also confirms the point (Bensberg 1996).

#### 4. Treuhandanstalt: both a public and private entity

Legally speaking, the Treuhand existed at the juncture between public and private law.<sup>44</sup> Article 25 of the Unification Treaty placed the agency under public law through its designation as a federal trustee agency.<sup>45</sup> The agency's mandates to privatize and restructure an economy were also clearly public goods designed to serve a public function.<sup>46</sup> On the other hand, the agency operated and acted as a private "holding" company responsible for thousands of subsidiary stock-holding companies and limited partnership firms. Birgit Breuel, the THA's longest standing president, argued on numerous occasions that the Treuhand was not a bureaucracy but a firm. I interviewed more than a dozen "privatization agents" and each one echoed Breuel's argument that the agency was not a bureaucracy but operated like a company. Even its internal managerial structure and 15 regional offices ("*Niederlassungen*")<sup>47</sup> resembled the structure of a German stock-holding company.<sup>48</sup> Moreover, the agency's relationship to buyers of assets was sanctioned not with public agreements but with private contracts and included clauses that very much resembled the deals private brokers make.

This dual character triggers two questions. First, is the agency a private holding company answerable to the standards of Germany's corporate laws or a public agency answerable to the standards and rules of public agencies? And second, how does this distinction alter the agency's definition of and approach to privatization?

No clear consensus exists in the German legal literature over the substantive legal position of the THA in either private or public law.<sup>49</sup> Some scholars (Krebs 1990) argue that the decisions of the THA are solely administrative acts. For example, the agency's decision to provide liquidity to firms through direct subsidies or guaranteed loans, or the decision to privatize, clearly affects a larger public. The THA's actions should, therefore, be subject to the jurisdiction of the administrative courts. A second position is that the

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<sup>44</sup>See also (Stechow 1991), (Stechow 1991).

<sup>45</sup>(Weimar 1993) notes, "The Treuhandanstalt is a trustee agency under public law responsible to the federal government but also the sole shareholder of private companies converted from the former 'people-owned' economic entities" (1). Author's translation of the following description, "Die Treuhandanstalt -- bundesunmittelbare Anstalt des oeffentlichen Rechts -- ist Anteilseignerin der bisher nicht privatisierten Kapitalgesellschaften, die im Zuge der treuhandgesetzlichen Umwandlung der volkseigenen Wirtschaftseinheit entstanden sind."

<sup>46</sup>See also the decision in the Kammergericht of Berlin, NJW 1991, 360; the Administrative Court of Berlin, NJW 1991, 376; and High Administrative Court of Berlin NJW 1991, 715.

<sup>47</sup>Interestingly the offices had been called "*Geschäftstellen*," a term more generally used to refer to offices of a bureaucracy. The name was changed to *Niederlassung* after unification and is primarily used in the private sector to refer to branches of a company.

<sup>48</sup>With the notable exception of the labor's equal representation in the executive committee.

<sup>49</sup>See (Stechow 1991) and (Weimar 1993) for a review.

THA operates in a special category of law between public and private, namely administrative private law ("*Verwaltungsprivatrecht*") (Weimar 1993). In this sense, public agencies pursue a public mandate in the form of private rather than public law. The venue is the private civil courts but the agency remains accountable to the norms and standards of public law<sup>50</sup>, that is those laws typically judged in the administrative courts.<sup>51</sup> In particular, the agency should be held to § 3 of the Basic Law which guarantees equal treatment under the law (Scheifele 1991).<sup>52</sup>

A third position is the so-called "two-stage approach" ("*zwei-stufen Lehre*" of administrative law developed shortly after the Second World War and applied to state subsidies for housing construction and farming (Ipsen 1956, 62). Following this approach the THA's actions can be divided into two parts. First is the decision-making process; "the whether, to whom and at what price" a property should be sold. The second part is the contract which sanctions the privatization decision. Under the two-stage theory, the former is an administrative action judged under standards of public law, whereas the latter should be judged solely under private law (Fahrenbach 1990). A final position is taken by Weides who argues that since the THA is not handing out any public goods through the sale of properties in the market, it should be judged solely under the standards of private law (Weides 1991).

In order to make sense of this confusion and its application to public administration it is helpful to think of the THA's legal status relative to external and internal actors and then ask how they impact the THA's instrumental rationality. The former refers to the THA's relationship to groups external to the agency ("*Treuhandaußenrecht*") but with whom the agency comes into contact while fulfilling its legislative mandate. The latter refers to the Treuhand's legal identity in relation to the firms and assets in its possession ("*Treuhandinneinrecht*") (Stechow and Kerber 1991a; Stechow and Kerber 1991b). Again, how do these different identities play out under private and public law? And second, what difference does the distinction make for public administration?

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<sup>50</sup> In particular, the agency should be held to § 3 of the Basic Law which guarantees equal treatment under the law (Scheifele 1991).

<sup>51</sup> It is important to distinguish another case: namely when an agency pursues a private goal such as the purchase of a car or the lease of property. Such a case falls under the legal concept of "*fiskalische Hilfgeschäfte der Verwaltung*" (Fiscal transactions that aid in the administration). The agency is held by the standards of private law in the civil court.

<sup>52</sup> See (Krebs 1990) for a critique.

## 4.1 External Legal Character

Despite its trustee designation in the THG, the German courts determined that the Treuhand fell within the jurisdiction of private law in carrying out its privatization mandate. Questions and complaints over the THA's sale of assets are thus the jurisdiction of the civil courts. To consider what this means it is useful to compare the different scenarios mentioned by various legal scholars (see Table 2). Control and accountability of the THA are associated with at least two factors: standing (who can sue) and the legal basis on which a suit may be filed, which concerns the extent to which one can make claims based on public and private responsibilities. Both dimensions define legal parameters that contribute to the THA's accountability. Standing determines the population that can hold the agency accountable whereas legal basis determines the range of issues for which the agency can be held accountable.

**Table 2: Legal Status of the THA to External Actors**

	<b>Standing</b>	<b>Legal Basis</b>
<b>Private Law (Weides)</b>	Narrow	Limited to private goods and contract
<b>Public Law (Krebs)</b>	Broad	Broad includes the agency's public mandates (" <i>Hoheitliche Aufgagen</i> ") outline in the THG and the Unification Treaty
<b>Administrative Private Law (Weimar)</b>	Narrow	Broad and includes in particular § 3 GG

The position that the THA should be treated as an entity under private law is argued by Weides and Manfred Balz, Legal Director in the Treuhandanstalt. Under private law, the conditions under which someone may sell a product are very broad. The sellers enjoy a great deal of freedom in terms of who and under what conditions they wish to sell. Consequently, a plaintiff's ability to question such decisions is limited. Claims are largely limited to questions of contract law: whether the Treuhand or the buyer has fulfilled obligations written in the contract or if the seller misrepresents a property during the sales process (Weimar 1993 13). In addition, the population which can sue is also relatively narrow. In Germany suits can be brought only by those affected by the actions of the defendant. In practice, this means that the agency is held accountable, in this instance, only by those with whom it makes a contract.

Other scholars argue that the THA's decision concerning the terms of privatization should be considered an administrative act and judged under the norms of public law (Stechow and Kerber 1991a and 1991b; Krebs 1990).

They argue that the agency is subject to §40 VwGO which holds an agent of the state accountable to all the rules of public law.<sup>53</sup> (Stechow and Kerber 1991b, 52) for example, argue that in its sales activities the THA is fulfilling a set of public mandates. Privatization affects the entire economic structure of the region and thus impacts actors other than just the buyer. As a result the legal relationship to external actors ("*Treuhandaußenrecht*") should be considered under public law and under the jurisdiction of the administrative courts.

Generally speaking the difference between private and public law is whether I have to give reasons for my decision. In private law I am considered an autonomous subject who need not give any reason. In public law I must give reasons, and those have to be legal. For instance, a public agent cannot simply prefer one group over another because that would violate §3 GG. As a public actor, therefore, the THA is more constrained. There is a broader basis upon which to file claims against the agency. Furthermore, standing in the administrative court is granted to a wider audience than simply the purchaser. The population extends not just to the buyers but also to disappointed buyers, communities and other groups affected by the decision. They may call into question whether the THA's decision is in line with the public goals mandated in the Unification Treaty and the Treuhandgesetz.

As a public entity operating under the norms of private law - Verwaltungsprivatrecht -- the THA is tied to various public laws but its actions are evaluated in the private courts. Its most important public constraint is a guarantee of equal treatment under the law (§ 3 GG). Disappointed buyers, therefore, have standing in the court. In practice, however, it is extremely difficult to hold the THA accountable under §3 GG because of the vagueness of the Treuhand Act. In other words, in order to argue a claim under § 3 GG, the plaintiff must demonstrate that there were clear violations of the sales priorities written into the THA. There were, however, no priorities given in the THG concerning how to privatize. Moreover, for the first two years there were only informal priorities developed for determining to whom and under what terms to sell a property. As a result, very few are successful in making such a claim in the civil courts.

Although the German courts initially favored the THA's public status, the Treuhand eventually succeeded in establishing its position as a private entity. The Chamber Court of Berlin<sup>54</sup> (Kammergericht) ruled the sale of assets is a public act in line with § 40 I VwGO<sup>55</sup> and is, therefore, the jurisdiction of the

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<sup>53</sup> The reasoning behind the justification is more complex than presented here. For a detailed account of the various justifications see (Weimar 1991, 815)

<sup>54</sup>KG (5 December 1990) ZIP 1991, 407.

<sup>55</sup>Unlike the United States where a single Administrative Procedures Act is applied, Germany has two different laws for the administrative procedures. The VwGO, Verwaltungsgerichtordnung and the VwVfG, Verwaltungsverfahrensgesetz (both translated

administrative courts. Similarly, the Administrative Court of Berlin<sup>56</sup> ruled that external complaints against the THA fall within the domain of the Administrative Courts. The court argued the defendant was a federal agency whose task of rebuilding the economy clearly fell into the domain of the state. The court noted "the sale of properties is done for economic as well as politically structural reasons" and was therefore -- even in its sales activities -- a public enterprise (NJW 1991, 377).

The administrative court decision was appealed to the High Administrative Court of Berlin.<sup>57</sup> The High Court overturned the decision of the lower court arguing that the agency was clearly acting as a private actor in its sales activities. The agency's legislative mandate was to sell properties as quickly as possible and to operate in a "business-like" fashion. The agency was therefore answerable to the laws of economics and the social market economy. Its activities are of a completely private-law nature and are thus the jurisdiction of the civil courts.

The implications of this high court ruling are even more significant given the procedural differences between civil and administrative courts. Civil courts in Germany are designed to adjudicate differences between two adversarial equals. The judge's role is presumed to be similar to referee whose ability to collect evidence and ask questions is limited by the *Verhandlungsmaxime* (Marx 1985, 49). Marx describes the *Verhandlungsmaxime* as judges being required to take a "passive" position with regard to the process and in particular the evidentiary proceedings. Under the *Verhandlungsmaxime* judges can not, for example, go beyond evidence presented by the parties in the court.

This stands in stark contrast to the administrative courts where the *Untersuchungsmaxime* is the norm that guides judges' behavior and evidentiary proceedings. The assumption behind Administrative courts is that judges must decide between two unequals: the state and the individual party subordinate to the state. As Smid notes: Administrative courts are their "in order to eliminate the inequality that exists between citizen and bureaucracy which in turn derive from the subordinate legal structures" (Smid 1990, 308).<sup>58</sup> The most important practical consequence of the *Untersuchungsmaxime* is, that the administrative court regularly orders the files of the administrative proceedings to be produced in the courtroom (Rüsken 1995). The *Untersuchungsmaxime* thus provides

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roughly as "administrative procedures laws"). The lower courts argued that the THA's sales activities were in line with the VwGO, however, the definition of what an administrative act is, is embodied in 35 VwVfG.

<sup>56</sup>VG Berlin (19 December 1990) NJW 1991, 376-379.

<sup>57</sup>OVG (22 January 1991) ZIP 1991, 198.

<sup>58</sup> Authors translation. The original reads, "um die aus der subordinationsrechtlichen Struktur des zwischen Buerger und Verwaltung bestehenden Rechtsverhaeltnisses folgenden Unleichheit zu beseitigen."

judges with far greater discretion in the collection of information. For example, judges may question witnesses or collect administrative information on topics not directly raised in the pleadings. The *Untersuchungsmaxime* "gives legitimacy to the questioning of the parties by a judge in cases where the complexity of the situation makes it unlikely that the parties themselves will provide all the information necessary to reach a decision" (Smid 1990, 309).<sup>59</sup>

By declaring that the THA's privatization decision belonged in the domain of the civil courts, the High Administrative Court of Berlin significantly limited the oversight the THA. A consequence of the decision is that it placed a premium on internal monitoring by the agency. Judges in civil courts are limited in their review of the procedures and decision-making processes that inform the privatization decision. They can not, for instance, look into the administrative files of other bidders in order to judge the fairness of the process. For both substantive and procedural reasons, the characterization of the THA's privatization activities as private law gave the THA the greatest room to maneuver and define for itself how it wished to create private property. Although the THA affected the regional development of an economy with its privatization decision, the basis of legal standing and action were limited to the dissemination of a private good by the state. Manfred Balz, head of the THA's legal department, confirmed the point, "It is clear that we (Treuhandanstalt) favored the private law position in our arguments and actions throughout all the legal proceedings because this status made our life much easier. I have always said that it would be one of the biggest mistakes if we were subject to the full control of the administrative courts. . . we clearly triumphed. Even the majority of legal scholarship has come to our side. There are hardly any more cases calling for us to appear before the administrative courts."<sup>60</sup>

In addition to privatization the THA was also charged with a trustee role with respect to its subsidiary firms. The next section considers the THA's legal identity as trustee or parent company to its firms.

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<sup>59</sup> Author's translation of the following: "eigene Fragen des Richters an die Parteien zu legitimieren, die in solchen Verfahren angebracht sind, in denen aufgrund der komplexen Voraussetzungen des streitigen Rechts zu erwarten ist, das die Parteien nicht von sich aus die entscheidungserheblichen Tatsachen vortragen koennen."

<sup>60</sup> Author's translation. The original reads: "Es ist klar, dass wir unserer Argumentation und in unseren Aktionen, bis hin zu den Prozessen, uns auf die privatrechtliche, rein zivilrechtliche Sicht gestellt haben, weil sie uns das Leben wesentlich leichter macht. Ich habe immer gesagt, es wäre ein GAU, größter anzunehmender Unfall, wenn wir einer vollen verwaltungsrechtlichen Kontrolle unterworfen waeren. . . wir haben in dieser Frage, sagen wir mal, gesiegt, auch in der Mehrheitsmeinung der Literatur." (Balz interview).



## 4.2 Internal Legal Character

Under the Treuhand Act, the agency is charged with privatizing firms and managing them: that is, restructuring them to make them competitive or, if necessary, sell off their parts in a liquidation process. Initially this meant managing over 8000 large conglomerates<sup>61</sup> employing over 4 million people. The enormous task raises questions concerning the legal identity of the agency with respect to firms. Was the THA a corporate holding company subject to the rules governing corporations in Germany or did it remain a public entity even in its activities as manager of firms? It should be noted at the outset that this is perhaps the most complicated aspect of the THA's legal identity. Given the constraints of this conference paper I can provide only an overview of the major issues, strategies and conclusions.

The strategy of the agency was to establish a special legal identity that would give subsidiary firms more autonomy than, for example, regional offices in a bureaucracy. On the other hand, the THA did not wish to lose control in ways that might impair the privatization process. The outcome is a mixture of private and public law that varies depending on the type of action the THA takes with respect to its firms. The following considers the three most important areas of action: control and oversight; reorganization and closure; and financing and liabilities.

### 4.2.1 Control and Oversight

The Treuhand's control over subsidiary firms is akin to a private holding company and follows Germany's private corporate law with several important caveats. The following considers three aspects of oversight.

First, in contrast to American firms, a holding company's influence over its subsidiary firm is quite limited in Germany. Influence is exercised through the control over the installation of company managers in the case of limited partnership (§46 Nr. 5 GmbHG) or through the installation (and firing) of an executive oversight committee of a stock-holding company (§101 I, 103 I AktG). The executive committee, in turn, chooses a managing committee to run the firm. The owner (THA) can only exercise influence indirectly, through the leadership of the committee.

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<sup>61</sup>After the firms were broken into smaller pieces the number totaled over 13000.

Such an oversight arrangement generates a mix of results. The THA is clearly in a position to exert influence and has on numerous occasions.<sup>62</sup> For example, in the case of the privatization of Electro Apparat Werk (EAW) in Berlin the former manager of the firm had been recruited and installed by the THA. He was extremely critical of the THA's intervention into his affairs through the Executive Committee. Information concerning the important actions in the firm were immediately passed through to the THA. He noted:

“In the firm you had an executive committee, manager and owner. However the owner, the THA, also sat on the executive committee. There was therefore a clear line of information going to the central office (THA). Moreover the executive committee did not operate like a normal executive committee since the owner's influence was great. The agency began to play a greater and greater role in the functioning of the firm.”

In addition, this indirect arrangement allowed the THA to remain a comfortable distance from the difficult decisions and consequences of the firm without losing control. The THA could, in a sense, blame the company's management for the firm's poor performance while also saddling the management with the difficult task of reducing the work force.

A final feature of this arrangement is that it placed enormous weight on the executive committee or firm management to act as the controller for the THA. THA employees I spoke with in the Revision, the internal controlling department of the THA as well as firm managers, noted that this was perhaps the most vulnerable aspect of the arrangement with respect to control since executive committees are often staffed with management of competitive industries in the West or through close personal contacts with Treuhand management.<sup>63</sup> Although the executive committees were put in place by the THA, interviews with THA employees suggest that the executive committees quickly shed their agent position and often became the principals of the firm management. Alternatively, a competitor serving on the board of a THA firm may have the interests of his primary employer rather than the THA's in mind.<sup>64</sup> Privatization agents often stood in opposition to Executive Committees who sided with firm management against the THA. Such an arrangement places in

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<sup>62</sup>For additional examples see FAZ (18 Nov. 1991, 18); FAZ (3 Dec. 1991, 19); FAZ (5 May 1992, 15); Die Welt (5 May 1992, 16)

<sup>63</sup> According to internal control workers, the THA's policy of picking a person to head the executive committee and then leaving it up to her to fill the rest of the position exacerbated this problem.

<sup>64</sup> A firm manager I spoke with who was also asked by Birgit Breuel to serve on an executive board of another company explains his experience with executive committee like this: “We (the THA) begged to the West German businesses to lone us some managers. So what did the West German businesses do? They said to their managers, ‘You go over to the THA for a short time and see what there is in our branch. See if there is something for us and if we can get at it. If we are unable to get it then make sure it is leveled.’ I know this is what happened I saw it.”

to question the effectiveness of the Executive Committee to act as effective controller of THA firms.

Second, the Treuhandhandgesetz is treated in the courts as an "Economic Steering Law" ("*Wirtschaftslenkungsgesetzes*") and thus falls under the Veto Law ("*Verbotsgesetz*").<sup>65</sup> Under §134 BGB, one can intervene directly in the activities of a company if that company's activities violate the intent of a law.<sup>66</sup> In the case of the THA, the holding company was allowed to intervene into the activities of its subsidiary firms if the activities are determined to hinder the THG, that is privatization. In practice the law did not provide the THA necessarily with a direct line of control over its subsidiary firms. Rather it was a justification for "passive" control (still exerted through management) or the exercise of the THA's power to veto certain spending decisions made in the firm.<sup>67</sup> To make substantive changes the THA had to intervene through the Executive Committee or management.

Third, because the THA is a federal public entity it is subject to budgetary laws § 112 II BHO<sup>68</sup> and §§ 53 and 54 HGrG which establish a number of reporting requirements not typical for a private agency. However, because the THA can take actions only through a firm's management, these reporting requirements are made the responsibility of the executive committee in the company or the manager. In other words the burden to report is placed on the firms. Reports include information about the internal organization of the company, balance sheets, and the production processes. The information is then passed on to the THA who in turn must make the information available to the Federal Auditors' Office ("*Bundesrechnungshof*"). A important question is what the Auditors' Office can do with the information. (Diederich *et. al* 1994) point out that it was unclear for quite awhile whether the Federal Auditors' Office could perform audits on THA subsidiaries under German corporate law. It was later established through action by the Bundestag that they could.

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<sup>65</sup>§ 134 BGB. The civil law's most best known application is Germany's infamous store closing hours.

<sup>66</sup> Under §134 BGB, the basic effect is the following: If I enter into a contract that violates the law, this contract may be null and void. But if I buy something in Germany after the closing hour the contract per se is not necessarily null and void. But I have in the course of my purchase violated another law which justifies intervention.

<sup>67</sup> I spoke with several *Begleiter* (person charged with the administration or guidance of the firms) who said this distinction was extremely important. One stated, "The management of the firms had to get approval from us (Treuhand) for expenditures over a certain amount. However, we could not directly influence the firm to take a certain strategy."

<sup>68</sup>§ 112 II BHO applies when, "ein Unternehmen in der Rechtsform einer bundesunmittelbaren juristischen Person des öffentlichen Rechts an einem Unternehmen in der Rechtsform einer juristischen Person des Privatrechts unmittelbar oder mittelbar mit Mehrheit beteiligt ist, die §§ 53 and 54 HGrG entsprechend."

#### 4.2.2 Reorganization and Closure<sup>69</sup>

In fulfilling its mandate under the Treuhand Act<sup>70</sup>, the THA was often forced to split up a large conglomerate in easier-to-sell pieces and/or close the operation of firms determined no longer capable of being saved.<sup>71</sup> In both instances the THA was treated as the majority shareholder (*Allein oder Mehrheitsgesellschafter*) and the laws under which the agency took action to restructure or close firms fell under private law.

In the case of closure, the designation of the firm as unsalvageable was considered an administrative act (§43 II VwGO) challengeable in the Administrative Courts. However, once the evaluation was completed the THA - as the majority shareholder -- could decide to place the firm into liquidation (§262 I,2 AktG, §60 I, 2, GmbHG) under private law. In this sense, the procedures reflected the two-stage theory mentioned above. The restructuring or splitting up of firms by the THA was made easier by the passage of the Splitting Law in April 1991 by increasing the rights of owners of THA firms. The law essentially placed the decision to reorganize in the realm of private law. Similar to the rules on closure, the THA as majority owner of its firms could choose to restructure them if it was determined to be economically necessary by a recognized expert.

#### 4.2.3 Financing and Liability

Treuhand firms that were deemed as "restructurable" by the THA initially required large subsidies to overcome the liquidity crisis brought about by the Social, Economic and Currency Union (July 1, 1990) and the collapse of East European markets. An important legal issue concerning the leadership in the THA was the agency's legal designation with respect to the financing of firms and the potential liability the THA was exposed to through its firms. The issue centered on whether the THA and its subsidiaries was a qualified actual company "*qualifizierte faktischer Konzern*"<sup>72</sup>; or whether the agency was a public bureaucracy subject to §34 of the German Constitution. The distinction had enormous implications for the agency and the government.

If the THA and its subsidiary companies constituted a private company, the THA was potentially required to compensate subsidiary firms for their losses at the point at which the relationship between holding and firm ended. It would have essentially given the firms a license to operate without any fiscal checks.

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<sup>69</sup>For more on the topic of closure see (Weimar 1993).

<sup>70</sup>§ 8 I TreuHG

<sup>71</sup>Determined through an expert's certified opinion and evaluation.

<sup>72</sup> A *qualifizierte faktischer Konzern* is the conglomerate consisting of the controlling company and one or more controlled companies that is treated like the conglomerate falling under §312 AktG without being one (see(Wolter 1992)).

This prompted Manfred Balz to note that the law made it practically impossible for a daughter company to go bankrupt. Second, as a private firm, the THA was potentially liable for the actions of its firms. Creditors filing against firms claiming compensation would have a right to attach claims on the THA and, in turn, the German government. And third, as a private corporation, the THA would be required to bring the capital reserve of subsidiary companies in line with rules governing stock-holding and limited partnership firms. The capital requirement for limited partnerships and stock-holding companies is DM 50,000 and DM 100,000 respectively. Of course firms received much more than that. However, the enormous deficits firms operated under would have meant that bringing them automatically in line with capital requirements would in practice have constituted a much greater uncontrolled transfer of public money.

Management in the THA (Breuel, Balz, Vonnemann) argued vehemently that the agency was not a corporation under §312 AktG.<sup>73</sup> They argued two points that reflected a broader ideology in the agency. First, they pointed out that §Art 312 assumes a relationship between two companies. Although a government corporation is capable of being considered a private actor,<sup>74</sup> it is far from clear that the THA was a company. A company pursues a private set of goals, primarily profit. The THA's goal was the redevelopment and recovery of an entire economy: clearly a public not private good. (Vonnemann 1991) noted, "The fact that the agency acts in a "business-like" way should not make one confuse it with an actual business." Second, the relationship between a holding company and its subsidiary firms in the private sense assumes that a holding company has the ability and interest in exercising power over its firms.<sup>75</sup> Officials in the agency argued that the THA was in no position to exercise that type of control. Moreover, the control it did exercise was indirect and limited to the installation of managers and executive committees.

In sum, the relationship between the THA and its subsidiary firms occupies a special position in German Law (Sonderrecht) that crosses public and private law, as well as, German corporate (AG) and limited-partnership (GmbH) law.<sup>76</sup> If the THA were a public company like the Germany's Telecom AG, the agency would fall clearly under German stock company law (Weimar 1991, 819).

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<sup>73</sup> Balz noted, "The THA has been characterized in the legal literature and in selective cases, as having direct responsibility for its firms. In the interest of insuring the THA's effectiveness and the protection of public money, we must fight against this." Translated from: "In der rechtswissenschaftlichen Literatur und in vereinzelt Prozessen wird die THA als für Verbindlichkeiten ihrer Beteiligungsunternehmen unmittelbar oder mittelbar verantwortlich angesehen. Diesen Auffassungen ist im Interesse unserer Handlungsfähigkeit, d.h. der THA, und der Schonung öffentlicher Mittel energisch entgegenzutreten." (Balz 1992, 446).

<sup>74</sup> Decision in the German High Court established the possibility that a government entity could also be considered a private company (BGH, Urt. , 13 Oct. 1977, BGHZ 69, 334)

<sup>75</sup> "Ausübung einheitlicher Leitung der herrschenden Gesellschaft in bezug auf die Konzernunternehmen." (Vonnemann 1991).

<sup>76</sup> For several excellent accounts see (Timm 1991),(Weimar 1991)(Weimar 1993).

However, as Manfred Balz (Balz 1992, 447) notes, "The THA and its subsidiary firms do not constitute a company . . . because its mandate does not affect a single private economic entity but an entire economy" (emphasis in original).<sup>77</sup> The connection of firms to the Treuhand was, therefore considered a temporary formality.

The result was a reinforcement of the legal distance between the agency and its firms while strengthening the agency's control over its subsidiaries. The THA was given greater discretion over the use of subsidies such as loan guarantees, relief of "old debt"<sup>78</sup> and an infusion of capital under 24 DMBiG<sup>79</sup>. At the same time, the agency was also shielded from exposure to the liabilities and responsibilities of a private holding company and could therefore operate with greater freedom. As one former employee<sup>80</sup> charged with special internal investigations within Treuhand put it, "The agency had the best of both worlds. It enjoyed the flexibility and autonomy of a private actor without any of the liabilities. It enjoyed the backing and status of public agency without having to fight out every privatization decision in the administrative courts."

## 5. Conclusion

The legal identity of the agency does not explain why the agency embarked on its particular course to privatization. However, it does help us understand why the agency was able to follow its course so resolutely. The THA is very much an anomaly. As one person I interviewed said, "It's unlikely we'll have another unification soon." However, it is precisely because of its unique nature that the agency is worth considering in a more general way. What are the conditions that contribute to radical institutional change? What is it that allowed the agency to maintain its course and close shop despite the external interests and institutional mechanisms one would expect to steer the agency off track? One

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<sup>77</sup>Die THA und die ihr zugeordneten Unternehmen bilden keinen Konzern. Die THA ist kein Unternehmen im spezifisch konzernrechtlichen Sinne der Art 15ff AktG, da sie nicht einen privatwirtschaftlichen, sondern einen gesamtwirtschaftlichen bestimmten auftrage hat."

<sup>78</sup>This refers to the debt firms had on the books of East Germany's banks prior to 1989. After the fall of the Berlin Wall the East German banks were taken over by their West German counterpart The debt was then owned to West German banks at the new currency rate of 1 East Mark to 1 West Mark.

<sup>79</sup>Opening Balance Sheet Act (22 Sept. 1990). Forced East German firms to report their companies assets and debits. The report was then used by the THA as a very rough guide for dispersing liquidity. Initially this was done very broadly. Later the THA attempted to evaluate each firm.

<sup>80</sup>Interviewee worked in the Treuhand for three years moving up the ranks to Abteilungsleiter. He worked in privatization, evaluation of firms and internal controls. His longest position was as a special investigator in the internal controls division of the agency.

conclusion from this paper is that grey areas in the law open up possibilities for outcomes counter to what one would predict.

In the case of the Treuhand, placing the decisions concerning privatization in the civil courts insured the agency the greatest degree of freedom. Waigel and Breuel's claim that the Treuhand did not perform structural politics, despite all evidence to the contrary, was far more easy to defend in the context of private law. Civil courts assume the judge is playing the role of referee between two equals. As a result, both plaintiffs and judges are far more constrained in their search for evidence and documentation from the defendant. Moreover, the standards by which the agency is held accountable are those of any private individual or group.

Correspondingly, the position of the internal character in the administrative courts and public law insured that the agency could maintain control without taking on the responsibility of a private holding company. It is obvious, as scholars have pointed out, that the Treuhand was in no position organizationally to oversee its firms and was therefore in no position to be held accountable according to corporate law. On the other hand, the Treuhand did make its presence felt particularly in the medium-to-large firms. However, the presence was limited primarily to questions of privatization. For instance, a company that embarked upon a plan to reinvest and reorganize itself was often told it had to wait until it had been sold. "The Treuhand's strategy was to keep firms on the line for as minimal as possible" said one THA director matter a factly. Such a course could only be maintained if the state was free from the requirements and liabilities of a private holding company.

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