German court agrees to insolvency plan for Karstadt store chain

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Last Friday the district court in Essen agreed to an insolvency plan for the Karstadt chain of stores in Germany. Billionaire investor Nicolas Berggruen is to take over as the company's new owner. The decision ended the longest lasting insolvency proceedings in the history of the federal republic, over 14 months.

At the start of June, Berggruen had won the agreement of the committee of creditors for his bid for the insolvent company. He promised to maintain the department store chain with its 120 locations and total staff of 25,000 and invest €240 million. A decisive factor in the positive response of the committee of creditors to Berggruen's offer was the stance taken by the public sector trade union Verdi, which backed his bid.

Berggruen declared that in the first place he would not be demanding further sacrifices from the company workforce, which has been forced to accept cuts to its wages and benefits during the past few years. These cuts had been worked out and approved by Verdi and its associated works councils.

The last such contract agreed by the union was in November 2009 with the insolvency administrator Klaus Hubert Görg. The contract involved the closure of several Karstadt branches as well as the elimination of vacation and Christmas benefits totaling €150 million up until the year 2012. On this basis the deal ruled out any compulsory redundancies.

Berggruen had made the final assumption of Karstadt conditional on the readiness of those owning the property on which Karstadt locations are situated to lower the high rents they demand. The negotiations over this issue dragged on during the past weeks until the landlords agreed to a rent reduction amounting to €400 million over a period of five years.

The final signatures from the landlord consortium only arrived at the last minute. One of the most prominent members of the consortium is the Highstreet group that owns the property of 86 department stores. The main investors in the Highstreet group are the US investment bank Goldman Sachs, the Deutsche Bank subsidiary Reef, as well as the companies Borletti, Pirelli and Generali. The enormous rents demanded by this consortium were one of the main reasons for the economic problems faced by Karstadt.

The former Bertelsmann manager Thomas Middelhoff, who had taken over as chairman of the executive of KarstadtQuelle in 2005 and renamed the Karstadt group the Arcandor AG in 2007, had played a leading role in the sale of Karstadt real estate to the Highstreet consortium and continues to profit personally from the high rents. The Verdi trade union and its deputy chair Margret Mönig Raane, who sits on the company's supervisory board, had also agreed to the sale of the Karstadt real estate.

On March 1, 2009, Middelhoff resigned from the chairmanship and quit Arcandor AG with a compensation package of €2.3 million. His successor, the former finance executive member of German Telekom, Karl Gerhard Eick, had been in office just a few months when the crisis intensified with Arcandor and particularly at KarstadtQuelle.

In May 2009 Eick and the Karstadt boss at that time, Stefan Herzberg, declared that Arcandor could only be saved with the help of a state endorsement totaling €650 million. The German government at that time, a grand coalition of conservative parties with the Social Democratic Party, refused to support the company with proceeds from its so-called "Germany Fund", arguing that the problems at Arcandor did not have their source in the world economic crisis of late summer 2008 but had begun at an earlier time.

Arcandor therefore had to apply for insolvency in June 2009 at the district court in Essen. The insolvency proceedings were opened on September 1, 2009. The insolvency administrator Klaus Hubert Görg replaced Eick as head of the company. After his job at the top for the duration of just of a few months, Eick was able to leave with a fat €5 million compensation deal in his pocket.

In October 2009 the Quelle mail order house was shut down with the loss of 7,000 jobs. Additional jobs were lost in related ranges including delivery services, shipping companies and the post. All efforts to find an investor had failed, Klaus Hubert Görg explained at the time. Due to the insolvency, those employed by the company, many of whom had worked for the company for years or even decades, were left with the prospect of no work and without a penny in compensation.

Karstadt had made its own plans for the contingency that no agreement be struck between Berggruen and the Highstreet consortium. Powerful interests, above all German banks and the Metro group, owner of Germany's second biggest department store chain, Kaufhof, sought to prevent a takeover by Berggruen so as to be able to pick up selected stores at rock-bottom prices following the bankruptcy of Karstadt.

The banks have long been working on plans for a new German department store chain based on merging the most profitable branches of Karstadt and Kaufhof. Such plans would have inevitably involved the closure of numerous smaller branches and the destruction of tens of thousands of jobs in the retail trade.

This danger has been averted for the time being, but the latest takeover involves no guarantee for the future of the company's 25,000 employees. The new Karstadt owner and billionaire Nicolas Berggruen has pledged to invest €65 million from its private fortune into the modernisation of Karstadt. A further €5 million is earmarked for creditors. More exact plans for Karstadt are to be presented at the beginning of October.

In the run-up to the latest deal, Berggruen had secured the agreement of Verdi for the division of the 120 Karstadt locations into three legally independent units: one section comprising so-called premium locations, a second for sports shops and a third for ordinary stores. This fragmentation of the concern opens the way for mergers with other enterprises. Experts are already speculating that this could represent the means for the Metro company to take over parts of Karstadt.

Either way, the future for the chain of stores is filled with hurdles: a comment in the *Süddeutsche Zeitung* of September 3 warns that the new Karstadt owner will not be able to keep his promises: "Dismissals are necessary…. The new owner will not be able to avoid drastic cuts. He will close department stores and will have to dismiss personnel. This is exactly what he promised not to do. It was only on this basis that Berggruen was able to win the crucial support of the Verdi trade union. But the new Karstadt owner will not be able to keep to his promise".

Under the title "After the rescue is before the rescue", the *Frankfurter Rundschau* on September 4 cited professor Elmar Kulke, from Humboldt university in Berlin: "Karstadt must lower the costs, at all levels…. Also personnel expenditure cannot be maintained at the current level".

The deputy chair of the trade union Verdi, Margret Mönig Raane, and the joint works council chairman Hellmut Patzelt are already trying to condition Karstadt employees to make further concessions and sacrifice. A union statement declares that the future is by no means guaranteed: "We will be confronted with changes and new challenges.… And this will not take place without conflict".