

Court Cases

A BRIEF CHRONICLE OF AND SOME NOTES ON THE BANKRUPTCY PROCEEDING OF FAGOR ELECTRODOMÉSTICOS S.COOP.

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After the announcement of its insolvency on the 15th November 2013 Fagor Electrodomésticos S.Coop. (a worker cooperative based in Arrasate-Mondragón, Basque Country, hereinafter “Fagor Electrodomésticos”) presented an application for its declaration of bankruptcy. That was accepted by the Commercial Court n. 1 of Donostia-San Sebastian (Juzgado de lo Mercantil número 1 de Donostia-San Sebastián) the 19th November.

In a context in which thousands of enterprises are declared bankrupt each year, the bankruptcy of Fagor Electrodomésticos was certainly shocking for various reasons. In this sense, the Court admits it’s a “special importance bankruptcy” due to different aspects such as the liabilities, the number of workers and creditors and the turnover, apart from its social and media resonance¹. Indeed, it was an enterprise with a considerable weight in the Basque economy (especially, in Gipuzkoa). At the same time, the shock could be explained by the fact that Fagor Electrodomésticos was an emblematic cooperative, “flagship” of the Mondragon cooperatives². The cooperative-system itself, which admittedly is not immune to economic and financial crises³, was questioned, and so was the viability of the Mondragon cooperatives, in a momentary “psychosis” which was surely more media-based than real. At the same time, the debate about the approach of cooperatives to the capitalist model and its consequences was reinforced.

From a legal point of view, this bankruptcy proceeding generated huge interest as a complex procedure was foreseeable, taking into account elements such as the size of the company, the existence of subsidiaries (some of them in other States), and the fact that it was the bankruptcy of a cooperative. The application of the insolvency legislation to these entities generates several issues⁴. In this case, the main laws of reference which should be applied were, on the one hand, the Spanish Insolvency Law (Law

¹ In this case, according to the Spanish insolvency legislation, at present the “special importance bankruptcy” declaration has consequences regarding to the number of bankruptcy receivers.

² Even if it’s not a corporate group in the usual sense of Corporate Law, it’s the first Basque business group and a reference of cooperativism across the world.

³ In VILLAFANEZ PEREZ, I., “Kooparatiben konkurtsoaren inguruan zenbait datu eta hausnarketa”, *REVES (Revista vasca de economía social – Gizarte Ekonomia Euskal Aldizkaria)*, Special number X anniversary, 2014, 117-135, we counted 447bankrupt cooperatives during the period 2005-2013 in Spain.

⁴ Although, as said, previously there had been many bankrupt cooperatives.

22/2003, of 9th July)⁵ and, on the other hand, the Cooperative Law of Euskadi (Law 4/1993 –Basque Parliament-, of 24th June).

Without an in-depth analysis of the several controversial aspects of the bankruptcy of a cooperative, we provide a rapid overview of some interesting points of the insolvency of Fagor Electrodomésticos, following a brief chronicle of its bankruptcy proceeding⁶.

As indicated, the bankruptcy of Fagor Electrodomésticos was declared the 19th November 2013 by the Commercial Court n. 1 of Donostia-San Sebastian, which judged it was ordinary⁷ and voluntary⁸, and ordered the intervention of the management and disposal powers⁹ by the bankruptcy receivers, and its registration in the Cooperative Register of Euskadi.

Together with that of Fagor Electrodomésticos, the bankruptcy declaration of the subsidiary Fagor Ireland Limited was applied. The court stated it was the competent tribunal to handle both bankruptcies, even if the subsidiary's registered office was in Ireland, as its effective management and supervision (and its "main interests centre") were actually in Arrasate-Mondragon, and this fact was easily noticeable. Consequently, both entities were declared bankrupt, and their bankruptcy proceedings were conducted in a coordinated way, without consolidation of assets and liabilities.

During the previous and following dates, the bankruptcy declaration of the remaining subsidiaries of Fagor Electrodomésticos was applied and accepted: the Basque enterprises Edesa S.Coop., Grumal S.L. and Proiek Habitat y Equipment S.A, and the Polish Fagor Mastercook S.A. All the bankruptcies have been conducted by the same court¹⁰.

One of the aspects of this bankruptcy proceeding, which has been (and still is) controversial, concerns the financial instruments of Fagor Electrodomésticos and Edesa, specially the voluntary capital contributions, the contributions of retired members, and the so-called subordinated financial contributions.

⁵ Unlike what happened in the past, when there was a debate about the legislation applicable to insolvent cooperatives (because of the discussion about whether the cooperatives are or not traders for Commercial Law), at present there's no doubt that this Law is applicable to cooperatives, as it's the reference Law to any insolvency (with very few exceptions).

⁶ Note that this bankruptcy proceeding has been a complex one, involving several judicial decisions with reference to different issues, not always directly linked to the particularities of cooperatives' insolvencies (for example, debt admission or compensation...).

Regarding the special characteristics of cooperatives' bankruptcies in Spain, we refer to our monograph VILLAFANEZ PEREZ, I., *Cooperativa y concurso. Estudio de las relaciones jurídicas con sus socios*, Marcial Pons, Madrid 2014, and the sources referenced in the bibliography. Also, MARTÍNEZ BALMASEDA, A., "Algunos aspectos jurídico-mercantiles tras el concurso de Fagor", *CIRIEC-España, Revista Jurídica*, n. 25, 2014, 281-312.

⁷ Not abbreviated.

⁸ As the application was presented by the debtor.

⁹ Not their suspension.

¹⁰ The exception was the French subsidiary Fagor Brant, whose bankruptcy was handled in France, and came into hands of Cevital.

In the case of Fagor Mastercook, several Polish creditors presented an international plea, alleging that jurisdiction was in Poland. This plea was dismissed by the Commercial Court n. 1 of Donostia-San Sebastian the 10th March 2014.

On the one hand, Fagor Electrodomésticos (as well as Eroski, another referential cooperative of Mondragon Corporation) had issued “Aportaciones Financiaciones Subordinadas Fagor” (subordinated financial contributions). As these financial instruments were quoted in the fixed income market, according to the insolvency legislation a bankruptcy receiver should be appointed by the National Securities Market Commission. Yet, the main problem referred to these financial contributions was the position of its holders, as they were subordinated and perpetual debt, close to capital contributions (they were hybrid instruments), so in an insolvency situation it was almost impossible to recover the investment. These contributions are regulated in the Basque cooperative legislation, and in principle they don’t raise problems respect to their legality. However, they’ve been challenged from the point of view of the contract consent, and there are several judicial pronouncements declaring their purchase contracts invalid on the basis that the distributors (financial institutions) failed to comply with the duty to inform retailer and consumer purchasers properly about the characteristics of these financial contributions, which have been considered complex financial products¹¹. In any case, these pronouncements are independent from the bankruptcy proceeding of Fagor Electrodomésticos, and the respondent parties are the distributors, as it is understood that they concluded the contracts on their own name.

On the other hand, the treatment of voluntary capital contributions and the contributions of inactive members such as those who, even when not participating in cooperative activity, (e.g. retired former working members) maintained their capital contributions has also been questioned. In some cases, it has been alleged that they are debts and so should be part of the bankrupt’s liabilities. Cooperative legislation clearly states that these contributions are part of the company’s capital (even if they could be accounted for as financial liabilities as a consequence of the IAS 32), that they are subject to entrepreneurial risk, that they are liable for the cooperative’s debts and losses and that, in the event of winding up, they will be returned to members after paying or assuring the cooperative’s liabilities. Hence they do not involve a reimbursement right, but a claim in the liquidation¹². However, that does not necessarily prevent the analysis of the consent of the members when acquiring or maintaining the contributions. Were contributors aware of the nature and characteristics of the funding tool they were buying and the level of risk they were assuming?

Concerning this last issue, the possibility of a declaration of culpability on the part of the bankrupt was particularly relevant. Some members intended to raise this by invoking depreciation of assets and fraudulent actions so as to impose personal liability on the cooperative’s directors and managers for

¹¹ Similarly as with the “preferential shares” (participaciones preferentes) sold by financial institutions to consumers.

Some court decisions in this sense: Supreme Court Sentence 715/2015, 30th November; Gipuzkoa Provincial Court Sentence (Section 3) 23/2015, 9th February; Bizkaia Provincial Court Sentence (Section 3) 346/2013, 18th September; Araba Provincial Court Sentence (Section 1) 10th October 2013 (in this case, referred to the subordinate financial contributions of Eroski).

¹² Regarding this issue, the Gipuzkoa Provincial Court Judgment (Section 2) 26/2015, 3th February, maintaining the pronouncement of the first instance judgement, after referring to the several financial instruments in the Cooperative Law of Euskadi, stated that the different financial contributions of members (including voluntary contributions and contributions of inactive members) derive from a commercial relationship, not from a labour relationship. On the other hand, against petitioners’ claims, it concluded that Edesa’s capital contributions and special contributions (“participaciones especiales”, a kind of subordinate contribution) couldn’t be recognised as Fagor Electrodomésticos’s debts, as, even if it was its parent firm, they had different legal personality, and their bankruptcy proceedings were coordinated, but without consolidation of assets and liabilities.

damages, or even for the debts not covered by the cooperative's assets. However, the 4th September 2014, in line with the criterion of the bankruptcy receivers and the prosecutor, the Court stated that the bankruptcy of Fagor Electrodomésticos was fortuitous, on the understanding that there hadn't occurred important irregularities which had generated or aggravated the insolvency, excluding the members of the board of directors from liability. All of the foregoing is without prejudice to the possibility of using other accountability mechanisms (outside the bankruptcy proceeding), such as the liability actions of the cooperative legislation. Thus, in December 2015 more than 900 claimants brought an action against Mondragon Corporation to claim the money invested in voluntary contributions and other financial instruments, alleging damages caused by misleading information that induced them to maintain their savings in Fagor Electrodomésticos and Edesa, as they had been led to believe that those savings were protected¹³. The claimants argued that Mondragon gave priority to its assets over the interests of the members (notably, inactive members). The action was allowed to proceed and the trial is expected to take place in spring 2018. The legal interest of this proceeding is high, as the autonomy of the Mondragon cooperatives, the relationships among the Corporation and the cooperatives, and possible liabilities derived from them are likely to be analyzed, together with some interesting issues related to cooperative membership (economic participation, involvement, information rights...).

On the other hand, it seems important to highlight that during the bankruptcy proceeding the members of the cooperatives weren't declared liable for the companies' debts and losses. This clarifies, at least in this case, a controversial issue referring to the cooperative legislation: the limited or unlimited liability of the cooperative members for the results of the activity.

Finally, the 18th March 2014 the liquidation phase of the bankruptcy proceeding of Fagor Electrodomésticos was initiated, and so were the liquidation of Edesa (21th March) and the rest of the subsidiaries, in all cases as requested by the debtors. However, the liquidation didn't imply the end of the entrepreneurial activity (at least in that moment), but the extinction of the legal personality of the debtors. In April 2014 the liquidation plans of both cooperatives were presented, plans which were coordinated, considering the high interrelation between them, and in order to facilitate the interest of potential investors in the different productive units. After evaluating several bids, the productive units were awarded to CNA group (Galagarza electrodomésticos S.L., later Edesa Industrial S.L.), taking into account the sum offered and the employment commitment¹⁴.

Three years after the extinction of the cooperatives Fagor Electrodomésticos and Edesa, their bankruptcy and its consequences are still news item. Apart from the previously mentioned action against Mondragon Corporation, Edesa Industrial SL has recently presented an application for its declaration of bankruptcy, a great part of its production has stopped and a collective dismissal of employees has been approved.

¹³ Among other questions, according to claimants, because Mondragon Corporation had hidden the real asset situation of Fagor Electrodomésticos, and had led members to believe that its intercooperation and solidarity mechanisms would maintain the company.

¹⁴ Some assets were transmitted to other interested parties during the proceeding (for example, in March 2014, some brands of Fagor Ireland to Cevital).