

ALERTS

Finance, Insolvency & Restructuring Alert - Chile Embraces The Corporate Rescue Culture Of U.S. Chapter 11 Reorganizations And Facilitates Cross-Border Cases By Revising Its Insolvency Law

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In 2014, the Chilean Legislature enacted legislation that substantially overhauls its prior insolvency law, liberalizing that law as it pertains to business insolvency cases commenced in Chile. As explained below, this new law incorporates a number of provisions that permit the reorganization of financially troubled businesses. Because of the high volume of trade in goods and services between the United States and Chile, these changes in the Chilean insolvency law are important to businesses based in the United States who are engaged in the import/export trade with Chilean mercantile companies.

Chile's Economy and Trade in Goods and Services Between the United States and Chile

Chile is considered as having the strongest economy in South America at present. The land is blessed with substantial mineral deposits with copper being its primary export; Chile is the world's largest producer of this metal. Agriculture is the occupation of approximately 13% of Chile's population, even though it produces less than one-half of domestic needs. Chile's gross domestic product (GDP) in 2012 was \$325.8 billion, which translates into \$18,700 per capita. GDP in 2012 grew at a 5.5% rate compared to the prior year. Chile's imports in 2012 were valued at \$74.9 billion, with the U.S. being its largest supplier. Chile's primary imports are petroleum and petroleum products, chemicals, electrical and telecommunications equipment, industrial machinery, vehicles and natural gas. Chile's exports in 2012 totaled \$78.3 billion, with the U.S. being its second largest customer behind China. In addition to minerals, Chile's primary exports are fruit, fish and fish products, paper and pulp, chemicals and wine.

In 1834, only 16 years after Chile gained its independence from Spain, a treaty of "Peace, Amity, Commerce and Navigation" was ratified by the governments of the U.S. and Chile. This treaty provided, inter alia, for broad trading privileges between the two countries, both of which enjoyed "most favored nation" status with respect to tariffs. International trade between Chile and the U.S. has blossomed ever since. In 2003, a free trade agreement was ratified by the two governments, which agreement came into force on Jan. 1, 2004. Trade has mushroomed ever since. The existence of this substantial level of trade, however, creates the risk of loss arising from the insolvency of American and Chilean business enterprises engaging in this trade. The remainder of this article will outline the primary provisions of the new Chilean insolvency law and will explain how these changes affect this insolvency risk.

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Background and Purpose of the New Chilean Insolvency Law

The new Chilean insolvency law was approved by Congress at the end of 2013, and will become effective in October 2014. The primary aim of the new Chilean insolvency law is to change the legislation's approach to insolvency in Chile, from a view that strongly disapproves of those entities responsible for their insolvency and focuses on the liquidation of the debtor's assets, to a perspective that is less harsh regarding the debtor, that facilitates its reorganization, and encourages the preservation of enterprise value and jobs. Another important objective of the new law is to establish a procedure that is faster and less expensive for creditors and that allows them to obtain higher recoveries.

Most Important Changes Introduced by the New Chilean Insolvency Law

Financial Protection in Case of Reorganization Agreements

The former insolvency law provided limited protection for the debtor during the reorganization process. The new Chilean insolvency law however, because of its focus on reorganization, increases this protection. One critical innovation is that, if a reorganization plan is approved by creditors representing 66% of the debtor's liabilities, secured creditors will be bound by the terms of this plan, even if they voted against it. This could mean, for example, that secured creditors, in the absence of a plan provision to the contrary, will not be allowed to foreclose on assets that secures their claims provided, however, that the court determines that this collateral is essential to the debtor's reorganization. This is a major shift from prior law, under which secured creditors could foreclose on liened assets, even when the reorganization proceedings were on course.

Another substantial amendment involves the early termination of contracts based on the debtor's insolvency. Under the new Chilean insolvency law, during a period of time following the debtor's filing of a reorganization plan, the debtor's contracts may not be terminated on the grounds of insolvency. Also, payment terms in contracts to which the debtor is a party will remain unaltered but these contracts may not be terminated by the non-debtor party due to nonpayment. Claims held by creditors violating these rules will be subordinated, and be paid after unsecured and "insider" creditors.

Revocatory Actions

This new law also improves the regulation of both subjective and objective revocatory actions (RAs), granting more legal certainty to creditors that provide loans or enter into transactions with the debtor before its declaration of bankruptcy.

A subjective RA allows a challenge to transactions executed during the two years previous to the commencement of the debtor's insolvency proceedings if the following conditions are present: (i) bad faith of the non-debtor party concerning the transaction; and (ii) the transaction caused harm to creditors. This is a major improvement over prior law - - it grants legal certainty to third parties and introduces an objective standard of judicial review (i.e., the market conditions and fairness tests).

An objective RA may be sought to revoke or avoid some transactions

executed during the year preceding the commencement of the proceedings, where one or more of the following conditions are present: (i) early payments made by the debtor to a third party; (ii) payments made in due time, but in a different manner than as originally agreed (e.g., accord and satisfaction); and (iii) mortgages and pledges granted in the debtor's assets to secure pre-existing debts. In these cases, to avoid invocation of the RA remedies of avoidance and recovery, the debtor or the third party must prove the transaction did not harm the debtor's creditors.

Finally, amendments to the debtor's bylaws made within six months preceding the commencement of insolvency proceedings may be avoided if they cause a decrease in the debtor's equity.

Debtor Opposition to Involuntary Liquidation Proceedings

The former insolvency law did not permit a debtor to oppose an involuntary liquidation petition filed by a creditor. Under the new law, the debtor may contest an involuntary petition through a special proceeding based only on a limited catalogue of exceptions. This proceeding contemplates two hearings: an evidentiary hearing and a sentencing hearing. In order to balance the rights of the parties, an observer will be appointed to monitor the debtor's activities during the opposition procedure. The petitioner may file for injunctive relief during the same period.

Cross-Border Provisions

For the first time in Chile, regulations regarding cross-border insolvency have been adopted. The new regulation addresses (i) the procedures required for Chilean courts and agencies regarding insolvency proceedings commenced abroad; (ii) the procedures required for foreign courts and agencies regarding insolvency proceedings commenced in Chile; (iii) the procedures for a debtor who is undergoing insolvency procedures simultaneously in Chile and abroad; and (iv) the procedures when foreign creditors wish to commence or participate in an insolvency proceedings in Chile.

The new Chilean insolvency law's cross-border provisions provide that all creditors, Chilean or foreign, shall have the same rights regarding the commencement of an insolvency proceeding and with respect to creditor participation in those proceedings.

Furthermore, under the new Chilean insolvency law, a Chilean court that has recognized the pendency of an insolvency proceedings abroad may take any of the following actions: (i) suspending the commencement or continuation of any individual proceedings against the debtor; (ii) suspending any process against the debtor's assets; (iii) suspending the debtor's right to transfer or encumber its assets; (iv) demanding information regarding the debtor's assets, business, rights, obligations or liabilities; (v) requesting the appointment of a foreign receiver responsible for the administration or sale of the debtor's assets located in Chile; (vi) granting injunctions; and (vii) decreeing any other measures that, under the new Chilean insolvency law, may be granted to Observers or Liquidators.

These new provisions will undoubtedly be of help for American investors, as they facilitate the cooperation between the insolvency institutions and courts in Chile and the United States.

Plan Voting Rights and Quorum

In contrast to prior law, new Chilean insolvency law prescribes that related persons have no voting rights regarding both reorganization plans and liquidation procedures. Formerly, related persons were able to vote concerning liquidation procedures. Another change is that the quorum for approval of pre-bankruptcy reorganization agreements has been amended, being lowered from creditors representing 75% of the debtor's liabilities to creditors representing 66.6% of the debtor's liabilities. This change is aimed at hastening the pace of Chilean reorganization cases.

Specialized Courts and New Insolvency Authorities

Insolvency cases will henceforth be assigned to special courts that have deep knowledge of insolvency laws and procedures. Bankruptcy cases will not be randomly distributed among civil judges as they formerly were.

In order to achieve higher efficiency and effectiveness through specialization, the new law creates authorities such as the observer, who is a person in charge of the reorganization process and the liquidator, a person in charge of the liquidation of assets.

Online Platform

A free online platform has been created on which court decisions will be published for notice purposes. This innovation will make reorganization cases faster and less expensive, as it replaces the former paid publications in the official gazette.

Conclusion

The new Chilean insolvency law will result in a faster and less expensive insolvency procedure, with substantially more emphasis on reorganization than liquidation, and will allow investors to acquire insolvent companies in a much safer, swift and efficient manner. This focus on reorganization has some short-term disadvantages for secured creditors, such as the reduction in the certainty and quality of their collateral and their ability to realize upon those assets quickly. Comprehensively considered, however, we believe the new regulation will benefit both creditors and debtors, favoring entrepreneurship, improving the Chilean business climate and economy, and likely resulting in an increase in the creditors' recovery rate. In the words of Chile's first European explorer, Pedro de Valdivia, Chile continues to prove itself to be "no better land in the whole wide world to live and thrive".

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