



# **INSOL International**

## **Chile's New Insolvency Law: Restructured for Corporate Restructurings**

**October 2014**



## Chile's New Insolvency Law: Restructured for Corporate Restructurings

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## **Acknowledgement**

INSOL International is very pleased to publish a special report – “Chile’s New Insolvency Law: Restructured for Corporate Restructurings”.

The new insolvency legislation titled “Law for Reorganization and Liquidation of Assets for Companies and Individuals” which was passed in January 2014 will come into effect on 1 October this year.

The introduction of this new law has been a positive attempt by the government to deal with the challenges that are encountered with the ever developing economic changes that are taking place in Chile. As the title suggests the main focus of the new law is corporate restructuring and consequently in the long term it will have a direct impact on foreign investment in the country.

The key parts to this paper include: the current law and its shortcomings, key areas of the new law and its advantages, and the impact on foreign creditors and cross-border proceedings.

INSOL International sincerely thanks Pedro A. Jimenez, Jones Day, USA; Rodolfo Pittaluga Jr., Deloitte Financial Advisory Services LLP, USA, and Pablo Herrera, Deloitte FAS, Chile for preparing this excellent paper.

**September 2014**



## Chile's New Insolvency Law: Restructured for Corporate Restructurings

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### I. Introduction

In January 2014, Chile passed Law No. 20.720, a new insolvency law titled Law for Reorganization and Liquidation of Assets for Companies and Individuals (the "New CBA"), which will take effect in October 2014<sup>1</sup>. The New CBA represents Chile's bold effort to make corporate restructuring a more viable alternative to liquidation in order to, among other things, continue to attract foreign investment into the country. This objective stems from criticism over the country's continued lag when it comes to evolving its insolvency system to mirror its current growing economic landscape<sup>2</sup>. Chile's economy is one of the strongest in Latin America, ranking first in the 2014 Index of Economic Freedom<sup>3</sup> and thirty-fourth in the World Bank's "Ease of Doing Business" rankings<sup>4</sup>. However, its current insolvency law, which permits workout agreements provided certain conditions are satisfied, is uncertain and impractical.

This article will discuss the most recent developments in Chile's insolvency law and highlight specific changes geared towards increasing a corporate debtor's ability to successfully reorganize<sup>5</sup>. Section II of the article briefly discusses Chile's current bankruptcy law and some of its shortcomings. Section III discusses the foundational changes proposed by the New CBA. Section IV discusses other key provisions of the New CBA. Finally, Section V discusses the New CBA's incorporation of cross-border insolvency principles and the rights of foreign creditors in a Chilean insolvency reorganization proceeding. The article concludes by noting that the New CBA has made great strides in addressing the shortcomings of the current law, and that such improvements are likely to continue to attract new capital. However, the article posits that the New CBA can be strengthened to provide additional protections for existing and new-money investors.

### II. The Current Law: Historical Perspective and Its Shortcomings

Chile has one of the strongest and fastest-growing economies in Latin America<sup>6</sup>. It was the first South American country to join the OECD<sup>7</sup> and is a major player in international trade and a host of foreign investment<sup>8</sup>. It has free trade agreements that extend to over 60 countries, including the United States<sup>9</sup>. China and the United States are its two largest export markets<sup>10</sup>, with its principal exports including metals, fruits, fish, wine, and other minerals<sup>11</sup>. The United States is also Chile's greatest source of imports, from which it imports petroleum, chemicals, and electrical and telecommunications equipment<sup>12</sup>. Foreign investment in Chile has continued to increase, and Chile has received international recognition for its success in attracting foreign direct investment<sup>13</sup>. According to the World Investment Report 2014 released by the United

\* The views expressed in this article are the views of the authors and not of INSOL International, London.

\* The authors gratefully acknowledge and wish to thank Amanda Parra, who will be joining Jones Day in the Fall of 2015, and Jose Bores Borrero, a Manager with Deloitte Financial Advisory (Chile), without whose contributions this article would not have been possible. The views stated in the article are solely those of the authors and should not be attributed to Jones Day, Deloitte FAS or Deloitte FAS Chile or INSOL International.

<sup>1</sup> Chile's Insolvency and Reorganization Superintendence, *Gobierno publica Nueva Ley que impulsa el emprendimiento de empresas y rehabilitación de personas naturales*, (Jan. 9, 2014) [http://www.superir.gob.cl/index.php?option=com\\_content&view=article&id=903:gobierno-publica-ley&catid=17:noticias&Itemid=20](http://www.superir.gob.cl/index.php?option=com_content&view=article&id=903:gobierno-publica-ley&catid=17:noticias&Itemid=20)

<sup>2</sup> Deloitte Chile Internal Study, *Restructuring in Chile* (2013 – 2014) at pgs. 4–5.

<sup>3</sup> See, The Heritage Foundation, 2014 Index of Economic Freedom, (2014), available at, <http://www.heritage.org/index/country/chile>. The Index of Economic Freedom is an annual guide published by The Wall Street Journal and The Heritage Foundation, See <http://www.heritage.org/index/about>.

<sup>4</sup> The World Bank Group, *Doing Business 2014: Economy Rankings* (2014), <http://www.doingbusiness.org/rankings>.

<sup>5</sup> While the New CBA also provides for the reorganization of individuals, this article will be limited to juridical entities, and thus, will not address any implications of the New CBA with regard to individuals.

<sup>6</sup> The World Bank, Chile: Overview, <http://www.worldbank.org/en/country/chile>.

<sup>7</sup> *Id.*

<sup>8</sup> CIE Chile Foreign Investment Committee, *Chile: A Land of Opportunity*, at 45 (July 2013), available at <http://www.ciechile.gob.cl/wp-content/uploads/2014/04/CHILE-LAND-OF-OPPORTUNITIES-A.pdf>.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 43–44.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 83.



Nation Conference on Trade and Development (UNCTAD), Chile was the world's 17th largest recipient of foreign direct investment in 2012 and 2013, and is the 3rd largest host for foreign investment in Latin America, after Brazil and Mexico<sup>14</sup>. The year 2013 represented the third consecutive year that Chile was placed among the top 20 recipients of global foreign direct investment<sup>15</sup>.

Chile's bankruptcy law is set forth in the Chilean Bankruptcy Act (the "CBA"), which is contained in the Chilean Code of Commerce. The current law was first promulgated in 1982 and subsequently reformed. Its current version contains all the requirements for declaring bankruptcy in the country, and the Superintendencia de Bankruptcy<sup>16</sup> is the administrative agency charged with overseeing all bankruptcy proceedings and ensuring their efficiency and transparency<sup>17</sup>. Prior to 2005, the exclusive remedy for distressed corporate debtors under the CBA was the speedy liquidation of its assets. In 2005, reforms to the CBA were enacted (the "2005 Law") which provided, for the very first time, a set of mechanisms to allow for a debtor to enter into a court-approved workout agreement with creditors as an alternative to liquidation<sup>18</sup>. However, under the current law, bankruptcy proceedings can last four to five years and cost up to fifteen percent of the debtor's assets, and net a recovery of only 26-29% of total debt<sup>19</sup>. As a result, business bankruptcy procedures provided in Chile's current insolvency law are infrequently used and liquidation is the predominant solution<sup>20</sup>.

## A. Evolving from a Liquidation-only Option

Although it provided a theoretical alternative to liquidation, the 2005 Law (currently in effect in Chile) fell short in creating a usable framework through which a debtor could successfully reorganize. Prior to 2005, the only relief available under Chile's bankruptcy law was the liquidation of a corporate debtor's assets<sup>21</sup>. The primary goal of the former, pre-2005 law was the fast, efficient, and equitable repayment of creditors<sup>22</sup>. Chilean legislators realized the importance of continuing the operation of a viable debtor's business for purposes of preserving employment levels and the economy in general. As a result, the 2005 Law was enacted to advance an alternative to liquidation<sup>23</sup>. The 2005 Law did this by fostering and enforcing agreements made between the debtor and creditors, whether struck in or outside the bankruptcy system. Specifically, the 2005 Law created a framework that provides for the possibility of restructuring through two types of agreements, extra-judicial agreements and judicial agreements, and attached certain processes and protections to each type of agreement<sup>24</sup>.

### i. *Extra-judicial Agreements: An Informal Process That Binds Signatories Only*

The 2005 Law makes clear that extra-judicial agreements (i.e. those agreements between creditors and a debtor that are reached outside of a bankruptcy proceeding) are to be recognized and binding upon the parties despite not being supervised by the court<sup>25</sup>. An out-of-court workout agreement can only be recognized if the debtor has not filed for bankruptcy<sup>26</sup>. The current law contemplates that while such extra-judicial agreements may prevent a business from needing to commence a formal bankruptcy proceeding, they are like any other contract in that they bind only the parties to the agreement and have no effect on non-party creditors<sup>27</sup>. Not surprisingly, then, an extra-judicial agreement does not give the debtor any breathing room to deal with hold-out creditors because there is no moratorium on debt collection or enforcement actions

<sup>14</sup> World Investment Report 2014: Investing in the SDG's Action Plan, at 61, available at [http://unctad.org/en/PublicationsLibrary/wir2014\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf)  
<sup>15</sup> *Id.*

<sup>16</sup> Known as "Superintendencia de Quiebras", this organization was created by the 2002 reform to Chile's bankruptcy laws. See The Superintendencia Bulletin, at 3, available at [http://www.superir.gob.cl/images/stories/pub\\_juridicas/boletin-juridico-publicacion-n2.pdf](http://www.superir.gob.cl/images/stories/pub_juridicas/boletin-juridico-publicacion-n2.pdf).

<sup>17</sup> See, Superintendencia's mission statement at

[http://www.superir.gob.cl/index.php?option=com\\_content&view=category&layout=blog&id=118&Itemid=181](http://www.superir.gob.cl/index.php?option=com_content&view=category&layout=blog&id=118&Itemid=181).

<sup>18</sup> José María Eyzaguirre Fernández, *Evolución histórica de la legislación concursal en materia de convenios judiciales: han logrado los cambios legales introducir alternativas efectivas a la liquidación de los bienes del fallido?*, at 26–27 (Superintendencia de Quiebras, 2010).

<sup>19</sup> The World Bank Group, *Doing Business 2014: Resolving Insolvency* (2014), <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>.

<sup>20</sup> *Infra*, Section II.B.

<sup>21</sup> José María Eyzaguirre Fernández, *supra* note 18, at 9.

<sup>22</sup> *Id.* at 26–28.

<sup>23</sup> Cód. COM., Libro IV De Las Quiebras, art. 1, [hereinafter "The 2005 Law"] available at

<http://www.leychile.cl/Navegar?idNorma=1974&idParte=862505> (stating that the objective of the law is to dispose of the debtor's assets in one proceeding, in order to pay the creditors.)

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at art. 169–170.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at art. 169.



against the debtor's assets<sup>28</sup>. Thus, in practice, extra-judicial agreements do not provide the necessary means for a debtor to comprehensively reorganize, nor do they provide sufficient protection for a debtor seeking to continue its business operations.

## ii. *Judicial Agreements: A Formal Workout Agreement Process*

Judicial agreements are more formal than extra-judicial agreements in that they are entered into under court supervision<sup>29</sup>. Unlike extra-judicial agreements, judicial agreements are binding upon all unsecured creditors, including dissenting minorities, once they are approved by the necessary quorum<sup>30</sup>. There are two types of judicial agreements: preventative agreements and resolution agreements<sup>31</sup>. Preventative agreements, as the name implies, are meant to avoid a bankruptcy filing. Resolution agreements are reached after the debtor has filed for bankruptcy in order to bring the bankruptcy proceeding to a close<sup>32</sup>. The 2005 Law's approach to *who* can propose a plan is dependent on exactly what type of agreement is being proposed. For example, only a debtor may prepare and propose a restructuring agreement as part of the preventative process. However, during a bankruptcy proceeding, both debtor and creditors may propose a resolution agreement. In a separate scenario, if an expert facilitator<sup>33</sup> is designated, the said person will be the one responsible for preparing and submitting a plan<sup>34</sup>.

Generally, there is no moratorium on actions against the debtor during the judicial agreement process. However, this may change if the debtor is able to garner sufficient support for its agreement. For example, the debtor enjoys a 90-day moratorium if it proposes a preventative agreement that receives the support of two or more creditors representing more than 50 percent of the total claims<sup>35</sup>. The debtor also receives the benefit of a moratorium and a speedier approval procedure if it garners the support of two or more creditors representing at least two-thirds of the total claims<sup>36</sup>.

## B. The 2005 Law's Shortcomings: The Need for Major Reform Recognized

While the judicial agreement process strives to give debtors an alternative to liquidation, the empirical data suggests that in reality, the 2005 Law was not successful in promoting reorganization as an alternative to liquidation. From 2006 to 2012, only 47 debtors successfully approved judicial agreements, compared to 855 debtors which were liquidated<sup>37</sup>. Furthermore, Chile's statistics, when compared to its Latin American neighbors and other countries tracked by the OECD, continue to place it low on global rankings for insolvency proceedings. For example, Chile's recovery rate, measured as a percentage of the estate, is 25.5%, compared to a 93% recovery rate in Colombia, and a 68% average recovery rate among OECD countries<sup>38</sup>. Additionally, Chile's bankruptcy proceedings last an average of 4.5 years, compared to 1.3 years in Colombia, 1.8 years in Bolivia, and an average of 1.7 years among OECD countries<sup>39</sup>. Furthermore, the cost associated with a bankruptcy in Chile is 15% of the debtor's estate, compared to 7% in Colombia<sup>40</sup>. As a result, Chile ranks 102<sup>nd</sup> out of 189 countries in the World Bank's "Resolving Insolvency" rankings<sup>41</sup>.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at art. 171. Note that under the 2005 Law, all bankruptcy proceedings are overseen and conducted in a court of general jurisdiction.

<sup>30</sup> *Id.* at art. 200.

<sup>31</sup> Termed "convenio judicial preventivo" and "convenio judicial simplemente," respectively. See *id.* at art. 171 and 186.

<sup>32</sup> *Id.* Note that if a resolution agreement is not reached, the debtor will enter liquidation proceedings.

<sup>33</sup> An expert facilitator is a third party selected by the debtor and approved by a majority of all claimants, including secured creditors, and is tasked with examining and assessing the debtor's affairs and preparing an agreement proposal that offers creditors and the debtor better prospects than what would be accomplished if the debtor were to liquidate. The court will appoint an expert facilitator if the debtor moves for said appointment. See, Deloitte Internal Study, *supra* note 2.

<sup>34</sup> THE 2005 LAW, *supra* note 23, at art. 177.

<sup>35</sup> *Id.* at art. 177 bis. Note that total claims is calculated as the total amount of claims that have been allowed and have been court approved. Title X of the 2005 Law outlines the process for filing proof of claims and disputing challenges to such claims. As part of this process, each creditor must provide valid documentation to justify the existence of a debt. Other creditors, the debtor or the trustee can challenge the validity of a claim. See *id.* at art. 131–32.

<sup>36</sup> An "express procedure" requires the judge to call a meeting of creditors to approve or reject the plan within 30 days of the plan's proposal. See *id.* art. 177 quater.

<sup>37</sup> Deloitte Internal Study, *supra* note 2, at 4.

<sup>38</sup> *Id.* at 4, 5.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 5.

<sup>41</sup> The World Bank Group, *supra* note 4.



Several key factors contributed to the 2005 Law's inability to provide an alternative to liquidation. First, unlike in many other countries, Chile did not have courts specializing in bankruptcy matters, leading to a high degree of unpredictability and unreliability over the length and success of a restructuring. Another limitation was that the law did not recognize out-of-court or pre-packaged restructurings, meaning that a debtor was required to commence a long judicial proceeding, and often with uncertain results because of the negative stigma associated with bankruptcy in Chile, to obtain formal approval of an out-of-court consensual restructuring plan agreed to between the debtor and its creditors. For this reason, debtors in Chile often waited too long to commence a judicial proceeding, resulting in many liquidations that could have otherwise been avoided. There are other examples of where the 2005 Law failed to provide a debtor with the necessary tools to effect a successful restructuring. For instance, the 2005 Law lacked important provisions necessary to (1) negotiate and approve a reorganization agreement, (2) provide incentives to providers of capital necessary to allow the debtor to reorganize its business, and (3) use a foreign bankruptcy system to enforce a plan confirmed by Chilean courts.

#### ***i. Debtor and Creditors Cannot Negotiate and Approve an Agreement***

Of the 2005 Law's shortcomings, perhaps the most significant shortcoming is that it fails to provide a structure upon which a debtor and its creditors are incentivized to engage in meaningful and productive negotiations. Four principal factors contribute to this reality. First, secured creditors are not bound by any reorganization agreement, as long as they do not vote for said agreement<sup>42</sup>. Thus, they need not participate in any negotiations and may continue to pursue their creditor remedies and collect on their claims.

Second, any judicial agreement must group all creditors as a single class and treat all creditors exactly the same<sup>43</sup>. The fact that different treatment among the various creditors is not permitted unless all creditors agree on the same alternative treatment prevents a debtor's agreement from garnering sufficient approval<sup>44</sup>. This, in turn, disincentivizes creditors from negotiating with the debtor. Contrast this approach with that provided by the US Bankruptcy Code, which authorizes separate classification of creditors and allows each class to be treated differently, but mandates the same treatment to each creditor within a particular class<sup>45</sup>. This approach gives a United States debtor greater flexibility in how it classifies and treats various creditors under a reorganization plan, making a consensual plan much more likely.

Third, in order for a judicial agreement to be approved, the debtor, together with sixty-six percent of the creditors whose claims must total at least seventy five percent of the debtor's liabilities must vote in favor of the agreement<sup>46</sup>. Contrast this approach to the one under Chapter 11 of the United States Bankruptcy Code, where a class of creditors is deemed to have accepted a plan when it is accepted by creditors holding at least two-thirds in amount and more than one-half in number of the allowed claims in that class<sup>47</sup>. In addition, under Chapter 11, a plan can be confirmed by the bankruptcy court, through the cram down process, regardless of whether a class has rejected the plan<sup>48</sup>. Because the 2005 Law requires all creditors to be classified together in the same class and does not allow a judicial agreement to be approved without acceptance by the entire class, the law in effect creates a very high hurdle for approval<sup>49</sup>.

Finally, the reality is that debtors are not able to develop a judicial agreement when creditors are permitted to pursue legal and non-legal actions against them. As previously mentioned, a debtor does not receive the protection of a moratorium, or stay, on actions pending against it or its assets while preparing a judicial agreement<sup>50</sup>. The debtor only receives temporary protection when it is able to garner sufficient support from creditors, which in practice may be difficult given that some creditors opt to exercise remedies rather than subject themselves to a long drawn-out process that may

<sup>42</sup> THE 2005 LAW, *supra* note 24, at art. 202.

<sup>43</sup> *Id.* at art. 178.

<sup>44</sup> *Id.*

<sup>45</sup> 11 U.S.C. § 1122.

<sup>46</sup> THE 2005 LAW, *supra* note 24, at art. 190.

<sup>47</sup> 11 U.S.C. § 1126(c).

<sup>48</sup> 11 U.S.C. § 1129(b).

<sup>49</sup> THE 2005 LAW, *supra* note 24, at art. 209.

<sup>50</sup> *See generally*, *id.* at art. 177.





lead to a lower recovery on their collateral. Under such a legal framework, there is little to no incentive for creditors who have leverage to negotiate with a debtor.

## **ii. New Money and Debtor-in-Possession Financing Not an Option**

The 2005 Law does not provide tools to incentivize funding or new money investing during the judicial agreement process. A key aspect of the reorganization law in many countries, including in the United States under Chapter 11, is the ability to enable a debtor to continue to operate its business so that it may turn it around and restructure same. To this end, Chapter 11 of the U.S. Bankruptcy Code gives a debtor the ability to finance its ongoing operations by obtaining new or additional credit. One of the main mechanisms the U.S. Bankruptcy Code employs to incentivize lenders to provide financing to a debtor is the granting of additional liens or super-priority in ranking of repayment, which give lenders to a debtor-in-possession a more secure position and more favorable treatment<sup>51</sup>.

However, the 2005 Law does not give distressed investors and debtor-in-possession ("DIP") lenders sufficient priority or security to incentivize financing. The priorities that a trustee<sup>52</sup> must adhere to during a liquidation, which are also followed under a judicial agreement procedure, are found in Chile's Civil Code and are as follows:

1. Category one includes:
  - a. Judicial costs incurred in the general interests of creditors;
  - b. Expenses incurred in connection with the recovery of assets, bankruptcy administration expenses, expenses incurred in the disposition of estate assets, and loans raised by the trustee to fund the above-specified expenses;
  - c. Employee claims such as salaries, severance payments, and social security payments; and
  - d. Government claims for withholding and surcharge taxes.
2. Category two includes claims secured with a pledge lien, a contractor's lien, or a transporter's cargo lien.
3. Category three includes claims secured with a mortgage lien.
4. Category four includes claims that have special protection under Chilean civil law, which are not prevalent in corporate bankruptcies.
5. Category five includes all other unsecured claims that do not have priority<sup>53</sup>.

Because of the above statutory priorities, a distressed investor or DIP lender only receives priority over other unsecured creditors. Additionally, these investors and lenders only gain recourse to assets that have not been previously mortgaged or pledged, which may prove to be of little, if any, incentive to a lender. Thus, in practice, lenders are not willing to provide financing in a reorganization under the 2005 Law<sup>54</sup>.

## **iii. Cross-border Insolvency Proceedings Not Recognized**

The 2005 Law's provisions on cross-border insolvency also contribute several weaknesses to Chile's bankruptcy system. Currently, the 2005 Law does not follow the UNCITRAL Model Law on Cross-Border Insolvency issues. Rather, under the 2005

<sup>51</sup> 11 U.S.C. § 364.

<sup>52</sup> In a liquidation proceeding, the Trustee or "el 'síndico'," is the one that manages the estate, and thus the one that manages distributions based on priorities. See The 2005 Law, *supra* note 23, Title III, art. 27.

<sup>53</sup> Cod. Civ., Libro IV, Title XLI, art. 2472.

<sup>54</sup> The 2005 Law makes no mention as to whether new money receives a preference under a preventative judicial agreement process. However, the 2005 Law does protect new money in a bankruptcy proceeding, as opposed to judicial preventative process. This preference only applies when a debtor that has continued its business operation ("continuación de giro") and specifically to creditors that have voted to allow the debtor to continue its operations. However, this preference for new money has little utility in the bankruptcy process because the debtor's business is typically not viable, and thus a turnaround is unlikely.





Law, the court of the debtor's domicile must hear bankruptcy proceedings. Under Chilean corporate law, a corporation incorporated in Chile is domiciled in Chile<sup>55</sup>. Thus, the bankruptcy of a Chile-domiciled debtor may only be declared and conducted by a Chilean court<sup>56</sup>. The effect of this is that an otherwise valid and successful Chapter 11 case in the United States ("U.S.") of a Chilean company would not be recognized in Chile<sup>57</sup>. A Chilean debtor can therefore not make successful use of the U.S. bankruptcy system even if it has affiliates and assets in the U.S. Additionally, non-Chilean debtors are not be able to have Chilean courts enforce a foreign bankruptcy proceeding. In sum, the 2005 Law (a) does not recognize the economic reality that debtors operate in a global economy and maintain assets in other countries, and (b) lacks a mechanism by which a Chilean court can recognize a foreign bankruptcy proceeding relating to a Chilean or non-Chilean debtor.

### III. New Law: Chile's Bankruptcy Law Restructured

In January 2014, Chile's Congress passed the New CBA, a set of reforms that are intended to further develop the country's reorganization regime<sup>58</sup>. The New CBA takes effect in October 2014 and is aimed at seriously promoting reorganization as an alternative for viable business debtors, far beyond the 2005 Law's attempt to do so. It promises to promote reorganization further than the 2005 reforms and embodies conceptual and structural changes to Chile's entire bankruptcy regime. Legislators and the Superintendence believe that this holistic approach to reform will incentivize all interested parties to make use of the reorganization alternative that is unworkable under the current law<sup>59</sup>.

At a fundamental level, the New CBA challenges existing stigmas around reorganization. The most obvious example of this challenge is found in Article 1 of the New CBA, which by its very title makes clear that the ultimate goal of Chile's bankruptcy law is to provide a structure for bankruptcy proceedings whether through reorganization or liquidation<sup>60</sup>. Its renaming and redefining of key terms also evidences the New CBA's support for restructuring. For example, effective October 2014, Chile's bankruptcy law will be referred to as an "Insolvency and Restructuring" law, instead of "Bankruptcy law"<sup>61</sup>. In addition, the former Superintendence of Bankruptcy will be renamed the Superintendence of Insolvency and Restructuring (the "Superintendence"), to parallel the change in the law's title<sup>62</sup>. Furthermore, the term "judicial agreement" will be supplanted with the term "reorganization"<sup>63</sup>.

The New CBA proposes an entirely new structure and creates new players. The 2005 Law's judicial agreements' structure is to be replaced by an entirely new chapter on restructuring procedures, titled "Bankruptcy Reorganization Procedures"<sup>64</sup>. This new procedure is organized around two types of reorganizations: (1) extra-judicial reorganization and (2) judicial reorganization. Additionally, two new key players are created by the law and designed to undertake prominent roles in a bankruptcy proceeding: the "Reorganization Supervisor"<sup>65</sup> and the "Liquidator". Moreover, specialized courts with a deep knowledge of and expertise in bankruptcy laws and procedures will have priority jurisdiction over all bankruptcy and reorganization proceedings<sup>66</sup>.

In addition to other changes to its liquidation, cross-border, and individual bankruptcy provisions, perhaps the New CBA's most laudable change is the introduction of tools designed to increase the likelihood of a successful corporate reorganization. This new law was inspired by the laws in other Organization for Economic Cooperation and Development (OECD) and Latin American countries including Colombia, Mexico, and Brazil which have been reformed so as to promote

<sup>55</sup> Cod. Civ., Title XLI, Libro IV, art. 202.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> Chile's Insolvency and Reorganization Superintendence, *supra* note 1.

<sup>59</sup> Nicolas Caceres, *Superintendencia defiende la nueva Ley de Quiebras: "Es la herramienta que hoy necesita Chile,"* (Jan 9, 2014), <http://www.lasegunda.com/Noticias/Economia/2014/01/905815/superintendencia-defiende-la-nueva-ley-de-quiebras-es-la-herramienta-que-hoy-necesita-chile>.

<sup>60</sup> COD. COM., Ley 20.720, art. 1 (effective Oct. 2014) [hereinafter "THE NEW CBA"]

<sup>61</sup> Caceres, *supra* note 60.

<sup>62</sup> THE NEW CBA, *supra* note 61, at Chapter IX art. 331, 332.

<sup>63</sup> "Reorganización" in Spanish; see Caceres, *supra* note 60.

<sup>64</sup> THE NEW CBA, *supra* note 61, at Chapter III: Del Procedimiento Concursal De Reorganización

<sup>65</sup> *Id.* at Chap. II ("Veedor" in Spanish).

<sup>66</sup> *Id.* at art. 3. Under the new law, Chile still will not have independent bankruptcy courts. Instead, courts that have a specialty in bankruptcy will be the preferred courts to oversee bankruptcy cases. The objective is to promote a more specialized bankruptcy system and concentrate the bankruptcy cases with specific judges that have the specialized knowledge and skills in bankruptcy law.



reorganization<sup>67</sup>. The main take away from the reforms in these countries is that economies benefit when bankruptcy laws encourage swift, low-cost procedures that result in the reorganization of viable businesses<sup>68</sup>.

### A. The New Players: Reorganization Supervisor and Liquidator

The debtor's three largest creditors, whether secured or unsecured, nominate the Reorganization Supervisor (the "Supervisor"), who must satisfy a certain set of criteria<sup>69</sup>. The Supervisor's main function is to facilitate the negotiations between debtors and creditors, with the goal of reaching a reorganization agreement<sup>70</sup>. In addition, said Supervisor is tasked with, among other things, safeguarding the interests of the debtor and creditors alike, compiling debtor information, following restructuring procedures, and providing status reports and information regarding any debtor misconduct to the Superintendence<sup>71</sup>. While responsible for overseeing many aspects of a reorganization proceeding, the Supervisor's most important charge is to evaluate the validity of claims and determine the value of the debtor's assets<sup>72</sup>.

The Liquidator is the authority responsible for overseeing all aspects of a debtor's liquidation procedure. The Liquidator, like the Supervisor, represents the interests of the creditors and the debtor<sup>73</sup>. The Liquidator's main responsibilities include: (1) taking inventory of the debtor's assets, (2) liquidating the debtor's assets, (3) distributing funds to creditors based on priorities, and (4) soliciting financing to cover the bankruptcy costs<sup>74</sup>.

### B. Extra-judicial Reorganization: Pre-packaged Plans Receive Judicial Protection

The New CBA recognizes an extra-judicial reorganization procedure, whereby a court approves an Extra-judicial Reorganization Agreement that was developed outside of the bankruptcy court<sup>75</sup>. The benefit of an extra-judicial reorganization is that it is generally more expeditious than, and does not involve many of the procedural hurdles associated with, a judicial reorganization, such as the appointment of a Reorganization Supervisor<sup>76</sup>. In order for an extra-judicial plan to be court-approved, two or more creditors whose claims represent at least 75 percent of the total claims corresponding to their respective classes must accept the plan<sup>77</sup>. While the bankruptcy court considers approval of the plan, the court stays creditor actions against the debtor, including solicitation of the debtor's forced liquidation<sup>78</sup>. However, during this time, the debtor is prohibited from disposing of any of its assets, except those that are essential to the debtor's ongoing business activities<sup>79</sup>. After approval, the extra-judicial plan has the same effect as a judicial reorganization plan in that it binds all creditors, regardless of whether they voted to accept the plan<sup>80</sup>.

### C. Judicial Reorganization: A New System Enables Swift Approval of Plans

While the 2005 Law was predominately focused on protecting creditors, typically at the expense of salvaging a debtor's viable business, the New CBA's judicial reorganization is more focused on turning the debtor's business around. The majority of the New CBA details the process for a judicial reorganization, whereby a debtor negotiates with creditors to develop a Judicial Reorganization Agreement<sup>81</sup>. Several of the key changes incorporated

<sup>67</sup> American Bankruptcy Institute Journal, *An Overview of Recent Bankruptcy Reforms in Latin America* (2005), [http://www.klgates.com/files/tempFiles/bbbb0097-2a2e-44af-a649-ba761a6dca33/article\\_mcevoy\\_0407.pdf](http://www.klgates.com/files/tempFiles/bbbb0097-2a2e-44af-a649-ba761a6dca33/article_mcevoy_0407.pdf).

<sup>68</sup> The World Bank Group, *Doing Business 2014: Resolving Insolvency*, <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency/what%20measured>.

<sup>69</sup> *Id.* at art. 22.

<sup>70</sup> *Id.* at art. 25.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at art. 36.

<sup>74</sup> *Id.* While a full discussion of the Liquidator's appointment procedures and responsibilities is beyond the scope of this article, that information can be accessed in Chapter II, Title 2 of THE NEW CBA.

<sup>75</sup> *Id.* at art. 102–114. An Extra-judicial Reorganization Agreement is an agreement entered into outside of a formal in-court bankruptcy proceeding by a corporate debtor and its creditors with the goal of restructuring the debtor's assets and liabilities and which is approved by the court in accordance with Chapter III, Title 3. *Id.* at art. 2 (2).

<sup>76</sup> *Id.* at art. 113.

<sup>77</sup> *Id.* at art. 109. Note that all creditors must still submit their claims for verification and court approval. The Reorganization Supervisor manages this process and is responsible for publishing all of the information on the Insolvency Bulletin. The Supervisor, debtor, and other creditors can object to the validity of a claim. Objections are to be heard by the court. *See id.* at art 70–72.

<sup>78</sup> *Id.* at art. 108.

<sup>79</sup> THE NEW CBA, *supra* note 61, at art. 108.

<sup>80</sup> *Id.* at art. 113.

<sup>81</sup> A Judicial Reorganization Agreement is one which is entered into by a corporate debtor and its creditors with the goal of restructuring the debtor's financial situation in accordance with Chapter III, Titles 1 and 2. *See id.* at art. 2 (1).



into the New CBA address the shortcomings of the 2005 Law. These changes include: (i) greater protection for the debtor by providing the debtor with a reprieve, or a “stay”, from creditor action to allow the debtor to consummate a reorganization, (ii) greater incentives for debtor and creditors to negotiate, and (iii) less onerous requirements for plan approval in order to reduce the time associated with a bankruptcy proceeding. It remains unclear what protections, if any, are afforded to existing equity holders under the New CBA. However, the New CBA does contemplate the potential for additional or new financing, as a mechanism for enabling a debtor to continue its operations.

### ***i. The Stay Period: A Moratorium on Actions Against the Debtor***

The New CBA provides more protection to the debtor during the reorganization process, including the creation of a stay period (the “Stay Period”)<sup>82</sup>. During the Stay Period, creditors are prohibited from, among other things, initiating any actions against the debtor’s assets and property on account of pre-bankruptcy filing defaults<sup>83</sup>. The Stay Period also protects against the initiation of an involuntary liquidation action<sup>84</sup>. Additionally, creditors are also prohibited from terminating their contracts with the debtor as a result of the debtor’s insolvency<sup>85</sup>. Any creditor that violates this rule will have its claims subordinated below unsecured and insider creditors<sup>86</sup>.

The Stay Period also protects the interests of creditors. This is predominately accomplished through the intervention of the Reorganization Supervisor, whom the debtor must co-operate with, into the Debtor’s business matters<sup>87</sup>. During the Stay Period, a debtor is not allowed to dispose of any estate assets, except those sold in the debtor’s ordinary course of business<sup>88</sup>. The debtor is also forbidden from modifying its bylaws without the authorization of the Supervisor<sup>89</sup>. The Stay Period lasts for an initial 30 days, but can be extended up to a total of 90 days (an additional 30 days if the debtor garners the approval of creditors representing 30 percent of its total debt, and another additional 30 days, for a total of 60 additional days, if the debtor garners the approval of creditors representing 50 percent of its total debt)<sup>90</sup>.

### ***ii. Creditor Classification: Incentivizing Support from Creditors***

Under the 2005 Law, secured creditors lose their security upon voting to approve the plan<sup>91</sup> and all creditors have to be classified together and treated exactly the same<sup>92</sup>. The New CBA dispenses with both of these requirements and allows secured and unsecured creditors to be classified separately, permitting secured creditors to maintain their liens and priority status under the plan<sup>93</sup>. Additionally, each class can negotiate for a treatment different than that proposed by the plan, so long as all members in a particular class are treated the same<sup>94</sup>. Thus, under the New CBA, a debtor is provided with greater flexibility to formulate and negotiate a plan that is more likely to receive creditor approval<sup>95</sup>.

### ***iii. Expediting the Plan Approval Process***

The New CBA expedites the plan approval process by, among other things, reducing the threshold required to approve a plan of reorganization. It provides that a plan is approved if: (a) the debtor approves the plan (b) at least two-thirds in amount of the creditors present at the vote, accept the plan, and (3) said creditor acceptances represent at least two-thirds in value of the total claims entitled to vote in each

<sup>82</sup> Translated from “Protección Financiera Concursal” in Spanish; See THE NEW CBA, *supra* note 61, at art. 57.

<sup>83</sup> THE NEW CBA, *supra* note 61, at art. 57 (1)(a).

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at art. 57 (1) (c).

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* at art. 57 (2)(a).

<sup>88</sup> *Id.* at art. 57 (2)(b).

<sup>89</sup> THE NEW CBA, *supra* note 61, at art. 57 (2)(c).

<sup>90</sup> *Id.* at art. 58.

<sup>91</sup> *Supra*, Section II. B.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at art. 61.

<sup>94</sup> *Id.* at art. 61. While equity holders still do not vote and are not classified under a plan, they do play a role in plan formulation and negotiations.

<sup>95</sup> The New CBA also introduces favorable tax treatment for claims that are restructured as part of a plan of reorganization. Pursuant to Articles 93 and 393 of the New CBA, creditors are entitled to recognize for tax purposes any losses resulting from the restructuring of a claim under a plan of reorganization.



respective class<sup>96</sup>. This is a lower threshold than that required under the 2005 Law, which required the debtor's approval, together with the approval by 66% of the creditors totaling 75% of the debtor's total claims. Like chapter 11 in the United States, claims of "insiders" are not counted for purposes of determining whether a plan of reorganization was accepted by the requisite majorities. First, no persons related or associated with the debtor may take part in the voting<sup>97</sup>. Moreover, the claims of any "Related Person" are not counted as part of the total claims for voting purposes<sup>98</sup>.

The New CBA also puts in place deadlines for complying with certain procedures, including challenging a proposed plan. Those creditors who wish to challenge a proposed plan are required to file their objections with the Supervisor within five (5) days of the plan's publishing in the Insolvency Bulletin (the "Challenge Period")<sup>99</sup>. The court then has ten (10) days from the last day of the Challenge Period in which to hold a hearing to address all of the challenges<sup>100</sup>. From there, the court has thirty (30) days to resolve the objections to the plan, and if said objections cannot be resolved, the debtor must propose a new plan within ten (10) days of receiving notice that the objection to the plan was sustained<sup>101</sup>. Finally, if a reorganization plan fails to meet the required quorum, then it is considered rejected and the creditors can conduct a special vote to determine whether the debtor should be allowed to propose another plan or if the debtor should proceed to liquidation<sup>102</sup>. If the creditors vote to allow the debtor to propose another plan, then the debtor is given ten (10) days to do so<sup>103</sup>. Moreover, the language of Article 78, which defines who is entitled to vote, refers only to creditors that existed as of the bankruptcy filing date<sup>104</sup>.

#### IV. Chile's New Law Proposes Several Advantages

Chile's New CBA introduces a number of other key provisions designed to further the continuation or reorganization of a distressed company, including provisions that make it easier to sell some or all of the assets of a debtor, and which may incentivize parties to lend to a debtor in bankruptcy<sup>105</sup>. However, the New CBA does not provide a mechanism by which new money investors can facilitate the reorganization of a debtor<sup>106</sup>.

##### A. The Authorized Sale of Some or All of a Debtor's Assets

The New CBA contains several provisions governing the sale of some or all of a debtor's assets during the pendency of a bankruptcy proceeding. Article 57(2)(b) provides that during the Stay Period, a debtor cannot consummate a sale of assets outside of the ordinary course of business, except in accordance with Article 74<sup>107</sup>. Article 74 provides that a debtor can effect a sale of assets outside of the ordinary course of business so long as the value of the assets being sold does not exceed twenty percent of the value of the debtor's fixed assets<sup>108</sup>. The value of the debtor's assets is to be determined by the Reorganization Supervisor<sup>109</sup>. Article 74 goes on to authorize a debtor to sell assets with a value in excess of 20 percent (20%) of the debtor's fixed assets, so long as such a sale has been approved by creditors representing at least 50 percent (50%) of the liabilities of the debtor<sup>110</sup>. This new tool should enhance the ability of a debtor to effect a going-concern sale of assets as part of its reorganization plan. What remains uncertain is whether the purchaser of a debtor's assets can obtain additional comfort in a bankruptcy sale by having the bankruptcy

<sup>96</sup> THE NEW CBA, *supra* note 61, at art. 79.

<sup>97</sup> *Id.* at art. 79.

<sup>98</sup> A "Related Person" includes: any affiliate or subsidiary that is part of the same company, all legal entities that are affiliated with the company, its directors, managers, and administrators of the company, and any person that alone or together with others can designate at least one member of the board or control 10% of the capital the company. See *id.* at art. 2, (referring to Ley 18.045, art. 100).

<sup>99</sup> *Id.* at art. 86. The Insolvency Bulletin is an electronic platform managed by the Superintendence which can be accessed by the public for free and where all the resolutions and actions taken in the bankruptcy proceedings will be posted in order to notify all parties. See *id.* at art. 2 (7).

<sup>100</sup> *Id.* at art. 87.

<sup>101</sup> *Id.* at art. 88.

<sup>102</sup> *Id.* at art. 96.

<sup>103</sup> *Id.* at art. 96.

<sup>104</sup> *Id.* at art. 78.

<sup>105</sup> See *infra* Section IV. A., B., and C.

<sup>106</sup> *Id.*

<sup>107</sup> THE NEW CBA, *supra* note 61, at art. 57(2)(b).

<sup>108</sup> *Id.* at art. 74.

<sup>109</sup> *Id.* at art. 76.

<sup>110</sup> *Id.* at art. 74.



court enter one or more orders approving a sale, free and clear of any claims and liens on the assets, as permitted under section 363 of the U.S. Bankruptcy Code<sup>111</sup>.

Similarly, the New CBA allows the sale of a debtor's assets in a liquidation as a going concern despite an objection by the debtor. In stark contrast, the current law requires the consent of the debtor in order to effect a going-concern sale of the debtor's assets, resulting in much lower recoveries to creditors. This change in the law should permit the going-concern sale of a company in order to maximize recoveries to creditors, as compared to more typical piecemeal sales that frequented liquidations.

## B. Authorizing Financing to Debtors

The New CBA also incentivizes parties not only to continue doing business with, but to lend to, a debtor during the pendency of the bankruptcy. For example, Article 72 of the New CBA provides an incentive for suppliers that continue doing business with the debtor<sup>112</sup>. Specifically, Article 72 states that the claims belonging to those creditors that continue doing business with the debtor while in bankruptcy shall enjoy a priority of payment over other unsecured creditors<sup>113</sup>. The one limitation under Article 72 is that such priority is limited to an amount not to exceed 20 percent (20%) of the total liabilities of the debtor<sup>114</sup>.

As is the case with the sale of assets outside of the ordinary course of business, Article 74 of the New CBA permits a debtor to obtain post-filing financing during the Stay Period<sup>115</sup>. The debtor may obtain new financing that does not exceed 20 percent of the amount of the debtor's total liabilities without the need of any creditor approval, and may also obtain new financing that exceeds the 20-percent threshold if creditors holding more than 50 percent of the total debt approve such a transaction<sup>116</sup>. Furthermore, Article 74 provides that any party that extends financing in accordance with Article 74 will enjoy a priority of payment for any such amounts, and that such amounts will not be included in the list of claims<sup>117</sup>.

Article 73 of the New CBA reaffirms Chile's emphasis on foreign trade. It states that any lender that provides financing to a debtor for the purpose of conducting business outside of Chile maintains a priority of payment over other creditors. This is the case so long as such a lender continues to service any existing lines of credit or extend new credit to the debtor in order to allow the debtor to continue its business outside of Chile<sup>118</sup>.

## C. Other Key Provisions: Equity Holders and Claims Purchasers

Article 67 of the New CBA contains the U.S. equivalent of the "absolute priority rule" – unless authorized by the debtor's creditors, shareholders and insiders are not allowed to receive a distribution under the plan unless allowed claims are paid in full<sup>119</sup>. Similarly, Article 79 provides that related parties, shareholders, and owners do not have the right to vote on a plan of reorganization<sup>120</sup>. Article 79 also provides that creditors who have purchased claims within 30 days prior to the bankruptcy filing are not allowed to participate in the meeting of creditors that will vote on the plan nor enjoy standing to challenge the plan<sup>121</sup>. Importantly though, Article 188 does permit the purchase of claims once a reorganization filing has been recognized by the court. Under Article 188, a creditor may purchase a claim and all attendant voting rights, but must purchase the claim in full and cannot later sell or transfer any portion of the claim or debt underlying such claim.

## V. Foreign Creditors and Cross-border Proceedings

The 2005 Law is silent with regards to cross-border insolvency. The New CBA, however, is the first Chilean bankruptcy law to adopt provisions regarding cross-border insolvency

<sup>111</sup> 11 U.S.C. § 363 (f).

<sup>112</sup> THE NEW CBA, *supra* note 61, at art. 72.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.* at art. 74.

<sup>116</sup> *Id.* at art. 74.

<sup>117</sup> *Id.* at art. 74.

<sup>118</sup> *Id.* at art. 73.

<sup>119</sup> *Id.* at art. 67.

<sup>120</sup> *Id.* at art. 79.

<sup>121</sup> *Id.*





proceedings<sup>122</sup>. In addition, it also contains procedures in the event that a Chilean debtor is the subject of parallel bankruptcy proceedings in Chile and abroad<sup>123</sup>. Most importantly, the New CBA enumerates procedures for foreign creditors who wish to participate in an insolvency proceeding in Chile<sup>124</sup>.

In conjunction with the enactment of the New CBA, Chile adopted the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"). Article 314 of the New CBA sets forth the procedure for soliciting recognition of an insolvency proceeding pending outside of Chile<sup>125</sup>. Specifically, Article 318 sets out the actions that can be taken upon recognition of a foreign insolvency proceeding, such as:

- Suspending individual actions against the debtor;
- Suspending a debtor's right to transfer or encumber its assets;
- Obtaining information regarding the debtor's assets, obligations or liabilities;
- Requesting the appointment of a foreign receiver responsible for administration or sale of the debtor's assets located in Chile; and
- Granting injunctions.

Articles 324 through 326 of the New CBA also include provisions for the co-operation between Chilean courts and foreign courts overseeing cross-border proceedings<sup>126</sup>.

The New CBA goes on to provide that all creditors, whether domestic or foreign, will be entitled to the same access, benefits, and protections<sup>127</sup>. Article 308 specifically provides that foreign creditors are to have direct access to the bankruptcy court overseeing the insolvency proceeding, subject to the caveat that such creditors are required to employ local Chilean counsel to formally appear before the court<sup>128</sup>. Article 312 recognizes that foreign creditors have the same rights as domestic creditors to commence an involuntary proceeding against a Chilean company<sup>129</sup>. Finally, Article 313 of the New CBA establishes that a court may provide for different or longer notice to foreign creditors where the facts and circumstances of the case dictate that foreign creditors be provided with different or greater notice<sup>130</sup>.

## VI. Conclusion

Chile's economy has been one of the darlings of Latin America and is poised to continue its upward trend, fueled in large part by the amount of foreign capital that continues to flow into the country. The reforms proposed by the New CBA should incentivize and give foreign and domestic investors confidence that Chile continues to be an attractive and safe country for investment opportunities. Indeed, many of the reforms incorporated in the New CBA acknowledge the important role that foreign creditors play in Chile's economy.

The New CBA makes clear that the law is aimed at protecting creditors first and foremost, with the protection of the debtor's going concern being the best way to accomplish this goal. To this end, the New CBA has addressed many of the shortcomings of the 2005 Law by establishing specialized courts to hear bankruptcy matters and by providing a debtor with the necessary tools to enable it to propose a plan that can be approved and bind all creditors. Among the tools which New CBA now gives a debtor are the Stay Period (during which time creditors cannot take action against the debtor's assets), the ability to classify creditors separately, and the ability and incentives for a debtor to obtain and potential lenders to provide, financing a debtor's needs to turn its business around domestically and abroad.

<sup>122</sup> *Id.* at Chapter VIII: Cross-Border Insolvency

<sup>123</sup> *Id.* at art. 314.

<sup>124</sup> *Id.* at art. 308–313.

<sup>125</sup> *Id.* at art. 314.

<sup>126</sup> *Id.* at art. 324–326.

<sup>127</sup> *Id.* at art. 312.

<sup>128</sup> *Id.* at art. 308.

<sup>129</sup> *Id.* at art. 312.

<sup>130</sup> *Id.* at art. 313.



One area in which the New CBA appears to fall short is the involvement by, and protection afforded to, equity holders. Whether this is because the law only intends to address the restructuring of debt (and not equity interests), or because of Chilean corporate law limitations, the New CBA is silent on a debtor's ability to non-consensually restructure the interest of existing equity holders. Indeed, the only mention of the rights of equity holders in the New CBA is found in the provision codifying the absolute priority rule, which states that equity cannot receive a distribution until all creditors have been paid in full, at least suggesting that equity interest cannot be extinguished absent consent.

The New CBA is also the first Chilean insolvency law to contemplate the involvement of new money, such as DIP lender or distressed investors. The law allows for new money to receive priority under certain circumstances, particularly if a lender is financing the debtor's business operations during the reorganization. Although it may fall short in actually incentivizing these entities to participate in a reorganization, the New CBA does appear to increase the number of restructuring options available to a debtor, which in turn are likely to incentivize lenders and investors to take part, and play a more active role in Chilean reorganization proceedings. The cross-border provisions in the New CBA also present greater protection for foreign investors and creditors. Specifically, the New CBA's cross-border provisions give foreign creditors the same rights and privileges in a Chilean insolvency proceeding as enjoyed by domestic Chilean creditors. In sum, many of the reforms in the New CBA specifically provide viable corporate debtors with the necessary tools to effectively and efficiently execute a successful restructuring, which benefits creditors and other parties alike.





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