

Principal Characteristics of Chilean Bankruptcy Law

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I. Summary

The bankruptcy law in Chile is published in law number 18,175 of the Commercial Code (the "Bankruptcy Law") which was made effective in 1982 and which nullified the prior law number 4,558 enacted in 1931. The Bankruptcy Law is inspired by the market economy as an instrument to reassign productive resources and permit the transfer of the assets of a failed debtor for reintegration into the economy. The Bankruptcy Law consists primarily of special Chilean legal conventions ("Convenios Judiciales") containing both (i) certain workout and reorganization provisions ("Convenios Preventivos Judiciales") which are intended to prevent the liquidation of the debtor and (ii) certain liquidation provisions which are intended to implement an orderly liquidation of the debtor's assets in satisfaction of the debtor's liabilities. These two systems are elaborated in greater detail below.

II. Regulation of the Debtor's Liquidation

Article One of the Bankruptcy Law provides that "a bankruptcy proceeding has the objective of consolidating all of the assets of a natural person or legal entity in order to satisfy its debts in the cases and in the method prescribed by the law." This definition demonstrates the procedural character of the Bankruptcy Law, which may also be viewed as jurisdictional in nature, under which a universal process is executed to liquidate or transfer the debtor's assets to pay creditors in order of indicated priority. This execution encompasses all of the debtor's assets and liabilities.

The Bankruptcy Law applies to debtors which are designated in Article 41 either as (I) "qualified" ("calificados"), which includes entities engaged in commercial, manufacturing, mining or agricultural activities or (ii) "not qualified" ("no calificados"), including entities engaged in all other activities. A qualified debtor may initiate a special action before a judge to declare bankruptcy or revoke certain legal actions which occurred prior to the declaration of bankruptcy. Qualified debtors may also be subject to a special criminal proceeding in order to determine whether the debtor declared bankruptcy due to fraudulent or negligent acts or whether the declaration was the result of circumstances which were not criminal in nature. In order to for a debtor to be qualified, the debtor must have been engaged in the qualifying activity at the time that the debtor entered into the defaulted contractual obligation which resulted in bankruptcy.

All terms of art used in this manuscript will be followed in parentheses by the translated original Spanish term indicated in italics. The translator used certain discretion in translating terms used in the Chilean legal system which do not have a precise equivalent or counterpart in the U.S. legal system.

III Elements of a Bankruptcy Proceeding

.The common elements to a bankruptcy proceeding in Chile include (i) the active party ("Sujeto Activo") initiating the bankruptcy proceeding consisting of either the debtor, one or more of the debtor's creditors or, in rare cases, the court; (ii) the passive, qualified, debtor ("Sujeto Pasivo") which is engaged in the qualifying business activities described above; (iii) the judicial action serving as the setting for the bankruptcy proceeding; and (iv) the judicial declaration, *condictio iris*, finding the debtor in bankruptcy. Each of these elements, as well as other components of a bankruptcy proceeding, are described in greater detail below.

A. The Active Party or "Sujeto Activo"

In order to request an adjudication of bankruptcy by a court of competent jurisdiction, Article 41 of the Bankruptcy Law provides that a qualified debtor (due to its specified business activity described above) must make the request within fifteen (15) days following the cessation of making payments of a commercial obligation. In the event that the qualified debtor does not comply with this time requirement, the debtor will be deemed criminally culpable in the bankruptcy case. This requirement does not extend to non-qualified debtors, including individuals and other entities.

B. The Debtor's Creditors

The debtor's creditors can solicit an adjudication of bankruptcy from the Court for the qualified or unqualified debtor. The petitioning creditors will invoke the causes and circumstances surrounding the debtor's insolvency. The judge's ruling declaring the debtor's bankruptcy initiates the process of appointing a Trustee, liquidating the debtor's assets and satisfying the debtor's liabilities.

C. The Court

The court may, *sua sponte*, declare the debtor's bankruptcy in the exceptional circumstances involving (i) the rejection by creditors of a reorganization plan proposed by a debtor; (ii) the joint and several liability of individual members of certain collective or commercial organizations denominated "Sociedad Colectiva Comercial" or "Sociedad en Comandita Comercial" if the applicable organization is in bankruptcy; or (iii) creditors rejecting a proposed surrender of the assets ("Cesion de Bienes") of an insolvent individual debtor.

D. The Passive Party or "Sujeto Pasivo"

The passive party may consist of a qualified debtor due its activity in manufacturing, mining or agriculture or an unqualified debtor. In contrast to legislation in other countries such as Italy, France and Germany, the Bankruptcy Law in Chile is not applicable exclusively to businesses, but rather it applies to every type of debtor entity. However, criminal penalties, fraudulent conveyance provisions and other matters may apply differently according to the type of debtor entity.

E. Grounds for an Adjudication of Bankruptcy

The Chilean legal system, which follows the French example on bankruptcy matters, provides certain special conditions under which a given debtor may be adjudicated bankrupt. The common law system present in Anglo-Saxon countries creates bankruptcy as the end result of a critical state of insolvency which is delineated in special bankruptcy laws which apply upon the request of petitioning creditors or debtors. Applicable Chilean legislation indicates that a business will be deemed to be bankrupt when it is found to be insolvent, which is defined by an inability to meet its ongoing obligations. Similarly, in France the business which ceases to satisfy its obligations will be declared to be bankrupt.

Article 43 of the Bankruptcy Law provides four (4) alternative grounds which permit a party to file a request for a bankruptcy proceeding. For the qualified debtor, the debtor must have ceased paying obligations. For all debtors, three (3) other grounds exist for initiating a bankruptcy case. These grounds can be generally described as complex but will be briefly described as follows:

1. Default

For a qualified debtor, such as a business engaged in commerce, manufacturing, mining or agriculture, the cessation of payments of a business obligation owed to the petitioning creditors will serve as grounds for an adjudication of bankruptcy. Common defaults may involve promissory notes, bills of exchange or other writings showing a monetary obligation owed by the business debtor.
a Qualified Debtor.

2. Pending Executions ("Titulo Ejecutivo")

When three (3) or more expired executions relating to diverse obligations arising from different transactions exist or at least two (2) other executions were initiated and insufficient assets existed with which to satisfy the obligations and costs of execution, a creditor has grounds for petitioning the court for an adjudication of bankruptcy. These grounds apply to both individual and business debtors. The expired or pending executions indicate insolvency and an inability to satisfy obligations.

3. Fugitive Debtor

If a debtor leaves Chile as a fugitive or if management of the debtor hides by closing its offices or business without leaving another person in charge of administration, sufficient cause exists for an adjudication of bankruptcy. This provision originates from laws enacted in the Middle Ages in Spain during the reign of King Alfonso X, which was incorporated into Chilean law as a result of the Spanish colonization of Latin America. A similar provision also existed in the French Commercial Code of 1809 which served as a model for the commercial code created in Chile in 1865.

4. Void Nonjudicial Workout Agreement

The fourth basis for petitioning a bankruptcy adjudication occurs when a nonjudicial workout agreement is void or is resolved without prejudice to the right of creditors to recover obligations not addressed by the agreement.

F. The Adjudication of Bankruptcy by a Court

The adjudication of bankruptcy occurs in most cases (except where the court enters a ruling *sua sponte*) as the result of an action initiated by the debtor or the creditor in a civil court. The action is declaratory in nature and is issued summarily in the presence of the debtor.

Generally an adjudication of bankruptcy results in a prompt liquidation of assets, although a business may be permitted to continue operating in the ordinary course in order to preserve its integrity and to permit a prompt sale of the business as one unit. Following the adjudication, the debtor is divested of its assets which are administered by a trustee ("Sindico de Quiebras") designated by the court. The debtor's assets are liquidated in accordance with direction provided by a creditors' committee ("Junta de Acreedores") or, in the absence of an agreement between the committee members, as determined by the Bankruptcy Law.

G. Plan of Reorganization ("Convenios Judiciales")

Plans of reorganization are submitted before the civil court which is competent to declare that a debtor is bankrupt. These plans are proposed by the debtor and its creditors in order to satisfy the debtor's liabilities under an agreement. The plan may be proposed prior to an adjudication of bankruptcy, in which case it assumes the character of a workout agreement, or after the court enters its declaration. The plan must be supported by the majority of creditors established by the Bankruptcy Law and it must be approved by the court.

In the event that a qualified debtor proposes a proposed workout agreement which is rejected, the court will order a liquidation. The same result will occur upon the occurrence of a default in a plan of reorganization or upon an order from the court nullifying the plan.

Translation: Santiago Estrada.