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BANKRUPTCY

Executive Summary

Overview of Chile's Insolvency Reform under Law No. 20,720

On 14 October 2014, Law No. 20,720 introduced a major overhaul of Chile's insolvency and bankruptcy system. This reform aimed to modernize an outdated framework and adapt it to the economic realities of the 21st century.

One of the core principles of the new law is the recognition that preserving a company's operations is often the most effective way to satisfy creditors, suppliers, and service providers. To support this objective, the legislation created new institutional mechanisms designed to reconcile the interests of stakeholders, within a flexible yet secure legal framework. This allows debtors in financial distress to reorganize their liabilities and resume operations.

At the same time, the law acknowledges that not all businesses can be saved. In such cases, it establishes a streamlined procedure for the sale of an insolvent debtor's assets to prevent unnecessary depreciation and facilitate the efficient reallocation of productive resources. This replaces the previously cumbersome process with a more dynamic and practical system.

This article provides a general overview of the framework established by Law No. 20,720, as updated by Law No. 20,536 on 10 May 2023. It outlines the available procedures, the main actors involved, the role and powers of the courts, and addresses aspects of international insolvency and netting provisions currently in effect in Chile.

BANKRUPTCY

Law No. 20,720 (the "Law"), enacted by Congress on 10 October 2014, now governs insolvency, bankruptcy procedures, and creditor rights in Chile. This legislation repealed the former system previously regulated under the Commercial Code. Subsequently, Law No. 20,563 (the "Reform"), enacted on 10 May 2023, further modernized and streamlined the procedures set forth in the Law.

The Law significantly restructured Chile's bankruptcy regime by introducing new mechanisms designed to prevent debtors from being declared bankrupt, while also broadening the scope of eligible debtors who may access these mechanisms. It also introduced changes in terminology to rename various existing institutions, aiming to alleviate the social stigma traditionally associated with bankruptcy, and to reframe insolvency as a path toward rehabilitation and renewed economic activity.

A key innovation of the Law is its departure from the traditional view of bankruptcy as the inevitable outcome for insolvent entities. It eliminates any reference to the word 'bankruptcy'. Instead, the Law provides for alternative procedures distinct from liquidation, thereby encouraging financial recovery rather than automatic dissolution.

The current legal framework contemplates three core procedures for addressing insolvency:

1. Reorganisation Procedure – Aimed at enabling debtors to restructure and continue operations.
2. Liquidation Procedure – A simplified process for the liquidation of assets and settlement of liabilities.
3. Renegotiation Procedure for Individuals – A non-judicial mechanism for individuals to restructure their personal debts.

The 2023 Reform further introduced two additional simplified procedures—a Simplified Reorganisation and a Simplified Liquidation—specifically designed to accommodate the needs of smaller companies, allowing them to navigate insolvency proceedings more efficiently and cost-effectively.

Although the intent behind the Law and its Reform was to reduce bureaucratic burdens and streamline the insolvency framework, all procedures applicable to corporate debtors remain judicial in nature, albeit with varying degrees of court involvement depending on the specific procedure.

DEBTORS

Debtors are classified into two main categories: (i) corporate debtors, which include both for-profit and non-profit organisations ("Corporate Debtors"); and (ii) individuals acting as debtors. The applicable legal procedures differ depending on the nature of the debtor.

This article focuses exclusively on the regulatory framework governing Corporate Debtors, including a detailed analysis of the procedures available to this category of debtor.

Note that banks, financial institutions, insurance companies, and other regulated entities are subject to special insolvency regimes. When such entities exhibit signs of financial distress, distinct rules and supervisory frameworks apply.

INSOLVENCY OVERSEERS AND BANKRUPTCY ADMINISTRATORS

As in the previous framework, the Chilean insolvency and bankruptcy system continues to provide for the involvement of designated officers responsible for overseeing the various procedures established under the Law. These officers have, however, been renamed and are now referred to as: (i) Insolvency Overseers—entrusted with supervising reorganisation procedures; and (ii) Liquidation Administrators—charged with managing the liquidation of assets of insolvent debtors.

Both Insolvency Overseers and Liquidation Administrators are individuals appointed by Chile's insolvency and bankruptcy regulator, the Superintendencia de Insolvencia y Reemprendimiento (the "SIR"), and are incorporated into a public registry maintained by this authority. To qualify for registration, candidates must meet rigorous professional standards and successfully pass a certification examination administered by the SIR.

Insolvency Overseers are primarily responsible for representing the interests of stakeholders involved in reorganisation proceedings. While their chief duty is to safeguard the interests of creditors, they are also expected to consider the debtor's interests, if these are compatible with the overall purpose of the proceedings.

The key distinction between Insolvency Overseers and Liquidation Administrators lies in the type of procedure to which they are assigned. Insolvency Overseers participate in reorganisation procedures aimed at restoring the debtor's financial viability. In contrast, Liquidation Administrators are involved in liquidation proceedings, whereby a debtor's assets are sold for the purpose of satisfying outstanding liabilities.

COURTS

Chilean law does not contemplate the existence of special courts of justice for resolving insolvency or bankruptcy issues. Hence, ordinary courts are tasked with trying and ruling all matters derived from or connected to insolvency or bankruptcy matters. The competent tribunal is that of the debtor's domicile.

REORGANISATION PROCEDURE

As previously indicated, one of the express objectives of the Law is to prevent companies from entering bankruptcy and liquidation. To this end, the Law establishes a specific legal framework designed to allow Corporate Debtors to avoid being declared bankrupt and subjected to a forced liquidation of their assets—namely, the Reorganisation Procedure.

The sole purpose of the Reorganisation Procedure is to facilitate an agreement between the Corporate Debtor and its creditors that enables the company to continue operating. The underlying rationale is that supporting a financially distressed company through a recovery process ultimately serves the interests of all stakeholders, particularly the creditors.

This agreement, known as the Insolvency Reorganisational Agreement, may take one of two forms:

1. Extra-Judicial Insolvency Reorganisational Agreement:
   This is an agreement negotiated directly between the debtor and its creditors outside the procedural framework of the Law. To be enforceable against creditors not party to the agreement, it must be submitted to a court for approval.

2. Judicial Insolvency Reorganisational Agreement:
   This is an agreement reached within the framework of the Reorganisation Procedure, involving a regulated negotiation process between the debtor and its creditors for the purpose of restructuring the debtor's assets and liabilities to avoid liquidation.

The Reorganisation Procedure is initiated by a filing submitted by the Corporate Debtor to the competent court, based on the company's financial distress. This filing must include a complete inventory of the debtor's assets and liabilities, along with a detailed list of its creditors and the amounts owed to each.

Simultaneously, the debtor must notify the Superintendencia de Insolvencia y Reemprendimiento (SIR) for the authority to appoint a Provisional Insolvency Overseer. This official is responsible for facilitating negotiations during the Reorganisation Procedure and acts as a representative of the creditors and the court in overseeing the debtor's conduct throughout the process.

If the filing meets the substantive requirements established by the Law, the court will issue a resolution initiating the

Reorganisation Procedure. Upon notification of this resolution—published in the official gazette by the SIR—the Corporate Debtor is granted a period of financial protection. For an initial term of 60 days, creditors are barred from enforcing collections, accelerating debts, initiating legal proceedings, or otherwise seeking payment. This period may be extended by two tranches of 60 days, or one tranche of 120 days, subject to the agreement of the creditors' meeting, for a total duration of up to 180 days.

During the financial protection period, the Law mandates that all existing contracts with the Corporate Debtor remain in force under their original terms. Unilateral termination or acceleration of obligations, or the execution of contractual guarantees based solely on the initiation of insolvency proceedings, is expressly prohibited. Breach of this prohibition renders the offending creditor subordinate in the order of payment—ranked below all affected creditors under the Reorganisation Agreement, including related-party creditors, but above shareholders of the Corporate Debtor.

Following the court's resolution, creditors have a 15-day window to file and verify their financial claims before the court, substantiating the amounts owed with supporting documentation.

Within the initial 60-day protection period, the Corporate Debtor must prepare a comprehensive business viability plan, detailing the proposed restructuring of assets and liabilities. This plan is subject to the approval of the creditors' meeting, which includes both creditors listed by the Corporate Debtor and those who have verified their claims in accordance with the Law.

Importantly, the Corporate Debtor retains control of its business operations during the Reorganisation Procedure. The Insolvency Overseer does not assume management responsibilities but functions as a supervisory authority, monitoring the debtor's management of the business throughout the process.

If a reorganisation agreement is reached, it must be approved by the court to become effective. If no agreement is achieved, the Corporate Debtor is declared insolvent and subjected to the Liquidation Procedure established by the Law.

Judicial Insolvency Reorganisational Agreements are binding on all parties, including creditors who did not participate in the creditors' meeting at which the agreement was approved.

As noted, the 2023 reform introduced a Simplified Reorganisation Procedure tailored for companies with limited financial capacity. This version reduces documentation requirements, lowers procedural costs, streamlines certain stages, and assigns a more active role to the Insolvency Overseer in facilitating agreements—thereby enabling a more efficient resolution for small-scale corporate debtors facing insolvency.

CREDITORS' MEETINGS

The Law allows for creditors' meetings, where Insolvency Overseers provide information and explain their undertakings.

The general rule is that agreements at creditors' meetings must be reached by an absolute majority of the creditors (considering their relative weight in the debtor's liabilities) that have been either recognised by the debtor or through contentious proceedings.

However, relevant agreements, such as approving the plan presented by a corporate debtor that has subjected itself to a Reorganisation Procedure, need the approval of two thirds of its creditors.

LIQUIDATION PROCEDURE

The Law establishes a Liquidation Procedure for the compulsory sale of a debtor's assets with the aim of satisfying outstanding liabilities and formally concluding the operations of an insolvent business.

This process is overseen by a Liquidation Administrator, whose primary responsibility is to liquidate the debtor's assets and distribute the proceeds to creditors in accordance with the legally established order of priority.

The ordinary courts of justice have jurisdiction over all matters related to the management and sale of the debtor's assets. Although the Law permits the parties to reach informal reorganisation agreements—even after the initiation of liquidation proceedings—thus potentially bypassing judicial intervention, in practice, most liquidations proceed under the direct supervision of the courts.

The Law allows for both voluntary and involuntary initiation of the Liquidation Procedure:

- Voluntary Liquidation: A debtor may initiate liquidation by filing a petition, provided it meets the legal requirements and has not already commenced a Reorganisation Procedure.
- Involuntary Liquidation: Any creditor may petition the court to declare a debtor bankrupt, even in the absence of a default, if there is sufficient evidence of cessation of payments or insolvency. Such insolvency must be substantiated before the court to trigger formal liquidation proceedings.

As part of the 2023 reform, the Law introduced a Simplified Liquidation Procedure to streamline the process for small enterprises and individuals. This version reduces procedural burdens, shortens statutory deadlines, and eliminates certain requirements—such as creditor meetings—unless specifically requested.

Legal Effects of the Declaration of Liquidation

The declaration of liquidation produces several immediate legal consequences:

a) Appointment of the Liquidation Administrator
The court formally appoints a Liquidation Administrator who assumes representation of the debtor's estate. This official is entrusted with liquidating the debtor's assets and distributing the proceeds to creditors in accordance with the legal priority system.

b) Jurisdictional Consolidation
All legal actions against the debtor must be transferred to the court presiding over the liquidation. This centralizes proceedings and ensures consistency in adjudication.

c) Loss of Asset Management by the Debtor
The debtor loses control over all attachable assets. These assets come under the exclusive management of the Liquidation Administrator, who is authorized to take any protective measures necessary to prevent their deterioration or loss. Importantly, the declaration of liquidation does not transfer ownership of the debtor's assets to the creditors; rather, it suspends the debtor's authority to dispose of them until claims are settled. Non-attachable assets remain under the debtor's control.

d) Suspension of Individual Enforcement Actions
Creditors are prohibited from initiating or continuing individual enforcement actions against the debtor. Instead, they must present their claims within the framework of the liquidation proceeding.

However, secured creditors—those holding collateral such as mortgages or pledges—retain the right to pursue separate foreclosure actions in court. Nonetheless, they must also file their claims within the liquidation procedure to be registered on the Liquidation Administrator's creditor list.

If, within the context of the bankruptcy proceeding, creditors resolve to continue operating the debtor's business, the rights of secured creditors to initiate individual actions remain intact unless they expressly consent to the business's continued operation. In such a case, any new obligations incurred during the operation will take precedence over existing secured claims.

Likewise, if the creditors agree to sell the debtor's assets as a going concern (i.e., as a business unit), this decision suspends the rights of secured creditors to enforce their claims separately, unless otherwise provided.

e) Claim Verification Period
Creditors have a period of 30 days from the publication of the liquidation declaration in the official gazette to file and verify their claims. Such filings must be accompanied by appropriate supporting documentation.

f) Rights of Termination and Avoidance of Prior Acts

The Law grants creditors the right to terminate certain contracts or acts entered by the debtor prior to the declaration of bankruptcy. These may include contracts entered for valuable consideration, as well as related security interests such as mortgages and pledges.

Creditors may initiate actions for termination within one year from the date of execution of the relevant contract or act.

SELLING OF ASSETS

There are several ways in which assets can be disposed, including:

- Through administration, known as the "continuing operations of the debtor's business."
- Through the sale of the assets, on an accelerated, ordinary or extraordinary basis (the latter includes the sale of the assets as a business unit).

ADMINISTRATIVE POWERS

The Law establishes a mechanism for the administration of the liquidation estate, whereby responsibility for managing the debtor's assets is transferred to the Liquidation Administrator upon the declaration of liquidation. As previously discussed, the Liquidation Administrator is entrusted with representing the collective interests of the creditors, as well as those of the debtor insofar as they align with the interests of the bankruptcy estate.

CREDITORS AND CLAIMS

The Law, together with the Civil Code, governs the priority of creditors and the order in which debts are to be paid. Creditors are to be paid according to the hierarchy and procedures expressly established by law.

Generally, claims are satisfied on a pro rata basis, proportional to the amount owed to each creditor, unless a legally established preference applies. The order of preference is as follows:

- First-Class Claims: These include taxes, employee wages, and judicial expenses incurred for the collective benefit of the creditors.
- Second-Class Claims: Secured claims backed by pledges, enforceable only up to the value of the pledged asset.

- Third-Class Claims: Mortgage-backed claims, enforceable only up to the value of the mortgaged property.
- Fourth-Class Claims: Claims by the tax authorities and public institutions, among others.

Unsecured or common creditors will only be paid from any remaining surplus in the estate after the preferred claims have been satisfied, regardless of how long their debts have been outstanding.

Only those creditors whose claims are listed in the List of Recognised Claims, prepared by the Liquidation Administrator, will be entitled to participate in the distribution of the estate.

It is also important to note that creditors may agree upon an alternative payment plan that deviates from the default legal framework. The Liquidation Administrator is required to adhere to such a plan, if it does not contravene the statutory order of priorities or the recognized claim amounts. However, the plan may modify the timing of distributions and the minimum amounts to be apportioned to each creditor.

CROSS BORDER CLAIMS

The Law does not distinguish between Chilean and foreign creditors. Consequently, the court resolution declaring bankruptcy may be notified to creditors located outside Chilean territory, inviting them to appear before the competent court and verify their claims within the legally established timeframe.

With respect to the recognition and enforcement of foreign judgments, including those arising from bankruptcy proceedings initiated abroad, the Chilean procedural system provides a framework primarily based on international treaties entered by Chile and the jurisdiction from which the judgment originates.

In the absence of an applicable treaty, Chilean law applies the principle of reciprocity. Under this principle, a foreign judgment will be recognized and enforced in Chile if the foreign country grants similar recognition and enforcement to judgments rendered by Chilean courts.

If neither an international treaty nor reciprocity is applicable, the enforcement of a foreign judgment may still proceed based on general principles of law, provided that the foreign judgment does not contravene Chilean public policy or jurisdictional rules.

Once the relevant legal requirements are satisfied, there is no restriction under Chilean law preventing the return of assets to a foreign representative, and such restitution may be made on the same terms and conditions as would apply to a Chilean representative.

CROSS BORDER INSOLVENCY

Unlike the previous bankruptcy framework, Law No. 20,720 introduces provisions governing cross-border insolvency for cases involving insolvent debtors domiciled in Chile, where formal cooperation with foreign creditors or foreign courts has been established. The principal aim of these provisions is to foster international cooperation between courts and other entities involved in insolvency proceedings, and to facilitate the reorganisation of Corporate Debtors, thereby safeguarding invested capital.

The Law contemplates two primary scenarios under its cross-border insolvency assistance regime:

1. Foreign Creditors Seeking Assistance in Chilean Insolvency Proceedings:
Foreign creditors are permitted to participate in any of the insolvency proceedings regulated by the Law. To do so, they must file a petition with the court overseeing the relevant insolvency proceeding in Chile, requesting recognition of the corresponding foreign insolvency process ("foreign insolvency proceeding recognition"). This application must be submitted by a duly appointed representative of the foreign creditor, in collaboration with a Chilean attorney. If the petition complies with the substantive legal requirements, the court will issue an order recognising the foreign insolvency proceeding. Upon such recognition, the foreign creditor, through its representative, may actively participate in the Chilean insolvency process and is entitled to file motions aimed at securing its claim.

2. Chilean Creditors Seeking Assistance in Foreign Insolvency Proceedings:
Chilean creditors involved in insolvency proceedings initiated abroad may request the intervention of the Superintendencia de Insolvencia y Reemprendimiento ("SIR") to act on their behalf in such foreign proceedings. Furthermore, the Law expressly empowers Chilean courts to communicate directly with foreign courts conducting the insolvency proceedings, with the purpose of requesting relevant information about the foreign debtor's financial status or the proceedings at hand.

It is important to note that the applicability of this second scenario is contingent upon the acceptance of such cooperation under the foreign jurisdiction's legal framework. In jurisdictions where this form of international cooperation is not permitted, Chilean creditors must resort to the traditional cross-border recognition mechanism. This involves submitting an international letter rogatory and obtaining recognition of the claim pursuant to the foreign country's legal procedures before the competent judicial or administrative authority.

NETTING PROVISIONS AND DERIVATIVES TRADING

Section 140 of Law No. 20,720 provides an express regulation regarding the enforceability of netting arrangements in the context of insolvency proceedings. Generally, the provision prohibits the operation of netting that has not been effected prior to the notification of the liquidation order issued by the competent court, in accordance with the legal framework.

Nevertheless, this general prohibition is subject to an important exception concerning so-called "related obligations." For the purposes of this provision, related obligations are defined as those obligations that, notwithstanding being denominated in a different currency, arise from derivative transactions—such as futures, options, swaps, forwards, or other financial instruments or derivative agreements—entered into between the same parties, on one or more occasions, and governed either by Chilean or foreign law, under the same master agreement, in the event of either voluntary or compulsory liquidation.

Additionally, Section 140 authorises the Central Bank of Chile to determine the general terms and conditions applicable to master agreements entered by banks or institutional investors, thereby providing regulatory oversight in this area.

The same section further establishes a key procedural rule: "each of the obligations originating from transactions carried out in the manner described shall be deemed due, liquid, and enforceable as of the date of the issuance of the insolvency resolution, and their value shall be determined on that date according to the terms and conditions of the relevant agreement."

Accordingly, when the application of valid netting rules results in a net payable amount by the Corporate Debtor, that amount is incorporated into the debtor's liabilities and treated as part of the estate subject to the Liquidation Procedure.

LIQUIDATION TERMINATION DECLARATION

Once the court issues a resolution declaring that the Liquidation Procedure has been fully executed, all obligations and debts incurred by the debtor prior to the commencement of the liquidation process shall be extinguished ipso jure, by the sole operation of law.

Furthermore, the debtor shall be entitled to regain control and management of any remaining assets, if such assets still exist upon the conclusion of the procedure.