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CHILEAN ECONOMIC GROWTH

Growing pains

Chile has one of the most stable economies in Latin America, experiencing steady growth year on year. As the country's corporate sphere becomes more sophisticated, so too must its regulation – but as lawyers in Santiago report, the road towards a mature regulatory framework is not without bumps, hears Rosie Cresswell

When Latin Lawyer held a round table for managing partners of Chilean law firms and local in-house counsel in 2009, the subsequent series of articles was entitled "There may be trouble ahead" – a nod to the fact that the country's business community fully expected to be hit by the global financial crisis at some point down the line.

Four years later and they are still waiting. When compared to markets around the world, the economic outlook for Chile looks good. As Jaime Carey of Carey notes, the country has seen activity in a lot of areas, from natural resources and energy (particularly renewables, hydro and thermopower), to agro-industry, construction and real estate, while economic growth has stayed between a comfortable range of 5 per cent and 6 per cent in recent years.

With its open market and business-friendly environment, Chile is widely seen as one of the safest places to invest in Latin America. Despite the withdrawal of European companies that have sold up in order to deal with problems at home, there continues to be a steady stream of foreign direct investment from elsewhere in the region, Asia and of course the US. As Alessandri's Fernando Jamarne says, there are plenty of signs of investor confidence – such as companies' willingness to import capital goods like cranes for construction and machinery for mining.

While the crisis elsewhere has not led to a downturn as such in Chile, it has altered the business climate to a degree. Marcelo Armas of Philippi, Yrarrázaval, Pulido & Brunner notes that there has been a dramatic change in financing players since the European banks have disappeared, but there is activity nonetheless. "Brazilians want a

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presence here but are not granting loans. The loan market is concentrated with Japanese as lenders and Scotiabank is active," he says. "Everyone is saying there are insufficient resources or funding for long-term financing but you still see projects financed by Japanese banks."

It remains to be seen how long this new scenario will last, but the situation is bolstered by local lenders coming to the fore. Pedro García of Morales & Besa notes that "it's increasingly common to see local syndicates compete with foreigners and put up US$700 million in project finance for a

long-term project, offering 21-year maturity, which is something foreign banks cannot offer due to internal regulation and Basel rules," he says. "It's interesting to see how local banks compete locally with sources traditionally coming from abroad."

There are other changes on the ground; Chile's corporate sector is becoming more professional as family investment groups, which control a large number of the country's major companies, improve their corporate structures. "Those family offices are being managed in such a way as to structure asset portfolios so they have controlling decisions or investment decisions," says García.

The local capital market is seeing more activity and new types of investors as it grows in sophistication. "Traditionally, the financial market used to depend on what the pension funds decided," says Cristián Barros of Barros & Errázuriz Abogados. "That has changed in the last IPOs and even bonds – pension funds have not invested or taken a minority stake. Family offices and other players are taking the role of financer and putting money in the market – that's a sign of growth."

Regulatory uncertainty

With economic growth comes an increase in regulation. As lawmakers and authorities in Chile endeavour to adapt to the rise in sophistication across a range of sectors, the biggest cause for concern for companies operating in the country has become regulatory uncertainty.

According to Felipe Larraín, Claro y Cía was recently approached by a UK firm for a list of the top 10 risks for doing business in Chile – environmental and regulatory permits were at the top, especially for

greenfield projects. Indeed, there have been several high-profile examples of energy projects which seemingly have all the permits necessary to go ahead but are unexpectedly blocked by a judge. At the start of March, a court halted the construction of a US$1.4 billion power plant by Spanish electricity company Endesa after fishermen complained of environmental concerns. The case follows other courts going against governmental approvals and environmental assessments which had supposedly given the green light for major projects, not least MPX's US$4.4 billion Castilla thermoelectric power plant.

So energy projects in Chile exist in an unpredictable environment, which sends out a negative message to investors. As Armas notes, "There must be a clear regulatory framework in which permits are granted and there must be assurance that the permit won't be revoked. Foreign investors and banks don't want to take the risk."

Regulatory issues in Chile are not limited to environmental permits; there is more red tape across the board, which is having an impact on companies' operations. As Baker & McKenzie's Diego Ferrada notes, "it is increasing the cost and time of projects significantly. Electricity projects take more time and are more complicated. Mining is the same. This is affecting lots of companies."

Authorities have been tightening up regulation in all sectors. "We see it in all aspects; tax and antitrust have changed a lot, every administrative issue is complex, labour, consumer protection, zoning and planning – it's all tougher," says Roberto Guerrero of Guerrero, Olivos, Novoa y Errázuriz.

But it's important to note that there are two sides to the regulatory issues. While the uncertainty surrounding certain projects is unwelcome, lawyers recognise that increasingly sophisticated regulation is a natural – and usually necessary – consequence of economic development. "Society has changed, the economy has changed. We have reached a level of development that requires firms to meet higher standards," says FerradaNehme's Paulo Montt.

Take Chile's antitrust regulation, which Armas says was probably a bit neglected before it was updated and in need of an overhaul. The problem today is that it is not yet working as it should be. "Antitrust, in connection with M&A projects, has never been more uncertain. We have to work to improve this," says Cariola, Díez, Pérez-Cotapos & Cía Ltda's Francisco Illanes, who points to the case of the LAN TAM

airline merger, which obtained all the approvals in Brazil ("a highly regulated jurisdiction"), while in Chile, and open-market economy, it encountered unforeseen problems.

Chile's lawyers, authorities and companies are learning to live with and apply the new rules, but there are teething problems. "We will move forward to a more stable system with this regulation, but we are living in a transition." says Barros.

Carey describes it as the country's development challenges. "In the past, we had regulations that have proven to be very simplistic. We are currently dealing with a complicated environment for energy and natural resources projects, which are confronting a lot of opposition from local communities and environmental NGOs, which have been able to stop huge projects, using this faulty and unsophisticated regulation. But I hope this is going to be ironed out soon."

"The public sector is trying to cope with its powers," adds Illanes. "We are learning, but we are not old timers; we have to find a way to manage ourselves and not stop business."

Fortunately, there is room for law firms to contribute to improving the framework. "We are not just consumers of regulation. We are involved in academia, we talk with regulators and provide opinions," says Illanes, who notes that regulators are largely open to opinion and will receive comments. "You give thoughtful black and white opinions you hope they will consider. There is collaboration where the public and private talk."

Regulators don't always follow lawyers' advice. For example, Armas says that the Central Bank's resolution on netting derivatives has been a big issue in the banking and finance area, which hasn't been changed despite requests to do so. "We are a non-netting jurisdiction and that is creating a lot of problems," he says. "In some cases they have asked for lawyers' opinions, but in other cases they haven't. It really depends on the ministry, the team working on the project."

The problem is exacerbated in Chile by the fact that lawyers from prominent firms were hired by the latest government when it took office. Conscious of the public's heightened sensitivity regarding conflicts of interest, lawyers now in government are keen to be seen distancing themselves from colleagues still in private practice, says García.

While it may not be perfect, there is at least a working relationship between the legal profession and regulators. Aninat Schwencke & Cia's Juan Pablo Schwencke thinks firms could benefit by interacting more with the judiciary too – especially in the current climate of unexpected rulings. "It's important that the business community interacts with the judiciary; decisions are created by judges," he notes. "Many of us in business law firms are trained overseas but are not related to the judiciary. We need to speak the same language even if we don't have to agree on rulings. We need to think of ways to improve our judiciary and make them understand the perspective of business lawyers."

But it's not an easy relationship to forge. As Illanes says, "They are concerned about how they relate to you and you are concerned about what's allowed and what's not allowed." While litigators have succeeded in an individual capacity, there is still some way to go before communications between judiciary and law firms are institutionalised. Chile's legal system is such that a judge rules on the basis of law and is not influenced by social issues, says Paulo Larrain of Noguera, Larraín & Dulanto. "The common law system jury is more involved in the community. It's very difficult to change the mentality of our judges to rule with influence on what's going on in the country," he says.

As Carey notes, the world is getting complicated, and on a regional, and indeed global scale, Chile doesn't score badly. Environmental issues in Ecuador are fiendishly complicated by comparison, while the scenarios in the US and Canada are very complicated, he points out. "In general terms I

think we have a strong, straightforward system compared to other places, although it still requires improvements."

Indeed, Chile ranks 37 in the World Bank's 2013 Doing Business report (out of 185 countries), and scores first in Latin America – so it's unlikely that the country's current issues are sufficient to send investors fleeing in the direction of other countries. "We might have some uncertainty, but it's low by Latin American standards," says Barros.

Of course, there are examples of where it is easier to conduct certain aspects of business or more difficult. For example, Jamarne points out that in Brazil a foreigner can't buy land without local participation, while in Chile there are no restrictions unless the land borders its

neighbours, at which point there are some in relation to nationals of those countries. Meanwhile, Paulo Larrain notes that Peru lags behind Chile in some areas of regulation – for example it doesn't have antitrust law – but in other areas, such as finance, it is more advanced and better suited to products created in the US and Europe.

While Chile learns to live with new laws, the good news is that it brings work for law firms. As Guerrero notes by way of example: "litigation has become very specialised; that's an opportunity for firms to grow, for firms to be bigger, for spin-offs, for experts in those fields to have a future."

Bullish about growth

Despite the teething problems, the Chilean legal market is understandably feeling optimistic. "Firms are hiring and investing and moving into new offices," says Illanes. "I think we are bullish as we have grown for the past three years."

In the time between the publication of the 2012 and 2013 editions of the Latin Lawyer 250, Chilean member firms have grown by 10 per cent on average, but it's notable that the legal market has not grown in size at the same pace as the country. With 138 lawyers, Carey is still the firm's largest firm by some margin, and Philippi is the only other firm to have broken the 100 lawyer mark (although Cariola is coming close with a headcount of 98).

In part this is because Chile's economy is not large. As Barros says; "This is a small market. We need to deal with conflict of interest frequently."

It's certainly true that the same corporate powerhouses have presided at the top of the legal market for many years – among the five firms with more than 60 lawyers, Barros & Errázuriz, founded in 1988, is a spring chicken compared to the others, which are all over 100 years old.

But that's not to say there are no new firms emerging. In the last 10 years there have been examples of "young, good lawyers leaving big law firms and setting up their own outfits," says García, and they seem to be doing well. Carey sees this as a natural evolution alongside the country's development. "The country has grown so much, so there is a lot of work that we used to do, but is too small today," he explains. "That's what smaller firms are doing. What was

once innovative is now commoditised. The market is changing – there is growth of smaller firms and space. There is a lot of work for everyone; we are not running into each other."

The newer, smaller firms have a good run of business advising the local companies that are growing in sophistication and demanding more legal services as a result. "A medium firm that charges a good rate will provide services to local banks. There is a whole range of work for medium firms to exist," says Armas.

So far the new firms are not viewed as a serious threat by the major players. "No one is keeping people out, but the system keeps the same people interacting," Armas says. "We have innovation within our firms too, so you don't see emerging firms." Certainly, the established big names still have the edge with large, international clients. "For complex deals and problems, companies go to firms that they can defend before the board as a sensible choice," says Illanes. An international company won't go to a medium firm that's not well known as they don't want to take the risk if something goes wrong. Time will tell whether these new players will become major rivals.

In the meantime, the competition for talent continues to be fierce – as with other maturing legal markets in the region. Guerrero says, "We didn't have summer programmes a few years ago and now most of us do. Access to good students at universities is a must and I can say that as dean [of Pontificia Universidad Católica de Chile] I am talking with almost every firm in Santiago."

The Chilean legal market is also experiencing its own evolution. Corporate lawyers in Chile match a certain social stereotype even more than most, but there are signs that the market is becoming more meritocratic. "We are also in a transition in terms of hiring people," says García. While firms have typically hired lawyers from top universities (and from the upper end of the social scale) they are beginning to recruit from a broader pool. There are also signs that firms are more willing to hire from each other than they were in the past, implying lateral hires at partner level – still largely non-existent in Chile – could become a reality.

And as the country's companies become more institutionalised and professional, so too do their relations with law firms. "We were such a small club and all very well connected with friends managing firms," says García. "It was easy for us to have knowledge of when someone is deciding to hire a firm, but once you have more professional

companies, like public companies, then the decision is not taken by the owner but the CFO, who will not only look at relations the owner had with friends but the quality of the firm."

Trouble ahead?

Law firm leaders in Chile are still wary of growing complacent, having experienced political and economic crises in the past. They are also only too aware of the country's dependence on the price of copper. "Every time there is a crisis we are terrified about what will happen to copper prices and it never drops down," says Armas. "If it does then we will really be in trouble. We are so used to high copper prices that we are dependent on that – our mental stability relies on high prices."

"We always think it's the last year of growth for Chile as we are open to the rest of the world," says Illanes. "As law firms, we have local and international clients, and we believe in a diversified client base." Firms have been impacted by the falling dollar given this is a commodities export orientated economy. "The price of the dollar will continue to be low and that hurts service exports," says Jamarne. "Our main source of income is the international market and large corporations and that has a big impact on law firms that do cross border work." Some firms in Chile have reacted to the appreciating peso by linking fees to local currency (see article on page 28).

Schwencke maintains that firms need to be prepared for the worst. "The challenge is waiting and preparing for the crisis that will come at some point," he says. But should the economy continue on the right track, and the regulatory issues be ironed out, Chilean law firms could be waiting for the downturn for some time yet.