The Private Equity Review

Fifth Edition

Editor
Stephen L Ritchie

Law Business Research

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EDITOR'S PREFACE

The fifth edition of *The Private Equity Review* comes on the heels of a solid but at times uneven 2015 for private equity. Deal activity and fundraising were strong in North America, Europe and Asia, but the year ended with uncertainty in the face of declining growth in China, Brazil and other developing and emerging markets, increased volatility in commodity, stock, currency and other financial markets, and deflation concerns in developed countries. Nevertheless, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. As large global private equity powerhouses extend their reach into new markets, home-grown private equity firms, many of whose principals learned the business working for those industry leaders, have sprung up in many jurisdictions to compete using their local know-how.

As the industry continues to become more geographically diverse, private equity professionals need guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 29 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

While no one can predict exactly how private equity will fare in 2016, it can confidently be said that it will continue to play an important role in the global economy. Private equity by its very nature continually seeks out new, profitable investment opportunities, so its further expansion into growing emerging markets is also inevitable. It remains to be seen how local markets and policymakers respond.

I want to thank everyone who contributed their time and labour to making this fifth edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2016

Chapter 4

CHILE

Andrés C Mena, Francisco Guzmán and Arturo Poblete[1]

I OVERVIEW

Chile continues to offer an attractive business environment. Chile was the first Latin American economy to join the Organisation for Economic Co-operation and Development, and is party to dozens of free trade agreements (including with the United States, the European Union, Mexico, South Korea and Brazil). In terms of competitiveness in Latin America, according to the ranking published by the Latin American Private Equity & Venture Capital Association (LAVCA),[2] Chile has remained the country with the best overall conditions for the private equity industry for 10 years in a row, even though the country experienced a downgrade on its score for taxation as a result of the tax reforms enacted during 2014. Confirming this, the 2015–2016 Global Competitiveness Report prepared by the World Economic Forum awarded Chile first place in the competitiveness ranking for Latin America, despite dropping two places in the global ranking.[3] The private equity/venture capital activity in Chile has continued to grow at a healthy pace: as of the end of 2014, there were 52 investment funds with an estimated amount of investments of US$1.088 billion, and 28 management firms. Private equity investments during 2014 reached US$692.2 million, doubling the 2013 amount. Accordingly, the number of private equity funds went from 11 to 19. Venture capital

1 Andrés C Mena is a partner at Kirkland & Ellis LLP. Francisco Guzmán is a senior associate at Carey. Arturo Poblete is a foreign associate at Kirkland & Ellis LLP.

2 LAVCA Scorecard 2015–2016.

3 Global Competitiveness Report 2015-2016 (http://reports.weforum.org/global-competitiveness-report-2015-2016/).

funds' investment experienced a smaller growth, reaching US$396.1 million during 2014, compared with US$362 million in 2013, and the number of funds increased from 30 to 33.[4]

i Deal activity

The private equity industry has grown permanently, in part, as a result of the country's general stability and the investor-friendly corporate, capital markets and tax legal framework. According to the 2015–2016 LAVCA Scorecard, investors continue to value the overall environment of institutional and legal certainty, the protection of intellectual property rights, the transparency of the judiciary and the low levels of corruption. The adoption in 2014 of the international financial reporting standards for all non-publicly traded companies has also helped to maintain Chile as a regional leader. Standard & Poor's raised Chile's credit rating in 2012 to AA-, leaving Chile with the highest credit rating in Latin America (the closest Latin American country is Peru with BBB+) and at the same level as China, the Czech Republic, Estonia, South Korea and Taiwan.

However, the private equity industry is in an early stage, which makes it particularly attractive for new investors. Unlike other countries (such as Brazil) the number of sponsors in the market is still limited and new players are attracted by the opportunity for better value.

The bigger players in Chile (i.e., funds with assets over US$100 million, and with a regional and not purely national focus) are managed both by foreign entities (such as Advent or CVC) and by some regional players (such as Linzor Capital Partners or Southern Cross Group). Other key sponsors in the country are Blackstone, Quilvest, Brookfield, KKR and Partners Group. These funds use local feeder funds to raise capital, mainly from institutional investors. Other local players include Aurus, EPG Partners, Gerens Capital, Sembrador Capital de Riesgo, Equitas Capital, InverSur Capital, BTG Pactual, Larraín Vial, Independencia, NXTP Partners Chile, IM Trust and Moneda Asset Management.

The size of most funds (private equity and venture capital) ranges from US$15 million to US$50 million.[5] This is consistent with the nature of the investors participating in the industry (i.e., low participation of institutional investors) and with the profile of the deals that are seen in the region, which are generally within the small and lower-middle market.

Typically, foreign sponsors enter the country associated with local firms that have a better understanding of the local market. Generally, that same local firm is the one that creates local feeder funds if the foreign sponsor is interested in raising funds from local institutional investors.

4 See Chilean Association of Investment Fund Managers and EY, 'Venture Capital and Private Equity Report 2014-2015'.

5 Ibid.

During 2014, while the aggregate amount of private equity investments in the Latin American region decreased by 11 per cent, the number of deals increased by 31 per cent. The final figures for 2014 indicated 306 deals for US$7.87 billion within Latin America.

The situation in Chile was even more optimistic. There were a total of 27 reported deals in Chile during 2014, compared to 12 deals reported in 2013, for an aggregate amount of US$867 million, a 27.7 per cent increase by volume compared with 2013 when the aggregate amount of investments reached US$679 million. As measured by deal count, the period showed a 125 per cent increase according to publicly reported deals. Exits decreased compared with the previous year, with two exits in 2014 compared with seven exits in 2013. Aggregate amount arising from of exits was not disclosed.

The table below shows reported deals in Chile during 2014 compared with deals in other countries in the region:

Country breakdowns	*2014 investments*				*2014 v. 2013 growth*	
	Amounts		*Distributions*			
Country	No. of deals	US$ deals (millions)	No. of deals	US$ deals	No. of deals	US$ deals
Argentina	28	153	9.2%	1.9%	366.7%	71.7%
Brazil	141	4,569	46.1%	58%	-4.1%	-24.2%
Chile	27	867	8.8%	11%	125%	27.7%
Colombia	38	665	12.4%	8.4%	90%	-36.7%
Mexico	49	1,314	16%	16.7%	63.3%	101.7%
Peru	14	134	4.6%	1.7%	100%	6.8%
Uruguay	4		1.3%	N/A	33.3%	N/A
Central America & Caribbean	5	172	1.6%	2.2%	66.7%	207.7%
Total	306	7,873	100%	100%	31%	-11%

Source: 2015 LAVCA Industry Data

The table below shows exits in Chile during 2014 compared with those in the other countries of the region:

Country breakdowns	*2014 exits*				*2014 v. 2013 growth*	
	Amounts		*Distributions*			
Country	No. of exits	US$ exits (millions)	No. of exits	US$ exits	No. of exits	US$ exits
Argentina	4	59	6.7%	1.3%	33.3%	-70.4%
Brazil	24	1,599	40%	34.5%	0%	-37.3%
Chile	2		3.3%	N/A	-71.4%	N/A
Colombia	10	1,525	16.7%	32.9%	233.3%	909.9%
Mexico	9	257	15%	5.5%	0%	-59.5%
Peru	3	310	5%	6.7%	0%	1,450.2%

Country breakdowns	*2014 exits*				*2014 v. 2013 growth*	
	Amounts		*Distributions*			
Country	No. of exits	US$ exits (millions)	No. of exits	US$ exits	No. of exits	US$ exits
Central America & Caribbean	4	256	6.7%	5.5%	0%	4,168%
Total	60	4,636	100%	100%	13.2%	24.5%

Source: 2015 LAVCA Industry Data

ii Operation of the market

The terms of private equity deals are fairly consistent with US industry standards. Frequently, transaction documents are based on US forms (including contracts drafted in English). Usual terms include representations and warranties, purchase price adjustments, anti-dilution provisions (including full ratchets), affirmative and negative covenants, events of default, indemnities and non-compete clauses. Shareholders' agreements are generally used for the corporate governance of the target company and to restrict the transfer of shares for the benefit of the private equity sponsor.

In some cases, the private equity seller may agree to escrow arrangements to secure buyer claims until the lapse of the statute of limitations (generally five years). Arbitration is the preferred dispute resolution mechanism for these transactions in almost all instances.

A typical sale process starts with the negotiation by the parties of the basic terms and conditions of the transaction, typically in the form of a term sheet. Term sheets may include indicative offers subject to due diligence conditionality. Often, the buyer will conduct the due diligence before the announcement of the transaction to the market, but a fair number of deals are announced without any due diligence having been carried out. Diligence 'outs' remain the norm, but it is standard practice for sellers to impose minimum thresholds and objective tests. Definitive purchase agreements will still be subject to conditionality, especially as they are relevant to governmental authorisations. For instance, in concentrated markets the approval of the antitrust authority will be a likely requirement, and transactions in the utilities sector will also require approval by the relevant authority (the sanitary authority in the water industry, the energy authority in the electric industry, etc.). If the sale process involves an initial public offering (IPO), prior approval by the Securities and Insurance Commission (SVS) will be required.

Unless there is an IPO, a deal will typically take between three and six months to close (of course, depending on the negotiations of the parties and the complexities of the deal, a particular transaction may take longer or shorter to close).

The management of portfolio companies usually have a significant portion of their compensation tied to stock options and other rewards linked to the performance of the company. Alignment of incentives and favourable tax treatment make this type of compensation very desirable in Chile.

II LEGAL FRAMEWORK

Chile allows for a number of corporate entities with different results in terms of control.

A Chilean corporation is managed by a board of directors, with certain specified decisions reserved to the shareholders.

A corporation can be publicly traded, or 'open', private or 'closed'. An open corporation is one that has issued equity shares registered with the SVS. Registration is voluntary, except where the corporation has 500 or more shareholders, or if at least 10 per cent of its capital stock is held by at least 100 shareholders. Open corporations are supervised by the SVS. All other corporations are closed. Closed corporations are not subject to the supervision of the SVS unless they are issuers of publicly traded securities (whether equity or debt) or if otherwise required by a special regulatory frame (e.g., insurance companies).

Corporations are managed and controlled by a board of directors appointed by the shareholders. The board has the broadest authority over the corporation and its affairs. Closed corporations must have at least three board members, open corporations at least five.[6]

There are statutory withdrawal rights for shareholders pursuant to which a shareholder can put its shares to the corporation upon certain actions being approved.[7]

Corporations in Chile require at least two shareholders.

Chilean law also provides for a corporate type similar to Delaware's limited liability company, with two critical distinctions: Chilean limited liability companies (LLCs) require a minimum of two members, and Chilean LLCs require unanimous consent to amend their charter in any respect, to accept new members or to allow existing members to assign their interest.

Share companies (SpAs) combine the best attributes of a corporation (free assignability of the equity interests) with the contractual flexibility of an LLC (the SpA does not require unanimous consent for amendments of its charter). An SpA can be formed by one or more persons (individuals or legal entities), and allows for any type of corporate agreement save for a few mandatory rules.

SpAs allow for a single equity holder and can have as many equity holders as desired. If an SpA, however, reaches the number of equity holders that would render a corporation an open corporation, then it will automatically become an open corporation.

If provided for in their charter, SpAs are allowed to make capital calls and issue equity interests if resolved by management (i.e., without the consent of the equity holders). Unlike corporations, there are no statutory pre-emptive rights (again, except as contemplated by the organisational documents). The organisational documents may indicate minimum or maximum percentages or amounts of capital that are to be directly or indirectly controlled by one or more shareholders. The repurchase of their own equity

6 An open corporation with a market capital capitalisation over a certain threshold (currently about US$50 million) must have at least seven board members.

7 Actions such as, *inter alia*, the conversion of the corporation into a different corporate type (LLC, SpA, etc.), a division or a merger of the corporation, a sale of substantially all of the assets of the corporation or the granting of guarantees or liens with respect to third-party obligations result in statutory withdrawal rights. A corporation's charter may provide for additional withdrawal rights.

interests is allowed for SpAs. Contrast this with corporations, which can make capital calls only if agreed by the shareholders. Statutory pre-emptive rights apply to equity issuances by a corporation. Corporations are also generally prohibited from acquiring their own shares and must distribute minimum statutory dividends (at an amount of 30 per cent of net earnings).

Most notably, however, an SpA may issue preferred shares accruing fixed or variable dividends. Features like preferred dividends accruing from specific businesses or assets are permitted (i.e., tracking stocks).

Chile also has investment funds. These can be structured as public funds (which are subject to substantive regulations by the SVS restricting the type and amount of assets in their portfolios, transactions with affiliates and periodic reporting to the market) or private funds (which are not subject to such regulations). Only public funds can publicly offer their securities.

i Sponsors' controlling investment of an entity

A sponsor seeking control of an investment in Chile will have to consider the specific features of each type of corporation.

Where the sponsor wishes to acquire control of a corporation, it will require at least the control of the number of shares required to control the board of directors and corporate decisions in shareholders' meetings – typically a majority of the outstanding shares. A number of material corporate actions require approval by at least two-thirds of the outstanding shares.[8] Some of those actions (such as the sale of more than 50 per cent of the assets and the creation of preferred shares) are material to private equity or venture capital sponsors. No corporate actions require unanimous consent of the shareholders.

Chilean law explicitly recognises shareholders' agreements and provides that they need to be 'deposited' with the corporation as a condition of the parties to it making claims against third parties based on such agreements. Chilean law, however, provides that shareholders' agreements are not enforceable against open corporations insofar as they create restrictions on the transfer of shares.[9] As a result, frequently liquidated damages clauses are agreed to by the parties in amounts large enough to create the appropriate incentives.[10]

SpAs provide the broadest flexibility in terms of contractual structuring provisions. The express recognition by the statute of contractual requirements in terms of maximum

8 Actions such as, *inter alia*, the conversion of the corporation into a different corporate type (LLC, SpA, etc.), a division or merger of the corporation, a sale of more than 50 per cent of its assets, a decrease in its equity capital, the valuation of equity contributions made in assets other than cash or a reduction in the number of members of the board of directors.

9 Section 14 of the Chilean Corporations Act.

10 In general, liquidated damages clauses are enforceable in Chile even if they are considered a 'penalty' or do not bear a direct relation to the expected damages caused by the breach of the relevant obligation.

(or minimum) levels of equity interests held by its members, the fairly broad flexibility to trigger increases or reductions in equity capital and the ability to repurchase their shares, *inter alia*, make SpAs highly desirable vehicles for private equity investors.

Uniquely, SpAs' charters can provide for 'squeeze-outs', whereby a minority holder can be forced to sell its interest upon another holder acquiring a certain threshold percentage. SpAs also allow for preferences consisting of multiple vote shares (and shares without voting rights).

In summary, a private equity sponsor will benefit significantly from the flexibility provided by an SpA when setting up a holding vehicle for its investment. By the same token, a sponsor investing in an existing SpA will need to conduct thorough due diligence and understand the implications of the SpA's organisational documents.

ii Structuring considerations for sponsors not domiciled in Chile

The key structuring considerations will be driven by control issues (as previously discussed), tax issues and the regulatory framework relevant to the industry in which the investment is made. For example, a number of activities in Chile have to be – at least directly – performed by corporations (banking, insurance, retirement funds administrators, etc.). In addition, corporations are the only corporate entity that allow for an IPO.

Similar to US tax law, Chilean law creates incentives for the use of leverage in a private equity transaction. Subject to certain conditions, Chilean tax law allows for tax deductions on account of interest payments. The same deduction does not exist for dividend payments.

Ordinarily, dividends remitted to non-Chilean sponsors are subject to a 35 per cent withholding tax rate. Interest payments are taxed at the same 35 per cent rate, but a 4 per cent reduced withholding rate applies, *inter alia*, to interest payments on loans made by foreign banks and financial institutions. In some cases, however, such as when the debt is guaranteed with cash or cash equivalents provided by third parties, in order to qualify for the reduced 4 per cent rate a 3:1 debt-to-equity ratio will have to be satisfied.

When structuring a transaction as a leveraged buyout, sponsors will have to ensure that the *pro forma* amount of debt of the target company (including the debt raised to finance the LBO) allow the surviving company to remain solvent. Chilean bankruptcy courts have jurisdiction to void transactions resulting in insolvent entities.

It is common to bridge a leveraged deal using short-term debt and then to refinance with long-term securities in the bond market or with a long-term secured loan.

Another reason for leveraging up a deal is that remittances of equity contributions to a foreign sponsor are first allocated to taxable retained earnings and profits. Accordingly, outflows of capital contributions can only be tax free if the Chilean business does not have accumulated earnings and profits that are taxable. There is no such requirement affecting principal payments on debt transactions.

iii Fiduciary duties and liabilities

The main source of fiduciary duties in the Chilean corporate context is the Corporations Act.[11] Directors of a corporation have an obligation to act with the degree of care and diligence that they would apply in their own affairs. They are jointly and severally liable for damages caused to the corporation or its shareholders for their fraudulent or negligent actions. The same principles apply to an SpA, unless it is not managed by a board of directors.[12] As a result, a private equity sponsor will not be directly exposed to liability with regard to other shareholders. The shareholders of a corporation (or an SpA) do not generally owe fiduciary duties to each other, and are permitted to act in their own self-interest.

Areas of concern for a sponsor arise in the insolvency context. While the Chilean courts do not apply the 'zone of insolvency' test to the same extent that a court in the United States might,[13] the Chilean Bankruptcy Act[14] does provide for liability on account of actions that are fraudulent to creditors. For example, Chilean courts may void a sale of assets consummated within two years of the insolvency of a company. They are, however, very unlikely to find liability for a sponsor other than in the very narrow circumstances of a fraudulent voidable transaction expressly provided for in the Bankruptcy Act or under criminal fraud statutes.

During the last three years the SVS has focused on compliance with the legal and regulatory requirements in connection with related party transactions (OPR). The criterion applied by the SVS to qualify a transaction as an OPR has been determined largely by specific facts and circumstances. For instance, in 2012, a capital increase in the energy company Enersis, was qualified as an OPR because the controller was paying for the equity shares issued to it, pursuant to the capital increase, in kind, while the minority shareholders had to pay for their shares in cash. On the other hand, a broad reorganisation of that same company in 2015, including several mergers and splits among Enersis and its subsidiaries, was not deemed an OPR by the SVS, even though the latter required to satisfy procedures and formalities applicable to an OPR. In the first case, assessing the fair market value of the assets that are being contributed by the controller as payment of the purchase price for its equity shares, and in the second case, assessing the fair market value of the company that is being merged into another company, were one of the main concerns for the minority shareholders, and characterising the transactions as an OPR could make a big difference in connection with that valuation process. In a private equity context, special attention should be paid to agreements between the holding company,

11 Section 41.

12 Section 424 of the Chilean Commercial Code.

13 Delaware courts have created the 'zone of insolvency' concept, effectively extending fiduciary duties of a board of directors to creditors when a corporation is close to insolvency. See *Credit Lyonnais Bank Nederland, NV v. Pathe Communications Corp*, 1991 WL 277613 (Del Ch 30 December 1991); *Weaver v. Kellogg*, 216 BR 563, 582-84 (SD Tex 1997); *Official Comm of Unsecured Creditors of Buckhead America Corp v. Reliance Capital Group, Inc* (In re Buckhead Am Corp), 178 BR 956, 968 (D Del 1994).

14 Sections 287 to 293.

the sponsor and the managers, on the one side, and the target or operating company on the other side, when the latter is a public corporation subject to the supervision of the SVS. This discussion might also be relevant in an acquisition involving a public company, were part of the purchase price is paid with shares of the purchaser or of another company, or in general, with any assets different from cash.

III YEAR IN REVIEW

i Recent deal activity

Continuing with the trend of the second half of 2014, the first half of 2015 has represented the strongest beginning of a year for the Latin American region since 2010, with an increase of 37 per cent in terms of deal count and 39 per cent in terms of invested amount.

The activity for the Andean region has been slightly slower in terms of the number of deals, but with an increase in terms of the invested amount.[15] Several important deals related to generation and distribution of energy took place between 2014 and 2015 regionwide, but particularly in Chile. For example, Global Infrastructure Partners acquired a 49.9 per cent interest in power generation company Empresa Eléctrica Guacolda from AES Gener, ECOSolar and the Danish Climate Investment Fund (KIF) announced the acquisition of 100 per cent of Vicuña Solar, two separate solar photovoltaic companies that will develop a generation project in the Elqui Valley and ECOSolar also acquired a minority stake in the 'Maria Elena' project, another solar power plant being developed and constructed in the Maria Elena municipality, Antofagasta.[16] The same trend is appreciated in terms of fundraising. For instance, Hudson Clean Energy Partners, a private equity focused in renewable energy, committed up to US$100 million for a strategic partnership with Sky Solar Holdings, Ltd to develop solar projects in Latin America (initially Chile and Uruguay) and Japan. SCL Energia Acticva, a Chilean fund manager, raised US$241 million for a fund that will invest in Latin American Energy Asstes (Americas Energy Fund II LP). Finally, during the last quarter of 2014, Ecus Private Equity launched a US$100 million fund to invest in the renewable energy sector in Chile.[17]

ii Financing

From a regulatory standpoint, it is worth noting that Chilean institutional investors, especially pension funds, are a key source of liquidity for private equity in Chile. They can only invest, however, in publicly traded entities, and face significant restrictions if investing in foreign investment vehicles and alternative assets (only 2.7 per cent of the pension funds' portfolio is invested in 'alternative assets' and less than 1 per cent

15 2015 LAVCA Mid-Year Data and Analysis.

16 Deals reported in the LAVCA web page (see www.lavca.org).

17 Deals reported in the LAVCA web page (see www.lavca.org).

in quotas of private equity/venture capital funds).[18] As a result, international private equity firms generally use local feeder funds to raise capital from institutional investors. Banks are also authorised to participate in private equity deals through their affiliates. Restrictions on the amounts invested (determined as a percentage of their assets) apply.

The Chilean Economic Development Agency (CORFO), the state development agency, is a significant source of financing for private equity and venture capital. CORFO encourages entrepreneurship and innovation by providing resources to start-ups or in key sectors of the economy. CORFO can provide direct financing (up to 40 per cent of the equity of a company) or financing through lines of credit available to private equity or venture capital investors. CORFO's financing can be unsecured, thereby allowing for additional third-party leverage on a secured basis. By the end of 2014, CORFO had committed equity contributions to 37 out of the existing 52 private equity/venture capital funds, for a total amount of US$579.2 committed funds, of which US$352.5 were effectively disbursed.[19]

iii Exits

Some of the recent exits are the sale by Ecus Private Equity, an independent private equity funds manager focused on Chile's small and middle market, of its stake in Albia (industrial laundry business) to Elis for US$14 million.

IV REGULATORY DEVELOPMENTS

i Regulatory bodies of the industry

Except for specific instances in the context of regulated industries, private equity transactions are generally not subject to special regulations restricting them. If a transaction involves public investment funds or public companies, a private equity sponsor is likely to have to deal with the SVS, which may exercise its overseeing powers. Private investment funds and private companies (including SpAs), on the other hand, are not supervised by the SVS.

For an IPO, both the issuer and its securities to be offered to the public need to be registered with the SVS. An application describing in detail the terms and conditions of the offer is required, and must include extensive information regarding the company (ownership structure, legal information, accounting, business and activities, risk factors, etc.) and its securities. The SVS has ample discretion to approve an application, and usually it will exercise it by asking for further information and for changes to the way information is presented. Once the observations are resolved, the issuer and the shares will be registered in the Securities Registry of the SVS. The SVS making observations is very common; however, an application not ending in an approved registration is extremely unusual.

18 See Chilean Association of Investment Fund Managers and EY, 'Venture Capital and Private Equity Report 2014-2015'.

19 Ibid.

ii Regulatory developments

In 2014, a new law entered into effect – the Unified Law on Funds – which is intended to transform Chile into a platform for the management of financial assets across the region. The new statute sets a common standardised framework for all funds, and simplifies the regulation for investment funds, mutual funds and their managers. New regulation of private funds was also enacted, featuring more extensive legal and regulatory requirements (ownership limitations, disclosure requirements, registration requirement for the manager).

The Unified Law of Funds includes tax incentives, such as a 10 per cent income tax rate for foreign national investing in funds, a tax exemption for foreign nationals investing in funds that hold more than 80 per cent of their assets outside Chile, as well as an exemption from value-added taxes on the portion of the management fees payable to an investment fund's manager related to fund interests held by non-residents. The government projects a threefold increase in investment fund activity as a result of the Unified Law of Funds having been enacted.

Another regulatory development has been a complete replacement of the bankruptcy and insolvency regime in Chile, which entered into effect on 10 October 2014. Under this new regime, a workout and reorganisation process similar to Chapter 11 of the United States Bankruptcy Code is favoured over the previously existing liquidation approach. This reform is expected to significantly reduce the amount of time that a company or person spends either in reorganisation or liquidation. The main purposes of this new bankruptcy regime are to facilitate the negotiation and approval of the debtor's reorganisation agreements, to improve the creditors' recovery rate in insolvency procedures and to regulate the effects of cross-border insolvency procedures.

Some of the main new features of this bankruptcy regulation are: (1) stronger financial protection for the debtor during the reorganisation period (which may last between 30 and 90 business days, depending on the percentage of the creditors supporting the reorganisation request); (2) restrictions on secured creditors for the purposes of foreclosing on their collateral, provided certain conditions are met; and (3) a new treatment of clawback actions, differentiating between objective clawback claims and and subjective clawback claims (the second kind of actions allow the creditors to rescind transactions within the two years previous to the insolvency proceedings if there was bad faith and the relevant transaction did not satisfy a fair market value and a fairness test).

Chilean tax regulations were also extensively reformed during 2014, with reforms including the following:

a an increase in corporate income tax;
b a new alternative regime for withholding taxes;
c new sourcing rules for debt instruments;
d more stringent rules for the capital gains tax regime;
e new rules setting forth that passive income of a foreign entity would be recognised on an accrual basis by the Chilean-resident controlling taxpayers;
f new tax haven and transfer pricing rules;
g new real estate taxation rules;
h an increase in the stamp tax rate;

i interest deductibility rules for loans destined to acquire shares, equity rights, bonds and other similar assets; and
h new general anti-avoidance rules establishing that obligations are triggered and payable in accordance with the legal nature of the business or acts carried out by taxpayers, regardless of their form, denomination or flaws.

Many of these rules have not yet fully entered into effect, and as such their impact on the private equity and venture capital landscape has yet to be determined.

A key aspect of the tax reform is the increase on the corporate tax burden for Chilean companies from the current 24 per cent rate to 25 or 27 per cent, depending on the regime companies adopt. For this purpose, the tax reform provides for two new tax regimes, an attribution regime that levies a 25 per cent tax rate on incomes obtained by companies in each tax year, which will be immediately allocated to their shareholders; and a partially integrated regime that levies with 27 per cent tax rate incomes obtained by companies. Under the second regime, shareholders are allowed to defer personal and withholding taxes until such profits are effectively distributed, but it only allows the use of a 65 per cent credit of the taxes paid by the company, unless the shareholder is resident in a tax-treaty country. The taxable basis of the corporate tax is broadened by way of:
a new controlled foreign entities (CFC) rules;
b modified thin capitalisation rules;
c disallowance and limitation of deductions;
d limitation on the use of tax losses; and
e limitation of preferential capital gains regimes and tax-free investment fund vehicles, among others.

Goodwill in excess of the market value of assets ceases to be subject to amortisation for tax purposes.

During 2015, a bill was presented in the Chilean Congress that seeks to amend certain dispositions of the tax reform. One of the proposed changes, as currently drafted, would limit the eligibility of the attribution regime explained above only to local investors. There is still no clear timetable for a vote on this bill.

V OUTLOOK

Chile has a competitive economy and a well-developed business environment. It has in place a smart regulatory framework with the necessary conditions to attract new investors and the private equity industry in general.

The new policies being implemented to improve the regulatory framework for investors in Chile, the continued growth of Chile's economy, the relatively early stage of the private equity industry in Chile and the number of exits over the recent past suggest the continued growth of the private equity industry in the country.

Appendix 1

ABOUT THE AUTHORS

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Andrés Mena is a partner in the New York corporate group of Kirkland & Ellis LLP. He concentrates his practice on debt finance and secured lending, specifically in acquisition and leveraged financings for private equity and corporate clients. He has worked on a broad range of LBO financings, including cross-border, working capital, asset-based, restructurings and debtor-in-possession transactions. He is part of the firm's Latin American practice.

Mr Mena is a graduate of the University of Chicago Law School (LLM, 2000) and the Universidad de Chile in Santiago (JD, 1998). Prior to being admitted to the New York Bar, he practised in Chile as an associate at Morales & Besa in Santiago, focusing on corporate finance matters.

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Francisco Guzmán is a senior associate of Carey. He concentrates his practice in M&A, private equity and venture capital transactions.

Mr Guzmán was awarded an LLM from Columbia Law School in 2010 (a James Kent Scholar, the highest honour awarded by the law school) and a JD from the Catholic University of Chile in 2006. He is admitted to practise law in New York (2010) and Chile (2006). Prior to working at Carey, Mr Guzmán practised at White & Case LLP in New York.

He is the author of *Información Privilegiada en el Mercado de Valores* ('Inside Information in the Securities Market', LexisNexis, 2007).

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