

New Constitution In Chile Would Affect Infrastructure Projects

By **Craig Miles and Vanessa Alarcon Duvanel**

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Chile's reputation for political and economic stability and a transparent business environment was shaken in 2019, when Chileans took to the streets decrying the country's inequalities and urging governmental reform. This unrest prompted an overhaul of Chile's existing constitution, and a new constitution will be submitted to a referendum Sept. 4.

If adopted, the new constitution will significantly alter the state's role in the economy by abandoning the existing priority of the individual in civil society and giving more obligations to the state. The impacts on existing and future public infrastructure projects could be significant.

The Draft New Chilean Constitution

Although the most extreme proposals were rejected during the rather chaotic one-year drafting process, the content of the draft new constitution creates uncertainties for existing and future investors in Chile.

Prepared by a left-leaning constituent assembly, the new constitutional text contains 388 articles, making it one of the longest in the world. At its core are social rights — to housing, water, health care, social security and decent employment — and the effective participation of indigenous peoples in the exercise and distribution of power.

The new constitution recognizes the rights of indigenous peoples to their lands, along with all associated rights to the resources on those lands. Generally, for all topics relevant to business in Chile, the new constitution sets out only guidelines, and leaves it to Congress and the executive branch to translate them into policy.

In case of approval, there will be a flurry of policy changes, with wide uncertainty as to how and when they will be implemented.

The draft constitution also addresses many environmental issues, and requires the state to act to prevent and mitigate the effects of climate change. It abolishes the privatization of water, and introduces a closer regulatory scrutiny over water usage, with permits to be granted by a national



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waters agency, and administrative powers to be conferred on regional basin councils, pursuant to future legislation.

The creation of the regional basin councils will lead to a decentralization of the power over the regulation and use of water resources toward smaller communities across the country. Indigenous communities will have a constitutional right to control and distribute water located on their lands.

In fact, the new constitution expressly declares the country to be a regional, plurinational and intercultural state, "made up of autonomous territorial entities" — politically, administratively and financially.

The draft text also brings changes to the government regime. The Senate is renamed the Regional Chamber, and will focus on the relationship between the country's different regions. The Lower House is renamed the Congress, and is given more powers in national and federal legislative matters, including the ability to propose spending bills — a power currently reserved for the president.

Finally, the mining industry has been a strong focus of the reform. Although the draft is more moderate than the initial proposals, it provides absolute control for the state over mines and mineral resources.

The draft contains 23 articles requiring the implementation of policies relating to the environment, social protection, innovation and technology, and small mining exploitations. The real impact of these provisions will only be known once those policies are enacted.

The risk that the plethora of rights and rules in the new constitution could conflict among themselves has added to the uncertainty. Recent polls suggest that the draft constitution does not meet Chileans' expectations, and is likely to be rejected. But neither a "yes" nor a "no" on Sept. 4 will bring immediate stability for investors in Chile.

The Impact of Chile's Constitutional Reform on the Construction Industry

The construction industry is a large contributor to Chile's gross domestic product, with housing and infrastructure — including transportation, energy, health and telecommunications — as the main sectors. Over recent years Chile has encouraged innovation and new technologies, including in the cleantech area, which has allowed important developments in renewable energy and green buildings.

The need for infrastructure investments remains immense. The current economic and political conditions, however, suggest that investments are unlikely to pick up soon.

If the new constitution is approved, the policies to be implemented are unclear. But some of the impacts on the construction industry can already be anticipated.

Financing for Infrastructure Projects

The draft constitution recognizes many new social rights that will require funding, and thus a strong economy. This could be difficult; the increased environmental protections in the new draft constitution and a growing inflation are likely to slow down the economy.

In addition, the existing pension system could be affected by the new priorities, and lead to reduced liquidities available for the domestic financial system that finances smaller projects. Larger

infrastructure projects that rely on international financing will not be immune from future Chilean policies, including increased taxes, royalties, etc.

Permitting Processes

The move away from a unitary state, with the creation of autonomous regions that will each have their own legal personality, assets and administrative powers, will increase bureaucracy, and likely extend the time required to obtain permits. The division of responsibilities will also increase the risk of conflicting decisions among communities.

These changes have the potential to cause uncertainty and delays on projects. Concessions will be undermined, with a completely different process by which the state will be the preferred provider of public interest good — making the renewal of existing concessions, and the availability of new projects to private investors, uncertain.

Environmental Protections

The environmental protection laws to be enacted based on the constitutional guidelines will be another source of increased project cost, and will cause an increased legal risk for investors in a range of industries, particularly in the mining sector.

Government Regime

The increased power given to Congress may make the Chilean legal system fragile. Even after all constitutional guidelines are translated into policies, there will be higher risk of legislative changes, as the asymmetrical bicameral system and the increased powers given to Congress could make populist measures easier to pass.

For example, the expropriation mechanism — including the conditions for expropriation — is not regulated in the constitution, and will have to be regulated by legislation. The content of such legislation, particularly the compensation due to the owner in case of expropriation, could be amended as the composition of Congress changes over the years.

On the other hand, if the Chilean people reject the new text, a new wave of political instability is expected, as the existing Pinochet-era constitution cannot remain, and the anti-private-sector climate will not disappear. What will come next is uncertain, even to the government.

Takeaways

Balancing investment opportunities with the risk posed by the new constitution and related legislation is challenging. However, investors can take certain steps to mitigate their risks, and be ready to act if and when a change negatively affects a construction project. These steps include:

- Reviewing project investment structures to maximize international investment protection under bilateral or multilateral investment treaties in force with Chile;
- Reviewing contracts and identifying possible remedies available to investors in case of normative changes;

- Reviewing the employment conditions on projects, and assessing possible improvements;
- Assessing the possible impacts of contemplated water rights and associated permit changes for projects; and
- Assessing and anticipating environmental protection measures that could be implemented in connection with projects.

Regardless of the outcome of the Sept. 4 referendum, foreign investors are encouraged to consider the strategic options available to them, including by monitoring public statements and legislative developments.

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