FOREIGN DIRECT INVESTMENTS IN SPAIN:
THE SUSPENSION OF THE LIBERALIZATION REGIME AS A RESULT OF COVID-19

For several decades now, Spain has managed to position itself among the countries in the world with **the highest foreign direct investment**. One of the reasons why it is an attractive destination for foreign investors is **the principle of freedom of movement of capital and of economic transactions with the outside world** pursued by that European and internal regulations. Indeed, with regards to foreign direct investments, the European Union and its Member States offered an open environment for investment, both within and outside Europe, which is enshrined in the Treaty on the Functioning of the European Union (TFEU) and which forms part of the international commitments of the European Union and its Member States.

Where is the foreign investment regime regulated in Spain?

The regime for foreign investment in Spain is governed essentially by the **Law 19/2003, of 4 July, on the legal framework for capital movements and economic transactions abroad**, and by the **Royal Decree 664/1999 of 23 April on foreign investments.**

This regulation establishes a general liberalization regime for foreign investments in Spain, consisting of an **"ex-post" declaration system**, which is implemented through the completion of certain forms and their notification to the Directorate General for International Trade and Investment of the Secretariat of State for Trade once and after the transaction in question has been carried out.

Recently, the internal regime has been complemented by the **Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union**, which applies from 11 October 2020, and which opens the door for Member States to maintain, at their own discretion, amend or adopt control mechanisms for foreign direct investment in their territory, on security or public policy grounds, establishing an "ex-ante" control system.

It is well known that the pandemic caused by Covid-19 has plunged businesses in much of the world into an unforeseen, deep, and still unpredictable economic crisis with a complicated solution. In this complicated socio-economic environment, and with the intention of protecting the internal business and productive fabric, both the European Commission and the Spanish Government adopted a battery of measures aimed at preventing solvent companies negatively affected by this crisis from leaving the market, among which we highlight:

- Communication from the European Commission COM (2020) 112 final of 13 March 2020 entitled "Coordinated economic response to the COVID-19 Outbreak";
- Royal Decree-Law 8/2020, of 17 March, to address the economic and social impact of COVID-19;
- Communication from the European Commission 2020/C 99 I/01 of 26 March 2020 entitled "Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets";

- Royal Decree-Law 11/2020, of 31 March, adopting urgent complementary measures in the social and economic field to deal with COVID-19; and
- Royal Decree-Law 11/2020, of 31 November, on urgent measures to support business solvency and the energy sector, and on tax matters.

In these two said Communications, the European Commission states that Member States must be vigilant and use instruments to prevent the loss of essential assets and technology, and it also stresses its concern at attempts to acquire health capacities or related industries (such as research centers) through foreign direct investment and the detrimental effects these could have on the European Union's ability to meet the health needs of its citizens.

In this context, and in accordance with the European Commission's statements, fears increased in Spain of the possibility that companies that are important for the economic systems of states could be acquired at derisory prices by foreign companies and, in the face of this threat, the current regime of generalized liberalization of foreign investment was perceived as a possible weakness that needed to be modified urgently.

The combination of the new regulations with the existing ones has brought about a significant change to the liberalizing legal regime governing capital movements and economic transactions with abroad that had been applicable in Spain since 1999.

In particular, the Fourth Final Provision of the Royal Decree-Law 8/2020 adds a new Article 7bis to Law 19/2003 of 4 July and provides for the **suspension of the liberalization regime for certain foreign direct investment in certain strategic sectors of the Spanish economy and, consequently, the need to request prior administrative authorization.**

A few days later, the Royal Decree-Law 11/2020 established, temporarily, **a simplified procedure for certain investments**, so as not to risk some transactions that were already underway (and to speed up the processing and resolution of some smaller investments).

Finally, in November, after several months of application of this new regime approved in March, the Spanish government decided to approve a reform of it with the Royal Decree-Law 34/2020, in accordance with which article 7bis of Law 19/2003 was again modified and **the suspension of the liberalization regime for foreign direct investment in Spain was extended to certain investments from the European Union and the European Free Trade Association**.

What do we mean by foreign direct investment?

Pursuant to the Royal Decree-Law 8/2020, a foreign direct investment is one that is made by residents from outside the European Union and the European Free Trade Association; or residents of countries within the European Union or of the European Free Trade Association, whose real or actual ownership corresponds to residents of countries not belonging to these geographical areas.

However, with the Single Transitional Provision of the last Royal Decree-Law 34/2020, is established a new temporarily regime which will be applicable until 30 June 2021, in accordance with which the concept of foreign direct investment affected by the suspension regime is extended to those investments to companies listed on the Spanish stock exchange or to unlisted companies if the value of the investment exceeds 500 million euro, as long as these investments are made by residents of countries within the European Union or of the European Free Trade Association other than Spain; or by residents in Spain whose real owner or actual ownership corresponds to residents of another European Union and European Free Trade Association country.

The concept of "real or actual ownership" is the same as the one provided for in the rules on the prevention of money laundering and refers to natural persons who owns or ultimately controls, directly or indirectly, more than the 25% of the capital or voting rights of the investor, or who otherwise exercise direct or indirect control over the investor.

In addition to the above assumptions, to be considered a foreign direct investment, the following requirements must also be met:

i. That the foreign investor holds a share equal to or greater than the 10% of the share capital of the Spanish company; or

ii. to acquire control of the Spanish company in accordance with the criteria set out in Article 7.2. of the Spanish Competition Act for economic concentrations.

Article 7.2 of the Spanish Competition Act for economic concentrations establishes that control shall result from agreements, rights or any other means which, taking into account the circumstances in fact and in law, confer the possibility of exercising decisive influence on an undertaking and, in particular, through property rights or rights of use of all or part of the assets of an undertaking, or through agreements, rights or any other means which make it possible to influence decisively the composition, deliberations or decisions of the bodies of the undertaking; furthermore, control shall be deemed to exist when the cases provided for in Article 42 of the Spanish Commercial Code occur.

Which sectors are affected by the suspension?

Faced with a foreign direct investment in Spain defined in the previous terms, it is necessary to analyze whether it takes place, because it affects **public safety, public order and public health**, in one of the following sectors:

1. Critical infrastructure, whether physical or virtual (including energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, and sensitive facilities), as well as land and buildings that are key to the use of such infrastructure;

2. Critical and dual-use technologies, key technologies for industrial leadership and capability, and technologies developed under programs and projects of particular interest to Spain,

including telecommunications, artificial intelligence, robotics, semiconductors, cyber security, aerospace, defense, energy storage, quantum and nuclear technologies, nanotechnologies and biotechnologies, advanced materials and advanced manufacturing systems;

3. Supply of essential inputs, in particular energy, which are understood to be those regulated by Spanish Law 24/2013, of 26 December, on the Electricity Sector, and Law 34/1998, of 7 October, on the Hydrocarbons Sector or those referring to strategic connectivity services or those relating to raw materials, as well as food security;

4. Sectors with access to sensitive information, in particular personal data, or with the capacity to control such information;

5. Media, without prejudice to the fact that audiovisual communication services under the terms defined in Spanish Law 7/2010, of 31 March, General of Audiovisual Communication, shall be governed by the provisions of said Law; as well as in

6. Other sectors not indicated above when the Government considers that they may also affect public safety, public order and public health in the country, by means of a Decree Law.

In the cases described, foreign investment cannot be made freely, but is subject to a system of prior authorization, which is set out below.

What other foreign direct investments require prior authorization?

Similarly, they also entail the suspension of the liberalization regime:

1. If the foreign investor is controlled directly or indirectly by the government, including public bodies or the armed forces, of a non-EU third country (for the purposes of determining the existence of the aforementioned control, the same criteria of Article 7.2 of Spanish Competition Act for economic concentrations are applied);

2. If the foreign investor has made investments or participated in activities in the sectors affecting security, public order and public health in another Member State, and in particular those listed in the previous paragraph (numbers 1 to 6); or

3. If there is a serious risk that a foreign investor carries out criminal or illegal activities.

Government powers

The Royal Decree Law 34/2020 introduces a new section 6 in Article 7bis of Law 19/2003, which empowers the Government to (by regulation) limit the definition of the sectors listed above, as well as to establish the types of foreign direct investment operations and the amounts below which they may be exempted from the prior authorization regime due to their nullity or scarce repercussion; and, in turn, and consequently, the Minister for Industry, Trade and Tourism is

empowered to issue the necessary rules for the implementation and application of the provisions issued by the Government in this respect.

How does the authorization procedure work?

Investment transactions falling under the above scenarios and affected by the suspension of the release regime **are subject to prior authorization.**

At the moment, in the absence of regulatory developments, the procedure to be followed for applying for and obtaining prior authorizations, is provided for in Article 10 of Royal Decree 664/1999, of 23 April, on foreign investments, and in Article 11 of the Order of 28 May 2001, which establishes the procedures applicable to declarations of foreign investments and their settlement, as well as the procedures for the presentation of annual reports and authorization files.

In accordance with these regulations, the request for prior authorization must be addressed to the Director General of Commercial Policy and Foreign Investment, and its resolution must be made by the Council of Ministers, on the proposal of the Minister of Economy and Finance and, where appropriate, of the head of the Department responsible for the matter and following a report from the Board of Foreign Investment.

The maximum period of resolution is six (6) months from the date of application; after such period without express resolution having been taken, the transaction shall be deemed not to have been authorized.

When can the simplified procedure be applied?

At the same time, the Royal Decree-Law 11/2020 establishes a transitional **simplified procedure** for those transactions:

a. For which there is evidence, by any legally valid means, of an agreement between the parties or a binding offer in which the price was already fixed, determined or determinable, before 18 March 2020; or

b. for transactions between 1 to 5 million euros.

In addition, foreign investments amounting to less than 1 million euros are exempt from authorization, even if they involve the takeover of more than 10% of a Spanish company.

In these cases, requests for prior authorization must also be addressed to the Directorate General for International Trade and Investment, but it is the Directorate General for International Trade and Investment itself who decides whether the authorization is granted or denied, following a report issued by the Foreign Investment Council.

This authorization is also subject to negative administrative silence, the maximum resolution period of which is thirty (30) days.

What are the consequences of not complying with the new regulation?

Investment transactions carried out without the mandatory prior authorization **will not be valid or have legal effects,** as long as their legalization does not occur; in addition, it constitutes a **very serious infringement punishable by a fine of up to the economic content of the transaction (which cannot be less than 30,000 euros), plus a public or private warning.**

When does it take effect?

The suspension of the liberalization regime has been applicable since 18 March 2020 and, although the first of the Royal Decrees-Laws 8/2020 envisaged maintaining the rule in force until it was amended by an agreement of the Council of Ministers, the second Royal Decree-Law 11/2020 eliminated this provision. Now therefore, although the regulatory development of the control mechanism is pending to be approved yet, and although with the recent application of Regulation (EU) 2019/452 modifications to the internal regulations may have to be introduced to adapt them to the terms contained therein; at this time, what we have explained is **the new normality** of possible transactions to purchase Spanish companies or business units.

In any event, it should be noted that this new legislation **does not replace the rules in force to date**, and therefore the special regimes affecting foreign investment in Spain established in sectoral legislation remain fully in force, such as, for example, the defense sector.

How might the recent entry into force of Regulation (EU) 2019/452 on foreign direct investment affect this?

The Regulation (EU) 2019/452 does not oblige Member States to apply a control mechanism for foreign direct investments. It simply establishes a European framework with general guidelines to be developed internally by each Member State. At the same time, this Regulation introduces **cooperation mechanisms** between Member States and **the intervention of the European Commission** for the analysis of direct investment from foreign investors.

The Regulation distinguishes the following three cooperation mechanisms:

(i) Firstly, Article 6 of the Regulation provides that **any foreign direct investment which is being subject to internal control in a Member State** (e.g. Spain) **must be communicated** (together with the information described in Article 9), **both to the other Member States and to the Commission**. This obligation is intended to allow them, respectively, to make comments or give an opinion if they consider that the investment in question affects security or public order.

(ii) Secondly, Article 7 of the Regulation provides that, **if a Member State considers that a foreign direct investment made by another Member State without control is likely to affect its security or public order, it may make comments for the Member State making the investment**.

If a Member State decides to make comments to the other **Member State**, at the same time, these comments must be sent to the Commission, who, similarly, may give an opinion if it considers that the foreign direct investment in question is likely to affect the security or public policy of more than one Member State.

(iii) Thirdly, Article 8 provides that **if the Commission considers that a foreign direct investment may, for reasons of security or public order, affect projects or programs of interest to the Union**, it may deliver an opinion to the Member State in which the foreign direct investment is planned or made.

These supranational processes do not replace the control of domestic foreign investment; and comments submitted by Member States or opinions issued by the Commission are not binding. However, the Regulation states that they must be "duly taken into account".

The first cooperation mechanism will concern foreign direct investment operations in Spain that are being monitored insofar as, before taking an internal decision, they must notify the information detailed in Article 9 of the Regulation to the other Member States and to the Commission and wait until the deadlines provided for in the Regulation have elapsed for them to comment and deliver an opinion, respectively. The Regulation itself provides that only in the exceptional and justified case where an immediate decision is required for reasons of security or public order, may a decision from a Member State be taken before the expiry of those deadlines. Thus, in addition to having to collect the information detailed in Article 9, this first mechanism of cooperation could end up slowing down foreign direct investment operations in Spain which require "ex-ante" communication, which, it should be remembered, are subject to negative administrative silence.

The other two cases of cooperation, numbers two and three, which cover all other foreign direct investment made in Spain and not subject to internal control, must be considered in so far as they could affect investments made in Spain up to 15 months after they have been made, since the Regulation allows Member States to make comments and the Commission to issue an opinion until then.

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