COVID-19: PRESSURE POINTS: MODIFICATION OF THE RULES GOVERNING CERTAIN FOREIGN INVESTMENTS IN SPAIN (MADRID)

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Legal Briefings – By **José Ramón Mourenza**

The Spanish Government has recently approved a set of provisions to tackle the crisis caused by the COVID-19 outbreak, which adopt a number of different measures with varying impact on different business sectors.

Of those measures, the modification and partial suspension of the framework of liberalisation applicable to foreign investments in Spain is of particular importance.

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Royal Decree-law 8/2020, of 17 March, on extraordinary measures to tackle the economic and social impact of COVID-19 ("**RDL 8/2020**"), modified Law 19/2003, of 4 July, on the legal regime applicable to capital movements and economic transactions abroad and on certain measures to combat money laundering ("**Law 19/2003**"), adding a new article 7 bis titled "suspension of the framework for the liberalisation of certain foreign direct investments in Spain". It has also therefore modified the regime of sanctions under Law 19/2003.

The new article 7 bis (which applies from 18 March 2020 and will remain in force until it is lifted by the Council of Ministers), complies with and is grounded on 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[i] ("**Regulation 2019/542**") – from which article 7 bis frequently takes its literal wording. As indicated in article 1 of Regulation 2019/542, it establishes a framework for the screening by Member States of foreign direct investments into the Union on the grounds of security or public order.

The main effect of the new regulation included by RDL 8/2020 is that certain foreign direct investments in Spanish companies by investors that are not resident in the European Union ("EU") or the European Free Trade Association ("**EFTA**") will be subject to prior authorisation.

Any matters not provided for in the new article 7 bis and in Regulation 2019/542 are currently subject to the provisions Royal Decree 664/1999, of 23 April, on foreign investments ("**RD 664/1999**").

However, it should be taken into account that the Council of Ministers, at its meeting held on 24 March 2020, has authorised the fast-tracking of a draft royal decree on foreign investments ("**the draft Royal Decree**"). The draft Royal Decree would replace RD 664/1999 and would continue to apply if and when the new article 7 bis of Law 19/2003 is ultimately lifted.

Taking into account the text of the draft Royal Decree that was submitted to public consultation [ii], we set out below: (i) the main rules under the new framework of prior authorisation for certain investments currently applicable pursuant to RDL 8/2020; (ii) the essential rules pursuant to the draft Royal Decree.

WHAT RULES APPLIED TO FOREIGN INVESTMENTS IN SPAIN UP TO NOW?

Up to now, foreign investments in Spain were liberalised pursuant to Law 19/2003 and RD 664/1999; as such, they were subject to a simple obligation to report the investment for administrative, statistical and economic purposes. There were certain exceptions to this in the case of very specific sectors, requiring prior authorisation (as was the case of foreign investments into Spain regarding activities directly connected to national defence, which were subject to prior authorisation, in accordance with article 11 RD 664/1999).

RDL 8/2020 suspends that general framework of liberalisation for a broad spectrum of foreign direct investments, making them subject to prior authorisation.

WHICH FOREIGN INVESTORS ARE AFFECTED BY THE REQUIREMENT IMPOSED IN RDL 8/2020 TO OBTAIN PRIOR AUTHORISATION?

According to RDL 8/2020, the obligation to obtain prior authorisation for certain foreign direct investments in Spain does not apply to all foreign investors; it only applies to foreign investors that **are not residents in a Member State of the EU or EFTA** (composed of Norway, Iceland, Liechtenstein and Switzerland).

It should be borne in mind that the United Kingdom retains its status as a EU Member State during the Brexit transition period (which in principle ends on 31 December 2020, but which may be extended by one or two additional years).

WHICH BUSINESS SECTORS ARE AFFECTED BY THE REQUIREMENT IMPOSED IN RDL 8/2020 TO OBTAIN PRIOR AUTHORISATION?

Depending on the specific status of the investor in question, the requirement to obtain prior authorisation may affect investments in any business sector or only those in certain strategic sectors, an exhaustive list of which is included in article 7 bis of Law 19/2003.

As such, **authorisation will at all times be required, irrespective of the sector involved, when the foreign investor is not an EU or EFTA resident and:**

- is directly or indirectly controlled by the government (including state bodies or the armed forces) of a third country. The criteria established in article 42 of the Spanish Commercial Code will be applied for the purpose of ascertaining that control.
- has made investments or has taken part in sectors that affect public safety, public policy or public health in another Member State, particularly the sectors listed in article 7 bis, as referred to below.
- where court or administrative action has been brought against it *"in the state of origin or another state on grounds of having engaged in criminal or unlawful conduct*

If the investor does not meet those criteria, authorisation will only be required when the investment is made in any of **the following sectors** (although including those already subject to authorisation, such as national defence):

- *"critical infrastructure, whether physical or virtual (including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities) and land and real estate crucial for the use of that infrastructure".* It should be borne in mind that the notion of "*critical infrastructure*" is not an open one nor subject to interpretation as article 7 bis expressly establishes that critical infrastructure will be composed of the infrastructure "*contemplated in Law 8/2011, of 28 April, which establishes measures to protect critical infrastructure (Ley 8/2011, de 28 de abril, por la que se establecen medidas para la protección de las infraestructuras críticas)*". The scope of that category of infrastructure is therefore limited to the critical infrastructure expressly established as such in the National Catalogue of Strategic Infrastructure (Catálogo Nacional de Infraestructuras

Estratégicas) regulated by Law 8/2011 as well as the implementing regulation approved by Royal Decree 704/2011, of 20 May[iv].

- *"Critical technology and dual use items as defined in article 2, number 1 of Council Regulation (EC) No 428/2009 of 5 May 2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items, including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace technologies, defence, energy storage, quantum and nuclear technologies, as well as nanotechnologies and biotechnologies".*

- *"The supply of critical inputs, in particular energy (...) and those related to raw materials and food security".* This is a very broad category, which, in the case of the energy sector, includes (pursuant to article 7 bis expressly) all of the activities regulated by the Spanish Electricity Sector Law 24/2013, of 26 December and the Spanish Hydrocarbons Law 34/1998, of 7 October.

- "Sectors with access to sensitive information, in particular personal data, or the ability to control that information, in accordance with Spanish Organic Law 3/2018, of 5 October, on the Protection of Personal Data and *digital rights". Again, this is a very broad category, given the generic reference to "sectors with access to (...) personal data".*

- "*The media*".

The list of sectors affected is therefore very broad. It must be borne in mind that article 7 bis establishes that **the Government may extend the authorisation regime to other business sectors,** provided that they have an impact on public safety, public order or public health. In accordance with article 10 RDL 664/1999 , extending the authorisation regime would have to be established expressly by Resolution of the Council of Ministers on the basis of a proposal submitted by the competent Ministry and a prior report issued by the Foreign Investments Board *(Junta de Inversiones Exteriores).*

WHICH TRANSACTIONS ARE AFFECTED BY THE REQUIREMENT IMPOSED IN RDL 8/2020 TO OBTAIN PRIOR AUTHORISATION?

The requirement to obtain authorisation affects foreign direct investments into Spain made by the aforementioned non-EU- or non-EFTA-resident investors provided that as a result of the investment:

- the investor comes to hold a shareholding interest equal to or greater than 10% in the Spanish company; or

- the investor (whether or not the 10% shareholding threshold is reached) comes to take part in the management or control of the Spanish company.

As a result:

- In the absence of a provision to the contrary, it should be understood that the new regime only applies to transactions that are currently ongoing and that, therefore, have not achieved closing by the date on which RDL 8/2020 entered into force (therefore, before 18 March 2020).

- At least according to the literal wording of the new article 7 bis of Law 19/2003, not all the types of investment referred to in article 3 RDL 664/1999 are subject to authorisation; only those involving a "*shareholding in Spanish companies*".[v]

  However, it should be taken into account that RDL 664/1999 defines this category in broad terms, by establishing that it includes e:

  - the incorporation of the company;
  - the subscription and acquisition of all or some of its shares;
  - the acquisition of securities such as subscription rights, bonds convertible into shares and other similar securities that, by their nature, provide an entitlement to acquire a stake in the company's share capital;
  - any transaction as a result of which voting and corporate rights are acquired.

- However, although asset deals do not fall within the scope of application of article 7 bis, certain assets and installations are connected to activities that must, in accordance with the law, be performed by entities exclusively devoted to performing that activity. As such, at least hypothetically, transactions involving the acquisition of assets or installations (although not the company owning them) might be subject to authorisation indirectly if it is necessary to incorporate an ad hoc company as a result of the transaction[vi.]

- Although the requirement to obtain authorisation is placed on *"direct" investments, Regulation 2019/542 expressly indicated in whereas 10 that "Member States that have a screening mechanism in place should provide for the necessary measures, in compliance with Union law, to prevent circumvention of their screening mechanisms and screening decisions" adding that, "This should cover investments from within the Union by means*

of artificial arrangements that do not reflect economic reality and circumvent the screening mechanisms and screening decisions, where the investor is ultimately owned or controlled by a natural person or an undertaking of a third country." It is therefore reasonable to conclude that investments made artificially by a foreign investor through an intermediary from a Member State of the EU or EFTA would be subject to the authorisation regime. This conclusion has greater traction when taking into account the contents of the draft Royal Decree, which expressly states that the domicile of the person or entity that has effective control over the investment will be taken into account in these circumstances.

- In principle, it seems prudent to infer that an investment in a Spanish parent company that, although not itself performing business in any of the sectors caught by the authorisation requirement, does so indirectly through subsidiaries or entities in which it holds a shareholding interest, would also be subject to authorisation. That was the opinion of the Spanish Supreme Court in judgment dated 4 March 2013 (appeal 753/2011) which only seemed to allow an exception to that rule if "*the parent company is not in a position to decisively influence the actions of its subsidiaries*", as could occur, according to the Supreme Court, in the case of "*groups of companies that are very decentralised geographically and functionally, with relatively autonomous subsidiaries across several countries), in which case it would prove difficult to connect the activities of the latter to the parent".*

- However, if the foreign direct investment is in a parent company whose domicile is in another Member State and that parent holds a stake in Spanish companies that perform any of the restricted sectors, it would seem that the cooperation mechanisms contained in articles 6 and 7 of Regulation 2019/452[viii] would have to be complied with if the Kingdom of Spain considers that the investment may indirectly affect its national security or public order.

HOW LONG WILL THE AUTHORISATION REQUIREMENT ESTABLISHED BY RDL 8/2020 LAST?

Although the Statement of Purpose of RDL 8/2020 states that the underlying reason for the measure is to tackle the "*certain threat*" to Spanish listed and unlisted companies posed by the impact of the COVID-19 outbreak on the world's stock markets, **the changes to the rules governing these investments are indefinite and will remain in force until they are lifted by the Council of Ministers.**

Therefore, no specific time period has been set and it is uncertain how long the exceptional regime established by RDL 8/2020 will last. However, insofar as it has been established on a temporary basis, it is to be expected that it will be lifted when the "*certain threat*" mentioned above has disappeared.

If the draft Royal Decree has been approved by the time the exceptional rules are finally lifted, the framework for screening foreign direct investments established in that draft will prevail at that time (even in the case of investments awaiting authorisation and that could, thus, be dispensed therefrom). This aspect will be looked at below.

WHAT PROCESS SHOULD BE FOLLOWED TO APPLY FOR AUTHORISATION?

According to RD 664/1999 (and on the basis of the modifications made to the structure of the Ministerial Departments since it was approved), an application for authorisation should be submitted to the Directorate General of International Trade and Investments (*Ministerio de Industria, Comercio y Turismo*). A decision on the application will be made by the Council of Ministers, pursuant to a joint proposal from the Ministry of Economic Affairs and Digital Transformation (*Ministerio de Asuntos Económicos y Transformación Digital*) and Ministry of Industry, Trade and Tourism (*Ministerio de Industria, Comercio y Turismo*) and a report issued by the Foreign Investments Board.

HOW LONG WILL IT TAKE TO ISSUE A DECISION ON THE APPLICATION FOR AUTHORISATION AND WHAT IS THE DECISION LIKELY TO CONTAIN?

It is established that a decision will be issued on the application within a maximum of six months; if no decision is issued within that time period, it is presumed that authorisation has been denied. If so, the applicant would be able to lodge an appeal against the presumed denial (contentious administrative appeal lodged before the Supreme Court, although it is also possible to lodge a prior and discretionary appeal for reconsideration before the Council of Ministers). The above notwithstanding, there is nothing to prevent a decision being issued in a shorter time period or a decision granting the authorisation being issued after the six-month term has elapsed.

As for the content of the decision, it will either deny or grant the authorisation sought. In the case of the latter, RD 664/1999 establishes that the authorisation must indicate the time period within which the authorised investment must be made (otherwise, it will be understood that it must be made within six months). If the investment is not made within the established term, the authorisation will expire unless an extension has been obtained.

Neither Law 19/2003 nor RD 664/1999 expressly establish that the authorisation can subject the investment to conditions or mitigating measures; however, it is reasonable to infer that it may do so. This possibility is expressly provided for in Regulation 2019/452 and is established expressly in the draft Royal Decree.

WHAT WOULD THE CONSEQUENCES BE OF NOT SEEKING OR OBTAINING AUTHORISATION WHEN REQUIRED TO DO SO?

Investments made without the required prior authorisation **will be legally void and invalid until they are legalised**. In addition, breach of the obligation to obtain authorisation would constitute a very serious offence, **which would lead to a fine (which could amount to the sum of the transaction)** and public or private reprimand.

DOES OBTAINING AUTHORISATION RULE OUT OR REPLACE SCREENING BY OTHER AUTHORITIES, ESPECIALLY IN MATTERS OF COMPETITION?

No. The authorisation obligation under article 7 bis of Law 19/2003 does not rule out or replace other authorisations or screening mechanisms that may apply to the transaction.

In particular, it does not eliminate the need for screening by Spanish National Securities Market Commission (*Comisión Nacional del Mercado de Valores, or CNMV*) in respect of takeover bids, in accordance with Royal Decree 1066/2007, of 27 July (although, if the application to the CNMV for authorisation for the takeover bid is submitted without having obtained authorisation under article 7 bis of Law 19/2003, the CNMV will not be able to issue its decision until evidence is produced that such authorisation has been granted).

Similarly, it should be understood that the regime of prior authorisation does not eliminate, but rather is in addition to, the ex-post control by the Spanish National Markets and Competition Commission (*Comisión Nacional de los Mercados y la Competencia*) into certain investments in the energy sector, in accordance with the ninth addition provision of Law 3/2013, of 4 June, on the creation of the National Markets and Competition Commission (*Ley 3/2013, de 4 de junio, de creación de la Comisión Nacional de los Mercados y la Competencia*).

WHAT ARE THE ESSENTIAL PROVISIONS OF THE AUTHORISATION REGIME UNDER THE DRAFT ROYAL DECREE, WHICH MIGHT REPLACE THE REGIME ESTABLISHED BY RDL 8/2020 WHEN IT IS ULTIMATELY LIFTED BY THE COUNCIL OF MINISTERS?

As mentioned above, at its meeting on 24 march 2020, the Council of Ministers authorised the fasttracking of the draft Royal Decree. The draft Royal Decree would replace RD 664/1999 and would continue to be in force even if the contents of the new article 7 bis of Law 19/2003 are ultimately lifted.

Although it should be taken into account that the draft Royal Decree may well be amended during the approval process, the essential content of the rules on screening foreign direct investments are:

- All foreign investments in activities directly related to national defence, weapons and explosives for civil use and the acquisition of real estate for diplomatic use by non-EU Member States are subject to authorisation (except, in the last case, if a reciprocity arrangement is in place that dispenses with that obligation).

- As a general rule, it establishes a framework of selective supervision of ongoing and past investments made by investors that are not EU or EFTA residents. Therefore, no general authorisation obligation is established; rather the Foreign Investments Board is authorised to require an investor to report an investment and provide an explanatory report when it understands that the investment entails a potential risk to security and public order. If so, the Foreign Investments Board will issue a report and, if there are grounds for doing so, the Minister for Industry, Trade and Tourism will make a proposal to the Council of Ministers to suspend liberalisation for that transaction and require that it be the subject of authorisation.

- It is understood that the acquisition of a Spanish company entails a risk to security and public order when it performs the following business activities, among others: (i) the

operation of critical infrastructure; (ii) the development, modification, control and operation of networks or information systems used to provide essential services and digital services; (iii) the production, commercialisation or distribution of dual use material, items or technologies; (iv) private security; (v) gambling; (vi) activities connected to terrorist financing[ix].

- The procedure and term for decisions on the application for authorisation are the same as indicated above: decision to be issued by the Council of Ministers within a maximum term of six months, and presumed denial of authorisation if no express decision is issued. However, it also expressly establishes that the authorisation may contain conditions or mitigating measures, a non-exhaustive number of which are listed.

- It establishes that, if an interposed entity is used to perform a transaction merely for structural reasons, the person or entity whose residence renders the investment a foreign investment will be the entity that has effective control over the company, investment fund or real estate.

- Investments that have not obtained the required authorisation or that have failed to fulfil the conditions imposed constitute a very serious offence, triggering the consequences described above.

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i. Indeed, the Commission, in its Communication of 25 March 2020, which offered "Guidance" to Member States when applying the new Regulation, pointed out that: "The Commission also calls upon those Member States that currently do not have a screening mechanism, or whose screening mechanisms do not cover all relevant transactions, to set up a full-fledged screening mechanism and in the meantime to consider other available options, in full compliance with Union law and international obligations, to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order, including health security, in the EU".

ii. Preparation of the draft Royal Decree started in 2019; it was submitted for public consultation between 27 March and 17 April 2019. See here.

iii. In the absence of further developing provisions, it should be taken into account how broad the definition is: it suffices that a proceeding has been opened in any country in the world, and the notion of "unlawful conduct", which is not defined, has a scope that is both extensive and difficult to delimit.

iv. Logically, the National Catalogue of Strategic Infrastructure is secret, in accordance with prevailing official secrets legislation. However, the owners of any critical infrastructure are perfectly aware of that it is critical as a number of very specific obligations are connected to its ownership. As a result, in the context of any transactions involving that infrastructure, the investor would have to obtain that information from the company it is intending to acquire.

v. The other types of investments referred to in article 3 RD 664/1999 are: a) the creation of branch offices or the increase in the number of branches; b) the subscription and acquisition of negotiable securities representing loans issued by residents; c) the acquisition of units in investment funds; d) the acquisition of real estate in Spain; and e) the creation, formalisation or participation in joint account agreements, foundations, economic interest groupings, cooperatives and co-ownership structures. The draft Royal Decree adds other types of investments which, in principle, should not currently be included in the scope of application of article 7 bis, such as: a) contributions made by shareholders to the net equity of Spanish companies that do not trigger a share capital increase; b) the financing of a Spanish company by companies belonging to its group by means of deposits, facilities, loans, negotiable securities or any other debt instrument; c) reinvestment of profits in Spanish companies..

vi. For example, article 28.2 of the Spanish Nuclear Energy Law 25/1964, of 29 April, establishes that the holder of the authorisation to operate a nuclear power station must be an entity whose exclusive corporate object is the management of nuclear power stations". Similarly, article 12.1 of the Spanish Electricity Sector Law 24/2013, of 26 December requires, among other things, that corporate entities that distribute electricity must have electricity distribution as their sole corporate object.

vii. The judgment examined a sanction imposed in connection with an investment made in a parent company that performed business related to national defence through its subsidiaries; as mentioned above, national defence is a sector that was already excluded from liberalisation and was thus subject to authorisation under article 11 RD 664/1999. This therefore constitutes an evident precedent for our purposes.

viii. Essentially, the indirectly affected Member State would be entitled to make comments and the European Commission could issue an opinion, as appropriate, which must be assessed by the competent authority of the Member State in which the investment was made.

ix. In this case the list of sectors affected is much more restricted than in RDL 8/2020, although it is also true that the list is not exhaustive. Otherwise, the transaction contemplated is strictly "the acquisition of a Spanish company

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