FOREIGN DIRECT INVESTMENTS IN SPAIN:
THE SUSPENSION OF THE LIBERALIZATION REGIME AS A RESULT OF COVID-19
&
ITS EFFECTS ON M&A TRANSACTIONS

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 offer 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, amend or adopt control mechanisms for foreign direct investment in their territory, on security or public policy grounds.

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, with the intention of protecting the internal business and productive fabric, last March 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"; and

- Royal Decree-Law 11/2020, of 31 March, adopting urgent complementary measures in the social and economic field to deal with COVID-19.

In the two 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, in Spain 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 has been applicable in Spain since 1999.

In particular, 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.**

What do we mean by foreign direct investment?

Pursuant to this new provision, 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. 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 order to be considered a foreign direct investment, the following requirements must also be met:

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

ii. Effectively participate in the management or control of that company.

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 technologies and dual-use items, including artificial intelligence, robotics, semiconductors, cyber security, aerospace, defense, energy storage, quantum and nuclear technologies, as well as nanotechnologies and biotechnologies;
3. Supply of essential inputs, in particular energy, hydrocarbons 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; 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.

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;

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. Whether administrative or judicial proceedings have been initiated against the foreign investor in another Member State or in the home State or in the State of origin or in a third State for carrying out criminal or illegal activities.

How does the authorization procedure work?

Investment transactions falling under the above scenarios and affected by the suspension of the release regime **will be 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, due to the need to speed up the processing and resolution of some of these requests for prior authorization, 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?

This 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 new and subsequent 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, which is still subject to obtaining prior authorization which is also subject to negative administrative silence.

WHAT DO WE UNDERSTAND BY FOREIGN DIRECT INVESTMENT?		WHICH SECTORS ARE AFFECTED BY THE SUSPENSION?	WHAT AMOUNT IS RELEVANT?	HOW DOES THE AUTHORISATION PROCEDURE WORK?
1º STATE OF ORIGIN	**2º TAKEOVER**	**4º SECTOR**	**4º MONETARY AMOUNT**	**5º AUTHORISATION**
Investor resident outside the EU and/or EFTA Investor resident within the EU and/or EFTA, controlled by an entity resident outside this territory	Takeover of 10% or more of the share capital Participate effectively in the management or control	A) Against public order, public safety and public health - Critical infrastructure - Critical technologies and dual-use products - Supply of critical inputs - Sectors with access to sensitive information - Media. B) Other sectors or cases at the decision of the Government if it considers that they may affect public security, public order and public health. C) That the investor: - is controlled by the government, public bodies or the armed forces; - has made investments or participated in activities in the sectors listed under A above; or - - has an open procedure for exercising criminal or illegal activities	< 1M€ →	Temporarily exempted from prior authorisation Declaration by means of model declaration forms
			>1M€ - <5M€ →	Temporarily subject to simplified prior authorisation
			>5M€ Before 18/03/2020 →	Temporarily subject to simplified prior authorisation
			>5M€ After 18/03/2020 →	Subject to prior authorisation, subject to negative administrative silence (art. 6 of Law 19/2003, of 4 July, as amended, which refers to Royal Decree 664/1999).
Investor resident in the EU and/or EFTA		(* Except for investments directly related to national defence which continue to be governed by R.D.L. 664/1999*)	(the amount is irrelevant) →	Declaration by means of model declaration forms
What are the consequences of not complying with the new regulation?		The operations will have no validity or legal effect until they are legalised; and It will be sanctioned as a serious infringement: - with a fine of up to the economic content of the operation (but it cannot be less than 30,000 euro); and - public or private reprimand.		