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FDI developments

Royal Decree 571/2023, of July 4, approves the long-awaited implementing regulation on foreign direct investment

Legal flash
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Key aspects

- The maximum term to resolve authorization applications is reduced from six to **three months.**
- The **exemption regime is modified**. Investments in strategic sectors in **companies with a turnover below €5 million** are exempt, with certain exceptions—and **time-limited transactions** without influence capacity. Certain transactions in the **energy sector** are also exempt.
- As regards funds, **management companies** are the beneficial owners of the investments.
- **Internal group restructurings** and **shareholding increases** not involving a change of control are not considered direct investment.
- The new regulation helps define the activities included in certain **strategic sectors**.
- It further defines transactions subject to authorization based on **the investor's profile**.
- It provides legal coverage for the prior consultation system.

Introduction

Following the entry into force of 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 ("**Regulation 2019/452**") and the legal amendments approved as a result of the COVID-19 crisis, Act 19/2003, of July 4, on the legal regime of capital movements and economic transactions abroad and certain measures to prevent money laundering ("**Act 19/2003**") was amended to introduce a new **article 7 bis modifying the general liberalization regime for foreign investments in Spain**.

From then on, certain **foreign direct investments** ("**FDI**") were subject to prior authorization, either because of the investor's profile or because they concerned one of Spain's main strategic sectors. For more information on the key aspects of this foreign direct investment authorization regime, see our legal flash Foreign investment in Spain: key issues.

Royal Decree 571/2023, of July 4, on foreign investment (published in the Official Gazette of the Spanish State on July 5, 2023) **approves the long-awaited implementing regulation** of Act 19/2003, on foreign direct investment ("**Spanish FDI Regulation**"). Its Chapter IV refers to the suspension of the general liberalization regime for certain foreign investments, with specific provisions for investments directly related to defense, arms, cartridges, pyrotechnic articles and explosives for civilian use and other material for use by the state security forces.

The **Spanish FDI Regulation will enter into force on September 1, 2023, although procedures initiated before that date will continue to be subject to the previous regime**—namely Royal Decree 664/1999, of April 23, on foreign investment ("**Royal Decree 664/1999**").

Main new developments

The Spanish FDI Regulation **seeks to provide greater legal certainty by helping define the strategic sectors or the investments subject to authorization based on the investor's profile. It also reduces by half the duration of authorization procedures**. Below are the most relevant developments, although the Spanish authorities already applied many of them as an interpretative criterion since the public hearing held in November 2021 for the draft regulation—similarly worded to the final version.

Repeal of Royal Decree 664/1999 of April 23, 1999, on foreign investment

The Spanish FDI Regulation **expressly repeals Royal Decree 664/1999, as well as any other regulations of equal or lower rank if their provisions are incompatible with the Spanish FDI Regulation**.

As regards funds, management companies are the beneficial owners of the investment

Act 19/2003 does not specify how to apply the concept of beneficial ownership in the case of investment funds. The Spanish FDI Regulation clarifies this issue and includes a specific rule in article 10.2.a for cases in which the investor is a collective investment undertaking or a closed-end collective investment undertaking resident in the European Union or in the European Free Trade Association, or similar entities or figures resident in third countries.

In accordance with the interpretation applied in practice, management companies will be considered the holders of the foreign investment. They are therefore subject to authorization, provided that the partners or beneficiaries do not legally exercise political rights or have privileged access to the company's information.

Internal group restructurings and shareholding increases not involving a change of control are not considered direct investment

Article 7 bis of Act 19/2003 did not expressly refer to internal group restructurings, and its wording raised the doubt as to whether these operations required authorization in some cases. However, it seemed sensible to argue that these restructurings did not entail changes in control, and thus should not be subject to prior authorization. This was the interpretative criterion established by the Directorate General for International Trade and Investment (the "DGII").

Article 14.3 of the Spanish FDI Regulation now expressly provides that **internal group restructurings are not considered direct investment**.

It also clarifies that **increases in shareholdings by anyone holding more than 10% that do not involve a change of control** are also not considered direct investment subject to previous authorization.

Further definition of strategic sectors

The Spanish FDI Regulation **further defines the activities included in certain strategic sectors**, which were not clearly identified under Act 19/2003, although the Spanish authorities already applied some of these criteria. We summarize some of these definitions below:

- It clarifies what is understood by critical and dual-use **technologies**, key technologies for industrial leadership and enablement, and technologies developed under programs and projects of particular interest for Spain, by referring to the relevant EU implementing legislation.

- It tightens the broad concept of **critical inputs** under Act 19/2003, although the new criteria are still rather vague. Critical inputs will be *those indispensable and not*

substitutable for the provision of essential services relating to the maintenance of basic social functions, health, safety, social and economic welfare of citizens, or the effective functioning of state institutions and public bodies, the disruption, failure, loss or destruction of which would have a significant impact.

It provides two additional criteria to determine the activities considered as critical inputs: (i) the development and modification of software used in the operation of critical infrastructures in certain sectors such as energy or finance, among others; and, more broadly, (ii) the indispensable and non-substitutable inputs to ensure the integrity, safety or continuity of activities affecting critical infrastructures, the supply of water, energy (hydrocarbons, renewable gases, biofuels or electricity), priority raw materials and telecommunications or transport services, healthcare, food safety, research facilities, and the financial and tax system.

In view of the above, it will be necessary to analyze the specific activity on a case-by-case basis, taking into account circumstances such as the target company's market share, the number of competitors and the substitutability of its products in the short term.

- The Spanish FDI Regulation defines more precisely the criteria for determining when a company has access to **sensitive information**. In particular:

  - Access to specific data on strategic infrastructures that, if disclosed, could be used to plan and carry out acts aimed at causing their disruption or destruction.

  - Access to databases relating to the provision of essential services of water supply, energy (hydrocarbons, gas or electricity) and telecommunications or transport services, healthcare, food safety, research facilities, financial services or the tax system.

  - Access to official databases that are not publicly available.

  - The development of activities subject to mandatory personal data impact assessment under article 35. 3 of the General Data Protection Regulation.

Further definition of transactions subject to authorization based on the investor's profile

Article 16 of the Spanish FDI Regulation breaks down the provisions of article 7 bis 3 of Act 19/2003 in relation to foreign direct investments subject to prior authorization based on the investor's profile:

- **Control by the government of a third country**. The Spanish FDI Regulation adds two relevant qualifications to determine whether there is actual control by the government of a third country: (i) any **significant financing**, including subsidies, offered by the government of that third country to the investor could be taken into

account; and (ii) **investments carried out by vehicles through which public funds or public employment pension funds are invested will not be under public control if that entity's investment policy is independent** and focused exclusively on portfolio profitability without any political influence of that third country.

- **Previous investments in strategic sectors**. Information received in the **framework of the FDI cooperation mechanisms** under Regulation 2019/452 may be used. In practice, the key is to analyze whether the investor has required prior authorization (granted, denied or conditioned) of foreign investments.

- **Serious risk of criminal or illegal activities**. In this regard, the **preferred criteria will be the existence of final administrative or judicial sanctions imposed on the investor in the last three years**, particularly in areas such as money laundering, the environment, taxation or the protection of sensitive information.

New exempt transactions: investments in strategic sectors in companies with a turnover below €5 million and time-limited transactions with no influence capacity

Under the Spanish FDI Regulation, the following transactions are **exempt from the prior authorization regime**:

- **Foreign investments in strategic sectors where the turnover of the acquired companies does not exceed €5 million in the last closed accounting year**, provided that their technologies have not been developed under programs and projects of particular interest for Spain.

  However, foreign direct investments will always be subject to authorization where they target electronic communications operators that meet any of the following conditions: (i) they are holders of concessions for the use of the radioelectric public domain, in frequency bands harmonized in accordance with EU legislation; (ii) they are holders of enabling instruments for the use of orbit-spectrum resources within the scope of Spanish sovereignty; or (iii) they have been classified as operators with significant power in a relevant market in the electronic communications sector. All transactions related to research activities or exploitation of mineral deposits of strategic raw materials are also subject to authorization.

- **Time-limited investments**, i.e., of short duration (hours or days), without the capacity to influence the management of the acquired company—being placement agents or underwriters of share issues and public offerings. It will be the end-investors who require authorization, as applicable.

- Investments entailing the acquisition of **real estate** not assigned to a critical infrastructure, or not indispensable and not substitutable for providing essential services.

An exemption regime is established for certain transactions in the energy sector

The Spanish FDI Regulation codifies the interpretation adopted by the DGII regarding critical inputs. It thus **establishes an exemption applicable to certain transactions in the energy sector that, due to their characteristics, are not considered a risk to national security**. This exemption will be applicable provided that the transaction is not also subject to authorization based on the investor's profile, in accordance with article 7 bis 3 of Act 19/2003.

Therefore, transactions that meet the following criteria will be exempt from authorization:

- The companies or assets acquired must not carry out regulated activities.
- As a result of the transaction, the company must not become a **dominant operator** in the sectors of electricity generation and supply, production, storage, transport and distribution of fuels or biofuels, production and supply of liquefied petroleum gases or production and supply of natural gas.
- Where the investment involves the acquisition of **electricity production assets**, the investor's total share of installed capacity by technology, regardless of the type, (i.e., the sum of previous direct or indirect holdings plus the new acquisition) must be less than 5% of the total installed capacity of the national generation park for that technology. To determine the investor's share, projects not in operation must be weighted based on their maturity and the degree of implementation of the associated investment project, taking into account their administrative processing status.
- Where the acquired company is an electricity retailer, its number of customers must be lower than 20,000.

Former *de minimis* rule

The Spanish FDI Regulation removes the exemption for investments under €1 million not subject to prior authorization. This was a transitory provision until regulatory determination of the minimum exempt amount for foreign direct investments in strategic sectors.

Procedural aspects

The maximum term to resolve authorization applications is reduced from six to three months for all types of transactions, regardless of their amount. All transactions will be processed through the ordinary procedure.

As in the past, the Council of Ministers will decide on authorization applications for investments exceeding €5 million. Otherwise, it will be the responsibility of the head of the DGII. However, **the maximum period for resolving the application and notifying the**

interested party is reduced from six to three months, including transactions equal to or less than €5 million that are not considered exempt under the new regime (which until now had to be resolved within one month and processed under the simplified procedure). Administrative silence continues to be negative.

This is one of the most positive measures of the new regulation, putting Spain on an equal footing with other Member States. It will significantly reduce the time periods for ordinary transactions, since the average resolution period used to be between four and five months.

Voluntary consultation procedure

Another positive aspect of the reform is that it codifies the possibility, until now admitted informally, of a voluntary prior consultation on whether the investment is subject to authorization.

- Consultations must be submitted to the DGII of the Ministry of Industry, Commerce and Tourism (or to the Ministry of Defense depending on the sector concerned), including all the information necessary to determine whether the operation is subject to authorization.

- The DGII will have 30 working days to respond, after a favorable report from the Foreign Investment Board, during which period no authorization may be requested.

- The resolution will be binding for the bodies and entities of the consulted authority.

- The proceedings will be confidential.

In practice, prior consultation is used in cases where there are sufficient legal grounds for considering that the operation is not subject to prior authorization, but for reasons of prudence the investor requires formal confirmation. If the DGII considers that it is necessary to request prior authorization, calculation of the period for resolution will begin at the moment of requesting the authorization. In other words, the days elapsed until resolution of the consultation are not taken into account for these purposes.

Other relevant aspects

- Investments carried out without prior authorization will lack validity and legal effects and the foreign investor in the Spanish company **will not be able to exercise political or economic rights** until the authorization is obtained.

- The Spanish FDI Regulation reiterates the possibility of authorizing transactions subject to compliance with the conditions imposed by the deciding body or the commitments submitted by the investor and accepted by the deciding body. However, unlike previous drafts, it does not include a list of possible conditions. It does establish that the administrative body in charge of monitoring compliance must be identified.

- Any notary public who becomes aware that a transaction is subject to prior authorization must inform the applicants of the need to obtain it.

- If two or more foreign investment transactions are carried out within a period of two years between the same buyers and sellers, they will be considered as **a single** transaction carried out on the date of the most recent one.

- Transactions carried out under the agreement of two or more investors only require one authorization application.

- A sort of coordination regime with the Spanish Securities and Exchange Commission ("**CNMV**") is established for acquisitions derived from public offerings of shares admitted to trading on a Spanish regulated market that are subject to foreign investment authorization. The DGII or the Directorate General for Armament or Material of the Ministry of Defense will notify the CNMV so that the offeror includes this information in the relevant documentation related to the offering.

For additional information, please contact our *Knowledge and Innovation Group* lawyers or your regular contact person at Cuatrecasas.