

## COVID-19 - Impact on Foreign Investments in Spain

### The Party is over for certain foreign investors

Royal Decree-Law 8/2020 of 17 March, published on the Official State Gazette of March 18, 2020, as amended and supplemented by Royal Decree-Law 11/2020 of 31 March, published on the Official State Gazette of April 1, 2020, adopts urgent and extraordinary measures to mitigate the socio-economic impact of the COVID-19 outbreak. In this context and to respond to the current situation, additional measures have been taken with specific regard to certain foreign direct investments in Spain (the "New Regulation")<sup>1</sup>.

In particular, the New Regulation provides for the *suspension of the deregulation regime for certain foreign direct investments in specific strategic sectors* of the Spanish economy - as detailed below- affecting the national security, public policy and public health (the "Strategic Sectors").

### What constitutes a foreign investment under the New Regulation?

Under new article 7-bis of Spanish Law 19/2003 of 4 July on legal regime of movements of capital and economic transactions abroad, foreign direct investments are defined as meeting the following requirements:

- a) made by residents of countries outside the European Union<sup>2</sup> ("EU") and the European Free Trade Association ("EFTA"); or,
- b) by EU or EFTA investors which beneficial owners are residents of countries outside the EU and EFTA, it being understood that a beneficial ownership situation exists when such person or entity: (i) owns or ultimately controls, directly or indirectly, a percentage greater than 25% of the capital stock or the voting rights of the investor; or (ii) directly or indirectly holds control over the investor by other means;

and provided that:

- a) as a consequence of the investment, the investor holds a stake equal to or greater than 10% of the capital stock of a Spanish company; or

---

<sup>1</sup> Until the New Regulation, foreign investments in Spain were mainly regulated by Spanish Royal Decree 664/1999 of 23 April on foreign investments and by Spanish Law 19/2003, of 4 July, on the legal regime of capital movements and economic transactions abroad and on certain measures to prevent money laundering, which set forth a system of general liberalization. In addition, specific rules apply to non-EU and non-EFTA residents investing in certain sectors, such as defense-related activities, gambling, audiovisual communications, air transportation, telecommunications, energy and financial activities.

The New Regulation anticipates Regulation (EU) 2019/452 of the European Parliament and the Council, of 19 March, establishing a framework for the screening of foreign direct investments in the EU on the grounds of security or public order, which shall apply as from October 11, 2020. And has been approved in the context of the Communication from the Commission dated 13 March 2020, as well as of the Communication from the Commission published 25 March 2020 [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, ahead of the application of Regulation (EU) 2019/452 (Regulation establishing a framework for the screening of foreign direct investments into the European Union)].

<sup>2</sup> The United Kingdom will retain the status of Member State of the European Union, pursuant to article 127.6 of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community until December 31, 2020 unless an extension is agreed.

# GARRIGUES

- b) as a result of the corporate transaction, act or agreement, the investor effectively participates in the management of a Spanish company or in its control (as such term “control” is defined in article 42 of the Spanish Commercial Code<sup>3</sup>).

## Which are the Strategic Sectors pursuant to the New Regulation?

The Strategic Sectors concerned by the New Regulation are:

- a) critical physical or virtual **infrastructures** (including those concerning *the energy, health, water, transport, communications, communications media, processing and data storage, aerospace, military, electoral and financial sectors*), as well as **lands and real estate needed for the use of such infrastructures**, as set forth in Spanish Law 8/2011 of 28 April introducing measures to protect critical infrastructures;
- b) critical **technology** and dual-use items (including *goods, software and technology, which can be used for both civil and military applications*) as defined in Council Regulation (EC) 428/2009 of 5 May, as well as *artificial intelligence, robotics, semiconductors, cybersecurity, aerospace or military technologies, technologies used for energy storage, nanotechnologies and biotechnologies*;
- c) supply of essential commodities, in particular **energy**, regulated under Spanish Law 24/2013 of 26 December and Law 34/1998 of 7 October, or those referred to **raw materials and food safety**;
- d) sectors with access to **sensitive data**, especially concerning the **treatment and process of personal data**, or capable to access to such information according to Spanish Organic Law on Protection of Personal Data and Guarantee of Digital Rights; and
- e) the **media** (without further specification).

In any event, the Spanish Government may also suspend the deregulation regime of foreign direct investments in sectors other than those specifically mentioned under letters (a) to (e) above if they affect in general the country's national security, public policy or public health.

## ***Other conditions to suspend foreign investments***

As from March 18, 2020, liberalization of foreign direct investments is also suspended if one of the following events regarding the subjective condition of the investor occurs (the “**Subjective Conditions**”):

- a) the foreign investor is directly or indirectly controlled by a third country government (including public agencies, the military or armed forces) defining control also as such term is defined under article 42 of the Spanish Commercial Code.

---

<sup>3</sup> Definition of control pursuant to article 42 of the Spanish Commercial Code: “control is understood to exist when a company, deemed the parent company, holds relations with another company, deemed the subsidiary company, in any of the following situations: (i) it holds the majority of the voting rights; and/or (ii) it has the power to appoint or dismiss the majority of the members of the governing body; and/or (iii) it can avail of the majority of the voting rights by virtue of agreements held with third parties; and/or (iv) it has exclusively assigned its voting rights to the majority of the members of the governing body, who are in office at the time of the preparation of the consolidated accounts and during the two years immediately prior thereto. Specifically, this circumstance shall be understood to apply when the majority of the members of the governing body of the subsidiary company are members of the governing body or senior management of the parent company or other company held by the parent company.”

# GARRIGUES

This Subjective Condition may impact to sovereign wealth and certain pension funds and other institutional investors who are natural investors in infrastructures, energy or other long term-long return structures in Strategic Sectors.

- b) if a foreign investor has made any investment or is involved in activities in sectors affecting national security, public policy and public health in another EU Member State (including activities that may be connected with the Strategic Sectors as defined above).
- c) if an on-going administrative or judicial proceeding has been brought against the foreign investor in another EU Member State or in its country of origin or in a third country concerning unlawful or criminal activities.

Although the New Regulation does not describe whether the foreign investor has to be convicted with no right to appeal or if being a defendant in an on-going administrative or judicial proceeding may suffice to block the investment based on the application of a Subjective Condition, it may be inferred that the opening of any administrative or judicial proceeding would mean that this Subjective Condition is met, even if the suspension would surely be more reasonable in the event that the investor has been finally found liable or guilty for the relevant criminal or illegal activities.

## How does the authorization procedure work?

The New Regulation sets forth that, as a condition precedent, the investments described above shall be subject to prior administrative authorization granted by the Spanish Government (Council of Ministers) in accordance with the conditions established by the competent administrative authority (i.e. the regulator of the affected Strategic Sector). Once the application for authorization is submitted, the Spanish Council of Ministers shall be the only body entitled to decide whether to grant or reject the authorization. Failure to obtain authorization within six (6) months will be deemed as a rejection (pursuant to the so called "*negative silence mechanism*" set forth in Article 6 of Spanish Law 19/2003 of July 4 in conjunction with Article 24, paragraph 1, of Spanish Law 39/2015, of October 1).

Transitional provision number two of Royal Decree-Law 11/2020, provides, on a temporary basis, for a simplified procedure (with an expedited thirty (30) day period to grant or reject the authorization) for those foreign investment authorizations that fall within the scope of the New Regulation if any of the following criteria are met:

- a) if it is possible to evidence the existence, prior to March 18, 2020 (date of entry into force of Royal Decree-Law 8/2020), of an agreement between the parties or a binding offer in which the price is set, (fixed or which establishes the rules for calculating it); or
- b) if the concerned transaction has a value ranging between €1,000,000 and €5,000,000.

Likewise, on a temporary basis and until it is developed by internal regulation, foreign investments below €1,000,000 are exempt from the required prior authorization.

According to the simplified procedure, applications shall be submitted to the Directorate General for International Trade and Investments, which is entitled to decide whether to grant or reject the expedited authorization following a prior report issued by the Board of Foreign Investment.

## What are the consequences of not complying with the New Regulation?

Any foreign direct investment executed without prior authorization or without meeting the conditions set forth in the New Regulations shall have no validity and legal effect until the necessary authorization is obtained, if not regularized pursuant to Article 6 of Law 19/2003.

In addition, failure to seek prior authorization or failure to comply with any condition set by the Spanish authorities in relation thereto as well as carrying out investment transactions before being authorized will constitute a very serious infringement and may trigger the following penalties: (i) a fine of up to the economic value of the transaction (in any case, for a minimum amount of €30,000); and (ii) public or private reprimand.

## What to expect moving forward

The New Regulation will apply to all those investments that will produce effects as from the date of entry into force of Royal Decree-Law 8/2020 (i.e., March 18, 2020)<sup>4</sup>.

It may be anticipated that foreign investors using SPVs, shell companies or ad hoc vehicles domiciled in Spain, EFTA or the EU are subject to the New Regulation.

Investors holding less than 10% of the share capital of a Spanish company which run its business activities in any of the Strategic Sectors, are unlikely to be subject to the provisions of the New Regulation unless they effectively participate in the management of said company or in its control and: (i) either they meet any of the Subjective Conditions mentioned above; or (ii) they are residents of countries outside the EU and EFTA, or EU or EFTA residents whose beneficial ownership corresponds to residents of countries outside the EU and EFTA. A review of the existing and projected shareholders agreements or other corporate documents will need to be considered to assess control or effective management.

In this situation of particular uncertainty, we deem appropriate to analyze on a case-by-case basis the features of each transaction and investor's profile to circumscribe the application of the New Regulation, especially considering that the Spanish Government adopted the above-mentioned measures with the scope to avoid that listed and unlisted Spanish companies, whose equity value is being reduced by the outbreak, may be acquired by foreign investors eager to profit from the unfavorable situation that such companies are now suffering.

## Is Spain following a global foreign investment protectionism era?

The EU has traditionally been seen as one of the world's most liberal foreign direct investment territories. However, as a result of the recent changes in the U.S. policy approach to foreign investment (*Foreign Investment Risk Review Modernization Act of 2018*), reinforcing the role, field of reviewing and competences of the Committee on Foreign Investment in the United States (the "CFIUS") and the trade wars of the last years it seems to have shifted the EU's perception on how to protect their big corporates and their strategic sectors from other trade blocks and leading economies.

---

<sup>4</sup> The regulation is unclear on the effective date applicable to direct investments made by a vehicle resident in the EU or EFTA which beneficial owner is resident outside said territories (which are subject to the application of the New Regulation pursuant to paragraph 1.b) of article 7-bis added by Royal Decree-Law 11/2020 and were not included in the first drafting of said article 7-bis introduced by Royal Decree-Law 8/2020) executed between March 18 and April 1, 2020.

# GARRIGUES

The EU's 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, ahead of the application of Regulation (EU) 2019/452 (Regulation establishing a framework for the screening of foreign direct investments), published as a Communication from the Commission dated March 26, 2020 (the "FDI Guidelines"), calls upon Member States to:

- a) *"Make full use its existing foreign direct investment screening mechanisms [(currently in 14 countries)] to take fully into account the risks to critical health infrastructures, supply of critical inputs, and other critical sectors as envisaged in the EU legal framework; and;*
- b) *for 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 use all other available options to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security, public order or public health in the EU, including a risk to critical infrastructures and critical sectors".*

By increasing foreign investments screenings the EU and its Member States are willing to avoid volatility, adverse effects to the valuation of European stock markets or undesired takeovers. The FDI Guidelines state that: *"In case of foreign investment from third countries in companies with valuations on capital markets that are considered well below their true or intrinsic value, the possibility to introduce restrictions could be considered taking into account the actual or potential impact of those investments on the safeguard of the abovementioned public interests (for instance whether they may lead to over-reliance on foreign investors from third countries for the provision of essential supplies or essential services). In terms of appropriateness of those measures, their potentially adverse impact on companies and the economy at large should also be considered and possibly mitigated."*

Investments that do not constitute foreign direct investment such as portfolio investments (which normally do not confer the investor effective influence over management and control of a company), are generally less likely to pose issues in terms of security or public order. However, as per the FDI Guidelines, where they represent an acquisition of at least qualified shareholding that confers certain rights to the shareholder or connected shareholders under the national company law (e.g. 5 %), they might be of relevance in terms of security or public order.

Not only the US and the EU are leading the global trend of reviewing foreign investment transactions in certain sectors. Recently, other economies such as Australia (April 1, 2020) are taking action to protect its markets. In Spain, in the midst of COVID-19 turmoil and as a consequence of the adverse impact that the pandemic is having over the IBEX-35 and other Spanish stock-traded companies' valuations, the Spanish Government seems to have joined the US, EU and other economies initiatives of controlling and protecting their "crown assets" indefinitely.