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Spain Extends its FDI rules to EU Resident Entities Until December 2022 and Publishes a Draft FDI Implementing Regulation

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Background

Another day, another ground-breaking change in Spain's FDI rules. November 2021 has been an eventful month for FDI in Spain. The following two developments are likely to be consequential in the evolution of the country's policy as regards foreign investments:

(i) More than a year after the establishment of the Spanish 2020 FDI *ex-ante* screening regime, Spain has finally published its long-awaited draft proposal of implementing regulation.

(ii) The *ex-ante* screening regime introduced in 2020 in the wake of the Covid-19 pandemic has been extended to EU resident entities until 31 December 2022

We will analyse these two reforms below and conclude this note with a preliminary assessment of these two measures.

The Ministry for Industry, Commerce and Tourism Publishes a Draft Implementing Regulation on Foreign Investments

Preliminary considerations

This regulation will take the form of an updated Royal Decree on Foreign Investments (the “**Draft Implementing Regulation**”). We are told by our contacts within the Authority that the Draft Implementing Regulation consolidates the Authority's existing practice so we have been making use of this text even before its formal enactment.

The Draft Implementing Regulation as Interpretation Criteria for the Substantive Provisions of the 2020 FDI *ex-ante* Screening Regime

Further Guidance on Potentially Sensitive Activities

One of the most interesting developments contained in the Draft Implementing Regulation is that it provides much-needed guidance on the scope of the sectors and activities which may lead to an FDI filing under Article 7 bis of Law 19/2003, on the basis of the activities of the target. Indeed, pursuant to Article 12 of the Draft Implementing Regulation, and simplifying a text which, on occasion is extremely long-winded:

(i) **“Critical infrastructures”** shall be understood as *“those thus characterised in application of Law 8/2011, of 28 April, establishing measures for the protection of critical infrastructures and which, consequently, appear as such in the National Catalogue of Infrastructures Strategies provided for in Article 4 of the said Law. Such infrastructures (whether physical, virtual, networks or systems) include the land and real estate that is necessary for its operations”*.

(ii) **“Critical technologies”** shall be understood as telecommunications technologies, artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear, nanotechnologies, biotechnologies, advanced materials and advanced manufacturing systems. The Draft Implementing Regulation provides that subsequent regulations can add or delete new technologies from this list.

(iii) **“Dual-use technologies”** shall be understood as those defined in Article 2(1) of *Regulation (EU) 2021/821 of the European Parliament and of the Council of 20 May 2021 setting up a Union regime for the control of exports, brokering, technical assistance, transit and transfer of dual-use items*.

(iv) **“Key technologies for industrial leadership and enablement”** shall be understood as the key enabling technologies for the future referred to in Council Decision (EU) 2021/764 of 10 May 2021 establishing the *Specific Programme implementing Horizon Europe – the Framework Programme for Research and Innovation, and repealing Decision 2013/743/EU*, or the regulation replacing it. These key enabling technologies include advanced materials and nanotechnology, photonics, microelectronics and nanoelectronics, life sciences technologies, advanced manufacturing and processing systems, artificial intelligence, digital security and connectivity.

(v) **“Technologies developed under programs and projects of particular interest to Spain”** shall be understood as those involving a substantial amount or percentage of funding from the European Union or Spain. Among others, this criteria includes those benefiting from funding under the instruments listed in the Annex *“list of projects or programmes of Union interest”* referred to in Article 8(3) 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 European Union*.

(vi) **“Fundamental inputs”** shall be understood as those inputs that are indispensable and cannot be substituted for the provision of essential services relating to the maintenance of basic social functions, health, safety, the social and economic well-being of citizens, or the efficient functioning of state institutions and public administrations, the disruption, failure, loss or destruction of which would have a significant impact.

More precisely, the above includes the following:

(a) inputs provided by companies developing and modifying software used in the operation of critical infrastructures in certain sectors (i.e. energy, water supply, telecommunications, finance

and insurance, healthcare, transport and food safety); and

(b) inputs necessary to ensure the integrity, safety or continuity of activities affecting critical infrastructure, the supply of water, energy, priority raw materials and telecommunications, transport services, healthcare, food safety, research facilities, or the financial and taxation system.

(vii) “Companies with access to sensitive information” shall be understood as those carrying out activities that are subject to a mandatory data protection impact assessment in accordance with Article 35(3) of the *General Data Protection Regulation (EU) 2016/679* and those with access to:

(a) specific data on strategic infrastructures which, if disclosed, could be used to plan and carry out acts aimed at causing the disruption or destruction of such infrastructures;

(b) databases relating to the provision of essential services (water supply, energy, telecommunications and transport services, etc.); and

(c) official databases that are not publicly accessible.

Guidance on Potentially Problematic Investors

Similarly, as regards investors who would be subject to the FDI screening mechanism irrespective of the nature of the activities of the target (i.e., foreign entities controlled by the government of a third country; entities who have made investments or participated in activities in sectors involving security, public order and public health in another Member State; and all investors, when there is a serious risk that the foreign investor may carry out criminal or illegal activities affecting public security, public order or public health in Spain), the Draft Implementing Regulation clarifies the following:^[1]

(i) The Draft Implementing Regulations empower the Spanish FDI authorities to investigate whether a government directly or indirectly controls the buyer, including through a significant financial contribution “*including subsidies*”.

(ii) Sovereign Funds are excluded provided their investment policy is “independent and focuses exclusively on the profitability of [their] portfolios and the political influence of a third State is impossible”.

(iii) In order to assess whether there is a serious risk that the foreign investor may engage in criminal or illegal activities that affect security, public order or public health in Spain, 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.

Criteria for Substantive Assessment

Finally, the Draft Implementing Regulation enunciates the **substantive criteria** that will determine whether a transaction subject to the Spanish FDI screening mechanism is authorised or not (or if it

is authorised subject to remedies). This decision will aim to guarantee the protection of legitimate objectives in the field of public policy that might be threatened by the relevant transaction, based on the risk that such investments could affect public safety, health and order, national defence or foreign action, as a consequence of: (i) their effects on the areas in which such investment takes place or in others related thereto; and (ii) the context and circumstances of the foreign investor[2].

Procedural Changes

The Draft Implementing Regulation also introduces some relevant changes that affect not only the recent 2020 FDI screening rules, but also those already in existence for investments in activities directly related to national defence^[3] and acquisitions of real estate for diplomatic purposes from non-European Union Member States^[4]. The Draft Implementing Regulation:

(i) Formally establishes and regulates the already “unofficially” available voluntary consultation procedures through which foreign investors can ask the relevant Authority[5] whether a particular transaction is subject to FDI authorisation or not prior to its implementation (a procedure which is so common that it is often referred to as a “Phase I”). [6]

Once the Draft Implementing Regulation enters into force, the duration of this consultation phase, which currently tends to last for six weeks, will be limited to 30 business days (six weeks). However, the said time limit can be suspended by the submission by the relevant Authority of a request for information.

Additionally, the Draft Implementing Regulation establishes that the Authority’s response will be binding on them and that the absence of a reply will imply that the transaction is subject to prior authorisation.

(ii) Clarifies that when a transaction may be subject to authorisation on different grounds[7] (i.e. investments in specific critical sectors or by specific investors –Article 7 bis of Law19/2003– and investments in activities directly related to national defence or weapons and other materials used by the State Security Forces and Bodies) the notifying party should file a single consultation form with the Directorate-General for International Trade and Investments of the Ministry of Industry, Trade and Tourism.

(iii) Limits the duration of the authorisation proceedings to three months (as opposed to the current six months)[8], after which, in the absence of the Authority’s decision, the authorisation would be deemed to be denied[9].

(iv) Exempts from the screening regime certain investments that are deemed to have little or no impact on the legal assets protected by the FDI screening mechanism (i.e., investments in the energy sector that do not refer to regulated activities and that meet certain conditions essentially regarding market presence; investments in targets with a turnover that does not exceed EUR 5 million; and investments in properties that are not assigned to any critical infrastructure or that are not indispensable and not substitutable for the provision of essential services)[10].

(v) Modifies the FDI screening mechanism applicable to investments in activities directly related to national defence by widening the activities expressly covered by the rule (to date limited to the

production of or trade in arms, ammunition, explosives and military equipment, and now also including those affecting industrial capabilities and areas of expertise needed to provide the equipment, systems and services that will provide the Armed Forces with the necessary military capabilities)[11].

(vi) Includes a new category of investments subject to FDI screening obligations: investments in activities related to the manufacture, trade or distribution of weapons, cartridges, pyrotechnic articles and explosives *for civilian use*[12].

New Regime as Regards *Ex-Post* Filings

As regards the regime of declarations for statistical and administrative purposes, the Draft Implementing Regulation introduces the following changes:

First, the Draft Implementing Regulation eliminates the *ex-ante* declaration obligations regarding investments originating from tax havens. All reportable statistical and administrative investments will have to be declared after their implementation, irrespective of their nature.

Second, the Draft Implementing Regulation modifies the list of transactions subject to *ex-post* declaration obligations[13]. In a nutshell:

(i) Declaration obligations will be limited to investments resulting in shareholdings of 10 % or more in the share capital of the Spanish company.

(ii) New types of transactions will be affected by the declaration obligations (i.e. contributions by shareholders to the net worth of Spanish companies that do not entail an increase in the amount of share capital; certain investments in funds managed by Spanish residents; certain financing operations to Spanish companies or subsidiaries of companies of the same group; and the reinvestment of profits in Spanish companies by non-resident investors).

(iii) The thresholds relating to the incorporation and formalisation of share accounts, joint ventures, foundations, economic interest groups, community estates are reduced from EUR 3 million to EUR 1 million (by the non-resident investor).

(iv) The threshold for investments in real estate is reduced from EUR 3 million to EUR 500,000.

Extension of the ‘Ex Ante’ Screening mechanism as regards EU residents until 31 December 2022

As a result of the change, and until 31 December 2022, Spain will have two alternative regimes of “*ex-ante*” foreign investment screening:

(i) A **general regime, applicable to non-EU or non-EFTA investors**, under which the acquisition of 10% or more of the shares in a Spanish company (or control of such company by any means) is subject to prior authorisation if (a) the target company operates in a sensitive sector or (b) the foreign investor has certain characteristics (i.e. is controlled by a foreign government, has previous

sensitive investments or has a history of illegal activity).

(ii) A **temporary regime, applicable to non-Spanish EU or EFTA investors**, under which the acquisition of 10% or more of the shares in a Spanish company (or control of such company by any means) is subject to prior authorisation if (a) the target company operates in a sensitive sector, and (b) the target company is listed in Spain or the value of the investment is more than €500 million. This regime applies until 31 December 2022, but it may be extended.

Comments

We cannot deny that we have mixed feelings regarding these developments. To those of us that are pro-market and / or still believe in the EU Internal Market as a fundamental corner of the Union with an (almost larger than life) mission of bringing the European economies together and / or consider that Spain needs investment from other EU countries, the extension of the rules applicable to EU residents, be it until 2022, constitutes a worrying turn of events. Moreover, these rules might face significant problems of enforceability resulting from the measures' far from obvious compatibility with EU law. EU protected free movement of capital allows discriminations on grounds of nationality but only to the extent that the protectionist measure is strictly necessary and proportionate to the achievement of a legitimate public goal. This will not be relevant, in practice, as regards most transactions, since it will be easier (and less risky) for corporations to resort to the consultation process than to challenge any over intrusive measures of the Spanish authorities before the courts. However, if and when the Spanish FDI authorities intervene and impose remedies that the parties do not agree with and / or even block a transaction, we foresee protracted litigation challenging the compatibility of this extension with EU law. To the extent that the question makes it to the CJEU by way of a preliminary ruling, the state of problematic transactions may not be settled for years.

[1] Article 13 of the Draft Implementing Regulation.

[2] Article 18(1) of the Draft Implementing Regulation.

[3] Article 11 of RD 644/1999.

[4] Third Additional Provision of RD 644/1999.

[5] I.e. either the Directorate-General for International Trade and Investments of the Ministry of Industry, Trade and Tourism or the Directorate-General of Armament and Material of the Ministry of Defence.

[6] Article 9 of the Draft Implementing Regulation.

[7] I.e. investments in specific critical sectors or by specific investors (Article 7 bis of Law 19/2003) and investments in activities directly related to national defence or weapons and other materials used by the State Security Forces and Bodies (Articles 15 and 17 of the Draft

Implementing Regulation)

[8] Article 10 of RD 644/1999.

[9] Article 18(6) of the Draft Implementing Regulation.

[10] Article 14 of the Draft Implementing Regulation.

[11] Article 15 of the Draft Implementing Regulation.

[12] Article 16 of the Draft Implementing Regulation.

[13] Article 3 of the Draft Implementing Regulation.

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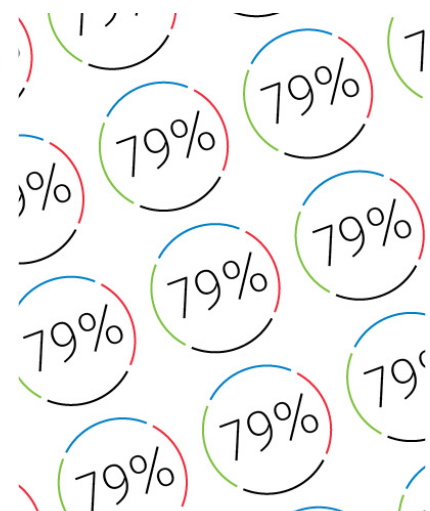
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