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Foreign Direct Investment in Spain – National Defense

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With the much-debated reforms to Act 19/2003, of 4 July, *on capital movements* ("**Act 19/2003**"), the Spanish foreign direct investment ("**FDI**") regime has been expanded over the past few years. However, FDI screening in relation to defense investments predates Act 19/2003 (and the recent FDI hype more broadly), and was regulated in Royal Decree 664/1999 of 23 April, *on foreign investments* ("**RD 664/1999**"). More precisely, Article 11 suspends the general liberalization regime for investments in "*activities directly related to defense*". Both regimes apply concurrently to investments in defense in Spain.

Below, we will consider the most important questions regarding the Spanish rules on FDI in relation to national defense.

What is considered to be an "*activity directly related to national defense*" subject to review?

Article 11 RD 664/1999 refers to the "*production of or trade in arms, ammunition, explosives and war materials*." The proposal for a Royal Decree on Foreign Investment ("**Draft Implementing Regulation"),** which can be used as guidelines in interpreting the Spanish FDI legislation, requires authorization for all activities "*affecting the industrial capabilities and areas of knowledge necessary to provide the equipment, systems and services that will provide the Armed Forces with the necessary military capabilities, as well as those related to the production (understood as the design and manufacture), maintenance or trade of defense material in general*." (Article 15(1) Draft Implementing Regulation).

Precedents as such are not publicly available. Usually, the Council of Ministers publishes a short statement that an investment has been authorized. The level of detail provided in these statements differ. Often it is not stated whether the authorization is subject to conditions, reasons for the decision or further details regarding the investment and the target company. In addition, Spain's defense authorities are remarkably opaque discussing them[1]. However, in our experience:

- The essential feature for a target company to be caught by the screening mechanism is that it is involved in the development or manufacture of any product that may be used for defense purposes. Thus, it is not relevant whether said company is a contractor of the Spanish Armed Forces, but rather whether it is able to become one on account of its business activities.
- In order to assess whether any given company's business is considered to be defense-relevant, from Spain's defense authority's standpoint, there are some useful criteria, including:

1. The target company is regulated by Royal Decree 679/2014, of 1 August, *on the Regulation for the control of foreign trade of defense material, other material and dual-use products and technologies*.
2. The target company holds any level of security clearance.

- Subcontractors are also captured by the screening mechanism. This could be the case of a provider of any input to a direct contractor of Spain's defense authorities.

Investments which were authorized by the Council of Ministers include the following:

- The EUR 11 billion investment of Raytheon Systems Limited, a British company, in Raytheon Microelectronics España SA in 2014. Raytheon Spain engages in activities related to national defense. The Spanish target manufactures guidance systems, microelectronic devices, electronic cards, sub-assemblies and electronic equipment which are used in products for national defense[2].
- In 2019 US private equity firm Rhone Capital via Prill Holdings SARL, an investment company registered in Luxembourg, acquired 45% of the Spanish Maxamcorp Holding and its subsidiaries, including Expal. The investment of EUR 265 million was authorized by the Council of Ministers[3] as well as an increase in shareholding to 71% two years later in 2021[4]. Maxamcorp is one of the largest manufacturers of explosives globally. Expal is a producer of weapons, electronic weapon systems, and munition for over 60 countries.
- In 2021, the Council of Ministers authorised the investment of the Indian Tech Mahindra Limited in Tech Mahindra Spain, S.L. allowing the "*commercialization of defense materials and dual use items, and the performance of activities related to defense in the technology sector in Spain*" [5]. The acquired company is dedicated to providing services and consulting in regards to information technology.

It should be noted that activities directly related to arms, ammunition, pyrotechnic articles and explosives for civilian use or other material for use by the State Security Forces and Corps are excluded from this definition and are subject to the (regular) FDI filing procedure before the Ministry of Commerce (Art. 16 Draft Implementing Regulation).

Who authorizes FDI regarding national defense activities?

In contrast to other sectors, FDI in defense activities must be notified to the Directorate General of Armament and Material – within the Secretariat of State for Defense at the Ministry of Defense – in accordance with Article 11 of RD 664/1999.

The approval of the investment corresponds to the Council of Ministers on a proposal from the Minister of Defense, and after hearing the Foreign Investment Board ("*Junta de Inversiones Exteriores*", in Spanish) – an inter-ministerial collegiate body – which has reporting duties, particularly in FDI authorization proceedings.

The Foreign Investment Board is made up of the following members: (i) the Director General of Trade Policy and Foreign Investment, as Chairman, currently María Paz Ramos Resa, an economist; (ii) a representative of each of the Ministerial Departments as well as the National Intelligence Agency (in Spanish, "*Centro Nacional de Inteligencia*"); and (iii) the Deputy Director General of Foreign Transactions Management, as Secretary, currently Ignacio Mezquita Pérez-

Andujar, another economist with a background at the Spanish Competition Authority.

Which foreign investments are subject to the defense screening mechanism?

Investments which result in the acquisition of at least 5% of the share capital or allow the investor to directly or indirectly form part of the management body are subject to the screening mechanism (Article 11(1) RD 664/1999).

If between 5% and 10% of the share capital is acquired, the investor must notify the Directorates General for Armament and Material, and for International Trade and Investment.

However, Article 15(2)(b) of the Draft Implementing Regulation mentions the possibility that if the notification is accompanied by "*a document in which the investor reliably undertakes in a public deed not to use, exercise or assign their voting rights to third parties, or to form part of any of the listed company's administrative body*" no authorization is required.

Who is considered to be non-resident in Spain?

According to Article 2 of Act 19/2003, the following persons are considered to be non-resident in Spain:

(i) Natural persons habitually residing in foreign territory, except for Spanish diplomats abroad and Spanish personnel rendering services in Spanish embassies and consulates or in international organizations abroad;

(ii) Foreign diplomats accredited to the Spanish Government and foreign personnel rendering services in foreign embassies and consulates or in international organizations in Spain;

(iii) Legal entities with registered offices outside of Spain;

(iv) Subsidiaries and permanent establishments abroad belonging to natural or legal persons resident in Spain; and

(v) Others that are determined by regulation in analogous cases.

EU investors fall within the definition of foreign investors and are subject to the mechanism.

The Spanish legislation has not been challenged before the European Courts in this regard. However, in line with Article 65(1)(b) of the Treaty on the Functioning of the European Union and the European Court of Justice's decision in Church of Scientology[6], Member States may "*take measures which are justified on grounds of public policy or public security*" restricting the EU protected right to free movement of capital. The Spanish judiciary is relatively pro-EU and has applied the direct effect of the Free Movement Provisions of the Treaty on several occasions. More particularly, for instance, Articles 63 and 65 of the Treaty have been invoked in many disputes regarding tax discrimination. In this regard, the ruling of the Supreme Court of 20 October 2021, appeal number 5921/2018, serves as a paradigm of the above.

Indeed, in the words of the Court: "*(…) following the consolidated case law of the ECJ, investment funds, in general UCITS, both resident and non-resident, must receive the same tax treatment. When this is not the case, and Article 63 of the TFEU is violated, without the exceptions of Article 65 TFEU, they are entitled to request the refund of the withholding tax on dividends received. Since it involves a violation of the principle of free movement of capital, this can also be extended to investment funds resident in third countries, non-members of the EU and the EEA*" (Our translation).

Are there any provisions for the investment made by a party resident in Spain that moves its residency outside of the country?

When a person or legal entity that is resident in Spain becomes a non-resident, any investments they hold in Spain will be considered foreign investments (Article 12 RD 664/1999).

Likewise, when a person or legal entity that is non-resident in Spain becomes a resident, any investments they hold in Spain will stop being considered foreign investments.

Who is responsible for filing a screening request? Which party bears the risk?

In line with Article 10(2) RD 664/1999, the filing must be made by the investor who is non-resident in Spain, and who, consequently, bears the risk.

What is the process for filing a screening request? Is there a particular deadline?

The filing must be submitted to the competent authority at the Spanish Ministry of Defense for authorization before closing the transaction. The Ministry requests information, including the composition of the investor's management bodies, information on shareholders who hold more than 5% of the shares, the annual financial statements, and the structure of the group.

A decision is issued by the Council of Ministers within six months. Until there is an authorization, the transaction cannot be closed.

If there is any change to the conditions authorized by the Council of Ministers, the Directorate General of Armament and Material must be notified and if they consider the changes to be minor, they can approve these changes directly. Otherwise, any change needs to be submitted through the formal process by making a new filing (Article 11(3) RD 664/1999).

Can the review process result in conditions being imposed on a transaction?

Yes, there are three possible outcomes of the review process before the Council of Ministers:

(i) The transaction is authorized as proposed by the parties;

(ii) The transaction is subject to conditions which need to be implemented; or

(iii) The transaction is blocked and cannot be executed.

How do parties submit a filing? Is there a fee?

The filing is to be submitted to the competent Directorate General with the Spanish Ministry of Defense. There is no filing fee, but the parties must fill out the filing form ("*Solicitud de Autorización de Inversión Extranjera*"), including general basic information of the investor and the Spanish target ("*Formulario Datos Empresa*"), and the form for the EU cooperation mechanism ("*Notification form (B)*"). The Spanish Ministry is obliged to submit the latter to the European Commission. The Ministry requires certain documentation and information regarding the Spanish target, the foreign investor, and the investment itself ab initio but reserves the right to ask for any additional information which might be needed during the review. This information includes, for example:

(i) Description of the target's main activity, and its activities related to defense;

(ii) Composition of the investor's management bodies; and

(iii) Investment objectives, plans, and means to achieve them.

In addition, documents presented to the Ministry for Defense need to be in Spanish and legalized. Translations need to be certified by an authorized translator[7].

Can transactions be concluded before screening process is finished? If not, are any sanctions imposed for doing so?

In transactions subject to the screening process, the transaction cannot be executed until authorization has been obtained. If the transaction is carried out without the required prior authorization, it will be considered non valid and will not have any legal effect (Art. 8(2)(b) Law 19/2003).

In addition, closing without filing a screening request or without waiting for the authorization as well as the lack of truthfulness in the process is punished with: (i) a fine of up to the amount of the economic value of the transaction, with a minimum of EUR 30,000; and (ii) a public or private reprimand.

What happens if the parties fail to comply with the conditions imposed?

If the parties do not comply with the conditions imposed by the Council of Ministers, the investor is subject to the sanctions described in Section 10 above. In addition, failure to comply with the conditions means that the transaction is void as it is deemed as not authorized.

How are sanctions set out?

In order to determine the amount of the applicable sanction, Art. 10 of Law 19/2003 refers to the following criteria:

(i) Nature and magnitude of the infringer;

(ii) Degree of responsibility and intention of the infringer;

(iii) Time elapsed between the infraction and the attempt to correct it on the interested party's own initiative;

(iv) Financial standing of the infringer;

(v) Past conduct of the infringer, regarding capital movements and foreign investment, for which any final sanctions imposed in the last five years will be considered.

What is the procedure for filing an ex-post declaration? Is there a particular deadline?

In addition to the ex-ante screening mechanism described above, every foreign investment needs to be declared within 30 days of closure of the transaction to the Ministry of Commerce. This ex-post declaration is merely for statistical purposes, and needs to be made for every foreign investment in a Spanish company[8]. The investor is responsible for making this statistical fling. Additionally, if a Spanish notary has been involved in the transaction, be it due to a legal obligation or by agreement of the parties, they shall submit information on the transaction to the Investment Registry (Transitory Provision, para. 2 RD 664/1999).

In certain cases, it is not the non-resident party who must file the declaration:

(i) In the case of investments made in negotiable securities carried out through investment services companies, credit institutions or other resident entities which act on behalf of and at the risk of the investor as an intermediary holder of said securities, this resident entity is required to file a declaration (Art. 7(2)(b)(2) RD 664/1999); and

(ii) Investment transactions in Spanish investment funds must be declared by the management company of the fund (Article 4 (3)(a) Draft Implementing Regulation).

Are sanctions imposed if an ex-post declaration is not filed? Are there sanctions for late filing?

The sanctions, administrative in nature, are the same as under Spain's horizontally applicable FDI rules. Articles 8 and 9 of Law 19/2003 establish sanctions for failure to make the statistical filing, as well as for lack of truthfulness, omission, or inaccuracy in the declaration, and for late filing.

Failure to declare transactions exceeding EUR 6,000,000 or, alternatively, lack of truthfulness, omission or inaccuracy in the data provided for transactions exceeding said amount is considered a serious offense and is subject to: (i) a fine of up to half of the value of the transaction, with a

minimum of EUR 6,000; and (ii) public or private reprimand.

Failure to declare transactions under EUR 6,000,000 or, alternatively, lack of truthfulness, omission or inaccuracy in the data of a declaration that does not exceed such amount, is punishable by: (i) a fine of up to one quarter of the value of the transaction, with a minimum of EUR 3,000; and (ii) private reprimand.

Finally, late filing of the declaration, without prior action of the Administration, is punishable with: (i) a fine between EUR 150 and EUR 300, when the delay does not exceed six months; (ii) a fine between EUR 300 and EUR 600, when the delay exceeds six months.

Spanish law provides no criminal sanctions for breaches of these rules.

We are not aware of any case in which the Spanish FDI Authorities have imposed such fines for the failure to make a statistical filing.

What is the statute of limitation?

In line with Art. 11 of Law 19/2003, the following infringements are subject to a statute of limitations of five years:

(i) Closing a transaction without filing an ex-ante screening request;

(ii) Closing a transaction before authorization from competent authorities has been acquired; and

(iii) Lack of truthfulness in the presented ex-ante filing.

The statute of limitations is three years for:

(i) Failure to file a statistical filing for transactions exceeding EUR 6,000,000; and

(ii) Lack of truthfulness, omission or inaccuracy in the data provided in the statistical filing for transactions exceeding EUR 6,000,000.

The following infringements are subject to a statute of limitations of one year:

(i) Failure to file a statistical filing for transactions under EUR 6,000,000;

(ii) Lack of truthfulness, omission, or inaccuracy in the data of an ex-post declaration filed for transactions under EUR 6,000,000; and

(iii) Late filing of a statistical filing when there has been no prior action or request by competent authorities.

[1] Spain's defense authorities do not issue any report treating investments in the defense sector. There are no statistics, general information about the parties or any kind of guidance regarding the filing obligation.

[2] See, *Defensa – Autorizada tres inversiones extranjeras en empresas relacionadas con la defensa nacional*, Minutes of the Council of Ministers of 31 October 2014, available at lamoncloa.gob.es, and *El Gobierno autoriza tres inversiones extranjeras en empresas relacionadas con la defensa nacional*, 3 November 2014, available at defensa.com.

[3] See, *Defensa – Acuerdos por los que se autoriza que la inversión extranjera en determinadas sociedades españolas se pueda destinar a actividades relacionadas con la defensa nacional*, Minutes of the Council of Ministers of 1 February 2019, available at lamoncloa.gob.es, and *El Gobierno autoriza la entrada de Rhône Capital en Maxam*, 5 February 2019, available at infodefensa.com.

[4] See, *Defensa – Inversión extranjera en la sociedad española Maxamcorp Holding S.L. para actividades relacionadas con la defensa nacional*, Minutes of the Council of Ministers of 19 January 2021, available at lamoncloa.gob.es, and *El Gobierno autoriza que la inversión de Prill Holdings en Maxam se destine a la defensa*, 20 January 2021, available at infodefensa.com.

[5] See, *Inversión extranjera para actividades relacionadas con la defensa nacional,* Minutes of the Council of Ministers of 7 December 2021, available at lamoncloa.gob.es.

[6] Judgement of the European Court of Justice of 14 March 2000 in Case C-54/99 *Eglise de Scientology*, ECR 2000 I-01335.

[7] See, Ministry of Defense; *Guidelines for the solicitation of authorization for foreign direct investments in activities directly related to national defense* ("*Guía para la solicitud de autorización de inversiones extranjeras en actividades directamente relacionadas con la defensa nacional*", in Spanish). Please note that the guidelines are only available in Spanish.

[8] For more information on the statistical filing, see Pablo Figueroa and Alejandra González-Concheiro; *Spain Extends its FDI rules to EU Resident entities Until December 2022 and Publishes a Draft FDI Implementing Regulation*, 17 December 2021, available here.

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