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Two Years with Spain's FDI Screening Mechanism – What Have We Learnt?

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Almost two and a half years have passed since Spain's Royal Decree Laws 8/2020, of 17 March, on *extraordinary urgent measures to address the economic and social impact of COVID-19,* 11/2020, of 31 March, *adopting additional urgent social and economic measures to address COVID-19,* and 34/2020, of 17 November, *on urgent measures to support business liquidity and the energy sector, and in tax matters* (the "**Revamped Act 19/2003**") took effect, radically overhauling Spain's approach to foreign direct investment ("**FDI**") screening.

We set out below the main takeaways from our practical experience with Act 19/2003 over the past two years, consider how transacting parties have been navigating Spain's FDI regime in practice, and highlight some continuing areas of uncertainty that Spain's Ministry of Industry, Commerce and Tourism ("**MICT**") might want to clarify in future guidance. [1]

A recap of Spain's FDI System

The Revamped Act 19/2003 introduced a hybrid investment screening regime, consisting of a (i) horizontally applicable set of rules, applicable to all sectors of the economy and (ii) a separate regime for defense-related transactions. Both regimes are mandatory.

General Regime

Under the general regime, parties must submit a notification to the MICT if they:

- Acquire (i) 10% or more of votes or shares in a Spanish entity or (ii) acquire control over said entity in line with EU competition law; *and*
- the target has activities in Spain within a specified list of sensitive sectors, *or* the Investor fulfils certain requirements, such as being directly or indirectly controlled by a foreign government, *e*., sovereign wealth funds.

Due to the suspensory nature of the mandatory regime, a transaction cannot close until it receives clearance.

The sectors listed as sensitive by the Revamped Act 19/2003 are the following: critical infrastructure, critical and dual-use technologies, access to sensitive information, supply of critical

inputs, and media and press. If the list sounds familiar: it is copied from the EU FDI Regulation. However, these sectors are interpreted very expansively by the authority.

The Spanish authorities can impose fines up to the value of the deal for gun jumping. Also, the transaction is deemed invalid under Spanish law until duly authorized.

Finally, it is also important to note that the *de minimis* thresholds for non-EU/EFTA investors are extremely low: EUR 1 million (EUR 500 million for investors from the EU/EFTA).

Defense

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 of a target with activity directly related to defense are subject to the specific defense screening mechanism.

In contrast to FDI falling within the general regime, FDI in defense activities must be notified to the Ministry of Defense, and ultimately authorized by the Council of Ministers. [2]

Two years of practical experience with the Revamped Act 19/2003

Like many governments, the Spanish Government's intention was to establish an agile mechanism capable of protecting Spanish corporations in the wake of the COVID-19 crisis from potential threats posed by foreign investors. We consider how effective the revamped Act 19/2003 is at reaching these goals, how investors have reacted to the new regime, and what we understand the MICT might want to clarify going forward in the much-expected FDI Implementing Regulation ("*Real Decreto de Inversiones*").

The Revamped *Act 19/2003* in Practice

We are spotting a number of emerging trends in the practice of the Spanish FDI authorities:

- Legal certainty does not appear to feature particularly high in the priorities of MICT. Shocking as this may sound to FDI practitioners, this is probably a consequence of the authority having national security as its objective.
- All regulators (not only FDI regulators) tend to conflagrate jurisdiction with substance. It is probably human to bend jurisdictional rules in the direction of notifiability when a transaction raises substantive concerns and in the direction of non-notifiability when it is banal. The Spanish FDI authority is no exception.
- The authority appears to believe it operates in a void in relation to substantive analysis. Russian, Chinese, and Iranian buyers appear to be considered the most problematic, but this is nowhere to be found in writing. It is probably safe to assume that North Korean and Belarusian buyers will be in the same category.
- For transactions caught by the threshold that do not raise substantive national security concerns, the MICT expects parties to submit the so-called "*consultations*". These are data-intensive filings

which usually lead to authorizations in two months (eight weeks).

- A bit like with competition law in-depth (Phase II) reviews worldwide, it is becoming increasingly problematic to predict the duration of a Spanish FDI Phase II investigation. The official deadline is six months. In practice, they tend to last around three months, but potentially problematic transactions can last (significantly) longer.
- We see a number of themes arising with respect to how deal conditionality is negotiated:
  - A shared interest in ensuring mandatory notification. Missing a mandatory MICT filing results in transaction voidness, which represents a shared risk for buyer and seller. As such, and as noted, by N. Kar and M. Daniel in relation to the UK regime: the "*inclusion of a condition in the transaction documents allowing for such a filing is typically uncontroversial*".
  - Risk allocation with co-investment. As noted, again, by N. Kar and M. Daniel in relation to the UK, "*where an acquisition is being made by a consortium of investors, there is a risk that some investors may pose a greater risk from a national security perspective. Transacting parties sometimes consider how consortium arrangements can be restructured or re-negotiated to mitigate this risk*". The same applies in Spain.

Potential Weaknesses of the System

After two years, we can safely confirm that Spain has an FDI system in place that is broadly effective and remarkably pragmatic (certainly compared with its competition law counterpart). However, the past two years have also shed light on some potential issues and areas where pending market guidance from the MICT will be very welcome. These include the following:

- The broad scope of Act 19/2003 has arguably resulted in too many notifications. The expansive scope of the regime, coupled with the breadth and ambiguity of certain mandatory sectors, has resulted in **a myriad of clearly benign deals being notified**. The MICT appears to be comfortable with this state of affairs, noting that (i) the overarching objective is preventing a single potentially problematic transaction goes unreviewed, (ii) case handlers are always available to discuss (which is, in our experience, both correct and commendable) and (iii) the reviews are swift (which tends to be the case, at least for unproblematic transactions). However, Spain is yet to prohibit a single transaction in the application of its FDI Act, and, according to the figures of the MICT, 82% of the transactions reported to the authority in 2021 were authorized in a cursory Phase I-like "consultation". [3] Such remarkably low levels of intervention probably constitute an indication that the thresholds are set too low.
- **The priority attached to the residence of the acquirer is bound to lead to problems**. If, say, Vladimir Putin started living in Budapest, any acquisition he would make in Spain would benefit from the *de minimis* regime for EEA residents.
- The authority is adopting a number of potentially *contra legem* stands, including the following:

1. **Asset deals**: whereas Act 19/2003 only subjects investments leading to (antitrust/EUMR-like) control to an obligation to file, the MICT appears to be of the view that asset deals are potentially in scope.
2. **Jurisdiction**: whereas Act 19/2003 appears to establish mandatory merger control like thresholds, in practice, transactions meeting those thresholds "*only*" trigger a consultation.
3. **Acquisitions of minority shareholdings**: whereas Act 19/2003 subjects non-controlling acquisitions of shareholdings of 10% or more to a filing without qualifying between direct and

indirect acquisitions, the MICT has sometimes (not always) considered that it is less interested in indirect non-controlling acquisitions. It remains to be seen whether this "*lack of interest*" is to be interpreted as a sweeping jurisdictional rule enabling parties to exclude a possible obligation (again, the MICT has not been entirely clear on this point).

4. **Further detailed guidance is urgently needed**. As of 22 September 2022, the horizontally applicable system still relies on the few articles which the revamped Act 19/2003 devotes to FDI. Precedent is mostly not public. The Spanish government appears not to be in a rush to approve Spain's Implementing Regulation (the "*Decreto de Inversiones*"). As a result:

- Due to a number of technicalities, liaising with the officials within the MICT is necessary. This is less than ideal as regards the predictability of the law. Also, one genuinely wonders what would happen to the system if the officials currently serving within the MICT leave their positions.
- Counsel is heavily relying on a Draft Implementing Regulation ("*Proyecto de Decreto de Inversiones*") which is not yet in force but which appears to consolidate the practice of the authority (for more information on this, click here).

All in all, two years after its inception, Spain's system of FDI feels still somewhat nascent and over-reliant on a handful of extremely hardworking officials. However, critics might want to remember that it is not overnight that a perfectly fine-tuned and fully-fledged enforcement system is born.

By way of example, in 1962 (*i.e*., more than 70 years after the enactment of the Sherman Act) the US Supreme Court confirmed the prohibition of a merger with combined market shares of 7.2% (cf. *Brown Shoe Co., Inc. v. United States*, 370 U.S. 294 (1962)). In 1966 (*i.e*., almost a decade after the signing of the then EC Treaties), the EU Court of Justice made interpretations of absolute territorial protection in exclusive territories that still haunt the EU distribution industry today (cf. Case 58/64 Case *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH*). In two and a half years, the Spanish FDI authority does not appear to have made a single (to call a spade a spade, wrong) decision of that calibre.

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[1] In this update, we broadly follow the structure of a very insightful article on the UK by our competitors (one of whom is a former colleague) Nicole Kar and Mark Daniel (see Kar, N., and Daniel, M., "Five months with the NSIA – what have we learnt?". The two quotes below can both be found in this article.

[2] For more information on the Spanish FDI screening mechanism for defense activities, see Pablo Figuero & Julia M. Böhme *Foreign Direct Investment in Spain – National Defense*, 27 August 2022.

[3] See *2021 EN CIFRAS.*

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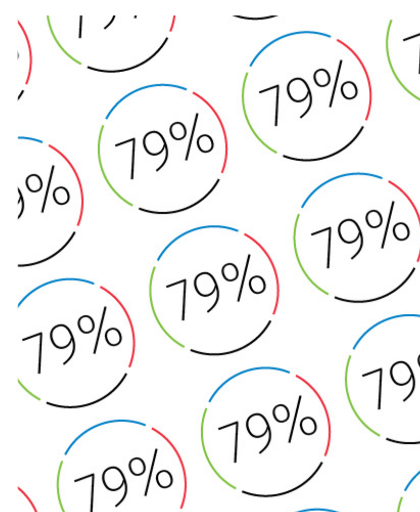

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