Regulation implementing the Foreign Direct Investment Act

In March 2020, Spain put in place a new foreign direct investment (**FDI**) screening system applicable to non-EU/non-EFTA companies covering also some specific EU investments.[1] The main issue encountered when advising on the FDI screening regime was that of the excessive ambiguity of the law, which it was hoped would be tackled by an implementing Regulation, finally approved last week by Royal Decree 571/2023, of 4 July, on foreign investments (**Regulation**). The Regulation enters into force on 1 September 2023 and does not apply to FDI applications filed before 1 September.

The Regulation provides much-needed guidance in various key aspects, such as the scope of the industries covered or the concept of affected investors, all of which has hitherto given rise to no few headaches.

1. Clarification of the scope and meaning of sensitive industries.

1.1. *Critical infrastructures* are those included in the National Catalogue of Strategic Infrastructures and the real estate required for their operation. The Catalogue is secret, which means that, in practice, investors will know about this circumstance only when carrying out their due diligence of the target.

1.2 *Industries (other than 'critical infrastructures', above) subject to prior FDI screening:*

- *critical technologies*: telecommunications, AI, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum, nuclear energy, biotechnology and nanotechnologies.
- *dual-use technologies*: those defined in Article 2.1 of EU Regulation 2021/821;
- *key technologies for leadership and industrial capacitation*: those referred to by EU Decision 2021/764 establishing the Specific Programme implementing Horizon Europe – the Framework Programme for Research and Innovation, including advanced materials, nanotechnology, photonics, microelectronics and nanoelectronics, life sciences technologies, advanced manufacturing and transformation systems, AI, digital security and connectivity;
- *technologies developed under the auspice of programs and projects of special interest to Spain*, implying a substantial amount or percentage of financing from the national or EU budget.[2]

1.3 *Essential inputs* are those indispensable and non-replaceable for the rendering of essential services to society and the State, which loss or destruction would have a significant impact. In particular:

- *software provided for use by critical infrastructures* in: *(i)* power generation, hydrocarbons and energy transmission networks and plants generally; *(ii)* water treatment; *(iii)* telecommunications installations and systems for voice transmission and data storage and processing; *(iv)* financing and insurance sector for operation of installations or systems used in the supply of cash, card payment systems, payment settlement and insurance provision; *(v)* health sector for hospital management, distribution of prescription pharmaceuticals and laboratories information systems; *(vi)* transportation installations and systems by air, sea or road; *(vii)* management of installations or systems for food supply.
- *Other indispensable and non-replaceable inputs* to guarantee the integrity, security or continuity of critical infrastructures.

1.4 *Companies with access to sensitive information* are *(i)* those with access to specific data on strategic infrastructures which, if revealed, could be used to carry out actions to destroy or perturbate their normal performance; *(ii)* companies with access to data bases related with the operation of essential services in the critical sectors listed under 4.3 above; *(iii)* those with access to official databases not accessible to the public; *(iv)* those carrying out activities subject to compulsory evaluation of impact on personal data pursuant to Article 35.3 of EU Regulation 2016/679, on personal data protection.

2. FDI screening in connection with sensitive industries that have no impact on public security.

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[1] This regime was amended several times. See our prior alerts reporting on this legislative development and its amendments here, here and here.

[2] Amongst others, those benefitting from financing by instruments contemplated in the Annex "list of projects or programs of interest to the Union" referred to by Article 8.3 of EU Regulation 2019/452 on direct foreign investment into the European Union.

The Regulation states that investments in sensitive industries are not subject to FDI approval when they bear no relation, or they bear only scarce relation, to public security, health or public order.

3. FDI screening in connection with industries 'ad hoc' declared as sensitive.

The Regulation contemplates the possibility of the Government requiring authorization for foreign investments in industries not listed as sensitive (and therefore as a general rule not subject to FDI screening). In these cases, FDI approval would be required if the Government considers, by means of an express decision, that security, public health or public order may be affected, regardless of the industry.

4. Affected persons – nature of 'foreign investor'.

4.1 *Foreign investors* are those where the ultimate entity having control (under the Competition Act) is a non-EU/EFTA entity. The residence of general partners (GPs) of investment entities (private equity, pension funds, etc.) is looked at for these purposes.

Foreign ownership is also deemed to exist where the foreign ultimate owner controls (individually or in concertation with others) 25% of the capital or voting rights of the investor.

In the case of investments in defence businesses, also EU investors are deemed as foreign for FDI purposes.

4.2 *Qualified investors* regarding which FDI authorization is required regardless of the sector of the economy where the investment takes place include *(i)* foreign State-controlled investors; *(ii)* investors having invested in sensitive sectors in other EU countries; and *(iii)* investors posing risks of illegal activities affecting public security. This provision is far too broad in the existing law and is now subject to some clarification as explained below.

4.2.1 *'Sovereign funds' investments may be excluded from FDI screening.* To ascertain if a given investor is related to a foreign government for these purposes, the following criteria are to be borne in mind: *(i)* the existence of 'control' pursuant to the criteria in the Competition Act; *(ii)* control by means of significative financing or subsidies from a third country; *(iii)* in the case of investment vehicles channeling State investments, they are deemed not to be controlled by a foreign State if it flows from their governance and nature of the management that the investment policy is independent and focuses solely in the profitability of the investments without foreign State interference.

4.2.2 *Investors having invested in sensitive sectors in other EU countries having potentially affected public order in another EU Member State.* To determine these, reference is made to the information received in the framework of the cooperation mechanisms in EU Regulation 2019/452.

4.2.3 *Risk of foreign investor carrying out criminal activities affecting public security.* Final decisions (*i.e.*, against which no further appeal is possible) in the prior three years against the investor for criminal or administrative breaches in areas such as money laundering, environment, tax or protection of sensitive information, are to be taken into account.

5. Exemptions.

5.1. *Internal restructurings and marginal shareholding increases.* The following shall not be considered direct investments: *(i)* internal restructurings within a group of companies; and *(ii)* increases in corporate shareholdings by a shareholder who already has a shareholding of more than 10% and which are not accompanied by changes in control.

5.2 *Investments in the energy sector* are exempted where *(i)* the target does not carry out energy regulated activities (in general, power generation plants or projects, as well as commercialization activities are not regulated within this context); *(ii)* that as a result of the investment, the investor does not become a dominant operator within the meaning of the sector regulation; *(iii)* when the investment targets power generation plants, that the resulting power share of the relevant generation technology controlled by the investor does not exceed 5%; *(iv)* when the target is an energy commercialization company, that the number of customers does not exceed 20,000.

5.3 *Investments in sensitive industries which are not regarded as critical infrastructures or defence related are exempted from FDI approval* if the turnover of the target company does not exceed €5 million in the prior year, provided its technology has not been developed within the framework of programs or projects of particular interest

to Spain. This exemption would not be available to investments in electronic communications companies *(i)* holding licenses for radioelectric spectrum use or using orbit-spectre resources within Spanish sovereignty; *(ii)* with significant market power any electronic communications market; or *(iii)* when the target relates to research activities and exploitation of mineral deposits of strategic raw materials.

5.4 *Exceptions to FDI approval in connection with national defence*. The Regulation exempts investments from prior authorization in the following cases: *(i)* investments in Spanish companies when they do not reach 5% of the share capital, provided that they do not allow the investor to form part, directly or indirectly, of its governing body; and *(ii)* acquisitions leading to holdings of 5-10% of the capital stock, provided that the investor notifies the transaction and certifies in public deed not to form part of the board of directors or governance body, nor to use, exercise or transfer to third parties its voting rights in listed companies (a suggestion that this latter requirement does not apply to privately held companies).

5.5 *Transitory investments*, *i.e.,* of a short duration (hours or days) in which the investor does not have capacity to influence the management of the acquired company because they are underwriters and underwriters of share issues and public offerings for sale or subscription of shares. It is the end-investors who, if necessary, require authorization.

6. *Substantive test, competent authorities, administrative guidance, timing of approvals and others.*

6.1 *The substantive test is the* 'preservation of security, health and public order, in accordance with Article 65 TFEU'.

6.2 *Competent authorities* to receive and process FDI screening applications are *(i)* the Directorate General of International Commerce and Investment of the Ministry of Industry, Commerce and Tourism (which refers the file to the Foreign Investment Board); and *(ii)* the Directorate General for Armaments at the Ministry of Defence regarding investments in defence related companies. These two Directorates also decide on the consultations submitted.

The Government (Cabinet) is responsible for deciding on the authorization, with the exception of investments below €5 million, which are decided by the Directorate General of International Commerce and Investment.

6.3 *Administrative guidance.* The Regulation contemplates the possibility of filing for guidance regarding whether or not a transaction must be filed for FDI screening. A response must be provided within 30 working days from filing of the consultation (*i.e.*, six weeks in the absence of official holidays). In case no response is provided with 30 working days, this is deemed as a decision that FDI approval is required.

6.4 *Three-month deadline.* FDI screening applications will be subject to a three-month deadline. In the absence of a decision after three months, the request for authorization is deemed rejected. Waiting periods can be stopped for instance in case of information requests.

6.5 There is an *anti-circumvention provision*, linking two acquisitions in less than two years as a single transaction.

6.6 *Timing of investment.* Authorized investments must be executed within six months from approval, unless an extension is obtained. Substantial variations of the investment structure must be subject to a new FDI application.

6.7 *Monitoring of FDI Decisions.* Is regulated in terms comparable to those under the Competition Act.

7. Infringements and Penalties.

7.1 *Infringements* include gun-jumping, in terms similar to those of merger control, including early implementation; providing false or incomplete information.

7.2 *Penalties* include *(i)* administrative fines ranging between €30,000 to up to the economic value of the investment; *(ii)* invalidity of the corporate or transactional agreements (*e.g.*, suspension of voting rights of shares).