

ROYAL DECREE-LAW 34/2020, OF 17 NOVEMBER: ANOTHER TURN OF THE SCREW FOR THE REGIME ON FOREIGN INVESTMENT POST COVID-19

Among the many measures that the Government adopted as a result of the declaration of the state of emergency by means of Royal Decree 436/2020, of 14 March, with a significant impact on investments in Spain, one that stands out is the suspension, effective as of 18 March, of the system of deregulation of foreign direct investment in Spain, implemented by Royal Decree-Law 8/2020, of 17 March, on urgent extraordinary measures to address the economic and social impact of COVID-19 ("**RDL 8/2020**"). As a result, the need for authorisation for foreign investment became the norm, when it had previously only been required exceptionally, for very specific sectors, when carried out by residents of countries outside the European Union ("**EU**") and the European Free Trade Association ("**EFTA**").

These rules were already amended by Royal Decree-Law 11/2020, of 31 March, which adopted urgent supplementary measures in the social and economic fields to deal with COVID-19 ("**RDL 11/2020**"), and revised once again by Royal Decree-Law 34/2020, of 17 November, on urgent measures to support business solvency and the energy sector as well as on taxation ("**RDL 34/2020**").

RDL 34/2020 further restricts the freedom to carry out foreign investments in Spain, with a transitional rule until 30 June 2021, which also requires authorisation to be obtained for certain investments in this case by residents of other EU and EFTA countries. This extension of the suspension is due to the continuation of the situation created by COVID-19 and, consequently, the desire to monitor the acquisition of listed and non-listed Spanish companies whose equity value is falling and that the Government could see as opportunistic. Meanwhile, RDL 34/2020 also adjusts procedural issues and

Key points

- Has there been a substantive modification to the new regime for foreign direct investment by residents of non-EU and non-EFTA states?
- What is foreign direct investment?
- What strategic sectors have been widened?
- In view of the modification of the definition of some strategic sectors implemented by RDL 34/2020, would authorisation be required for investments that have been signed but that are pending closing and that would fall into the new regulated sectors?
- What other modifications does RDL 34/2020 make to Act 19/2003?
- What does the transitional regime on the suspension of deregulation of certain foreign direct investment by residents of other EU and EFTA countries consist of?
- What is foreign direct investment for the purpose of this transitional regime?
- Should authorisation be obtained for those investments signed but pending closing to which this transitional regime applies?

clarifies definitions of sectors affected by the suspension of the regime on deregulation of foreign direct investment by non-EU investors.

For the purposes of this client briefing, we will first be discussing a group of issues related to the corrections to the foreign investment regime for citizens who are not resident in the EU or the EFTA, established by RDL 8/2020, and then a second group of issues, on the main new feature of this RDL 34/2020, namely, subjecting certain investments in Spain by EU and EFTA citizens to authorisation.

A. REGIME OF FOREIGN DIRECT INVESTMENT BY PERSONS RESIDENT OUTSIDE THE EU AND THE EFTA

1. Has there been a substantive modification to the new regime for foreign direct investment by residents of non-EU and non-EFTA states established in article 7 bis of Act 19/2003, on movement of capital and financial transactions with foreign parties and certain measures for the prevention of money laundering ("Act 19/2003"), introduced by RDL 8/2020 and 11/2020?

No. The modification introduced does not represent a relevant or structural modification or a relaxation of the current system. Specifically, the following changes are introduced:

- a) The definition of foreign direct investment is amended, which is probably the most significant change.
- b) The scope of some strategic sectors in which the system of deregulation of foreign direct investment in Spain is suspended is widened.
- c) Two of the three objective circumstances of the foreign investor that render the investment subject to prior authorisation, regardless of the sector, are changed.

Moreover, the government is entitled to legislate to implement certain aspects of the suspension regime regulated in article 7 bis of Act 19/2003.

2. What is foreign direct investment as of the entry into force of RDL 34/2020?

This means all those investments made by residents of countries outside the EU and the EFTA, when the investor becomes the holder of a stake greater than or equal to 10% of the share capital of the Spanish company, or when, as a result of a corporate operation, act or legal transaction, the investor acquires control of the company, in the terms of article 7.2 of the Defence of Competition Act (*Ley 15/2007, de 3 de julio, de Defensa de la Competencia*, "LDC"). This reference to the LDC for the purposes of analysing whether the investment implies control of the Spanish company is the main new development introduced by RDL 34/2020 as a second criterion for capturing foreign direct investment by residents of non-EU and non-EFTA countries.

Prior to the entry into force of RDL 34/2020, the second criterion for defining the investment was whether, as a result of a corporate operation, act or legal transaction, "*effective participation in the management or control*" of a company was acquired, with "*effective participation*" understood as the ability to appoint a member of the Board of Directors of the Spanish company, and "*control*", that which results from article 42 of the Commercial Code. Meanwhile, RDL 34/2020 replaces these two criteria with that of "*control*" according to the rules on economic concentrations. This means that it will be necessary to analyse not just whether the investor can appoint more than half of the members of the Board of Directors, but also whether there are other circumstances (such as the existence of an agreement between shareholders granting it vetoes on certain strategic issues) which grant it control in the sense of such rules (that is, the possibility to exercise decisive influence over the company).

Apart from this, the regime envisaged for indirect investment is maintained, that is, the need for authorisation when the investor acquires control of 10% of share capital or control of the company, acting through a company resident in the EU or EFTA, provided the investor located outside the EU or EFTA holds or ultimately controls, directly or indirectly, a percentage of more than 25% of share capital or voting rights of the investment vehicle, or when it otherwise exercises

direct or indirect control over the same.

The government has not taken advantage of the occasion to clarify whether the regime suspending the deregulation of foreign direct investment in Spain by residents of countries outside the EU and EFTA includes the sale and purchase of assets. Although the wording of the rules does not indicate as much, the Ministry of Industry, Trade and Tourism (the "**Ministry**") has in fact extended the need for authorisation to cover asset purchases.

3. What strategic sectors have been widened?

As we know, the need for authorisation for foreign direct investment applies only to companies operating in defined strategic sectors (which essentially correspond to the ones envisaged in European Regulation 2019/452 on this area), notwithstanding the possibility of the investment being subject to this regime due to the objective circumstances of the investor, regardless of the sector. The strategic sectors are essentially the following: critical infrastructure, critical technologies, essential supplies, sector with access to sensitive information and the media.

RDL 34/2020 widens the scope of the "critical technologies" and "essential supplies" strategic sectors. The definition of "critical technologies" is extended to include the following sub-sectors: "*key technologies for industrial leadership and skills, and technology developed via programmes and projects of particular interest for Spain, including telecommunications*" and "*advanced materials and advanced manufacturing systems*". The definition of "essential supplies" now includes "*strategic connectivity services*".

Moreover, a mention of the strategic sector "*social media*" is included to underline that the provisions of Act 19/2003 in this sector are understood notwithstanding the provisions on foreign investment for audio-visual communications services in the General Audio-visual Communication Act (*Ley 7/2010, de 31 marzo, General de Comunicación Audiovisual*). This mention is however irrelevant, as Act 19/2003 is not understood as replacing the system of foreign investment envisaged in sector-specific regulations. It would have been more useful, for example, to clarify what should be understood as sectors with access to sensitive information, "*personal data in particular*".

RDL 34/2020 envisages that the Government can legislate to establish the definition of the strategic sectors defined in section two of article 7 bis of Act 19/2003 for the purposes of the application of the system of suspension of deregulation of foreign direct investment in Spain.

4. What modification is made to the regime of objective circumstances affecting investors resident in countries outside the EU and the EFTA?

RDL 34/2020 amends letters a) and c) of section three of article 7 bis of Act 19/2003 which regulates the objective circumstances affecting the investor that trigger the regime for suspension of deregulation of foreign direct investment in Spain, regardless of the sector of the investment, and which are now worded as follows:

- a) If the foreign investor is directly or indirectly controlled by the government, including public bodies or the armed forces, of a third country, the criteria established in article 7.2 LDC apply for the purposes of determining the existence of such control. The amendment consists precisely of replacing the old reference to article 42 of the Commercial Code with the precept from the LDC.
- b) If there is a serious risk of the foreign investor exercising criminal or illegal activities, that affect public safety, public order or public health in Spain. In this case, the former circumstance which alluded to the existence of "*administrative or judicial proceedings, against the foreign investor in another Member State or in the State of origin or in a third State, due to the exercise of criminal or illegal activities*" has been removed. Although the derogated criterion caused difficulties of interpretation, the new one is even more conflictive, as it is a question of a subjective interpretation by the Administration on the future.

The Government should have taken advantage of this modification to limit the criterion that has not been amended, that is, whether the foreign investor has made investments or participated in activities in the sectors that affect safety, public order or public health in another Member State, and in strategic sectors in particular. This is one of the objective circumstances in which foreign investors most commonly find themselves and that represents a relevant obstacle due to the breadth with which it is drafted. It is due to this circumstance that many operations are subject to authorisation even though the investment in Spain does not correspond to any of the strategic sectors defined in the rules.

5. In view of the modification of the definition of some strategic sectors implemented by RDL 34/2020, would authorisation be required for investments that have been signed but that are pending closing and that would fall into the new regulated sectors?

Yes, for example, investment operations in companies devoted to key technology for leadership and industrial skills, or developed via programmes and projects of particular interest for Spain, including telecommunications, or that provide strategic connectivity services, signed but not executed, are subject to prior authorisation as of 19 November 2020.

6. What other modifications does RDL 34/2020 make to Act 19/2003?

It introduces a new section 6 in article 7 bis, by virtue of which the Government will be able to legislate to establish the categories of operation and amounts below which foreign direct investment operations will be exempt from the prior authorisation system, having little or no repercussions on the legal assets that the suspension of deregulation of foreign direct investment protects. We do not know when the Government will approve the regulations establishing these categories and amounts.

According to the transitional regime established in RDL 11/2020, at present, investment operations for an amount of less than one million euros are exempt, unless the Government legislates to state otherwise.

7. Has RDL 34/2020 introduced any time limits to the regime on suspension of deregulation for foreign investment by residents of countries outside the EU and the EFTA?

No.

While it is true that it initially seemed, from the rules in RDL 8/2020, that the new regime could be limited in time, with the amendment introduced by RDL 11/2020, and while there are still arguments for maintaining the temporary restriction, the suspension of the regime for the deregulation of foreign investments has remained valid after the 30-day period following the lifting of the state of emergency. The provision for regulatory implementation of the new rules in both RDL 11/2020, and in the recent RDL 34/2020, as well as the establishment of transitional rules applicable under both texts, would seem to indicate that the intention of the text is to maintain the indefinite term of the new regime on suspension of deregulation of foreign direct investment in Spain until derogated by law.

B. TRANSITIONAL REGIME ENTAILING THE SUSPENSION OF DEREGULATION OF CERTAIN FOREIGN DIRECT INVESTMENT BY RESIDENTS OF OTHER EU AND EFTA NATIONS

The main novelty contained in RDL 34/2020 is the introduction of a new transitional regime entailing the suspension of the deregulation of certain foreign direct investment by residents of other EU and EFTA Member States, which will be subject to the rule for the authorisation of foreign direct investment by Spain's Council of Ministers as from the entry into force of RDL 34/2020 until 30 June 2021, notwithstanding that such date may be extended if another Royal Decree-Law is approved. This is a transitional rule that could infringe EU principles of freedom of establishment and free movement of capital and, for that reason, it will be difficult for the Spanish Government to deny authorisation to an actual, non-opportunistic EU investor backed at the European level.

1. What is foreign direct investment for the purpose of this transitional regime?

Foreign direct investment consists of all investments made by residents of other EU and EFTA Member States, when the investor attains a stake of at least 10% of the share capital of the Spanish company, or when, as a result of the corporate operation, act or legal transaction, control over such company is acquired, in the terms of Article 7.2 LDC, explained in section A.2. above.

It is important to note in this regard that:

- In principle, the rule only sets out the regime for investing in companies, and not for other transactions such as asset purchases. However, as stated earlier, bearing in mind that for the purpose of foreign direct investment made by investors who are residents of countries outside the EU and the EFTA, the Ministry has in fact extended the need for authorisation to asset purchases, it is reasonable to believe that it will apply this same criteria while this transitional regime is in effect, to foreign direct investment by residents of other EU and EFTA countries. In any event, it is advisable to first make an enquiry to the relevant administrative body to confirm if the specific transaction envisaged would be subject to prior authorisation.
- Direct investments that permit the investor to acquire control over 10% of the share capital or control of the company also require authorisation, even if the investor is acting through a Spanish resident company. RDL 34/2020 establishes in this regard that such indirect ownership exists when investors from other EU or EFTA nations ultimately hold or control, either directly or indirectly, more than 25% of the investor's capital or voting rights, or when they hold control over the investor, directly or indirectly, by other means.

2. Does RDL 34/2020 affect foreign direct investment in any activity?

No. It applies only to those investments in companies operating in the same strategic sectors in which the deregulation of investment by non-EU and non-EFTA nationals has also been suspended, defined in section five of Article 7 bis of Act 19/2003. The strategic sectors in question are as follows:

- a) Critical infrastructure, whether physical or virtual (including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure and sensitive facilities), as well as land and real estate vital to the use of such critical infrastructure, understood as being those included in Act 8/2011, of 28 April, establishing measures for the protection of critical infrastructure.
- b) Critical technologies and dual-use items, key technologies for leadership and industrial skills, and technologies developed via programs and projects of particular interest to Spain, including telecommunications, artificial intelligence, robotics, semiconductors, cybersecurity, quantum, aerospace and defence technologies, energy storage, nuclear technology, nanotechnologies and biotechnologies, advanced materials and advanced manufacture systems.
- c) Critical supplies, in particular energy, understood as such those regulated in Spanish Electric Sector Act 24/2013, of 26 December, and in Act 34/1998, of 7 October, on the Hydrocarbons Sector or those referring to strategic services of connectivity or raw materials, as well as food safety.
- d) Sectors with access to sensitive information, in particular to personal data, or with the capacity to control such information, in accordance with Organic Act 3/2018, of 5 December, on Personal Data Protection and the Safeguard of Digital Rights.
- e) The media, notwithstanding that the audio-visual communication services in the terms defined in General Audio-visual Communication Act, will be governed by the provisions of that act.

As can be seen, the list of sectors is truly long and has given rise to uncertainties right from its entry into force, which to date have had to be resolved by means of preliminary enquiries to the Ministry.

3. Does this regime apply to foreign direct investment in listed companies in Spain?

Yes, regardless of the investment amount.

For the purposes of this transitional regime, listed companies in Spain are considered to be those companies whose shares are admitted for trading, either in full or in part, on a Spanish official secondary market and have their registered address in Spain.

4. Is there any exemption from obtaining authorisation in this transitional regime?

Yes. Foreign direct investment in non-listed companies if the investment amount does not exceed 500 million euros, regardless of the sector.

5. Should authorisation be obtained for those investments signed but pending closing to which this transitional regime applies?

Yes. Investment operations carried out by investors from other EU or EFTA Member States in companies operating in the strategic sectors listed in section 2 above, which are signed but pending execution upon the entry into force of RDL

34/2020, are subject to prior authorisation starting on 19 November 2020, provided the investment exceeds 500 million euros or concerns a listed company in Spain.

6. For how long will this transitional regime be in effect?

Until 30 June 2021.

There is a possibility that the Government could decide to extend this date by Royal Decree-Law, when the end date of this transitional regime approaches, depending on the status of the health crisis caused by the COVID-19 pandemic.

7. Are the consequences of failing to obtain authorisation the same as those for foreign direct investment by residents of non-EU and non-EFTA nations?

Yes.

8. On a procedural level, does the same procedure apply as that for obtaining authorisation in the case of foreign direct investment by residents of non-EU and non-EFTA nations?

Yes.

CONTACTS



Jaime Almenar
Partner, Regulatory

T +34 91 590 4148
E jaime.almenar
@cliffordchance.com



Carme Briera
Counsel, Regulatory

T +34 93 344 2210
E carme.briera
@cliffordchance.com



Octavio Canseco
Associate, Regulatory

T +34 91 590 9416
E octavio.canseco
@cliffordchance.com

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www.cliffordchance.com

Clifford Chance, Paseo de la Castellana 110,
28046 Madrid, Spain

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**Javier García de
Enterría**
Partner, M&A

T +34 91 590 4102
E javier.garciadeenterria
@cliffordchance.com



Javier Amantegui
Partner, M&A

T +34 91 590 7576
E javier.amantegui
@cliffordchance.com



Samir Azzouzi
Partner, M&A

T +34 91 590 9475
E samir.azzouzi
@cliffordchance.com



Miguel Barredo
Associate, M&A

T +34 91 590 7593
E miguel.barredo
@cliffordchance.com