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International Investment Protection and FDI Screening

Restricting Investors' Rights in the Interest of National Security?

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In our series of briefings, we highlight some of the key issues of International Investment Law (IIL). In this fourth edition, we focus on the complex relationship between IIL and foreign direct investment (FDI) screening laws.

FDI has become subject to increasing scrutiny as states grow more wary of the potential security risks these capital flows may imply. Rising geopolitical tensions have led to the growth and strengthening of FDI screening frameworks globally. In particular, many EU Member States have adopted screening laws with the EU being currently in the process of revising and strengthening the FDI Screening Regulation. In Germany, FDI screening has been part of the Foreign Trade and Payments Act for some time, the review mechanisms have been tightened and the intervention thresholds lowered in recent years. Screening measures are typically taken out of national security concerns and can range from a transaction being blocked from the outset or only being allowed under certain conditions to even being retroactively prohibited and unwound.

On the other hand, this rise of screening measures may frustrate foreign investors' expectations who sought to acquire local businesses or shares therein. This begs the question of whether these investors could have recourse to the protection and arbitration mechanisms of IIL. At first glance, the answer seems to be no: Whereas FDI screening is typically applied *ex ante*, i.e. before an investment is made, IIL typically only offers protection to investments that have already been made. A closer look, however, reveals a complex relationship that is highly dependent on the facts of the case and the applicable law. It may therefore be worthwhile for investors affected by foreign FDI control measures to assess their options under IIL.

Ex-ante FDI Screening

When it comes to FDI screening measures adopted prior to an actual investment, the applicable investment agreement's scope is decisive to the question if IIL could be of any relevance to the foreign investors. Many treaties indeed explicitly exclude future investments from their scope or provide a carve-out for FDI screening measures under their dispute resolution clauses. Other treaties, however, may also cover future investments and the early phases of FDI transactions. Some treaties provide explicit rights of

entry, while others offer “best effort” clauses or remain silent on pre-investment protections.

The definition of investment or investor is key to assessing whether pre-investment phases are covered. In addition, some of the substantive obligations of the agreement may extend their protection to investments yet to be made. For example, the most-favoured-nation or national treatment clauses of an agreement may be drafted in such a way as to guarantee non-discriminatory treatment even in the pre-investment phase. A minority of international investment agreements also contain specific obligations for states to grant market access to foreign investors or clauses protecting early transfers of capital prior to the establishment of an investment.

In some cases, and depending on the wording of the applicable agreement, foreign investors could thus be protected under IIL if their planned or early-stage investment is restricted by *ex-ante* FDI screening measures. However, this protection may be limited to the individual substantive obligations covering the pre-investment phase. Many modern investment agreements include clauses that allow a host state to invoke exceptions on essential security or public policy grounds. These clauses can significantly limit the rights investors have to claim against the state, particularly concerning measures taken as part of pre-investment screening.

Ex-post FDI Screening

Conflicts between IIL and FDI screening regimes may also arise when national laws allow for investment reviews after completion. For instance, Germany’s FDI screening framework includes provisions to reassess and, if necessary, restrict foreign investments post-acquisition in certain cases. In addition, the proposed update to the EU Screening Regulation would require all EU Member States to introduce optional post-transaction screening for deals that were initially exempt from mandatory notification and thus not reviewed beforehand.

Unlike most proposed or early-stage investments, established investments screened after their acquisition could generally invoke the full protections under an investment agreement. The prohibition of an already established investment following a FDI screening procedure might constitute a breach of substantive treaty obligations, such as the national treatment standard, given that domestic investors are by definition exempt from FDI screening. However, whether such protections apply depends critically on the precise scope and language of the relevant treaty.

Equally important is the type of screening measure adopted by the relevant authority. For example, retroactively prohibiting an established investment is more likely to constitute a breach of state obligations under IIL than merely imposing conditions post-

transaction. Nonetheless, states may assert that such measures are justified under essential security or public purpose exceptions provided within the relevant agreement.

Screening of Pre-Existing Investments

The extension of an existing investment underscores the intricate overlap between IIL and FDI screening regimes. For instance, an initial investment might fall below the FDI screening threshold, allowing it to proceed without review by local authorities. However, a subsequent expansion – such as acquiring additional shares in the same company – could trigger *ex-ante* screening rights by the host state authorities and prompt governmental action in the interest of national security.

In such cases, the protections of most investment agreements would likely cover the subsequent transaction as an extension of the original investment. This could mean that if screening measures infringe on the investor's rights under IIL, the investor might pursue recourse through investor-state dispute settlement to seek compensation. Consequently, the relevant investment agreement might offer the investor comprehensive protection against pre-screening measures in this context.

BLOMSTEIN is highly experienced in advising on all issues related to FDI screening and monitors developments in international investment protection closely. We are at your disposal to assist you with any matter in these areas, in particular regarding the specific German and European context. If you have any questions or would like us to cover a specific topic, please do not hesitate to contact Roland Stein, Pia Hesse, Tobias Ackermann, and Sarah Beischau.

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