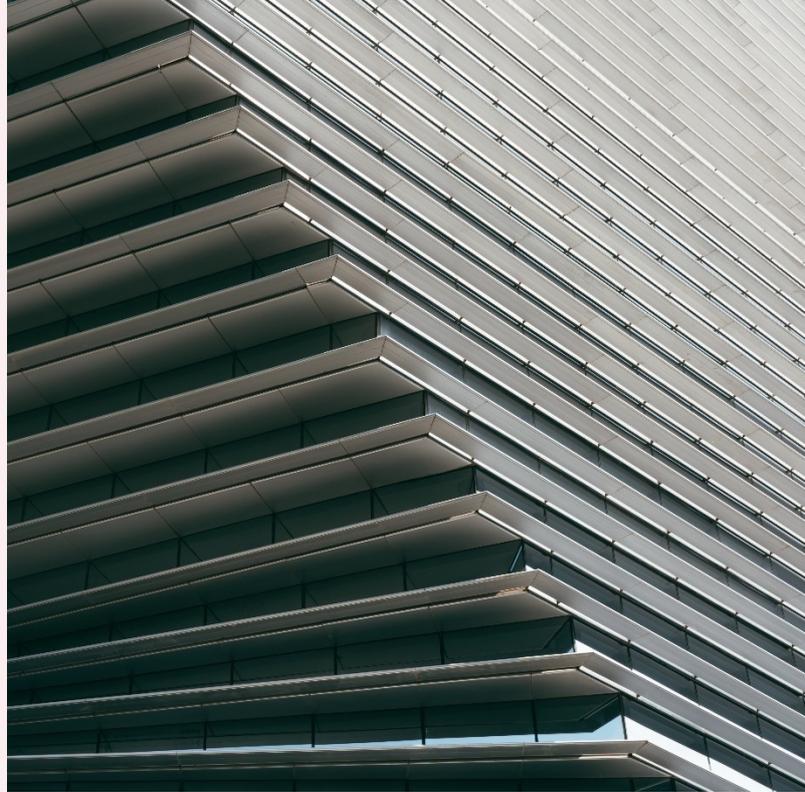


Navigating Spain's foreign investment screening in the Defence industry

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The government of Spain has legislated an instrument for screening, and potentially vetoing or conditioning, foreign investments in National Defence activities. In a context where we are seeing increasing national budgets in Defence, the consequent expansion and consolidation of the sector and a great deal of interest in it, this instrument will likely be used extensively in coming years.

Key issues

Investors in Defence industries and services will need to know the main features of this legislated screening instrument, so as to properly structure their commercial operations in this field

- 1 Broad concept of National Defence activities
- 2 Application of foreigner status to EU investors
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- 4 Low investment thresholds
- 5 Processing deadlines
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Broad concept of National Defence activities

Article 18 of Spanish Royal Decree 571/2023, of 4 July, on Foreign Investment, which governs this preventive screening mechanism, refers to investment in "activities directly related to National Defence".

This should be read, however, in the current context of threats and hybrid wars, which has caused industries and services until recently not considered sensitive to Defence (one example is telecommunications, as the case may be), to now be just that. Similarly, any activities that, although carried out in sectors that would not normally be associated with the military, provide the Armed Forces with capabilities, should be considered activities directly related to Defence. This includes, for example, the supply of uniforms by the textile sector, or the provision of field rations and catering services, if for military personnel, by the foods sector.

The activities of all companies open to foreign investment must therefore be scrutinised, as they could fall within the scope of this legislation through some connection to Defence (a public contract, for instance), which, at first glance, could go unnoticed.

Application of foreigner status to EU investors

This is the only non-exceptional and transitional case in which European Union investors are regarded as foreigners, and is thus a noteworthy exception to the free movement of capital and freedom of establishment in the EC.

The requirement to undergo this screening also does not take into account the investor's profile or background. So, however inoffensive and impeccable its track record may be, if it invests in Defence industries and services, it must be screened.

The government's great discretionary powers

As this is an issue affecting Spain's foreign security, which is one of its constitutionally mandated duties, the government has great discretionary powers in this field when:

- considering whether a company performs activities that are directly related to National Defence, which triggers this screening mechanism as a result;
- authorising or vetoing foreign investment, or making it subject to certain conditions; and
- in this last case, establishing the specific conditions to which the investment is subject in order to be approved.

Precisely because it is an extremely discretionary matter, the Spanish courts cannot replace the government's criteria. So, an investor whose investment is vetoed or made subject to conditions cannot count on such government decision being annulled by the courts (unless due to blatant defects of form).

Low investment thresholds

This instrument legislated by the Spanish government is triggered upon slightly lower thresholds than the investment screening instrument in other sectors that are also sensitive but not related to Defence. This is how it works:

- if the investment in the Spanish company amounts to less than 5% of its share capital, it will be exempt, as long as it does not involve the investor's direct or indirect entry into its management body; and
- if the investment amounts to 5% or more of the share capital, prior administrative approval will be required (unless it does not exceed 10% and the investor agrees – and this is notarised before the government – not to use, exercise or assign its voting rights, and not to enter the company's management body if it is a listed company).

Processing deadlines

The legislation establishes that applications for approval, when required, must be resolved within three months of their date of submission.

However, it should be noted that:

- any requests for additional information or documentation by the body processing these applications (currently, the Directorate General for Defence Industry Strategy and Innovation, "DIGEID") suspend the deadline until a reply is received;
- in practice, the deadline can be extended due to the exhaustive and unavoidable steps that all applications must go through in their processing:
 - review by the DIGEID
 - request for internal reports, reports from other ministries and/or reports from intelligence services
 - invitation to the consultative body (Spain's Foreign Investment Board, "JINVEX"), at which all ministerial departments are represented, to give its non-binding opinion
 - final submission for decision by the Council of Ministers, which will also be valid only for a limited period (usually six months), during which time the investment must be completed or the entire process begun again. (Note that the DIGEID can decide directly whether the transaction, due to its nature, characteristics or amount, does not affect "the essential interests of Defence", which again will be assessed at the discretion of the DIGEID itself.)

Therefore, when structuring commercial transactions to which this legislation applies, investors must anticipate potential contingencies, especially in relation to closing dates and the acceptance of the conditions imposed.

Harsh consequences in the event of non-compliance

If an investment transaction that is subject to this prior approval materialises without notifying such subjection, and therefore without the required government approval, the legal consequences are significant because:

- the transaction would not be considered valid under Spanish law (which would imply, for example, that it is not possible to appoint directors in the company acquired or to record anything at the Commercial Registry);
- the investor could be fined an amount as high as the actual investment (meaning millions, depending on the investment amount); and
- there would also be a reputational risk, since the imposition of the fine could be published in Spain's Official Gazette.

It is therefore clear that it is of vital importance for foreign investors in the Defence sector in Spain to obtain thorough legal advice on this issue.

Need for approval for already-established companies in Spain entering the sector

The Royal Decree on Foreign Investment speaks to the need to obtain approval prior to investing in Spanish companies already active in Defence. But this should be interpreted (as has consistently been done) as also including those cases where Spanish companies with foreign capital not active in this sector until now – and for which the entry of foreign partners did not require prior approval – begin to operate in this field.

Therefore, foreign investors should pay attention not only to the expansion of their portfolio in Spain, but also to those Spanish companies that already form part of their portfolio. Because if these Spanish companies wish to enter the Defence sector (by bidding for public tenders from the Armed Forces, for example), they will also need the same approval.



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