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CONOP 133

OPINION OF THE LEGAL SERVICE*

Subject : Joint Proposal for a Council Regulation amending Regulation (EU) 267/2012 concerning restrictive measures against Iran
- doc. 12453/12

Introduction and background

1. In this opinion, the Council Legal Service will provide a written response, as requested by the Foreign Relations Counsellors Working Party, to several questions which have been raised concerning the above-mentioned proposal.

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2. The proposal, which is based on Article 215 TFEU, provides for the addition of a new Article 43a to Regulation (EU) 267/2012 concerning restrictive measures against Iran. This new provision concerns the situation where a person or entity subject to a freezing of funds has been granted a licence by a Member State for the exploration or exploitation of hydrocarbons within the EU. It is intended to cover the situation of the Rhum gas field in the North Sea, for which the UK Government issued a licence in the late 1970s to the BP company and the Iranian Oil Company (UK) Ltd ('IOC (UK)'), which is a subsidiary of a company (NICO) owned by the National Iranian Oil Company. BP and IOC operate the licence jointly through a contractual arrangement between themselves. The gas field started to produce gas in 2005 and the licence still has five years to run before it expires.

3. The Rhum gas field has been closed since the adoption of Regulation (EU) 961/2010 in October 2010, which was the predecessor to Regulation (EU) 267/2012. Article 8 of that Regulation prohibited the supply to any Iranian person or entity of certain equipment and technology for key sectors of the oil and gas industry, including exploration and production. It also prohibited the provision to any Iranian person or entity of technical or financial assistance related to such equipment and technology (Article 9). The term *'Iranian person, entity or body'* included any legal person owned or controlled directly or indirectly by the State of Iran or any public authority of Iran (Article 1 (m)). IOC (UK) fell within this definition since it is owned by a subsidiary of the National Iranian Oil Company which is itself owned by the Iranian State.

The prohibitions in Article 8 and Article 9 applied to the Rhum gas field. Article 8(1) prohibited the supply of this equipment and technology "*directly or indirectly, to any Iranian person, entity or body or for use in Iran*", which indicates that the prohibition can apply where the equipment and technology is to be used outside Iran. It is true that Article 8(2) specifies that the equipment and technology is "*for […] key sectors of the oil and gas industry in Iran*". Nevertheless, the purpose of Article 8 is also to avoid the risk of circumvention by Iranian-owned oil and gas companies operating outside Iran, which would otherwise easily be able to transfer such equipment and technology to companies operating in Iran.[1] Therefore the prohibition applies also to equipment and technology used outside Iran by Iranian persons or entities.

Article 10 of the Regulation also stipulated that the above prohibitions did not apply to transactions required by a *"trade contract"* concluded before the entry into force of the Regulation, nor did they prevent the execution of an obligation arising therefrom. Even if one admits that contracts for ensuring maintenance and safety at the Rhum gas field would qualify as *"trade contracts"* for this purpose, the exemption only applies to contracts concluded before the entry into force of the Regulation, and could not be used to allow for the conclusion of subsequent contracts once the prior contracts expire.

Article 11(1) and (2) of the Regulation prohibited the granting of any financial loan or credit to any Iranian person, entity or body engaged in the exploration or production of natural gas, without any limitation as to geographical location. The same applies to the provisions in Article 21 concerning restrictions on the transfer of funds to an Iranian person, entity or body and to the prohibition in Article 26(1)(a)(ii) on providing insurance to an Iranian legal person, entity or body.

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[1] This interpretation is also supported by Article 30 of the Regulation, which expressly provided that for the purpose of the prohibitions in Articles 8 and 9, inter alia, any person or entity holding rights derived from an award by a Government other than Iran of a production sharing agreement (i.e. relating to natural resources outside Iran) is not to be considered an Iranian person, entity or body. This exemption was designed to cover the 'Shah Deniz' project in Azerbaijan, in which NIOC participates. If those prohibitions did not apply anyway to 'Shah Deniz' because it is located outside Iran, it would not have been necessary to provide this exemption in Article 30. Article 30 does not apply to the Rhum gas field because the Rhum licence does not constitute a *"production sharing agreement"*.

4. **NOT DECLASSIFIED**

5. Finally, the proposed amending Regulation envisages that IOC (UK) would be included on the list of persons and entities subject to a freezing of funds in Annex IX to Regulation (EU) 267/2012 concerning restrictive measures against Iran. As a consequence, IOC (UK)'s share of the profits resulting from the resumption of activity at the Rhum gas field would be paid into a frozen account, and they would only be released to IOC (UK) once the Council decided to withdraw the measure freezing its funds.

Content of the proposed amending Regulation

6. The new Article 43a which the proposed amending Regulation would introduce provides as follows (underlining added):

1. "By way of derogation from Article 8 [prohibition on supply of equipment for the oil and gas industry], Article 9 [prohibition on provision of related technical assistance], Article 17(1) [… restrictions on financing of certain enterprises], Article 23(2) and (3) [… freezing of funds], Article 30 [restrictions on transfers of funds] and Article 35 [restrictions on insurance], the competent authorities of a Member State may authorise under such conditions as they deem appropriate, activities related to the exploration for, or exploitation of, hydrocarbons within the Union undertaken pursuant to a licence for such exploration or exploitation issued by a Member State to a person, entity or body listed in Annex IX [asset freeze] if the following conditions are met:

(a) the licence for the exploration for, or exploitation of, hydrocarbons within the Union was issued prior to the date on which the person, entity or body listed in Annex IX was designated;

(b) the authorisation is necessary to avoid environmental damage in the Union or to prevent permanent destruction of the licence's value, in case a Member State conducts temporary administrative management of the licence and/or of the pipeline and infrastructure used in connection with the licensed activity, on a temporary basis in accordance with the applicable national legislation."

2. The derogation provided for in paragraph 1 shall only be granted for such period as necessary and its validity shall not exceed the validity of the licence issued to the person, entity or body listed in Annex IX. In case the competent authority considers that subrogation to contracts or the provision of indemnities is necessary, the period of validity of the derogation shall not exceed 5 years.

3. The Member State concerned shall notify the other Member States and the Commission of its intention to grant an authorisation at least ten working days prior to the authorisation. In case of threat to the environment in the Union requiring urgent action to prevent damage to the environment, the Member State concerned may grant an authorisation without prior notification and shall notify the other Member States and the Commission within three working days after having granted the authorisation."

7. This new Article 43a(1) would neither oblige a Member State to authorise activities of exploitation nor to assume temporary administrative management of a licence issued to a listed entity. Rather, by derogation from the relevant prohibitions and restrictions in the Regulation, it would allow a Member State to authorise activities pursued under a licence granted to a listed entity if such authorisation is necessary to prevent environmental damage or to prevent destruction of the licence's value, in case the Member State conducts temporary administrative management of the licence in accordance with the applicable national legislation. It may therefore be argued that the reference to temporary administrative management is not intended to regulate at the EU level the forms that administrative management should take under the law of the Member State concerned.

However, it also appears from Article 43a(1)(b), as presently drafted, that it would be a necessary condition for the granting of such an authorisation to pursue activities related to the exploitation of the gas field, that the Member State in question conducts activities that can be recognised in the EU context as constituting temporary administrative management of the licence.

8. It is in the light of the above elements and considerations that the Legal Service will now respond to the questions put to it.

1st Question: Is the proposed amending Regulation necessary in order to allow for the UK to ensure the safety of the Rhum gas field ? Would a UK law not suffice?

9. Firstly, if one accepts the reality of the assessments made in the above-mentioned COREUs, which the Legal Service is not in a position to verify, it would be necessary to adopt an act amending Regulation (EU) 267/2012 in order to provide, in particular, for the extension of the existing exemption for prior trade contracts in Article 10 of the Regulation to cover new contracts to ensure safety and maintenance at the gas field after the existing contracts expire. Derogations or exemptions would also be necessary with regard to Articles 9, 17, 30 and 35, as well as from Article 23 if it were decided to freeze IOC (UK)'s funds. Such derogations are provided for in the proposed new Article 43a.

Derogations and exemptions to the current Regulation must take the form of an EU act and cannot be adopted unilaterally by a Member State. However, the conditions under which Member States may authorise such derogations and exemptions do not need to include temporary administrative management by a Member State of the licensee's interest in the gas field. Nothing would prevent the amending Regulation from leaving it to the Member States' laws and procedures to decide, *"under such conditions as they deem appropriate",* on the type of management of the exploitation that would be appropriate to achieve the aim pursued.

10. According to the above-mentioned COREUs, key contracts which are required to maintain the safety of the Rhum gas field will expire in late 2012. Therefore, assuming that the purpose of the new provision is to ensure that contractors and other service providers continue or resume working on it by allowing them to deal with the UK Government instead of IOC (UK), some of the questions posed are whether the UK can adopt legislation in due time which would allow it to assume temporary management of IOC's interest in the gas field, whether there is already UK legislation in force which allows for that or which provides a legal basis for the rapid adoption of measures allowing for it, or whether the terms of the licence granted to IOC (UK) envisage such a possibility. Such questions are a matter of UK domestic law which the Council Legal Service cannot, and should not, answer.

11. However, the Legal Service was also asked whether the existing Article 43 in the Iran Regulation would constitute an authorisation by the EU for the UK Government to assume such temporary administrative management. The existing Article 43 provides that:

> *"1. A Member State may take all action it deems necessary to ensure that relevant international, Union or national legal obligations concerning the health and safety of workers and environmental protection are respected where cooperation with an Iranian person, entity or body may be affected by the implementation of this Regulation.*
>
> *2. For the purpose of action taken pursuant to paragraph 1, the prohibitions in Articles 8 and 9, point (b) of Article 17(2), and Articles 23(2), 30 and 35 shall not apply."*

This provision, drafted in broad and sweeping terms, authorises the Member States to take all actions necessary for the protection of the environment, including if this is found to be proportionate, to assume temporary management of a third party's interest in a licence for the exploitation of a gas field to the extent this is compatible with other applicable law. However, this provision only concerns action which is necessary to ensure the health and safety of workers and environmental protection, excluding action related to the safeguarding of the license's economic value, which is also a stated purpose of the temporary administrative management of IOC (UK)'s interest in the Rhum gas field and of the resumption of production at the gas field.

12. To conclude on this question, the Legal Service is not in a position to confirm whether the proposed amendment is a prerequisite for the safety or the resumption of exploitation at the Rhum gas field. However, it would not be possible for derogations such as those in the proposed new Article 43a (1) to be applied unilaterally by a Member State in the absence of an EU act providing for such derogations. If Member States were to be authorised to grant such derogations, the conditions under which this authorisation would be implemented need not include temporary administrative management of a licensee's interest in a gas field.

It is not for the Legal Service to express an opinion on the domestic legal bases under which temporary administrative management of IOC (UK)'s licence in the Rhum gas field could be assumed if the proposed new Article 43a was adopted without including any reference to such temporary administrative management.

2nd Question: Is the proposed amending Regulation compatible with Article 345 TFEU and respect for property rights? Could the EU be held liable to pay compensation?

13. In addressing this question, it is necessary to distinguish between a decision to freeze IOC (UK)'s funds, on the one hand, and temporary administrative management by the UK Government of IOC (UK)'s licence in the Rhum gas field, on the other hand.

14. Article 345 TFEU provides that *"The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership"*. Article 345 TFEU confirms the neutrality of the Treaties regarding national provisions governing property ownership, and makes clear that the EU has no competence to regulate the national systems of property ownership.[2] Although restrictive measures adopted by the EU do affect individual property rights (see below), they do not affect the systems of property ownership in the Member States. In the present case, the proposed new Article 43a (1) would not affect the system of property ownership in any Member State. Rather, it refers to a situation which might be created by the decisions of a Member State. Consequently, it is not the law of the EU that would have an effect of expropriation nor of authorising such expropriation.

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[2] However, the case-law of the Court has confirmed that Article 345 TFEU (formerly Article 222 EEC, then Article 295 EC) cannot be relied upon to justify national rules which conflict with other Treaty provisions such as the prohibition against discrimination on grounds of nationality (Case 182/83, *Fearson v. Irish Land Commission*) and the rules on competition and State aid (Case 323/8, *Intermills v. Commission*). The Court stated in the *Konle* case C-302, 97 (para. 38) that *"although the system of property ownership continues to be a matter for each Member State under Article 222 of the [EEC] Treaty, that provision does not have the effect of exempting such a system from the fundamental rules of the Treaty"*.

15. The case-law of the Court has established that respect for property rights, as enshrined in Article 1 of the First Additional Protocol to the ECHR, and as recognised in the constitutional traditions of the Member States, is a general principle of EU law but does not constitute an absolute right.[3] The same applies to the freedom to pursue a trade or profession.[4]

In the *Kadi and Al Barakaat* case, the Court ruled that the freezing of the funds of the persons concerned *"constitutes a temporary precautionary measure which is not supposed to deprive those persons of their property. It does, however, undeniably entail a restriction if the exercise of [… the] right to property that must, moreover, be classified as considerable, having regard to the general application of the freezing measure…"* (para. 358).

It is therefore necessary to assess whether such a restriction on the exercise of the right to property can be justified.[5] With regard to the EU's restrictive measures against Iran, the EU General Court stated in the *Bank Melli Iran* case T-390/08 that their objective *"is to stop nuclear proliferation and its funding and so to bring pressure to bear on the Islamic Republic of Iran to put an end to the activities in question. Such an objective, which corresponds to those pursued by [UN Security Council] Resolution 1737 (2006) and falls within the more general ambit of efforts to maintain international peace and security, is legitimate"* (para. 67). It concluded that the restrictions imposed by the asset freezing measure on the applicant bank's freedom to carry out economic activity and its right to property were not disproportionate in relation to the objective pursued (para. 71). These findings were upheld by the Court of Justice on appeal, in case C-548/09 P (paras. 113-117).

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3 *Kadi and Al Barakaat* cases C-402/05 P and C-415/05 P (para. 355): *"According to settled case-law, the right to property is one of the general principles of Community law. It is not, however, absolute, but must be viewed in relation to its function in society. Consequently, the exercise of the right to property may be restricted, provided that those restrictions in fact correspond to objectives of public interest pursued by the Community and do not constitute, in relation to the aim pursued, a disproportionate and intolerable interference, impairing the very substance of the right so guaranteed."*

4 Case 4/73, *Nold v. Commission*, para. 14.

5 *Kadi and Al Barakaat* case (para. 360):*"there must also exist a reasonable relationship of proportionality between the means employed and the aim sought to be realised."* The Court also recalled the *Bosphorus* case C-84/95, with regard to economic sanctions giving effect to resolutions of the UN Security Council, and observed (para. 361) that "*the importance of the aims pursued by a Community act is such as to justify negative consequences, even of a substantial nature, for some operators, including those who are in no way responsible for the situation which led to the adoption of the measures in question, but who find themselves affected, particularly as regards their property rights."*

16. The applicable basis for a decision by the Council to freeze the funds of IOC (UK) would be Article 23 (2) (d) of Regulation EU 267/2012, which refers to *"persons, entities or bodies that provide support, such as material, logistical or financial support, to the Government of Iran"*. In this regard, it may be considered that IOC (UK), since it is part of the NIOC group of oil and gas companies which is wholly-owned by the Iranian State, would provide financial support, through the profits which it earns, to the Iranian Government. Consequently, a decision to freeze the funds of IOC (UK) on this basis would in principle be legally defensible.[6]

With regard to the temporary administrative management by the UK Government of IOC (UK)'s interest in the licence, it should be argued that this is a consequence not of the amending EU Regulation but rather of UK domestic law. However, it cannot be completely excluded that the EU would be held responsible for having mentioned as a possibility - and therefore recognised as valid under EU law - the temporary administrative management of IOC (UK)'s interests. Indeed, the reference to temporary administrative management in the proposed new Article 43a, as presently drafted, includes it as part of the conditions for granting an authorisation by way of derogation from the prohibitions and restrictions in the Regulation (see para. 7 above). Therefore, the deletion of the reference to temporary administrative management as part of the conditions for granting an authorisation would certainly make the defence of the interests of the Union stronger in the case of a dispute. And, more fundamentally, it would avoid setting the precedent of establishing the administrative management of the interests of a private entity as a permissible form of implementation of Treaty-based obligations.

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[6] Furthermore, if IOC (UK) sought to challenge a decision by the Council to freeze its funds before the EU General Court, it is not certain that such a challenge would be admissible. It is doubtful that IOC (UK), which is indirectly wholly-owned by the Iranian State, has the necessary quality (*locus standi*) to invoke alleged breaches of fundamental rights before the EU Courts (cf. Article 34 ECHR which provides that actions by *"governmental organisations"* are inadmissible). This point was expressly left open by the Court of Justice in the *Bank Melli Iran* appeal case C-548/09 P (para. 113): *"Without its being necessary to take a position on whether the appellant, as an entity which is held, in its entirety, by the Iranian State, was able to rely on the protection of the right to property as a fundamental right…"* This question is also the subject of a pending appeal by the Council to the Court of Justice against the judgment of the EU General Court in Case T- 509/10, *Kala Naft* , which concerns another subsidiary company of NIOC.

That said, it should be noted that the effects of an asset freeze against IOC (UK) (independently of the other prohibitions and restrictions in the Regulation) would be to prevent activities and production at the gas field. Indeed, the effects of an asset freeze against companies within the EU normally prevent them from continuing to do businesses, since it is prohibited to make payments to such companies or to make economic resources available to them.[7] Consequently, in the particular circumstances of a licence for a gas field, temporary administrative management of the licence by the Government of a Member State would ensure that the licensee's investment and interests are protected, since production would continue and thereby generate profits for the licensee, even though they would be held on a frozen account, whereas no profits can be generated if the gas field is closed.

17. With regard to losses allegedly resulting from temporary administrative management by the UK Government of IOC (UK)'s licence, it could be argued that any such losses are not attributable to the EU since the proposed new Article 43a does not impose any obligation on a Member State to assume such temporary management (see para. 7 above). Moreover, a claimant seeking compensation for damages always has to substantiate and quantify the actual losses sustained.[8] That would be difficult to establish in the case of IOC (UK), since the temporary administrative management of its licence by the UK Government would ensure that the Rhum gas field could resume production and hence generate profits for IOC (UK), whereas the gas field is presently closed.

Furthermore, it is to be recalled that, in order to satisfy the conditions for the EU to incur non-contractual liability for the unlawfulness of the conduct of the institutions, the case-law requires a sufficiently serious breach of a rule of law for the protection of individuals.[9] According to this case-law, *"The decisive test for a finding that this requirement has been satisfied is whether the institution concerned has manifestly and gravely disregarded the limits of its discretion […] The determining factor in deciding whether there has been such an infringement is therefore the discretion available to the institution concerned."*[10]

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7 The EU General Court acknowledged this fact in the *Bank Melli Iran* case T-390/08 (para. 71): *"the applicant's freedom to carry on economic activity and its right to property are restricted to a considerable degree, on account of the adoption of the contested decision, for it may not, in particular, dispose of its funds situated within the territory of the Community or held by Community nationals, except by virtue of special authorisation, and its branches, domiciled in that territory, may not conclude new transactions with their customers."*

8 Joined Cases C-104/89 and C-37/90, *Mulder and others v. Council and Commission*, paras. 59 at seq.

9 See e.g. case C-390/95 P, *Antillean Rice Mills*, paras. 58 and 59.

10 Case T-341/07, *JM Sison*, para. 35.

In the *JM Sison* (damages) caseT-341/07, the Court ruled that although the Council had wrongly applied the criteria for designating persons and entities associated with terrorism in Common Position 931/2001/CFSP, it had not committed a sufficiently serious breach of law as to incur non-contractual liability. It may also be noted that the latter criteria, which refer to a decision taken by a competent judicial authority concerning a person's involvement in terrorist acts, afford a narrower margin of discretion than the condition in Article 23 (2) (d) of Regulation (EU) 267/2012 which refers to providing financial support to the Government of Iran.

18. To conclude on this question, it must be noted that the temporary administrative management of the assets whose funds are frozen affects the property rights of the entity concerned, but in a manner that is not necessarily negative for the economic interests of the entity concerned. An action against the Union for liability on the basis of the proposed new provisions cannot be excluded, but its chances of success, on the basis of the current case-law, are limited.

3rd Question: Is it possible to designate IOC (UK) without also listing NIOC and other NIOC companies? Could EU operators still deal with NIOC after IOC (UK) is listed?

19. The conditions for designating IOC (UK), i.e. on the basis that it provides financial support to the Government of Iran, are equally applicable to NIOC and other companies owned directly or indirectly by it. However, the Council is not legally obliged to freeze the funds of all companies providing financial support to the Government of Iran: it has a discretion in this regard. Therefore, the Council could legitimately consider, for example, that it is appropriate only to designate a subsidiary of NIOC operating in the EU such as IOC (UK), especially since it is exploiting natural energy resources of a Member State.

In the *Bank Melli Iran* case T-390/08, the EU General Court dismissed the argument of the applicant bank, based on the principle of equal treatment, that other Iranian banks had not been designated, by ruling (para. 59) that *"even if the Council had in fact omitted to adopt measures freezing the funds of certain Iranian banks engaged in, directly associated with or providing support for nuclear proliferation, that fact cannot properly be put forward by the applicant, because the principle of equal treatment must be reconciled with the principle of legality, according to which no one may rely, to his own benefit, on an unlawful act committed in favour of another."* The General Court reached the same conclusion concerning a subsidiary of a listed bank in the *Melli Bank plc* joined cases T-246/08 and T-332/08 (para. 75), including with regard to the argument that other subsidiaries of the latter bank had not also been listed (para. 53). This finding was upheld by the Court of Justice on appeal in case C-380/09 P (para. 62).

Finally, if the Council decided to designate IOC (UK), EU operators would remain free, in principle, to continue doing business with NIOC and other NIOC companies that are not listed. In the *Melli Bank plc* joined cases T-246/08 and T-332/08, the Court ruled that the fund-freezing measures in question only applied to those entities listed in the Annexes to the legal acts concerned, and not to other companies forming part of the same group of companies as the listed company, if those other companies were not also listed (para. 146). However, EU operators would still have to take care not to make resources available indirectly to IOC (UK) through their dealings with NIOC and other NIOC companies (see also the anti-circumvention clause in Article 41 of the Regulation (EU) 267/2012).