

FINANCIAL CRIME BRIEFING

UK sanctions framework: the complexities of the control test

A key feature of the UK's financial sanctions framework is that not only designated persons are subject to sanctions, but also entities that are owned or controlled by designated persons, even if those entities are not on the sanctions list.

However, the precise scope and practical application of the control concept is complex, and this complexity has recently increased following:

- The Court of Appeal's decision in *Mints and others v PJSC National Bank Trust and another* ([2023] EWCA Civ 1132).
- The High Court's decision in *Litasco SA v Der Mond Oil and Gas Africa SA and another* ([2023] EWHC 2866 (Comm)).
- The guidance on ownership and control issued jointly by the Treasury's Office of Financial Sanctions Implementation (OFSI) and the Foreign, Commonwealth & Development Office (FCDO) on 17 November 2023 (the control guidance) (www.gov.uk/government/publications/ownership-and-control-public-officials-and-control-guidance/).

Determining control

For the purposes of the UK's Russia-related sanctions, the control test is set out in regulation 7(4) of the Russia (Sanctions) (EU Exit) Regulations 2019 (SI 2019/855) (2019 Regulations) (regulation 7(4)) (see box "The control test").

In its general guidance on financial sanctions, the OFSI sets out examples of situations where the control test may be relevant, such as the power to appoint members of the administrative, management or supervisory bodies, or controlling a majority of voting rights (www.gov.uk/government/publications/financial-sanctions-faqs).

Enforcement guidance

The OFSI has also issued enforcement guidance explaining how it assesses potential sanctions breaches (www.gov.uk/guidance/uk-financial-sanctions-guidance). Where breaches result from an incorrect assessment

of ownership or control, the OFSI considers, among other things, the degree and quality of research and due diligence conducted on the relevant entity's ownership and control.

How much due diligence should be conducted will depend on the specific circumstances, but the OFSI would generally expect evidence of:

- Careful scrutiny of information obtained, particularly where efforts appear to have been made by designated persons to avoid relevant thresholds, which may include open-source research as well as direct contact with the relevant entity to probe indirect control mechanisms.
- An assessment of the sanctions risk based on that information.
- A determination of what would be an appropriate level of due diligence in light of that risk.

The OFSI also expects ongoing monitoring of sanctions compliance.

Recent case law

The application of the control test has been considered in some recent cases.

Mints. *Mints* arose in the context of alleged conspiracies resulting in uncommercial transactions whereby loans were replaced with worthless, or near worthless, bonds. The defendants applied to the High Court for a stay of proceedings on the basis of the claimants' status as actual or alleged sanctioned entities. The High Court refused the application and the Court of Appeal dismissed an appeal.

While not determinative of the outcome of the appeal, the court considered, obiter, that PJSC National Bank Trust (NBT), a 99% owned subsidiary of the Central Bank of Russia (the central bank), was, for sanctions purposes, controlled by President Putin and/or Ms Nabiullina, who is the governor of the central bank.

The court stated that this was on the basis that the broad language used in regulation 7(4)

makes it clear that regulation 7(4) does not have any limit as to the means by which a designated person is able to achieve the result of control. In particular, the court rejected an interpretation of regulation 7(4) under which ownership and control does not include control through political office, partly because of the potential uncertainty as to what would count as political office. The court noted that the consequence of this construction could be that every company in Russia is to be regarded as controlled by Mr Putin and hence subject to sanctions. In this respect, the court highlighted that Mr Putin is at the apex of a command economy and, therefore, in a very real sense, and certainly in the sense of regulation 7(4), could be deemed to control everything in Russia.

While the court acknowledged that this consequence would arguably be absurd, it considered that the remedy is not for judges to put a gloss on the language of the 2019 Regulations to avoid that consequence, but for the government and Parliament to clarify the wording of the 2019 Regulations.

Litasco. In *Litasco*, Litasco SA applied for summary judgment on a claim for sums due under a contract, which the defendant companies sought to resist by raising various arguments, including in relation to sanctions. Dismissing these arguments, the High Court granted summary judgment.

The court rejected the defendants' contentions that Litasco was controlled either by Litasco's shareholder and former director, Vagit Alekperov, given that the evidence before the court did not establish a triable case to that effect, or Mr Putin, or both.

Regarding the latter point, the court initially sought to distinguish *Mints*. Noting the strong links between NBT and the central bank, as well as the links between the central bank and the Russian government, the court highlighted that the defendants had not proved that Litasco was presently under the de facto control of Mr Putin.

However, the court went further, interpreting regulation 7(4) as being concerned with an existing influence of a designated person

over a relevant affair of the company, rather than a state of affairs that a designated person is in a position to bring about. It stated that, if this were not the case, it would follow that Mr Putin was arguably in control of companies that he does not know about and whose affairs are conducted without any thought of him. The court therefore rejected the contention that Litasco was under Mr Putin's control, despite accepting that it is strongly arguable that Mr Putin could place all of Litasco or its assets under his de facto control, should he decide to do so.

Notably, the court felt sufficiently confident in this conclusion to reject the defendants' suggestion that the case should proceed to trial as a test case for the issue of control under the 2019 Regulations, considering there to be no arguable evidential basis for such a debate.

Control guidance

Shortly after the Court of Appeal decision in *Mints*, on 16 October 2023 the FCDO issued a public statement regarding the government's position on the application of the control test (<https://content.govdelivery.com/accounts/UKFCDO/bulletins/375e351>). The control guidance elaborates on this position. Key points are that:

- The policy intention of UK sanctions regulations is to ensure that sanctions cannot be easily circumvented.
- The FCDO does not intend for sanctions measures targeting public officials to prohibit routine transactions with public bodies, such as taxes, fees, import duties, the purchase or receipt of permits, licences or public utility services.
- The FCDO does not generally consider designated public officials, such as government ministers, to exercise control over a public body, such as a government ministry, in which they hold a leadership function, so that the affairs of that public body should be considered to be conducted in accordance with the wishes of that individual.

The control test

The control test in regulation 7(4) of the Russia (Sanctions) (EU Exit) Regulations 2019 (*SI 2019/855*) provides that a person who is not an individual (C) is owned or controlled directly or indirectly by another person (P) if it is reasonable, having regard to all the circumstances, to expect that P would, if P chose to, be able, in most cases or in significant respects, by whatever means and whether directly or indirectly, to achieve the result that affairs of C are conducted in accordance with P's wishes (see *feature article "Divesting Russian interests: issues for companies"*, www.practicallaw.com/w-039-7042 and *News brief "Russian sanctions: responding to a complex situation"*, www.practicallaw.com/w-035-3181).

However, if there is sufficient evidence to demonstrate that a designated individual exercises control over a public body then, depending on the circumstances, the control test may be met. A relevant consideration could be, for example, whether the designated person derives a significant personal benefit from payments to the public body, such that they amount to payments to that person rather than the public body.

If the FCDO considered that a public official was exercising control over a public body under UK sanctions regulations, the FCDO would look to designate the public body as well as the relevant public official.

For the purposes of regulation 7(4), the government does not consider that Mr Putin exercises indirect or de facto control over all entities in the Russian economy merely by virtue of his position as Russian President.

Key takeaways

For businesses with interests in jurisdictions where the financial sanctions framework may be relevant, there are some key issues to bear in mind.

Public sector entities. The OFSI and the FCDO do not automatically deem public sector entities to be controlled by public officials in leadership positions in relation to that entity, although control may be established through evidence showing strong links between a public sector entity and sanctioned public officials. While the

Court of Appeal in *Mints* did not expressly state that it considered the central bank to be controlled by Ms Nabiullina, it is arguable that the court proceeded on this basis, which would have wide-ranging repercussions for the Russian banking sector, although the court did not explain what facts led to that conclusion.

Private entities. There is no presumption on the part of the government that a private entity is subject to the control of a designated public official simply because that entity is based or incorporated in a jurisdiction in which that official has a leading role in economic policy or decision making. There exists a tension on this point between *Mints* and *Litasco*. While *Litasco* seems aligned with the government's position, as well as market expectations, it is hoped that further court decisions will clarify this issue.

Importance of due diligence. Ultimately, whether an entity is under the control of another person is subject to a case-by-case assessment, and it is advisable for counterparties of such entities to conduct appropriate due diligence. What levels of due diligence will be sufficient is, again, case specific, depending on the sanctions risk arising from the specific circumstances.

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