Campbell Johnston Clark

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Non-Designated Persons and asset freeze

*What are the responsibilities of the "commercial person" who seeks to comply with UK sanctions against Russia, but is unclear as to whether the entity they are dealing with could be considered to be owned or controlled by a Designated Person? **Duncan Ealand**, Director, CJC, and associates **Simran Keightley** and **Ahmed Hassan** examine the UK's Ownership and Control Provisions.*

The starting point for most sanctions compliance checks is an initial review of each of the parties involved in the transaction to see if they are listed/designated on any of international sanctions databases. For the UK sanctions regime, HM Treasury's Office of Financial Sanctions Implementation ("**OFSI**") publish a list of designated individuals and entities ("**Designated Persons**").

Regulation 11 of The Russia (Sanctions) (EU Exit) Regulations 2019 (the "**Regulations**") includes an asset freeze regime, which applies not only to Designated Persons but also to the assets of an entity that is owned or controlled by a Designated Person. *(See Regulation 11(7), which provides that "For the purposes of paragraph (1) funds or economic resources are to be treated as owned, held or controlled by a designated person if they are owned, held or controlled by **a person who is owned or controlled directly or indirectly (within the meaning of regulation 7) by the designated person**."* (emphasis added)".

Regulation 7 of the Regulation sets out the meaning of "owned or controlled directly or indirectly" as follows:

> *(1) A person who is not an individual ("C") is "owned or controlled directly or indirectly" by another person ("P") if either of the following two conditions is met (or both are met).*
>
> *(2) The first condition is that P—*
>
> > *(a) holds directly or indirectly more than 50% of the shares in C,*
> >
> > *(b) holds directly or indirectly more than 50% of the voting rights in C, or*
> >
> > *(c) holds the right directly or indirectly to appoint or remove a majority of the board of directors of C.*
>
> *(3) Schedule 1 contains provision applying for the purpose of interpreting paragraph (2).*
>
> (4) *The second condition is that 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**.* (emphasis added)

First Condition

On the face of it, the "**First Condition**" gives clear factual markers for determining 'ownership or control' (i.e., it should be possible to determine this by checking the relevant company constitutional documents with respect to shareholding and voting rights, etc.).

However, particularly in relation to "*indirect*" ownership/control, Schedule 1 of the Regulations further expands the scope of what may constitute the "*indirectly*" holding of "*a right*" or "*a share*".

For example, Para 9 of Schedule 1 states that a person holds a share "*indirectly*" when that person has a "*majority stake*" in another person who holds the right or holds the share. The concept of "*majority stake*" is defined at para 9(3)(c) as including a situation where A "*has a right to exercise, or actually exercises, dominant influence or control over B*".

This appears to widen the scope of what would constitute ownership by a Designated Person quite significantly. For example, according to the Regulations, as written, "Entity A", which is not included on the OFSI's sanctions list, will nevertheless have its assets and funds frozen if it is determined that a Designated Person can exercise a dominant influence (i.e., has a majority stake) over a person or entity who holds more than 50% (in aggregate) of the shares in Entity A.

Accordingly, the test to see whether Entity A is owned or controlled by a Designated Person under the First Condition requires (1) a check of Entity A's shareholding (and voting rights) but also (2) a check of whether any Designated Person has a majority stake in any non-designated shareholder or non-designated rights holder with more than 50% of the shares/rights in Entity A. There is therefore a 'once removed' element to the check: First, you look at Entity A's shareholding/voting rights, then you look, once removed, at the majority stake of any non-designated majority shareholder / rights holder

Second Condition

In August 2022, the OFSI released the 'UK financial sanctions: general guidance', which included some examples of circumstances in which it is reasonable to expect that a Designated Person would be able to ensure the affairs of an entity are conducted in accordance with the person's wishes. These included:

- *Having the right to exercise a dominant influence over an entity, pursuant to an agreement entered into with that entity, or to a provision in its Memorandum or Articles of Association, where the law governing that entity permits its being subject to such agreement or provision;*

- *Having the right to exercise a dominant influence referred to in the point above, without being the holder of that right (including by means of a front company);*

- *Having the ability to direct another entity in accordance with one's wishes. This can be through any means, directly or indirectly (For example, it is possible that a designated person may have control or use of another person's bank accounts or economic resources and may be using them to circumvent financial sanctions).*

However, in a recent case, **PJSC National Bank Trust v Mints [2023] EWHC 118 (Comm) (the "PJSC NBT Case")**, Mrs Justice Cockerill, when handing down her judgment, called into question the legality and enforceability of this particular aspect of the Regulations, in obiter dicta.

This case dealt with whether the entry of a judgment by an English court in favour of two Russian banks (the "**Claimants**"), one of which was subsequently listed on the OFSI's list of Designated Persons and the other which was argued to also be subject to the asset freeze by virtue of it falling within the "ownership or control" of a Designated Person, would in fact be unlawful and whether allowing proceedings to

continue in a separate case involving these banks while sanctions remain in force would cause serious prejudice to the defendants (the "**Defendants**") on the basis that the Claimants cannot lawfully satisfy adverse costs orders, provide security for costs or pay any damages that may be awarded on their cross-undertaking.

The ownership and control element was only dealt with in obiter dicta in the judgment as Mrs Justice Cockerill had already ruled that the Defendants' main case (i.e. that it would be unlawful to enter a judgment in favour of the Claimants in the underlying case because they were sanctioned, etc.) had failed and so there was no need to consider whether the 2nd Claimant, who was not specifically listed on the OFSI list, would also fall within the scope of the asset freeze sanctions by reason of their 'ownership or control' by a Designated Person. Accordingly, the judge stated that in respect of this element she would only "*express a conclusion briefly and somewhat tentatively*".

In determining whether the second Claimant was owned or controlled by a Designated Person, it was accepted by the parties that factually the control test would be satisfied in that, at least pursuant to the Second Condition of the Regulations, relevant Designated Person(s) (Vladimir Putin and the Governor of the bank of Russia) were able to, in significant respects achieve the result that affairs of the Claimants be conducted in accordance with the Designated Persons wishes, (irrespective of whether they have in fact done so in the past).

But when considering the question *"is it the intention of the Regulation to catch such control*?", Mrs Justice Cockerill stated that she was inclined "*to the view that that is not the intention*".

There were a number of reasons for this. First, Mrs Justice Cockerill stated that although the wording in Regulation 7(4) (Second Condition) is wide, it must be looked at in full context – which means having regard to the rest of Regulation 7. "*Regulation 7(2)… is essentially about ownership, direct or through a chain of companies or via a nominee…"* she stated, *"It [therefore] lends force to the submission that 7(4) is essentially "backstopping" any form of ownership and control which falls slightly outside 7(2)"*.

Second, the Judge considered arguments relating to Article 7 of the ECHR and to the common law presumption against doubtful penalisation. In respect of the latter, Simon Brown LJ in *Ricketts v Ad Valorem Factors Ltd* [2004] BCC 164 at [30] gave the following summary:

"*…the court should strive to avoid adopting a construction which penalises someone where the legislator's intention to do so is doubtful, or penalises him in a way which is not made clear*."

Mrs Justice Cockerill stated that "*there are powerful "real world" reasons why this is a case for (if necessary) resolving the question by reference to the principle against doubtful penalisation. This is legislation which imposes not insignificant criminal sanctions… commercial people also need to know if a particular company (say, Gazprom or NBT) is sanctioned*."

Third, the Judge stated that it *"seems implausible that it was intended that such major entities as banks (or other major entities such as Gazprom)… were intended to be sanctioned by a sidewind, in circumstances where they would have no notice of the sanction and be unable themselves to challenge the designation…*".

Fourth, Mrs Justice Cockerill considered the general guidance published by the OFSI in August 2022, in particular the section quoted earlier in this Article, concluding that "*…The UK Government will look to designate owned or controlled entities/individuals in their own right where possible*". Mrs Justice Cockerill interpreted this wording in the guidance as indicating that "*it is not the intent for complex investigations to have to be made or evidence gathered — because the list should generally set out the persons targeted*."

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Mrs Justice Cockerill's assessment of and conclusions on the ownership and control element of the Second Condition in the Regulations (Reg 7(4)) will undoubtedly be well received within the commercial world, as it places an emphasis on the need for certainty and appears to be sympathetic to "commercial people" who are trying to determine whether or not a particular company is sanctioned.

However, it is important to note that these comments were given in obiter and so, although persuasive, they are not binding. This case is being appealed, with the hearing currently set for early July 2023, and if the Court of Appeal take a different view on the main case and the ownership and control elements do become relevant, they may be interpreted differently.

Another point to note is that although Mrs Justice Cockerill expressed the view that the 2nd Claimant was not owned or controlled by the Designated Person in that case (Mr Putin or Ms Nabiullina), these were political office-holders and the Judge suggested that the issue of 'control' by corporate office-holders may be different. It is also of note that OFSI's latest guidance, published in March 2023, states that "*where OFSI determines that a breach has occurred, and an incorrect assessment of ownership and control of an entity is relevant to the commission of the breach… the OFSI may also consider a failure to carry out appropriate due diligence on the ownership and control of an entity… as an aggravating factor*". This seems to expressly place an obligation on commercial entities to investigate and gather evidence even where an entity / individual is not expressly targeted on the OFSI list, which goes against the Fourth point made by Mrs Justice Cockerill in the PJSC NBT Case (highlighted above).

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Where does this leave the "commercial person" who seeks to comply with UK sanctions, but is unclear as to whether the entity they are dealing with could be considered to be owned or controlled by a Designated Person?

The Court has certainly given a strong indication of how they would interpret the Regulations, taking a narrow approach to the Second Condition (R.7(4)) such that the 'commercial person' would not be expected to carry out complex investigations into who is a Designated Person. However, the latest guidance published by the OFSI does appear to place the burden of carrying out such due diligence on the "commercial person" and lists a number of areas of enquiry which the OFSI may expect to be undertaken by persons seeking to establish whether an entity is owned or controlled by a Designated Person.

For now, we can only recommend that such due diligence is undertaken to the best of each person's abilities and as appropriate to the risk-level of the subject transaction.

As to the actual legality of imposing penalties (either criminal or civil) upon persons as a result of dealings with the assets of a Designated Person which is considered by the OFSI to satisfy the "control" element of the 'ownership or control' provisions of the Regulations, we would note the following segment from Mrs Justice Cockerill's definitive judgment in the PJSC NBT Case:

> *"I accept that OFSI's views are not determinative or even appropriate to the main analysis, in that questions of English law are decided by the English court and not by OFSI or anyone else who makes public statements about them.*
>
> *OFSI's views are — and are accepted to be — capable of being of persuasive value dependent on the reasoning involved in those views, in the same way as a textbook or article may be."*

Accordingly, we shall be watching closely to see if the Court of Appeal does deal with this particular element of the Regulations in its judgment.

If they do not, then unfortunately this is a point which is unlikely to be examined by the courts unless someone subject to a penalty from the OFSI were to seek a judicial review of that decision (an undertaking which would be both cost intensive and by no means guaranteed to succeed).

In the meantime, the CJC sanctions team and has guided insurers, managers, ship-owners and charterers on various sanctions compliance issues. This work has included, among other things, carrying out sanctions checks on proposed fixtures for vessels and advising on potential liability for rejecting voyage orders under charterparties where a proposed fixture may result in a breach of sanctions or a breach of any sanctions terms in a vessel's financing agreements; preparing internal sanctions compliance policies for shipping companies.

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