

New Decision on UK Sanctions “Ownership and Control” Test: UK Court of Appeal Removes Guardrails to Control Test

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On 6 October 2023, the UK Court of Appeal handed down judgment in the case of *Mints v National Bank Trust and Bank Okritie*. Although the Court of Appeal upheld the lower court’s substantive decision, it disagreed with the lower court’s views on the limits of the UK’s “ownership and control” test in the sanctions context. The Court of Appeal stated that the “control” test is to be interpreted broadly and effectively subjects to UK sanctions any entity in which a sanctioned (designated) person “calls the shots.” The Court of Appeal disagreed with the lower court’s finding that the “control” test was intended to act as a “backstop” to ownership and did not extend to control exercised through political office. The Court accepted the potentially drastic ramifications of its finding, noting that “*the consequence might well be that every company in Russia was ‘controlled’ by Mr Putin and hence subject to sanctions.*”

BACKGROUND

The case involves claims brought by two Russian banks—National Bank Trust (“NBT”) and Bank Okritie—against Boris Mints and others, alleging a conspiracy to enter into uncommercial transactions. The defendants applied for a stay on the grounds that the litigation was impacted by sanctions imposed under the Russia (Sanctions) (EU Exit) Regulations 2019 (the “Russia Regulations”). One of the claimants, Bank Okritie, was designated under the Russia Regulations. The defendants alleged that the other, NBT, was controlled by designated persons, namely Mr Putin and Ms Nabiullina, the governor of the Central Bank of Russia. The application for a stay of the litigation raised three issues: (i) whether the Court could enter judgment in favour of the claimants; (ii) whether the Office of Financial Sanctions Implementation (“OFSI”) could grant licences authorising certain litigation-related activities (including the payment by the claimants of adverse costs orders); and (iii) whether NBT was controlled by designated persons for the purposes of the Russia Regulations.

FIRST INSTANCE DECISION

At first instance, Mrs Justice Cockerill dismissed the application for a stay, finding that (i) the Court could enter judgment in favour of designated persons; (ii) OFSI could grant licences authorising the activities in question; and (iii) NBT was not controlled by Mr Putin and Ms Nabiullina for the purposes of the Russia Regulations. Given the Court's decision on the first two issues, the Court did not have to rule on the third issue of "ownership and control." That part of the judgment was therefore non-binding *obiter*. Nevertheless, the Court of Appeal allowed an appeal on all three issues.¹

COURT OF APPEAL DECISION

The Court of Appeal considered all three issues and unanimously ruled as follows:

The Judgment Issue

On the judgment issue, the Court of Appeal agreed with the first instance judge that the Russia Regulations did not prohibit the entry of judgment in favour of designated persons. In relation to the Russia Regulations and the UK post-Brexit sanctions framework generally, the Court held that the "*clear intention was that the post-Brexit sanctions regime should maintain continuity with the 2014 EU Regulation and should not effect any substantive change*" (at [193]). The Court also noted that section 44 of the Sanctions and Anti-Money Laundering Act 2018 ("SAML") was predicated on the designated person being able to pursue civil proceedings to judgment; "*otherwise the defence would be unnecessary*" (at [210]). The Court held that it could reach this conclusion without reference to the principle of legality, *i.e.*, the principle that legislation should not be read as restricting fundamental rights if the legislature's intent is not clear, but that the latter reinforced the Court's conclusion.

The Court of Appeal also rejected an argument that such judgments could be viewed as a route to circumventing the Russia Regulations. The Court re-affirmed the circumvention test set out by Briggs LJ in *R v R*, [2016] Fam 153, which requires one to determine whether the "*common objective*" sought to be achieved is one which the regulatory regime seeks to prohibit or control, regardless of whether you take a "*normal*" or "*abnormal*" route to achieve that objective.

¹ See the Debevoise Update on the first instance decision here:
<https://www.debevoise.com/insights/publications/2023/02/uk-high-court-issues-key-decision-considering-uk>.

The Licensing Issue

The Court of Appeal also agreed with the first instance judge that OFSI was entitled to issue licences authorising the relevant litigation-related activities on the basis that such activities could come under the “*extraordinary expenses*” licencing ground. The appellants argued (as they did at first instance) that “*extraordinary expenses*” was a narrow ground that would not apply to a cross undertaking in damages, but the Court held that it was necessary to take a broad approach to the licensing grounds contained in the Russia Regulations.

The Control Issue

Given that the Court of Appeal upheld the first instance ruling on the first two issues, it did not have to address the ownership and control issue. The Court noted that the control issue was a point of “*general significance*” that had been “*fully argued*” and therefore addressed it, albeit on an *obiter* basis.

As the Court recognised, the control issue has significant ramifications for the application of financial sanctions restrictions in the UK. The Russia Regulations state that the prohibition on dealing with funds owned by a designated person, and the prohibition on making funds available to a designated person, extends to entities that are “*owned or controlled directly or indirectly (within the meaning of regulation 7) by the designated person*”. In other words, if an entity is owned or controlled by a designated person, that entity must be treated as a designated person for the purpose of the asset freeze.

Regulation 7 deals with the meaning of “*owned or controlled directly or indirectly*” and sets out two independent conditions for the establishment of “ownership or control.” The first is that a person holds 50% of the shares or voting rights in an entity or has the right to appoint or remove a majority of the board of directors. The second is that it “*is reasonable, having regard to all the circumstances, to expect that P [the designated person] 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 [the company] are conducted in accordance with P’s wishes.*”

In contrast to the approach taken by the first instance judge, the Court of Appeal observed that the second condition is described “*in wide terms*” and does “*not have any limit as to the means or mechanism by which a designated person is able to achieve the result of control*” (at [229]). The Court rejected the argument that the second condition is only intended to deal with “*more complex structures*” of ownership that could not fall within the scope of the first condition. The Court found that the second condition is not, therefore, limited to “*some form of personal control*” (at [230]). It observed that there is

no carve-out for control that designated individuals exercise through their political or corporate office. The Court accepted the appellants' characterisation of the second condition as covering all entities in respect of which a designated person "*calls the shots*" (at [232]). On that basis, the Court concluded that NBT was controlled by Mr Putin and/or Ms Nabiullina within the meaning of regulation 7 of the Russia Regulations.

The Court acknowledged that, by adopting this interpretation of regulation 7, "*Mr Putin could be deemed to control everything in Russia*" (at [233]). The Court noted that the drastic consequences this entailed were a result of the "*clear and wide meaning*" of regulation 7, coupled with the UK government's designation of Mr Putin "*without having thought through the consequences that [...] Mr Putin is at the apex of a command economy*". The Court therefore suggested that the UK government could change the position by amending the legislation or de-listing Mr Putin.

KEY TAKEAWAYS

The Court of Appeal decision on the control issue constitutes a radical departure from the much narrower approach endorsed by the first instance judge. As the Court of Appeal itself recognised, the new approach could be read to mean that every company in Russia could arguably meet the conditions of regulation 7 and so would have to be treated as a designated person. That is a significant departure from the status quo and effectively moves the position back to what it was before the first instance decision, when there was a significant degree of ambiguity in the market as to how the "control" test should be applied.

The view that NBT should be treated as controlled by Ms Nabiullina is particularly surprising given that, at the time of her designation, the Foreign, Commonwealth and Development Office stated that "[t]he UK Government does not consider that Elvira Nabiullina owns or controls the Central Bank of the Russia Federation for the purposes of reg. 7." The Court's decision also complicates determinations on whether certain Russian state-owned entities, such as Gazprom or Rosneft, should be treated as designated persons.

As noted, the Court of Appeal view on the control issue is *obiter* and not binding on other courts. That said, absent legislative action (which appears unlikely), that view currently represents the highest judicial opinion on the control issue and will be persuasive if the issue presents itself again before the English courts.

Importantly, the question of whether Mr Putin exercises *de facto* control over the whole Russian economy (or some yet-undefined part of it) has not been resolved. The parties

in the *Mints* case agreed that Mr Putin could exercise *de facto* control over all Russian entities but disagreed on whether *de facto* control was sufficient under the UK “ownership and control” test. In other words, there was no factual dispute as to whether Mr Putin “called the shots” at the defendant banks. The issue was limited to the scope of the “control” test as a matter of legislative interpretation. As a result, there may be scope to argue about the precise nature of Mr Putin’s control of Russian entities, including whether he can “call the shots” at all or some Russian companies.

Given the ramifications of the judgment, it remains to be seen whether the UK legislature will intervene to “correct” the position on the control issue by, for example, setting limits to the scope of the “ownership and control” test under the Russia Regulations or whether the UK government will take steps to clarify which entities are subject to a UK asset freeze.

For now, businesses that deal with Russian counterparties may need to recalibrate and review how they determine whether an entity is “controlled” by a designated person, including considering whether designated Russian political figures could exercise *de facto* control over that entity. Due to the apparent disconnect between this Court decision and the UK government’s position, businesses should give careful consideration to any transactions involving Russian companies, especially state-owned companies. Businesses that have made contractual commitments to counterparties not to do business with entities “controlled” by designated persons may also need to review whether this decision impacts on such contracts.

The Debevoise sanctions team is available to answer any questions you may have regarding the judgment or its implications for your business.

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Please do not hesitate to contact us with any questions.



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