English High Court Clarifies UK Sanctions "Reasonable Cause to Suspect" Standard

14 May 2024

On 3 May 2024, the English High Court handed down judgment in the case of *Vneshprombank LLC v Bedzhamov* [2024] EWHC 1048 (Ch), setting an important precedent on factors that could establish a "*reasonable cause to suspect*" that an entity remains owned or controlled by a UK asset frozen person even after formal transfer of ownership. The case also confirmed that even where a "*reasonable cause to suspect*" is established, an offence would only occur if the relevant entity is in fact owned or controlled by a UK asset frozen person.

The judgment follows from the recent High Court and Court of Appeal decisions in the case of *Mints v National Bank Trust and Bank Okritie* (Mrs. Justice Cockerill was also the first instance judge in the Mints case) and *Litasco SA v Der Mond Oil and Gas Africa SA & Locafrique Holdings SA* [2023] EWHC 2866 (Comm).

Background

The decision arose from an application made by the defendant (Mr. Bedzhamov) for declarations as to whether there was reasonable cause to suspect that the claimant was funded by a company—A1 LLC ("**A1**")—that was owned or controlled by designated persons for the purpose of the Russia (Sanctions) (EU Exit) Regulations 2019 (the "**Russia Regulations**").

A1 is part of the Alfa Group, whose three founders and largest shareholders—Mikhail Fridman, German Khan and Alexey Kuzmichev—were all designated under the Russia Regulations on 15 March 2022. The applicant argued that there was a reasonable cause to suspect that A1 continued to be owned, held or controlled by a designated person despite two transactions purportedly transferring ownership of A1 to a new shareholder:

1. On or around 15 March 2022, Mr. Khan and Mr. Kuzmichev sold their shares in A1's parent to Mr. Kosogov, an Alfa Group employee.

2. On 22 March 2022, Mr. Kosogov, Mr. Fridman, Mr. Khan and Mr. Kuzmichev sold all their shares in A1 to Mr. Fayn, a general director in A1.

The Russia Regulations make it an offence to deal with funds or economic resources where there is a reasonable cause to suspect that they are owned, held or controlled by a designated person. The applicant argued that the existence of a reasonable suspicion in this regard was enough to make out the relevant offence under the Russia Regulations (i.e., it is not necessary to prove that, as a matter of fact, the funds or economic resources in question were owned, held or controlled by a designated person): any payment made to the claimant would entail making funds available to its litigation funder, A1, and, as there was a reasonable cause to suspect that A1 was owned by designated persons, any payment would therefore be a breach of the offence.

The issue was therefore whether the existence of a reasonable suspicion is enough in itself to make out the offence, or whether, in addition to a reasonable suspicion, the funds or economic resources must in fact be owned, held or controlled by a designated person.

Reasonable Cause to Suspect

The Court provided a detailed breakdown of what it considered to constitute the test for "*reasonable cause to suspect*," drawing on existing case law on this concept in the context of anti-terrorism and other financial crime laws.

In the context of the ownership of A1, the applicant argued that any person who has a prima facie reasonable cause to suspect must freeze the assets or commit an offence unless it is possible to dispel the suspicion. The Court held that, if this view were correct, anyone who deals with funds or economic resources held by a person they had reasonable grounds to suspect was a designated person (or was owned or controlled by a designated person) would be guilty of the offence, even if that person were not in fact designated. This would amount to an extension of criminal liability contrary to the principle that penal legislation must be interpreted on a strict basis, which meant that it could not, therefore, be the correct interpretation. The Court also pointed to the legislative history of the Russia Regulations, noting in particular the explicit intention to continue the EU regime without any substantive changes, with the EU regime having only prohibited dealing with funds or economic resources actually owned, held, controlled or belonging to an asset frozen person.

On that basis, the Court held that the offence requires proof that the person whose funds are dealt with is in fact a designated person, not just that there is a reasonable

suspicion that they are a designated person. Interestingly, however, the Court accepted that establishing a "*reasonable cause to suspect*" would in effect be a "*stepping stone*" towards making a factual determination relating to such "*ownership and control*."

Notably, the Court also gave little weight to a legal analysis prepared by an independent law firm which purported to support the validity of the transaction.

Joint Arrangements

The Court then considered the issue of whether there was reasonable cause to suspect that A1 was owned or controlled by designated persons, namely Mr. Fridman, Mr. Khan and Mr. Kuzmichev. Ultimately, the Court held that, at least prior to March 2022, there was reasonable cause to suspect that there had been a joint arrangement in place between those individuals, including because: (i) together they owned 95% of A1; (ii) they founded A1 and ran A1 together from its founding; and (iii) the individual shareholdings were structured in such a way that together any two of them had a functioning majority vote, and together their control was effectively complete. On that basis, there was reasonable cause to suspect that A1 was owned or controlled by designated persons prior to the designations in March 2022.

Sham Transfers

The Court then considered the position from March 2022, including whether the two transfers in March 2022 (set out above) were genuine. The Court undertook a critical review of information available relating to the relevant transfers and pointed to "*multiple overlapping indications*" that suggested that the transfer was in fact a sham, i.e., not a genuine and arms' length transaction. These indications included the following:

1. The lack of any rationale for the purchase by Mr. Fayn. There was no account of his ability to actively run the business due to his age and lack of experience.

2. Mr. Fayn's previous role as a nominee shareholder role in A1 from 2017-2020, holding 0.01% of the shareholding.

3. The low price paid for the acquisition: Mr. Fayn paid only £714 for the entire share capital of A1, with no credible justification for such a low valuation.

The Court therefore concluded that the sale was likely not an arms' length commercial sale and was accordingly persuaded that the "*reasonable cause to suspect*" standard would

have been met on the facts of this case, i.e., there was a reasonable cause to suspect that, both before and after March 2022, A1 was owned or controlled by designated persons. The Court did not, however, deal with the separate issue of whether A1 in fact remains owned or controlled by designated persons, as this point did not need to be determined until there was an actual payment required to A1 (which was only a litigation funder for one of the parties, with some suggestion that they would step away from the transaction).

OFSI Guidance

As in the High Court *Mints* judgment, Mrs. Justice Cockerill cast some doubt on the value of OFSI guidance when interpreting sanctions legislation, finding that "[OFSI] *Guidance can be significant in interpreting legislation—but whether it is or not depends upon the Guidance*." In this case, Mrs. Justice Cockerill stated that the OFSI guidance dealing with "*reasonable cause to suspect*" and minority interests in the context of the ownership and control test: (i) did not analyse the provisions of the Russia Regulations; (ii) appeared to have retrospective effect; and (iii) seemed to have been based on a draft of the Russia Regulations that was different to what was ultimately enacted. Consequently, the Court placed very little (if any) weight on the OFSI guidance in reaching a determination on the points set out above, highlighting the potential pitfalls of over-relying on OFSI guidance when interpreting the Russia Regulations.

Commentary

The case confirms that businesses need to undertake a critical review of purported changes of ownership of entities affiliated with designated persons, as a "*reasonable cause to suspect*" can be established even in the absence of any definitive evidence about a particular transaction being a sham. While criminal liability would still be dependent on a prosecuting authority then being able to establish that a transaction in fact involved a dealing with an entity owned or controlled by a designated person, in most cases it will not be practical for a business to make such a determination, putting the business at risk from the moment that the "*reasonable cause to suspect*" threshold is reached.

Importantly, this decision was reached in the context of the Court considering the relevant standards required for criminal prosecution of a sanctions offence. OFSI's power to impose civil penalties for financial sanctions penalties is based on a lower standard of proof; it only needs to establish that a certain set of facts exists on a "*more*

likely than not" basis. OFSI is also not required to establish the mental element (i.e., to show "*reasonable cause to suspect*") when imposing a penalty.

It also remains to be seen how the English courts will interpret the Section 44 defence under the Sanctions and Money Laundering Act 2018, which provides a defence to civil proceedings for acts done in the reasonable belief that they are necessary for the purposes of compliance. However, given the degree to which a business will be put on risk if the "*reasonable cause to suspect*" test is satisfied, it appears that a "*reasonable belief*" that this test is met may in itself be sufficient to trigger the defence.

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