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Impact of sanctions on payment obligations

May 26, 2023

One of the many legal consequences of Russia's full-scale invasion of Ukraine in February last year was that businesses were faced with having to analyse the exact remit of sanctions laws and the extent to which they caught payment obligations under pre-existing arrangements, often in very short timescales and while the laws were changing. Here the High Court looks at that very question in the context of payment obligations under some letters of credit.

A refusal to pay because of sanctions

Two Irish companies had leased aircraft to Russian airlines. The Russian airlines provided standby letters of credit—issued by the Russian bank Sberbank and governed by English law—as security for their obligations under the leases.

While a standby letter of credit should be as good as cash and is payable, absent fraud or illegality, there can be problems in getting an issuing bank located in another jurisdiction to pay, and some banks pose a greater credit risk than others. So, it is common for a lessor in this situation to get such a letter of credit confirmed by a bank which has a higher credit rating located in a more friendly jurisdiction. By confirming a letter of credit, the confirming bank becomes primarily liable to pay if the beneficiary serves a valid demand on it. On paying, the confirming bank becomes entitled to reimbursement from the issuing bank. In this instance, UniCredit's London branch had confirmed the letters of credit in the years preceding Russia's full-scale invasion of Ukraine in February 2022.

Following the invasion, the EU and the UK imposed enhanced sanctions against Russia which included a ban on leasing aircraft to Russian entities. The sanctions triggered events of default under the leases and obliged the airlines to return the aircraft to the Irish lessors. The lessors terminated their leases and served demands under the letters of credit on UniCredit. The demands were for more than USD60 million in total. Five of the aircraft have still not been repossessed by the lessors.

UniCredit refused to pay, on the basis that it was unlawful to pay under sanctions imposed by the UK, the EU, and the U.S. without a licence from the relevant authorities.

UK, EU and U.S. sanctions all in play

By the time judgment was handed down, UniCredit had been granted licences to make the payments by the EU and UK authorities. The parties had agreed that for the purposes of determining this dispute the

relevant EU sanctions were materially the same as the UK sanctions and that the principal amounts due could be paid in a currency other than USD.

As a result, the judge had only to determine:

- whether UK sanctions regulations had prohibited payment before the UK licence was granted (in order to resolve the remaining issues of costs and interest); and
- whether U.S. sanctions effectively excused UniCredit from making the payment in USD.

Meaning of “in connection with” under UK sanctions

UniCredit claimed that UK sanctions prevented it from paying in three ways.

- Firstly, confirming the letter of credit would amount to providing financial services or funds “in connection with” an arrangement whose object was the supply of an aircraft to a Russian entity (a breach of [Regulation 28](#) of the Russia (Sanctions) (EU Exit) Regulations 2019).
- Secondly, [Regulation 11](#) prohibited it from dealing with funds or economic resources owned, held or controlled by a “designated person” (i.e. Sberbank) because paying the lessors and being reimbursed by Sberbank meant it was dealing with Sberbank’s money.
- Thirdly, by paying the lessors it was “making funds available for the benefit of a designated person”, ([Regulation 13](#)) as by paying it would ultimately benefit Sberbank by releasing it from its obligations to pay the lessors under the letters of credit.

The judge accepted none of these arguments. Regulation 28 in this context was not retrospective, the aircraft had already been supplied to Russia and UniCredit had provided financial services long before Regulation 28 came into effect. UniCredit’s obligation to pay the lessors was not enabling the supply of aircraft to Russia. Had UniCredit fulfilled its obligations it would have benefitted the non-Russian lessors; not the Russian bank Sberbank (which remained liable to reimburse UniCredit) nor the Russian airlines (which remained liable to reimburse Sberbank). Furthermore, Sberbank only became a designated entity (and so sanctioned) under Regulations 11 and 13 after the lessors had made demands under the letters of credit.

U.S. sanctions and the rule in *Ralli Bros*

The U.S. sanctions were relevant because the letters of credit were denominated in USD. It is a long-standing rule of English law known as the rule in [Ralli Brothers](#) that the English court will not enforce an obligation which requires a party to act unlawfully in the required place of performance.

The demands under the letters of credit required UniCredit to make payments to accounts in London and Dublin. Consequently, the obligations had to be performed in England and Ireland. Nevertheless, if payment was made by bank transfer, it would probably have had to pass through a U.S. correspondent bank and so might have been caught by sanctions and therefore, the *Ralli Brothers* principle might have applied. However, the letters of credit permitted UniCredit to tender cash and so, the judge held, it remained obliged to make the payment.

It would take between 12 and 20 wheelbarrows to move USD60 m in USD100 bills, depending on the exact size of the wheelbarrows and on whether the notes were new or used, so the proposition has its

drawbacks. Nevertheless, the judge found that UniCredit could comply with its obligations under the letter of credit without resorting to moving funds through the U.S. banking systems. (Whether using a correspondent bank in the U.S. was illegal was not ultimately decided.)

Was there a “reasonable belief” that sanctions prevented payment?

UniCredit then sought to rely on [section 44](#) of the Sanctions and Anti-Money Laundering Act 2018 which says that you are not liable in civil proceedings for any act or omission done in the “reasonable belief” that it is in compliance with sanctions.

While the court held that UniCredit did have this belief, it was found not to be a reasonable one. It should have been clear that the obligation to pay under the letters of credit was autonomous (and not dependent on receipt of funds from Sberbank, as UniCredit argued).

Judgment: *Celestial Aviation Services Limited v UniCredit Bank AG, London Branch* - [main hearing](#) and [consequentials](#)

Permission has been sought to [appeal](#).

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