

Court of Appeal decision - impact of international sanctions on obligations under letters of credit

13 June 2024

What's this about?

On 11 June 2024, the Court of Appeal handed down judgment in *Celestial Aviation Services Limited v UniCredit Bank GmbH*[1]. The case looked at whether UniCredit was entitled to refuse payment under standby letters of credit issued in relation to aircraft leases to Russian airlines because of UK and US sanctions against Russia.

Our Head of Economic Crime Compliance, Ben Cooper says...

"The Court of Appeal's judgment in Celestial v UniCredit is a significant decision for all sanctions practitioners in banks and other financial institutions. It represents a slight reversal of the recent trend in the UK and across Europe of successful challenges against Russian sanctions. The Court of Appeal confirmed that the UK's Russia sanctions should be interpreted broadly to ensure that 'all objectionable arrangements are caught, such that the purpose of putting pressure on Russia is achieved'. Banks should take note and ensure they are applying this wide interpretation of the UK's Russia sanctions and seek licences where appropriate."

The points not to miss...

On 10 April 2024, the Court of Justice of the EU ruled that the EU sanctions against Russian citizens Mikhail Fridman and Petr Aven were invalid, sparking widespread commentary that this would lead to a number of successful challenges to Russian sanctions across Europe.

It's against this backdrop that this case was heard before the Court of Appeal on 14 and 15 May 2024. At the first instance, the Commercial Court held that UniCredit was not entitled to refuse payment under the letters of credit (**LoC**) because the UK's Russia sanctions did not apply where the aircraft were supplied before the sanctions came into effect. So, all eyes were on the Court of Appeal.

In a unanimous judgment the Court of Appeal held that there was nothing in Reg. 28 of the *Russia (Sanctions) (EU Exit) Regulations 2019*[2] (the **Russia Regulations**) that limited their effect to arrangements entered into on or after 1 March 2022, or provided any other form of grace period (in contrast to the EU position).

Further, making a payment under the LoC represented the provision of "funds", and it did not matter that the payees were unconnected with Russia. It was enough that the funds were provided in connection with a relevant arrangement. The words "in connection with" in Reg. 28(3)(c) Russia Regulations are very broad and do not require any form of legal dependence.

The Court of Appeal concluded that the purpose of the Russia Regulations “*is not simply to prevent further aircraft going to Russia by preventing financing arrangements that facilitate that, albeit it undoubtedly does achieve that. Rather, it is a relatively blunt instrument that is intended to cast the net sufficiently wide to ensure that all objectionable arrangements are caught, such that the overall purpose of putting pressure on Russia is achieved*”. The Court of Appeal’s view is that this “*approach obviously risks catching arrangements that may not be seen to be within the overall mischief. But the solution that the UK government has adopted for that is to provide for exceptions, both via the licensing regime ... and by further legislative exceptions contained in Part 7 of the [Russia Regulations]*”.

The Court of Appeal also considered whether UniCredit would have had a defence under s.44 Sanctions and Anti-Money Laundering Act 2018, which provides protection for acts done for the purposes of compliance when there is reasonable belief that the act is required. The Court of Appeal considered that UniCredit’s belief about Reg. 28(3) was reasonably held and so s.44 would have been engaged (although this would not provide any protection in relation to US sanctions). UniCredit was required to form a view on new legislation at short notice and there was “no doubt” that the literal words of Reg. 28 of appear to catch payments under the LoCs. It was important to avoid viewing the position with the benefit of hindsight.

The Court of Appeal also concluded that even if the *Ralli Bros*[3] principle was engaged so that US sanctions were potentially relevant, UniCredit was precluded from relying on them because it did not make reasonable efforts to obtain a licence from the US Office of Foreign Assets Control. This was due to the terms of the licence request, rather than the time taken to make it.

The Court of Appeal also commented that it did not endorse the first instance decision that UniCredit could have paid in cash, or that payment could have been made by transfer in a different currency. No demand for payment in cash or a different currency was in fact made, and the terms of the LoCs clearly stipulated that a conforming demand would be for the transfer of US dollars to a specified bank account.

At a glance...

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[1] *Celestial Aviation Services Limited v UniCredit Bank GmbH, London Branch (formerly UniCredit Bank AG, London Branch) and Constitution Aircraft Leasing (Ireland) 3 Limited & another v UniCredit Bank GmbH, London Branch* [2024] EWCA Civ 628

[2] As amended by the Russia (Sanctions) (EU Exit) (Amendment) (No. 3) Regulations 2022

[3] *Ralli Bros v Compañía Naviera Sota y Aznar* [1920] 2 KB 287