

11 July 2023

CIF Weekly – issue 37

Celestial Aviation Services Limited and Constitution Aircraft Leasing (Ireland) 3 Limited and another v UniCredit Bank AG (London Branch)¹ – Sanctions imposed against Russia do not excuse compliance with standby letters of credit

The Commercial Court addressed the impact of sanctions imposed against Russia on payment obligations under standby letters of credit.

Facts

The Court heard two claims together: the Claimants, Celestial Aviation Services ("**Celestial**") and Constitution Aircraft Leasing (Ireland) 3 Limited and Constitution Aircraft Leasing (Ireland) 5 Limited (together, "**Constitution**"), were Irish aircraft lessors seeking payment as beneficiaries under standby letters of credit (the "**LCs**").

The LCs related to aircraft leases agreed with Russian air companies between 2005 and 2014. They were issued between 2017 and 2020 by Sberbank Povolzhsky Head Office ("**Sberbank**") and confirmed by the London branch of the German bank UniCredit Bank AG ("**UniCredit**"). Each was governed by English law and payable in US dollars.

The sanctions imposed against Russia following its invasion of Ukraine in February 2022 triggered events of default under the leases which were then terminated. Celestial and Constitution demanded payment under the LCs, and it was common ground that the payment demands were all conforming. However, UniCredit refused to make payment on the basis that it was prohibited by sanctions imposed by the UK, the EU and the US against Russia.

The issues for determination before the Court were:

1. *Did the UK sanctions regime (specifically, Regulations 11, 13 and 28 of the Russia (Sanctions) (EU Exit) Regulations 2019) prohibit payment under the LCs? It was agreed by the parties that the analysis in relation to the EU*

sanctions regime² is materially the same as in relation to the UK sanctions regime.

2. *If not, did UniCredit nonetheless have a reasonable belief that it was prohibited from making payment such that it could rely on the defence in section 44 of the Sanctions and Anti-Money Laundering Act 2018?*
3. *Did the US sanctions regime suspend or otherwise excuse UniCredit's non-performance of its obligation to pay in US dollars under the LCs?*



Principal Judgment

The principal judgment addressed the first and third issues with the second issue being held over for the

¹ [2023] EWHC 663 (Comm) (23 March 2023) and [2023] 1071 (Comm) (5 May 2023).

² The relevant regulation being Article 3c of Council Regulation (EU) 2022/328.

hearing dealing with consequential matters arising out of the principal judgment.

UK sanctions regime (and, by implication, EU sanctions regime)

The Court rejected UniCredit's defence holding that it was not prohibited from making payment under the LCs:

- As starting point, the purpose of the legislation should be identified.
- Confirming the importance of the autonomy principle, which says that a standby letter of credit gives rise to payment obligations independent of the underlying transaction, the Court held that payment by a German bank (UniCredit) to Irish companies (Celestial and Constitution) could not be said to be intended to benefit the Russian lessees.³
- It was a "*wholly collateral matter*"⁴ that payment by UniCredit may have the effect of discharging the independent obligations of the lessees and Sberbank towards Celestial and Constitution. Importantly, no financial benefit was given to Sberbank because it remained liable to UniCredit or to the Russian lessees because they, in turn, remained liable to Sberbank.
- The sanctions regime "*operated prospectively and not retrospectively*".⁵ The aircraft were supplied to Russian lessees and UniCredit's provision of financial services (in confirming the LCs) occurred long before the sanctions were in force. The payment obligation was therefore lawful at the time it came into effect and all that remained was for it to be fulfilled.
- There was no basis for a reading of the regulations whereby transactions that fall within deliberately broad drafting are then permitted at the discretion of licencing authorities. Instead, the guidance suggests that the licencing authorities may grant licences, notwithstanding that a transaction is prohibited, if that is consistent with the aims of the sanctions.

US sanctions regime

In the Court's view, the operation of the US sanctions regime did not assist UniCredit:

- There was no relevant prohibition under US law when the payment obligations to Celestial accrued, but there may be potentially relevant prohibitions in relation to Constitution. While the "*final arbiter*

as to what US law is is the US Court",⁶ UniCredit had not satisfied the burden of proving to the English Court that payment under the LCs would have breached US law.

- Applying *Libyan Arab Foreign Bank v Bankers Trust Co*,⁷ the Court decided that the requirement to pay in US dollars did not require a US correspondent bank's involvement because where a payment under a contract is denominated in US dollars the recipient can demand payment in cash. Therefore, the rule, established in *Ralli Bros v Compania Naviera Sota y Aznar*,⁸ that English law will not enforce an obligation if performance of that obligation would require the performing party to act unlawfully in the required place of performance, was not engaged.



Comment

This judgment provides important clarity on: (a) the application of the autonomy principle in relation to sanctions and payment obligations under letters of credit; (b) the effect of new sanctions on lawful, pre-existing obligations; and (c) the impact of payment being US dollars in an English law contract where global sanctions regimes are relevant.

Specifically, this judgment offers clear and comprehensive guidance on the interpretation of Regulations 11, 13 and 28 of the Russia (Sanctions) (EU Exit) Regulations 2019. While the issues were decided in relation to these regulations and in the context of sanctions imposed against Russia following its invasion of Ukraine, the clarity provided by the Court, including its commentary on the construction of sanctions regulations, is likely to be relevant to other regulations

³ Moreover, UniCredit was not dealing with Sberbank's property when making payment but satisfying its own payment obligations.

⁴ Paragraph 126(4).

⁵ Paragraph 126(2). See also paragraphs 137(1) and 145(1).

⁶ Paragraph 188(1).

⁷ [1989] 1 QB 728

⁸ [1920] 2 KB 287

under the Russia regime as well as under other sanctions regimes.

Please click [here](#) for a copy of the full judgment.

Consequential Judgment

At the request of the parties, the second issue before the Court was addressed at the consequential hearing.

Please click [here](#) to read Stephenson Harwood's article on the consequential judgment.

Please click [here](#) for a copy of the full judgment.

Author



Hayley Flood

Associate, London

D: +44 20 7809 2619

M: +44 078 8029 4938

E: hayley.flood@shlegal.com

Contact us

We hope that you find this update both useful and interesting. If you have any comments or would like to learn more about this topic, please get in touch with either your usual SH contact or any member of our commodities team by clicking [here](#).