Court of Appeal Overturns the Decision in Celestial Aviation Services Ltd v Unicredit Bank SA

23 July 2024

On 11 June 2024, the UK Court of Appeal handed down judgment in the case of *Celestial Aviation Services Ltd v Unicredit Bank SA* [2024] EWCA Civ 628, allowing in part the appeals against two related High Court decisions.[1]

The Court of Appeal's decision brings clarity on three important issues relating to the UK's autonomous sanctions regime:

- The UK's restriction on the provision of financial and other ancillary services may apply in relation to Russia-related sales and exports that occurred before the relevant sanctions were imposed;

- The general defence to liability for actions taken in the "*reasonable belief*" that they were necessary to comply with UK sanctions is broad and allows for a conservative interpretation of UK sanctions; and

- The circumstances in which foreign sanctions (in this case U.S. sanctions) can be used as a basis to argue that a contract has become illegal to perform.

Background. The *Celestial* case concerns letters of credit that were issued by a designated entity, Sberbank, and confirmed by Unicredit (the Appellant) in the context of lease agreements between certain Irish aircraft lessors and Russian airlines. The Irish lessors (the Respondents) were the beneficiaries of those letters of credit. Unicredit obtained licences in the UK (both in respect of export restrictions and Sberbank as a designated entity) and made the principal payments to the Irish lessors. The key issue in the High Court proceedings was whether interest and costs payments by Unicredit to the Irish lessors would breach UK or U.S. sanctions regulations.

The High Court concluded that UK sanctions did not prohibit Unicredit from paying out under the letters of credit, as the payment arrangement was separate from the

[1] Celestial Aviation Services Ltd v Unicredit Bank SA [2023] EWHC 663 (Comm) and Celestial Aviation Services Ltd v Unicredit Bank SA [2023] EWHC 1071 (Comm), as discussed in our client update, *available* here.

aircraft lease and, moreover, the lease predated the relevant export restrictions (which were imposed on 1 March 2022). In relation to the impact of U.S. sanctions, the High Court ruled that a payment by Unicredit would not necessarily be illegal, as it could be made in cash instead of via a correspondent U.S. account. Finally, the High Court decided that Unicredit could not rely on the Section 44 defence as its belief that payment under the letters of credit would breach applicable sanctions prohibitions was held to be unreasonable.

Scope of Restriction on Financial Assistance for Transactions Affected by Trade Sanctions. Regulation 28 of the Russia (Sanctions) (EU Exit) Regulations 2019 (the "Russia Regulations") prohibits the provision of financial services in connection with the export or supply of certain types of "*restricted goods*", including aircraft. The Court of Appeal found that the "*in connection with*" test involved establishing a "*factual connection*" and did not require any form of legal dependence. While the obligations under letters of credit are "*autonomous*" in the sense that payments do not depend on whether the beneficiary has a claim under the underlying contract, the letters were only issued because of the aircraft leases and were factually connected to them. On that basis, the Court concluded that the letters of credit were made "*in connection with*" the leases and financial services restrictions therefore applied to them.

Further, the Court of Appeal decided that the effect of Regulation 28 is not limited to arrangements entered into after 1 March 2022. The wording "*restricted goods*" in Regulation 28 is simply a definition by reference to a list of goods; it is not an indicator of their "*restricted*" character. In the circumstances, "*restricted goods*" meant "*aircraft*", and financial assistance in connection with the export of aircraft was prohibited regardless of the date of the lease.

The Court of Appeal noted that Regulation 28 is a "*relatively blunt instrument that is intended to cast the net sufficiently wide to ensure that all objectionable arrangements are caught*". However, to limit the extremely broad scope of rRgulation 28, the UK government has chosen to grant licences on a case-by-case basis, rather than provide a grace period for all pre-existing arrangements.

Section 44 SAMLA. Section 44 of SAMLA provides that a person is not liable to any civil proceedings in respect of any act or omission taken in the "*reasonable belief*" that it was done to comply with UK sanctions regulations.

The High Court adopted an extremely narrow interpretation of the "*reasonable belief*", ultimately finding that Unicredit's risk-averse conclusions on a complicated sanctions topic did not meet this standard. This came as a surprise to the market as the presumption had been that Section 44 is a complete defence which does not require

businesses to undertake detailed legal analysis to establish the "*reasonable belief*" standard.

The Court of Appeal disagreed with the narrow interpretation and found that Unicredit's belief that payment under the letters of credit would breach sanctions prohibitions was reasonable. The Court noted that Unicredit had to form a view on new legislation at short notice in circumstances where the "*literal words appear[ed] to catch payments under the LCs*". In this respect, Lady Justice Falk warned against setting the standard under Section 44 too high by "*viewing the position with the benefit of hindsight, having heard argument from well-prepared legal Counsel and with the benefit of judicial consideration that might ultimately appear to make clear what was in fact not at all clear at the relevant time*".

The Court of Appeal's decision has returned the interpretation of Section 44 to what businesses considered a practical reading of a "*reasonable belief*". This also brings Section 44 closer to the pre-Brexit "*no liability*" rule under EU sanctions, according to which liability does not arise for anything done in the good faith belief that it was necessary to comply with EU asset freeze restrictions, provided such actions do not amount to negligence.

Of note, the Court of Appeal then considered the scope of the Section 44 defence and concluded that it did not cover claims for recovery of a debt that is lawfully due but unpaid because of sanctions imposed on the creditor *after* the debtor's default. On this basis, the Court of Appeal concluded that Section 44 could not protect Unicredit against a claim for interest and costs relating to the unpaid amount under the letters of credit.

***Ralli Bros* Principle and U.S. Sanctions**. The *Ralli Bros* principle applies where performance is not illegal under English law but is illegal in the place where the contract has to be performed. Many parties have previously sought to apply this principle to justify a failure to perform where their counterparty is targeted by U.S. sanctions.

Lady Justice Falk broke the *Ralli Bros* principle down into two separate issues: (i) whether the performance is illegal and (ii) whether the non-performing party has made "*reasonable efforts*" to avoid illegality, such as obtaining a licence from the sanctions authorities allowing it to complete performance.

Having found that the terms of the letters of credit did not authorise payments in cash or in any currency other than U.S. dollars, the Court of Appeal went on to discuss whether Unicredit had made "*reasonable efforts*" to avoid any illegality in making the respective payments. Lady Justice Falk concluded that, although Unicredit had filed a licence application with the U.S. Office of Foreign Assets Control, that application was narrowly framed and focused on processing a payment by Sberbank. The application

therefore fell short of a "*reasonable effort*", meaning that Unicredit could not rely on the *Ralli Bros* principle.

Takeaways. Following the recent Celestial decision, UK businesses must be mindful of the extremely broad character of UK ancillary financial service restrictions, which may affect transactions entered into before particular trade sanctions kick in.

On the other hand, the Court of Appeal's interpretation of the Section 44 defence should give businesses comfort and reassurance when adopting a conservative interpretation of sanctions prohibitions.

The reaffirmation of the *Ralli Bros* principle is also helpful for businesses facing multijurisdictional sanctions issues, as it gives them a basis to argue that an English-law contract has become illegal to perform as a result of foreign sanctions. In addition, the decision in *Celestial* sets a clear expectation regarding how far contractual provisions can be stretched to accommodate payment to U.S. sanctioned persons. It also gives an indication of what efforts to overcome U.S. sanctions will suffice to constitute a defence against a sanctioned person's claim.

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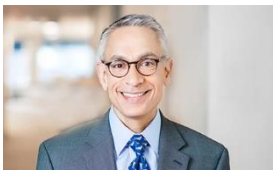

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