Mortgagee’s duties

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Summary

An unsecured creditor was unable to establish that a mortgagee owed it a duty of care in the conduct of a sale of aircraft.

PK Airfinance SARL v Alpstream AG (21 December 2015)

Background

Caelus Aviation Ltd (‘Caelus’), a company associated with the National Reserve Corporation group (the ‘NRC Group’), owned three aircraft which it had leased to Olympic Airways. In 2009, it borrowed a senior loan of $84m from PK Airfinance SARL (‘PK’). The PK loan was secured by a mortgage over the three aircraft. Alphastream Ltd (‘Alphastream’), another member of the NRC Group, agreed to provide a junior loan of $75m to Caelus. This junior loan was unsecured and was subordinated to all of PK’s rights. The PK security over the three aircraft was on terms that it also secured two loans which had been made by PK to two other companies in the NRC Group in 2007 ($120m) and in 2008 ($51m). Those loans related to the purchase of seven aircraft which were to be leased to the airline, Blue Wings. The loans were further secured by mortgages over the seven aircraft in favour of PK. By various intercreditor agreements between the parties, Alphastream was expressed to be at the bottom of the payment waterfall in respect of the payment proceeds of the three aircraft as an unsecured creditor of Caelus. The Caelus loan was, and still is, fully performing. But in 2010 the insolvency of Blue Wings precipitated defaults by the two borrowers under the 2007 and 2008 loans. PK began enforcement action and took possession of the seven aircraft in February 2010. On 22 March 2010, PK decided to proceed with an enforcement sale. An auction took place on 17 May 2010, by which time the legal title to the aircraft had passed from the two borrowers to Wells Fargo, as an owner trustee. PK was the successful bidder, purchasing at the price of $148m.
Alphastream challenged the sale on the basis that PK had acted in breach of its duties as mortgagee, principally its duty to use its ‘best endeavours to obtain the best price reasonably obtainable’ (the true value was said to be $157.3m or possibly $160.6m), and had failed to act in good faith or for a proper purpose. One of their main complaints was about the way in which the auction had been conducted. Alphastream claimed that these breaches of duty had caused a loss to it, because the value of Caelus’s equity in the three aircraft (which was to be the source of its repayment) had effectively been reduced by about $11m, the amount of the undervalue. This was as a consequence of the three aircraft securing not just the 2009 loan but also the 2007 and 2008 loans and therefore, due the auction sales proceeds being insufficient to repay the 2007 and 2008 loans in full, the three aircraft having to bear any shortfall in repayment of the 2007 and 2008 loans, thereby reducing what would be available to Alphastream at the bottom of the payment waterfall. In the High Court, Alphastream’s claim was successful. PK appealed.

Decision
The Court of Appeal allowed PK’s appeal, on the simple ground that Alphastream was not owed any duty of care by PK. Alphastream was only an unsecured creditor of Caelus, and so was not within the classes of person to whom an enforcing mortgagee owes any duty (i.e. the mortgagor, a subsequent mortgagee, a co-mortgagor, and a guarantor). To extend the duty to the ‘residual beneficiary of the proceeds’ would be a departure from established authority. In addition (a) there was no evidence of the amount of the Caelus debt to Alphastream, and (b) as the three Caelus aircraft were still unsold, no loss to Alphastream could be ascertained.

BLP comment:
This case displays a reluctance on the part of the court to extend the beneficiaries of a mortgagee’s duty of care.

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