

# Treatment of senior unsecured debt in European leveraged finance transactions: Court of Appeal confirms no duty to unsecured third party creditors on enforcement

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In our recent note “Treatment of senior unsecured debt in European leveraged finance transactions: the need for an intercreditor agreement”, which can be viewed [here](#), we addressed the increase in flexibility in European financings to incur senior unsecured debt and the risk that the lack of any agreed intercreditor arrangement may impair senior secured lenders’ ability to realise recoveries from a European Credit Group.

In its recent judgment in *PK Airfinance Sarl v Alpstream AG*, the Court of Appeal has reaffirmed the existing rule that a security holder upon a distressed sale of security assets does not owe a duty under English law to unsecured creditors, even if it is foreseeable that those unsecured creditors might be affected by the proceeds achieved in such a sale. The Court of Appeal has also re-confirmed that the security holder’s duty to act fairly and reasonably is owed only to the security provider and that it is for the security holder to decide the method and timing of the disposal.

In situations where European Credit Groups are increasingly looking to incur unsecured debt, the Court of Appeal’s decision provides a degree of comfort to secured creditors with its reinforcement of the scope of their duties as security holder.

## Background

In *PK Airfinance Sarl v Alpstream AG*, the defendant (“**PK**”) provided financing in connection with the purchase of seven aircraft. PK subsequently provided financing in connection with the purchase of an additional three aircraft. PK received mortgages over all ten aircraft as well as shares in the borrowers to secure these loans. The financing of the seven aircraft was cross-collateralised by mortgages over the additional three aircraft and vice versa.

The claimant (“**Alpstream**”) was an unsecured junior creditor of the buyer of the three additional aircraft and was only entitled to receive repayment if there were any proceeds left after the senior obligations secured by the cross-collateralised mortgages were repaid.

When the operator of the initial seven aircraft defaulted, PK sold those seven mortgaged aircraft at public auction and successfully bid for them. Alpstream brought a claim against PK alleging that the seven aircraft had been sold at an undervalue and arguing, among other things, that PK owed a duty to Alpstream as the

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ultimate recipient of the balance of the proceeds of any future sale of the three aircraft to take reasonable steps when disposing of the seven cross-collateralised aircraft to obtain the best price reasonably obtainable, and that PK was in breach of that duty.

## No Duty to Unsecured Creditors

The Court of Appeal upheld the position that a security holder who exercises its power of sale over secured assets owes an equitable duty to the security provider to take reasonable care to obtain the best price reasonably obtainable at the date of the disposal, noting that it is, however, for the security holder to decide whether and when to sell even if the timing is unfavourable to the security provider.

The Court of Appeal found that to extend the duty of PK as security holder to unsecured junior creditors or other possible ultimate recipients of the balance of the sale proceeds under the payments waterfall would involve a departure from established authority, which it did not believe to be justified. In particular, the Court of Appeal found that Alpstream was not a creditor of the operator of the initial seven aircraft and had no interest, actual or contingent, in those aircraft or the proceeds of their sale. In addition, it had been contractually agreed that Alpstream, as a junior creditor, was to be subordinated to PK and was not to have any security interest in respect of the junior debt owed to it. In these circumstances, in the Court's view, PK did not owe any duty in equity or otherwise to Alpstream in any capacity.

## Conclusion

This judgment is a useful reminder of a security holder's duties and to whom they are owed. In particular, the decision of the Court of Appeal provides a degree of comfort to secured creditors by reinforcing the position that security holders do not owe any duty to those with no recognised interest in the security assets and that a security holder is free to choose when and how it wishes to dispose of the security assets. Given the increased flexibility in European financings to incur senior unsecured debt, this is a welcome reaffirmation of the existing law.

However, if, as discussed in our previous note, senior secured creditors begin to enter into specific intercreditor arrangements with unsecured creditors in order to implement payment blocks, standstill provisions and a release mechanism, then unsecured creditors, as a *quid pro quo*, may well take this opportunity to push for contractual valuation protections.

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