

**IN THE HIGH COURT OF JUSTICE**  
**QUEEN'S BENCH DIVISION**  
**COMMERCIAL COURT**

**BETWEEN:-**

- (1) ALPSTREAM AG**  
**(a company incorporated under the laws of Switzerland)**  
**(2) ALPSTREAM AVIATION MALTA LIMITED**  
**(a company incorporated under the laws of Malta)**  
**(3) CIS INTERFINCOM AG**  
**(a company incorporated under the laws of Switzerland)**  
**(4) ALPHASTREAM LIMITED**  
**(a company incorporated under the laws of Malta)**

**Claimants**

**and**

- (1) PK AIRFINANCE SÀRL**  
**(a company incorporated under the laws of Luxembourg)**  
**(2) GE CAPITAL AVIATION SERVICES LIMITED**  
**(a company incorporated under the laws of Ireland)**  
**(3) JETBLUE AIRWAYS CORPORATION**  
**(a company incorporated under the laws of the United States of America)**

**Defendants**

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**PARTICULARS OF CLAIM**

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**INTRODUCTION**

1. The claim relates to 7 Airbus A320-200 aircraft ("the Disputed Aircraft") which were purchased by subsidiaries of the Claimants and then leased to Blue Wings AG ("Blue Wings"), a German airline. The Claimants provided security and junior finance. The First Defendant ("PK") provided finance. In due course PK repossessed the Disputed Aircraft, carried out very extensive works on them,

and purported to sell them to itself at prices which were a substantial undervalue.

2. Further, 6 of the Disputed Aircraft were transferred to PK's associated company, the Second Defendant ("GECAS"), and then leased to the Third Defendant ("JetBlue") as part of a pre-ordained scheme under which JetBlue obtained them at below market rentals and GECAS obtained collateral advantages, not credited to the mortgage account.

PK's duties in equity

3. PK owed duties in equity to the Claimants in respect of the sale of the Disputed Aircraft by reason of the following:
  - 3.1 By a transaction which closed on 4 October 2007, the First Defendant ("PK") provided financing of US\$120 million to Alpstream Aviation Limited ("AAL"), a wholly-owned subsidiary of the First Claimant ("Alpstream"), in connection with AAL's purchase of five Airbus A320-200 aircraft with manufacturer's serial numbers 1240, 1257, 1546, 1557 and 1650.
  - 3.2 By a transaction which closed on 7 April 2008, PK provided refinancing of US\$51 million to Betastream Limited ("Betastream") in connection with Betastream's purchase of two Airbus A320-200 aircraft with manufacturer's serial numbers 1464 and 1785. Betastream is a wholly-owned subsidiary of the Second Claimant ("Alpstream Malta") which in turn is a wholly-owned subsidiary of Alpstream.
  - 3.3 The Third Claimant ("CIS") provided junior finance on each of the two above transactions as follows: (a) US\$38.5 million to AAL; (b) US\$18,481,999.70 to Betastream.
  - 3.4 By a transaction which closed on 2 October 2009, PK provided US\$84 million to Caelus Aviation Limited ("Caelus") in connection with Caelus's purchase of three new Airbus A320-200 aircraft with manufacturer's serial numbers 3990, 4065 and 4094 ("the Caelus Aircraft"), which aircraft were then, and remain, leased to Olympic Airlines.

- 3.5 Under a Subordinated Facility Agreement dated 5 October 2009, the Fourth Claimant (“Alphastream”) advanced US\$75 million to Caelus to fund the purchase of the Caelus Aircraft. Subsequently Caelus made part-repayment of this advance in the sum of US\$18,413,038, resulting in an outstanding total of US\$56,586,962.
- 3.6 PK was granted mortgages over each of the Disputed Aircraft and the Caelus Aircraft and further took security over the shares of the borrower entities by means of a mortgage dated 4 October 2007 between Alpstream and PK in respect of the shares of AAL and a pledge of shares agreement dated 7 April 2008 between Alpstream Malta and PK in respect of the shares of Betastream.
- 3.7 Each of the above security arrangements secured all the obligations of all three borrower entities (AAL, Betastream and Caelus) under their respective facility agreements with PK.
- 3.8 Further, a Deed of Cross-Collateralisation was entered into on 6 October 2009 between (among others) PK, the borrower entities, and the junior lenders (CIS and Alphastream), and which varied Deeds of Proceeds dated 4 October 2007 and 7 April 2008 (the “DCC”). The DCC regulated the distribution of proceeds received or recovered by the Security Trustee, PK, following an event of default and arising from any of the assets concerned, namely the total of 10 aircraft and the shares in any of the entities owning those aircraft. In summary, such proceeds after payment of costs and expenses were to be applied in payment to PK of amounts due in respect of the facility relating to the particular aircraft concerned; then in payment to PK in respect of sums due to PK in respect of the other facilities; and only then to payment of sums due to CIS and Alphastream.
4. As a consequence of the arrangements summarised above:
- 4.1 Each of the holding companies of the borrower entities for the Disputed Aircraft, namely Alpstream and Alpstream Malta, has at all material times been in the position of a co-mortgagor with the borrower entities.
- 4.2 Each of the junior lenders in relation to the acquisition of the Disputed Aircraft, namely CIS and Alphastream, has an interest in the proceeds

of PK's enforcement of its security over the Disputed Aircraft and/or over the related borrower entities.

4.2.1 CIS is the junior lender in respect of the Disputed Aircraft and entitled to the proceeds after (in particular) satisfaction of liabilities owing to PK.

4.2.2 The residual proceeds from sale of the Caelus Aircraft payable to Alphastream as junior lender in respect of those aircraft fall to be reduced by any amount outstanding to PK in respect of the Disputed Aircraft after realisation of the proceeds of the Disputed Aircraft.

5. By reason of the Claimants' interests in the equity of redemption, in enforcing its security over the Disputed Aircraft and/or the shares of the respective borrower entities, PK owed each of the Claimants duties in equity:

5.1 To take all reasonable steps to obtain the best price reasonably available;

5.2 Not to sell the mortgaged assets at less than market value;

5.3 To act reasonably in incurring costs and expenses chargeable to the mortgage account, and to the accounts under the DCC;

5.4 To take all reasonable steps to maximise the net proceeds of sale;

5.5 To act in good faith, and not for purposes other than enforcing its security.

#### Purported enforcement of PK's security

6. On 13 January 2010, Blue Wings' air operator's certificate was suspended by the German civil aviation authority. In purported reliance on its security rights arising under the transactions referred to above, PK then took the following steps:

6.1 On various dates in January or February 2010 PK took possession of the Disputed Aircraft.

- 6.2 On 15 January 2010 PK (acting under assignments dated 4 October 2007 and 7 April 2008) exercised the rights of AAL and Betastream as lessors under the leases of the Disputed Aircraft to Blue Wings and terminated each of the leases with Blue Wings.
- 6.3 By notices dated 22 January 2010 to AAL and Betastream served pursuant to clause 19.21 of the respective Facilities and a notice dated 25 January 2010 to Caelus served pursuant to clause 19.20 of the Caelus Facility, PK (among other things) declared all of each Aggregate Loan together with all accrued interest under each such Facility to be immediately due and payable.
- 6.4 On 4 March 2010 PK informed Alpstream that its intended maintenance and refurbishment works for 3 of the Disputed Aircraft were estimated to total US\$28.2 million.
- 6.5 Also on 4 March 2010 PK informed Alpstream that GECAS, purportedly acting under remarketing agreements entered into on 12 February 2010 between GECAS and AAL/Betastream as owners of the Disputed Aircraft, had entered into Letters of Intent with JetBlue, an American airline, for leases of 3 of the Disputed Aircraft. PK sought agreement to certain further conditions, said to be required by JetBlue.
- 6.6 On 4 March 2010 PK also sought confirmation by 10 am on 9 March 2010 that Alpstream was committed to a new facility agreement with PK having regard to the intention to lease to JetBlue and carry out the proposed level of works.
- 6.7 That confirmation was not given, nor were the further conditions agreed to. Instead, in its letter of 8 March 2010 Alpstream raised a series of queries and complaints regarding PK's proposed level of works and proposed entry into the leases with JetBlue.
- 6.8 By letters dated 9 March 2010 PK required repayment by 10 March 2010 of the loans for the Disputed Aircraft and the Caelus Aircraft.
- 6.9 By a letter dated 17 March 2010 from PK to Alpstream, PK notified Alpstream that it would without further notice enforce its remedies under the Mortgage Over Shares in respect of the shares of AAL and exercise all its rights pursuant to the Mortgage Over Shares. By a

further letter dated 17 March 2010 from PK to Alpstream Malta, PK notified Alpstream Malta of alleged Events of Default and that it would be exercising all the remedies available under Article 9 of the Pledge of Shares Agreement in respect of the shares of Betastream.

- 6.10 According to the terms of a notice provided by PK's solicitors to Alpstream on 14 April 2010, PK stated its intention to hold a public auction of the Disputed Aircraft on 18 May 2010, as follows:

*"Notice is hereby given that... PK Airfinance S.a r.l. (the "Secured Party") as security trustee and beneficial interest holder of certain owner trusts that hold title to the Aircraft... by virtue of certain defaults under certain facility agreements and in accordance with certain aircraft mortgages entered into in favour of the Secured Party as mortgagee, the Secured Party [sic] will cause the sale, at a public auction, of all its right, title and interests in and to the following:... [the airframes and engines of the Disputed Aircraft were then itemised, together with their records]."*

- 6.11 The notice stated that the sale was subject to the conditions set out in the notice. It further stated that buyers were encouraged to perform such due diligence as they deemed necessary.
- 6.12 On 4 May 2010 PK informed Alpstream that the Disputed Aircraft and their engines were already inducted into maintenance in different locations all over the world. In a conversation on 6 May 2010 Christophe Beaubron of PK informed Volker Blau of Alpstream that the Disputed Aircraft and their engines were not available for inspection. At a meeting on 11 May 2010 attended by Nils Hallerstrom and Christophe Beaubron of PK and David Bartlett of GECAS Alpstream requested access to the Disputed Aircraft and their technical records which PK/GECAS again refused.
- 6.13 On 18 May 2010 the auction was held. The only persons to attend were PK itself and Deltastream Limited (an associated company of the Claimants). The only bids were from PK. These bids were accepted by PK through its solicitors Clifford Chance acting as auctioneer. Thus PK conducted the sale and the purported purchaser was PK itself.
- 6.14 Notwithstanding the terms of the auction notice, PK has asserted in correspondence that the sale at the auction was not effected by PK in its capacity as mortgagee of the Disputed Aircraft. PK has stated that, as

mortgagee of the shares of AAL and Betastream, it instructed those companies to transfer the Disputed Aircraft to Wells Fargo (understood to be a trustee), and to cause Wells Fargo to sell them at the auction.

- 6.15 The sale price in total was US\$171.4 million.
- 6.16 During 2010 extensive maintenance and refurbishment works (“the Works”) were carried out by PK on the Disputed Aircraft (with the apparent exception of MSN 1464). PK has yet to provide final statements of account to the Claimants but according to its provisional statements provided on 12 January 2011 a total of over US\$49 million has been spent on the Works.
- 6.17 On dates unknown to the Claimants, according to information supplied by the First and Second Defendants, PK entered into purported transfers of the Disputed Aircraft (it appears with the exception of MSN 1464) to its associated company GECAS. GECAS then entered into purported leases of those aircraft with JetBlue as lessee.
- 6.18 By about 6 June 2010 PK’s position was that MSN 1464 could not be economically repaired. According to PK’s later statements MSN 1464 was sold for a total of US\$13,407,000, i.e. resulting in a reduction in the aggregate sale price for the Disputed Aircraft to US\$160,207,000.
- 6.19 PK has failed to provide final statements of account in respect of the mortgages.

## **LEGAL CONSEQUENCES UNDER THE MORTGAGES**

### **Purported sale was void**

7. The purported sales of the Disputed Aircraft at the auction on 18 May 2010, and any subsequent steps to complete them, were sales to PK, procured by PK acting as mortgagee. Such transactions are outside the powers conferred on PK as mortgagee whether under the Borrower Company Mortgages or the Aircraft Mortgages, and are void:

- 7.1 If (as PK now asserts) the sale was by Wells Fargo as trustee for the Borrower Companies acting on the direction of PK as mortgagee of those companies, PK had no power as mortgagee to cause those

companies to sell their assets to itself, either directly or through an intermediary. In particular:

- 7.1.1 PK was conducting the sale. A mortgagee's power of sale does not extend to selling to a person conducting the sale.
  - 7.1.2 PK's power of sale extended only to the shares of the borrower companies and not to the assets of those companies; and/or
  - 7.1.3 PK's power to exercise the normal rights of the shareholders did not extend to directing a sale of the corporate assets to itself, nor to directing a transfer to a third party in order that the third party could sell to PK.
- 7.2 Alternatively, if (as the notice of auction stated) PK was selling its own interests in the Disputed Aircraft, PK was not empowered to sell the mortgaged assets to itself.

8. Because the sales were void:

- 8.1 PK remains under a continuing duty as mortgagee to deal with the mortgaged asset.
- 8.2 Further, PK is liable to account or make compensation for any loss caused by its failure to obtain the best price reasonably obtainable in a sale which it was authorised to make or procure. For the reasons set out below, PK if acting reasonably would have obtained a better price and/or spent less on the Works than in fact was the case.

Burden on PK to justify purported sale in any event

9. If, contrary to the foregoing, PK had power to sell or procure the sale of the Disputed Aircraft to itself, such a sale is subject to the same restrictions as a sale by a mortgagee to a connected party. Accordingly the sale is in breach of duty unless PK can discharge the burden of showing (1) that all reasonable steps were taken to obtain the best price reasonably available; (2) that the sale was not at an undervalue; and (3) that it acted in good faith.



Burden on PK to justify reasonableness of expenditure

10. The burden is on PK to justify the reasonableness of any expenditure incurred by it and which it seeks to charge to the mortgage account and/or to take into account in calculating the net proceeds distributable under the DCC.

Breach of equitable duties to act reasonably

11. Without prejudice to the burden of proof on PK, the Claimants allege that in breach of its equitable duties to the Claimants:
  - 11.1 PK failed to take all reasonable steps to obtain the best price reasonably available for the Disputed Aircraft;
  - 11.2 PK sold the Disputed Aircraft at an undervalue;
  - 11.3 PK incurred unreasonable expenditure on the Works; and/or
  - 11.4 PK conducted the sale process and procured the Works with a view to ensuring that JetBlue obtained the Disputed Aircraft as lessee;
  - 11.5 Further or alternatively, the arrangements with JetBlue involved collateral advantages for the benefit of PK and/or GECAS, rather than maximising the value of the secured assets for the benefit of all concerned including the Claimants.

The best particulars the Claimants can currently give are set out below. These will be amended as appropriate after disclosure. For the avoidance of doubt, the Claimants also rely on those particulars as matters which PK will need to explain before it can discharge the burden of proof (without prejudice to the generality of that burden).

**FAILURE TO TAKE ALL REASONABLE STEPS TO OBTAIN THE BEST PRICE**

12. PK has refused to provide details of the steps (if any) which it took to market the Disputed Aircraft beyond advertisements of the auction referred to in paragraph 6.10 above. Pending disclosure the Claimants allege that PK failed fairly and properly to expose the Disputed Aircraft to the market, for the following reasons:

- 12.1 Although Airbus A320-200 aircraft are widely used and regularly traded within the aviation industry, PK failed to attract a single independent bidder to the auction.
- 12.2 PK has asserted that 38 persons contacted it in relation to the auction. If correct (which is not admitted), since none of them attended with the exception of an associated company of the Claimants, Deltastream Limited, it is to be inferred that PK failed to take reasonable steps to follow up any interest and ensure that it materialised in attendance at the auction or other forms of bidding.
- 12.3 PK chose sale by auction notwithstanding that it is unusual within the aviation industry and was disadvantageous for the seller, i.e. not calculated to attract the best price, given that (a) prospective buyers were placed under a strict timetable and (b) negotiation over the scope and therefore cost of works was precluded.
- 12.4 Although PK embarked on the extensive programme of the Works, which it asserted was necessary to put the Disputed Aircraft into a marketable condition, PK took no steps to secure the benefits of that work in terms of increased price. For example:
- 12.4.1 the condition that the Disputed Aircraft were being put into was not advertised in the notices for auction, which merely referred to sale on an “as is, where is” basis;
- 12.4.2 the proposed terms of sale gave no contractual protection of any kind to the buyer in respect of the condition of the aircraft;
- 12.4.3 revised versions of the terms of sale (produced late on 17 May 2010 and re-revised early on 18 May 2010, the day of the auction) specified a delivery condition but merely entitled the buyer to discuss an adjustment to the price if the delivery condition was not met.
- 12.5 PK did not permit interested parties to inspect the Disputed Aircraft. Moreover PK offered no or no real contractual protection to any buyer at auction as to the condition of the Disputed Aircraft. Thus a buyer would have neither the benefit of any contractual warranty as to condition nor the possibility of inspecting the aircraft before purchase.

PK's notice of sale encouraged buyers to perform due diligence but in practice no or no adequate opportunity for due diligence was available.

12.6 The terms of sale were unreasonable and highly unlikely to attract independent buyers.

12.6.1 No terms were available at all until 11 May 2010, only 7 days before the auction. By contrast the cut-off point stated in the notice of 14 April 2010 for registration for attendance at the auction was 5 days in advance.

12.6.2 Although proposing to spend (and in due course spending) a typical amount in the region of US\$9 million on works on each of the Disputed Aircraft, amounting to almost 40% of their eventual sale price at the auction, PK offered no or no real contractual warranties to any purchaser. Specifically: (a) PK's first version of the sale terms merely offered the Disputed Aircraft on an "as is, where is" basis; (b) PK's next version, made available only at 5:23 pm on 17 May 2010, the day before the auction, incorporated a delivery condition but the remedy if it was not met was only a requirement to discuss in good faith an adjustment to the purchase price to reflect the actual condition; (c) a final version at 9:42 am on 18 May 2010 made it express that failure to meet the delivery condition would not be a repudiatory breach of the sale contract.

12.6.3 PK imposed onerous conditions on purchasers. Its first version of the terms required purchasers to pay 10% of the price as a deposit on the day of the auction and a further 40% within 2 days. The deposit would be unrefundable if the sale failed to complete for any reason whatever, for example the seller's fault, illegality or total loss. PK's next version dated 17 May 2010 allowed 2 extra days to provide the 10% and 8 extra days for the 40% of the deposit, but was otherwise unchanged.

12.6.4 There was no adequate warranty as to title. The only warranty to be given was free and clear of security interests created expressly by the seller.

- 12.6.5 The first version of the sale terms provided that the delivery location would be determined by PK. This would or could be unattractive to unconnected potential bidders, who might have particular requirements depending upon tax and other considerations. In contrast, it would not be unattractive for a sale to PK or its connected entities, who could agree the delivery location. The wording was only changed the day before the auction, so as to contain an obligation to seek to agree a mutually acceptable location;
- 12.6.6 The first version of the sale terms provided that the purchaser would only have 3 business days' notice of the Expected Delivery Date. This was an unreasonably short period which would be unattractive to unconnected potential purchasers. Such term was amended (to 10 business days) only in the draft terms provided to Alpstream on the morning of the auction.
- 12.7 The delivery schedule proposed by PK for the Disputed Aircraft was unattractive.
  - 12.7.1 Aircraft were to be delivered between July and October 2010. This meant they would miss or largely miss the Northern hemisphere's summer season which is the most lucrative time for many airlines.
  - 12.7.2 There was no effective sanction against PK failing to meet the delivery schedule.
- 12.8 PK took further steps which would inevitably have discouraged independent bidders:
  - 12.8.1 Adopting a policy that it would set, but not disclose, a reserve price.
  - 12.8.2 Stating in the auction notice that it reserved the right to bid itself.

### **SALE AT AN UNDERVALUE**

- 13. The sale of the Disputed Aircraft was at a substantial undervalue. Without prejudice to the generality of the Claimants' case:-

*Sale in the condition into which the Disputed Aircraft were to be placed by PK*

- 13.1 The open market value of the Disputed Aircraft in the condition in which PK intended to place them was between about US\$195-205 million.
- 13.2 On the basis (as was the case under the terms of PK's Sale and Purchase Agreement) that the seller was to bear responsibility for the cost of the Works, the price agreed by PK of US\$171.5 million therefore constituted an undervalue of between about US\$24.5-34.5 million.

*Sale in the condition in which PK repossessed the Disputed Aircraft*

- 13.3 The Disputed Aircraft in their actual condition on repossession by PK had a market value of about US\$145 million, assuming that works would be carried out by the purchaser.
- 13.4 PK's anticipated net proceeds from the sale at the auction on 18 May 2010 were US\$105 million, i.e. the price of US\$171.5 million less anticipated Works costs of at least US\$66.5 million.
- 13.5 Accordingly the sale price represented an undervalue of about US\$40 million.

**UNREASONABLE MAINTENANCE AND REFURBISHMENT WORKS**

*(i) Unreasonable to carry out the Works pre-sale and/or without warranties*

- 14. It was unreasonable to carry out substantial works in circumstances where (1) because the sale preceded the Works, a purchaser could not satisfy itself of their satisfactory completion by inspection, but also (2) PK was not offering purchasers any or any adequate contractual warranties or other rights in respect of the benefit of the Works.
- 15. In any event, the Works enhanced all the Disputed Aircraft to a very high condition. This was unnecessary and unreasonable:-
  - 15.1 There is a well-established worldwide market in the Airbus A320-200, of which 2,200 were in active operation by May 2010. Over 200 airline operators use fleets of A320-200s. Relevant features of industry standard practice are as follows.

- 15.1.1 The most important costs are scheduled engine maintenance if involving performance restoration, and major structural checks.
  - 15.1.2 As well as being expensive these procedures take significant time during which the aircraft is necessarily off use.
  - 15.1.3 Engines can be restored to different levels of efficiency which will imply a certain expected life and hence likely period before the next major check. A full restoration will imply longer expected life, and will cost more.
  - 15.1.4 Likewise life limited parts can be replaced either with new parts or with cheaper used parts.
  - 15.1.5 Different operators have their own schedules of use and maintenance with correspondingly different needs and preferences for aircraft condition. Different operators' patterns of use also impose differing levels of wear and tear on aircraft, e.g. according to the frequency of use and atmospheric conditions.
- 15.2 For the above reasons and in accordance with standard market practice, a reasonable lessor would normally consider aircraft individually and to decide in conjunction with a particular lessee what level of work is necessary to bring the key components, in particular engines, up to the standard required by that operator in the light of its particular requirements.
- 15.3 For the same reasons a seller of A320-200 aircraft acting reasonably in pursuit of the highest obtainable net realisation would not commit itself in advance of the sale to a high level of maintenance and refurbishment works.
16. By contrast with normal commercial practice, PK and GECAS had reached a decision before the auction that a high level of maintenance and restoration of the Disputed Aircraft was to be undertaken.
- 16.1 PK stated in its letter of 9 April 2010 that the work which it was procuring on the Disputed Aircraft was required to meet "*minimum*

*commercially acceptable delivery conditions under any proposed leases*". PK further stated in that letter that all of the Disputed Aircraft were not in good condition and their redeployment costs would be high, implying that similar levels of expenditure to those given for 3 aircraft on 4 March 2010, i.e. in the region of US\$9-10 million per aircraft, would be required in all 7 cases.

- 16.2 In a telephone conversation on 6 May 2010 between Volker Blau of Alpstream and Christophe Beaubron of PK, Mr Beaubron confirmed that the work would be carried out under any circumstances and that costs estimated at nearly US\$9 million per aircraft would be incurred.
- 16.3 Immediately before the auction on 18 May 2010 Mr Beaubron stated that costs would be US\$9.5 – 10 million per aircraft.
- 16.4 The Claimants further rely on the Induction Report prepared by Pratt & Whitney Air New Zealand Services for GECAS on 5 May 2010 relating to engine V11678 and which is headed "*GECAS/JetBlue*" and describes the reason for removal as "*performance restoration*", by which was meant a full performance restoration. As set out below, performance restoration (which is the highest level of refurbishment for an engine) is not a standard delivery condition in the A320 market.
- 16.5 PK asserted in its letter of 9 April 2010 that the Works represented the "*minimum commercially acceptable delivery conditions under any proposed leases*". As set out above, PK did not offer any or any real contractual delivery condition to buyers, thereby contradicting its own position. In any event, the assertion was incorrect.

(ii) *The major cost components of the Works were unnecessary*

- 17. The Works' major components were:
  - 17.1 Carrying out the major structural checks on the airframes significantly before the 6 and 12 year intervals at which the manufacturer requires those checks; and
  - 17.2 Carrying out a full performance restoration on each engine.

Neither task was commercially necessary or in accordance with industry standard practice.

(a) Structural checks

18. As at March 2010, the majority of the Disputed Aircraft were aged between 8 years and 9 years. The oldest was 10 years and 3 months.
  - 18.1 To the best of the Claimants' information, 6 year checks were not due until dates between May 2011 and March 2012. 12 year checks were not due until dates between June 2012 and April 2014.
  - 18.2 Notwithstanding the lengthy periods until structural checks were required, PK carried both 6 and 12 year checks out on all the Disputed Aircraft<sup>1</sup> in 2010, and had decided to do so in advance of the auction on 18 May 2010. As from June 2010 (i.e. allowing 5 months after repossession), the 6 year checks were advanced by periods of between 12 and 21 months. The 12 year checks were advanced by periods of between 24 months and 46 months.
  - 18.3 While some period free from significant maintenance is typical at the commencement of a lease, many lessees will accept a minimum of a year (and its equivalent in flight hours or cycles). Alternatively lessees may seek some form of contribution from a lessor towards the costs of significant maintenance early in the lease. The Claimants specifically take issue with PK/GECAS's assertion in a Technical Report given to NRC representatives on 6 June 2010 ("PK's Technical Report") that a 20 month clearance period for scheduled maintenance was minimum standard lease practice, and further that it would be reasonable for a lessor to carry out in advance a 12 year check falling due shortly after that 20 month period.
  - 18.4 Moreover, performance of the 6 and 12 year checks would be a very substantial benefit to a new operator which would thereby obtain an airframe in an "as new" condition, i.e. with the same interval before heavy maintenance as a new aircraft would enjoy.

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<sup>1</sup> With the apparent exception of MSN 1464.



(b) Engine performance restoration

19. There was no general market requirement to carry out a full engine performance restoration on A320s of the condition and remaining life of the Disputed Aircraft. Without limitation to the generality of the foregoing:

19.1 PK's Technical Report admitted that a performance restoration was not a standard delivery condition.

19.2 GECAS's proposed lease terms to JetBlue did not require an engine performance restoration but only that each engine would have at least 6,000 flight hours or 4,500 flight cycles before the next scheduled performance restoration (in itself above market norms).

19.3 The Blue Wings fleet also included 2 further Airbus A320s ("the Meridiana Aircraft") which were separately financed, repossessed by the lender concerned in April 2009, and remarketed in 2010 by Avinco, aviation brokers. They were leased to Meridiana Airlines in July/August 2010. The leases, which were at monthly rentals above GECAS's proposed leases to JetBlue, also did not require engine performance restoration, but only the lesser of 4,000 flight hours or 2,000 flight cycles until the next scheduled performance restoration.

20. There was no justification in the condition of the Disputed Aircraft's engines for undertaking a performance restoration:-

20.1 The Disputed Aircraft had significantly varying histories as summarised below.<sup>2</sup> It was inherently unlikely that all of their engines required full performance restoration, so as to make them marketable:

Date of manufacture: June 2000 to March 2002

Cycles since new (engines): 5,612 to 13,020

Hours since new (engines): 18,096 to 33,951

Cycles since new (aircraft): 10,077 to 13,531

Hours since new (aircraft): 28,330 to 35,034

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<sup>2</sup> On the basis of information provided by the Defendants.

- 20.2 Unless the result of a borescope inspection showed that the internal condition of the engine failed to meet manufacturers' requirements and limits for operation, a shop visit would not be required (i.e. the manufacturers' requirements would not compel the engine to be taken off wing for maintenance).
- 20.3 Only 6 of the 14 engines failed a borescope inspection in early March 2010.
- 20.4 Moreover, if a shop visit was required, a level of maintenance substantially less than full performance restoration was available under the engine manufacturers' Maintenance Management Plan, namely, a "Hot Section Rework / Refurbishment". By contrast, full performance restoration returns the engine to a condition equivalent to that of a new engine, and involves a far more intrusive, and therefore lengthy and expensive, level of inspection and repair or replacement.

*(iii) Examples of excessive spending*

21. The Claimants set out below certain specific criticisms of the engine works performed in respect of engine V11678, which on repossession was on aircraft MSN1546. Given the reverse burden of proof, the criticisms are not comprehensive but are given as specific examples of the unnecessary and unreasonable scope of the Works as undertaken by PK/GECAS:

- 21.1 PK/GECAS were advised by the Induction Report of 5 May 2010 and Teardown Report of 12 June 2010 from Pratt & Whitney Air New Zealand that the engine was overall in good condition for its age and cycles.
- 21.2 Despite this advice, the cost of works to this engine exceeded US\$3 million<sup>3</sup> which was similar to the average engine costs planned by PK on the express basis that all the aircraft were in poor condition and had been badly maintained.

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<sup>3</sup> US\$2.505m after credits. It is unknown whether the credits were carried through to the mortgage/DCC accounts.

- 21.3 8 out of 16 items of work were upgraded in order to meet Pratt & Whitney's qualifying requirements for an engine performance restoration, i.e. were required only because of PK/GECAS's decision to achieve restoration. In 7 of those 8 cases, the qualifying requirement was for work to be carried out at Level 2.9 (performance restoration) or Level 3 (refurbishment), the latter being the highest possible level of repair work.
- 21.4 The High Pressure Turbine (HPT) Stage 1 blades were all replaced with new blades at a cost of US\$523,000. 60 of the 66 existing blades were also repaired at a cost of US\$66,000. A credit was given for US\$190,000 which (subject to proof) is assumed to be in respect of the repaired blades. Accordingly a net cost of US\$399,000 was incurred on this component alone, when the cost could have been limited to US\$66,000 plus the cost of purchasing a small number of blades if any were unrepairable (such purchased blades being of similar remaining life to the 60 repaired blades unless none were available).

*(iv) Comparison with other ex-Blue Wings aircraft*

22. The unreasonable level of expenditure incurred on the Disputed Aircraft is further shown by the outcome of the Meridiana Aircraft.
- 22.1 The Meridiana Aircraft formed part of Blue Wings' fleet until April 2009 and were subject to the same patterns of use and maintenance programmes as the Disputed Aircraft.
- 22.2 The Meridiana Aircraft were stored from April 2009 until April 2010. Before they were leased out to Meridiana maintenance work was then carried out at a total cost of approximately US\$4.6 million for both aircraft<sup>4</sup>, i.e. an average of US\$2.3 million compared to PK/GECAS's figures of US\$9-10 million.

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<sup>4</sup> This figure excludes approximately US\$200,000 per Meridiana aircraft which is due to be incurred in the future for removal of the existing in flight entertainment system. Since that system is a proprietary JetBlue system (because these aircraft were originally operated by JetBlue), there was no need for PK to incur a removal cost if the Disputed Aircraft were to be returned to JetBlue use.

22.3 The true comparable cost of repair of the Meridiana Aircraft was in fact lower than US\$2.3 million because maintenance records and documents for the Meridiana Aircraft had been lost by the repossessing bank and significant extra work was incurred as a result of this loss, which was included in the US\$2.3 million.

22.4 Further, the cost of US\$2.3 million included works which were to be carried out to suit the new lessee's particular requirements and which by agreement were to be carried out by Meridiana and charged to Alpstream (in comparison with PK/GECAS's approach referred to in paragraph 14 above).

*(v) Comparison with parted-out value achieved by PK for MSN 1464*

23. A comparison of the expenditure with the value achieved for aircraft MSN 1464 indicates that PK's expenditure on the Disputed Aircraft was unreasonable.

23.1 According to information supplied by PK, MSN 1464 was in its opinion in a very poor state on repossession, having been cannibalised by Blue Wings for parts to be used on other aircraft, and in contrast with the other Disputed Aircraft was beyond economic repair.

23.2 Despite this, on PK's own figures it sold MSN 1464's parts for a total in excess of US\$13 million.

23.3 By comparison, the average sale price achieved at the auction was only US\$24.5 million per aircraft. In order to justify expenditure in the region of US\$9 million or more per aircraft, this implies that the value absent any expenditure would be below US\$15.5 million.

23.4 On PK's own case the remaining Disputed Aircraft were in a significantly better state than MSN 1464 on repossession. Their value at the time of repossession must accordingly have been significantly better than an aircraft which could only be parted out.

*(vi) Inconsistent with previous history and expectations*

24. The Works were well in excess of previous expectations and also inconsistent with the actual history of the Disputed Aircraft:

- 24.1 The German aviation regulator, the LBA, issued Blue Wings' Air Operators' Certificate (AOC) on 4 May 2009. An AOC may only be issued if the aviation authority is satisfied of the airline operator's ability to ensure continued airworthiness.
- 24.2 PK inspected the Disputed Aircraft in April/May 2009. At a meeting in Zurich on 19 May 2009, Per Waldelof of PK confirmed to Anatoli Kachirski, Michael Souvorov and Volker Blau of Alpstream that the aircraft were in good condition.
- 24.3 Blue Wings' maintenance programme for the Disputed Aircraft for 2010 contemplated maintenance costs of approximately €12 million. Furthermore, as at 31 December 2009 the balance in a maintenance reserve account maintained by Blue Wings was US\$17.96 million. The maintenance reserve account remained available for use by PK.
- 24.4 Blue Wings' AOC was withdrawn by the LBA on 13 January 2010, for financial not operational reasons. 6 of the 7 Disputed Aircraft were in use by Blue Wings up to very shortly before 13 January 2010. It is to be inferred that those 6 aircraft were airworthy and fit for commercial operation (and so not in urgent need of significant repairs).
- 24.5 PK arranged a new Maintenance Funding Facility with Alpstream and its subsidiaries and issued a Term Sheet on 23 February 2010 providing for a new US\$25 million facility for the purpose of debt repayment and maintenance and refurbishment costs. This was intended to provide for works costs after taking account of the maintenance reserve from Blue Wings of US\$17.96 million and provided for works averaging US\$4.8 million for each of the Disputed Aircraft (and on a new eighth aircraft which was to be added). The estimated cost included removal of JetBlue's in-flight entertainment system (which was not necessary in the event of transfer to JetBlue itself). Engine refurbishment costs were estimated at US\$2.9 million for a pair of engines. Thus both total costs and engine costs were estimated by PK itself at about half the level which PK asserted from the time of its letter of 4 March 2010.

**THE SALE AND THE WORKS WERE CARRIED OUT TO ENSURE THAT THE DISPUTED AIRCRAFT WERE LEASED TO JETBLUE AND/OR TO OBTAIN COLLATERAL BENEFITS FROM JETBLUE**

25. The Claimants rely on the following matters:

25.1 The JetBlue lease terms, as evidenced in letters of intent apparently negotiated by GECAS and which were summarised in PK's letter of 4 March 2010 (the "LOIs"), were highly unfavourable to the proposed lessors:

25.1.1 The rental of US\$170,000 per month was well below the market rate. For A320s in the condition referred to in the LOIs, a market rent as at March 2010 would have been about US\$220,000 and in the condition into which the Disputed Aircraft were in fact placed US\$240,000 or more.

25.1.2 The rates of payment in lieu of maintenance reserve amounts to be required from JetBlue (at the end of the lease) were significantly below market norms, which were: US\$16,000 per month for the 6Y check and US\$4,000 per month for the 12Y check; US\$175 per flight hour for the engine parts and US\$32 per flight hour for the APU.

25.2 In an interview with Flightglobal published on 20 May 2010 Dave Barger, chief executive of JetBlue, stated that the 7 used A320s were being acquired on

*"very favourable lease terms"*.

In a further interview with Flightglobal published on 23 July 2010 Mr Barger described GECAS's offer relating to the used A320s as

*"a very nice financial proposal... Boy, you bet we'd do that"*.

25.3 There was no reason for GECAS, a highly experienced aircraft lessor, to have entered into below market terms without receiving or anticipating some corresponding benefit.

25.4 Prior to 2010 JetBlue had delivery slots from Airbus Industrie for new A320s. On an unknown date before 20 May 2010, JetBlue announced that it was deferring 6 delivery slots between 2011-12 and 2015 and was