

**UAB „VERMOSA“ UAB,
AN ADMINISTRATOR OF THE COMPANY IN BANKRUPTCY „STAR1 AIRLINES“**

REPORT

**on the course of bankruptcy
10-12-2010 to 08-06-2011**

Vilnius

2011

1. Beginning and Course of Bankruptcy Process

Vilnius District Court by 21-10-2010 resolution in the civil case No. B2-7803-585/2010 and on 10-12-2010 the Court of Appeal of Lithuania by a resolution in the civil case No. 2-2287/2010 instituted the bankruptcy proceedings against „Star1 Airlines“ UAB (code of legal person 125366558, 1 Pelesos Str. / 2 S. Darius ir S. Girėno Str., Vilnius). The bankruptcy was initiated by a company director, because such right and obligation is established by the Law on Companies. "VERMOSA" UAB was assigned as the bankruptcy administrator. The resolution regarding initiation of bankruptcy came into effect on 10-12-2010.

By 16-12-2010 Order No.Į-11 „Vermosa“ UAB assigned Algimantas Zajankauskas (ph. 8 678 25252, permit No. 753 of provision of administration services) as an authorized representative in these bankruptcy proceedings.

A representative authorized by “Vermosa” UAB, an administrator of company in bankruptcy UAB „Star1 Airlines“ , by fulfilling an obligation of Vilnius Regional Court and pursuant to the Clauses 3 and 4 of Part 4 of Article 10 of the RL Enterprise Bankruptcy Law notified the “Registru centras” VĮ Register of Legal Entities about instituted bankruptcy proceedings and in accordance with the legislation registered the status of company in bankruptcy of private limited liability company “Star 1 Airlines” AB. State Tax Inspectorate of Vilnius Region, Vilnius city office of Council of the State Social Insurance Fund Board, credit and insurance institutions servicing the company in bankruptcy were notified about instituted bankruptcy proceedings. The administrator notified by letters other courts hearing the cases wherein property claims are filed against this company, including among them those relating to employment relationship. Lithuanian Bailiff Chamber and “Regitra” VĮ were contacted regarding information; the information was received from Mortgage Register and Attachment Register as well as information about immovable property possessed by the company.

Other interested parties were notified about institution of bankruptcy proceedings and further performance (termination) of concluded contracts by registered letters and notices in press.

All known creditors of company in bankruptcy were informed about institution of bankruptcy proceedings by notices in press and they were asked to submit their financial claims to company in bankruptcy “Star1 Airlines” by enclosing debt evidencing documents and indicating how their financial claims are secured.

The representative authorized by the administrator sent notices to the courts wherein asked pursuant to the Part 2 of Art. 15 of the RL Enterprise Bankruptcy Law *“all civil cases in which claims, including claims relating to employment relationship, have been filed against the enterprise shall be referred to the court which instituted bankruptcy proceedings”* and pursuant to the Part 2 of Art.166 of the RL Code of Civil Procedure *“when in the course of investigation of case wherein the property claims are filed against a respondent it becomes evident that bankruptcy or restructuring proceedings are instituted against the latter, the suspended case shall be referred to the court which instituted bankruptcy or restructuring proceedings and the latter shall renew and include it into a bankruptcy or restructuring case”* to suspend the civil proceedings wherein property claims are filed against the respondent „Star1 Airlines“ UAB among them also the claims related to employment relationship and refer such cases to the court investigating the bankruptcy case, *i.e.* to Vilnius Regional Court.

2. Transfer-Acceptance of Documentation and Assets

Having received a copy of effective resolution the administrator contacted the company manager Martynas Laivys and delivered to him the request regarding transfer of documentation and assets. The main documentation was transferred on the established time; however a part of company documents has been already taken under the statement by investigator of pre-trial investigation because prior to the resolution to institute the bankruptcy proceedings coming into effect the pre-trial investigation regarding presumably committed criminal activity was commenced. The company leased the premises from other enterprise at 1 Palesos Str. and due to difficult financial situation the company was indebted for lease, thus taking over of other documentation was carried

out later, having the arrangements made with the premises lessor who limited illegally an access to premises.

Currently a part of company documentation is also taken for the pre-trial investigation; therefore it is complicated for the administrator to carry out certain actions and procedures due to which the public prosecutor department needs to be contacted with request. For instance, after becoming evident that claims and statements of creditors-passengers are taken from the company together with other documents, the administrator contacted the public prosecutor department in order such files to be returned to the administrator, because they are not of importance for pre-trial investigation, but are needed for urgent finding and registration of creditors. However, a prosecutor refused to satisfy the request allowing only an access of documentation taken for investigation. Having reviewed the documents, it became evident that there are 12 files of aforementioned claims consisting of several pages in each and price of 1 page copy is 1 litas.

After negotiations with representatives of public prosecutor department the compromise was found – it was allowed for us to copy documentation ourselves, however even in that case the transportation of documents, scanning and other works caused additional expenses. However, at the same time data of several hundreds of passengers was received – claims they submitted to the company prior to instituting the bankruptcy proceedings and they lawfully expected such their claims to be registered and recorded. A part of passenger claims was received from CAA to which passenger claims were sent after disruption of company operations, there were about 600 of them.

It has to be noted that Civil Aviation Administration provided information on its own initiative and this information was useful to administrator.

Data of passenger claims and accounting need to be stated separately. The Company already had the established claim accounting and examination procedure, because in spring and summer of the year 2010 many passenger claims have been already received regarding refunds and canceled flights due to volcanic eruption when such flights were canceled in many European countries. The passengers could submit the claims by electronic mail, claims were registered and money transferred to passengers. However, later when at the end of September 2010 the company aircraft was detained in Ireland and as result of that the flights were terminated completely and later the bankruptcy proceedings instituted, this registration of claims was completely lost or terminated.

Not a single accounting system was used in the accounting of company and there were no proper connection among them. For instance, ticket reservation and sale to passengers, tourism agencies and other persons were carried out in other system related to general ticket reservation system and subsequently the data gained access to the general accounting system which was managed by accounting software *Navision*. Transfers from tourism agencies and transfers for tickets were getting into the company accounting already with other parameters. Having the passengers written their claims prior to institution of bankruptcy proceedings the same as to tourism agencies, the credit invoices had to be issued and they had to be registered as company creditors. This was not made in time; therefore this work caused more time and other expenses to the administrator. Later all passenger claims - including those received earlier and submitted later, were registered and the passengers were included into the list of creditors.

However, we would like to apologize those passengers-creditors who had to send their claims repeatedly.

The Administrator notices, that other main accounting documents and registers were stored and processed satisfactorily, the company manager and accounting officer provided answers and explanations regarding verification of accounting data; therefore greater difficulties were not experienced due to that. For instance, in opinion of administrator, the data about wages and debts to employees were transferred properly. That facilitated also execution of employees dismissal issues.

In the event of bankruptcy the company assets are transferred according to the company balance sheet drawn up on the effective date of bankruptcy proceedings. Because the company accounting was managed using accounting software, there were not problems in drawing up the balance sheet and the balance sheet data are provided in this report below. According to the balance sheet drawn up on 16-12-2010, the company in fact did not have long term assets, the assets were

accounted only for little more than LTL 2000 – these were few old tables and cupboards. During the previous accounting financial period the company possessed long term assets for LTL 51 000, however during the year 2010 such assets were depreciated or sold. The main part of company assets is namely current assets the book value of which amount to LTL 12 626 000. Such assets increased from LTL 7 800 000 to aforeindicated amount compared with the previous financial period.

It needs to be noted that the largest part of these assets consists of debt liabilities, *i.e.* amounts receivable during one year – debts of other enterprises.

The largest part of debt amounting to about LTL 10 200 000 is attributed to one company "Star holidays" which is related to "Star 1 Airlines" company.

16 12 2010

(accounting period)

1 LTL

(level of report precision and currency)

	Assets	Note No.	Financial year	Previous financial year
A.	LONG TERM ASSETS		2.326	51.840
I.	INTANGIBLE ASSETS		0	0
I.1.	Development works			
I.2.	Prestige			
I.3.	Patents, licenses			
I.4.	Software			
I.5.	Other intangible assets			
II.	TANGIBLE ASSETS		2.326	51.840
II.1.	Land			
II.2.	Buildings and constructions			
II.3.	Machinery and equipment			
II.4.	Vehicles			
II.5.	Other installations, devices, tools and equipment		2.326	51.840
II.6.	Construction in progress			
II.7.	Other tangible assets			
II.8.	Investment assets		0	0
II.8.1.	Land			
II.8.2.	Buildings			
III.	FINANCIAL ASSETS		0	0
III.1.	Investments to subsidiaries and associated companies			
III.2.	Credits to subsidiaries and associated companies			
III.3.	Amounts receivable in one year			
III.4.	Other financial assets			
IV.	OTHER LONG TERM ASSETS		0	0
IV.1.	Deferred tax assets			
IV.2.	Other long term assets			
B.	CURRENT ASSETS		12.625.991	7.814.687
I.	STOCKS, PREPAYMENTS AND CONTRACTS IN PROGRESS		66.457	182.605
I.1.	Stocks		52.114	19.201
I.1.1.	Raw materials and complement production			
I.1.2.	Production in progress			
I.1.3.	Manufactured production			
I.1.4.	Other stocks		62.845	19.201
I.1.5.	Long term tangible assets intended for sale			
I.2.	Prepayments		14.343	163.404
I.3.	Contracts in progress			
II.	AMOUNTS RECEIVABLE WITHIN ONE YEAR		10.292.502	4.548.156

II.1.	Trade debtors		10.262.758	4.440.901
II.2.	Debts of subsidiaries and associated companies		29.744	107.255
II.3.	Other amounts receivable			
III.	OTHER CURRENT ASSETS		2.175.478	2.908.122
III.1.	Current investments			
III.2.	Termed deposits			
III.3.	Other current assets		2.175.478	2.908.122
IV.	CASH AND CASH EQUIVALENTS		91.554	175.804
	TOTAL ASSETS:		12.628.317	7.866.527

Deposit paid for aircraft to aircraft leasing company makes about LTL 2 000 000 from current assets. It needs to be noted that according to the terms and conditions of aircraft lease agreement, that was breached by company "Star1 airlines", a part of deposit was off set after the company suspended the payments for aircraft lease. Due to this reason recovery of this deposit is very complicated, expensive and it is little probable, because the company is at fault regarding violation of international agreements and claims of aircraft owning company regarding loss may exceed the deposit residue. This issue is being examined by administrator lawyers and the litigation possibility is being consulted, therefore the creditors shall be notified about this as soon as new information becomes available.

Stocks make a small part of current assets - about LTL 52 000, however they include not only lubricants intended for aircrafts that was acquired by the company in September of the year 2010, but also aircraft fuel that remained in the aircraft on which the attachment is levied and there were no possibilities to take it back - levying of the attachment was carried out in accordance with international requirements, thus filing of the claims is not advisable.

Regarding the debt of company "Star holidays" amounting to LTL 10 200 000 the following explanations may be given. This company was a travel organizer and ordered flights from company "Star1 Airlines". Debt accrued during several months, the total amount of provided flight organization services exceeds 50 million litas, thus amount of debt not exceeding 20 percent of scope of services with respect to debt incurrence itself as if does not contradict the principles of regular commercial-economic activity, however its value expression is very considerable. Therefore, the lawyers of administrator still examine the agreement by and between these two companies and shall assess how terms and conditions of these agreements were observed and who was liable for that. The most important is that bankruptcy proceedings were instituted also against the company "Star holidays" one month earlier. Balance value of assets of this company is slightly bigger than 1,5 million litas, but debts exceed 16 million litas, from which LTL 600 000 consists of debts to exactors of first and second in line. Because tangible assets amounts hardly to value of several tens of thousands and current assets consist mainly of debt liabilities, thus there are only small theoretical possibilities, that at least a part of debt shall be recovered from this enterprise.

3. Regarding Financial Claims of Creditors

During the period of 45 days from the effective date of the court decision to institute bankruptcy proceedings established by Vilnius Regional Court, the majority of creditors of "Star1 Airlines" UAB in bankruptcy stated their financial claims prior to the established time limit, *i.e.* by 24-02-2011.

It needs to be stated that the most work and time expenses were incurred in registration and verification of credit claims of passengers. The reasons of such situation have been already mentioned above. Information on enterprise bankruptcy was published and all known creditors were notified, however the administrator did not have a considerable part of passenger data, thus had to search for it additionally and that required additional time. Considering the specific situation, the passengers were also allowed to submit creditor claims by electronic mail in order to accelerate their registration process. Then a flow of claims being received increased considerably, particularly in

January 2011. In order the list of creditors to be more precise, the administrator addressed the court in order to extend the time limit for submission of credit claims. Thus, the credit claims were accepted by 17-03-2011. That made available possibilities to all aggrieved passengers to submit their claims.

The aforementioned requirements were verified with company financial accounting documents and after drawing up the list of financial claims of creditors such requirements were submitted to Vilnius Regional Court for approval.

Vilnius District Court (judge V. Zelianka) by the 19-04-2011 resolution approved the list of financial claims of creditors of company in bankruptcy „Star1 Airlines“ UAB. The list of credit claims approved by the court is presented as annex hereto.

Total amount of filed claims equals to LTL 10 406 284. Amount of exactors of first in line equals to LTL 1 493 362 (employees), exactors of second in line – LTL 341843 (taxes), remaining third in line exactors not passengers - LTL 7 546962 and passengers – LTL1 024 284. In fact credit claims of passengers amount to about 1,5 million litas, because a part of claims are filed through agencies or other legal persons that organized trips and collected money from passengers. Currently the administrator continues receiving the claims and registering them, subsequently they shall be submitted to the court for approval and the list of creditors shall be revised and as result of this the total amount of credit claims may increase by several percents.

The administrator analyzed the reasons causing the increase of company credit liabilities and making the company insolvent within the short period of time. First of all, it needs to be noted that the company providing low cost flight services already experiences greater risk from the very beginning and in case of unanticipated circumstances or due to disorders in settlements, right away it shall incur greater loss than usual. The company was established in the year 2000, it changed character of its operations several times and having changed its name from “HC Airways” the company started new operations that were different from the previous ones. It needs to be recognized that when starting new activity the company already had considerable loss, thus the possible great business risk was present from the very beginning. The company did not have its own aircraft, thus it leased one. In spring of 2000 the Company started lacking funds to make the payments for aircraft lease and other needs, because it started receiving less income from flights a part of which was canceled due to volcanic eruption. The company started receiving many claims from passengers as result of canceled flights. Simultaneously other expenses were not decreasing, for instance aircraft lease fee and other expenses. In summer of 2010 the company already delayed payment of wages to its employees and the situation was becoming even worse. Manager and shareholders of the Company tried to remedy the situation searching for investors, however their efforts were ineffective. In September of 2010 the aircraft as detained as result of debts to aircraft owners and flight operation was altogether terminated. Credit liabilities could have been lesser, if activity had been suspended and bankruptcy proceedings instituted earlier and this way passenger ticket reservation could have been canceled that was carried out while the entity being insolvent even after levying attachment against the aircraft. The bankruptcy reasons of the main enterprise creditor – company “Star holidays” are also very similar and they caused partially insolvency of “Star 1 Airlines” – both companies rendered services and attempted to compete in market by rendering services below service cost.

Regarding satisfaction of claims of creditors. As it has been already mentioned above, the tangible assets are not found and present in the company. The value of which would amount at least to LTL 50 000, thus the main source of funds could only be the recovery of debt liabilities and also recovery of damage probably caused to the enterprise by other persons at fault. Due to these reasons the administrator may not forecast at least more precisely time limits of claim satisfaction and possibilities; however it states that such possibilities are limited.

4. Employees of „Star1 Airlines“ in Bankruptcy

Having the bankruptcy administrator of "Star1 Airlines" UAB started the administration of the enterprise 64 employees were employed in it. All employees were notified about dismissal from work due to enterprise bankruptcy, two meetings of employees were organized wherein it was tried to provide to the employees all information about enterprise bankruptcy and also to explain possibilities about compensation payment procedure and amount from the Guarantee Fund. It is to be noted, that on a day of institution of bankruptcy proceedings only several company employees were employed, the downtimes were executed for other employees due to terminated operations. Dismissal of employees was not executed earlier, because there were no funds to make settlements with them.

Pursuant to the Clause 11 of Part 3 of Art.11 and Part 1 of Art.19 of RL Enterprise Bankruptcy Law and Art. 137 of RL Labor Code the employees were dismissed from their positions on 10 January 2011.

Creditor claims of employees amount to almost LTL 500 000. That makes about 14 percent of all creditor claims.

It is to be noted that the administrator did not extend employment contracts with enterprise employees and did not conclude new ones in order to save social insurance funds that would have to be paid for them, but it was decided to use the services of companies rendering accounting services, also to assign the works to employees of administrator.

Having the court confirmed the list of creditors, it shall be possible to apply to the Guarantee Fund to satisfy the claims of employees and it is anticipated to do so by June 15.

5. The debtors of the company „Star1 Airlines“

We had been working with the debtors of the company „Star1 Airlines“ through all the bankruptcy period. The scope of the work is large, because the part of the debtors is abroad, the part of the debts is shown at the accountancy inaccurately, for example, there are no credit invoices or just for some unknown reasons the data had not been included in to the accounts. The part of the foreign debtors did not answer to the claims, so we are collecting the data to start legal proceedings against them. We would like to note that these debts are not very high, less than 200 000 LTL.

6. About the transactions checking

According to the Enterprise Bankruptcy Law article 11, part 3, point 8, the administrator is checking the transactions of the company „Star1 Airlines“. The biggest part of the transactions are the agency contracts with the travel agencies and other routine commercial contracts. We would like to note that the part of the documents had been already taken by the Vilnius County Police Chief Economic Crime Investigation Division which is caring out the pre-trial investigation according to the article No 205 of the Penal code of Republic of Lithuania (A misleading statement about the legal person).

The administrator had already asked the Ministry of Transport to submit the internal audit results of the Civil aviation administration's activities in pursuing the supervision of the company "Star1 Airlines". The administrator is analyzing the question of responsibility of the public authorities not to abolish the flights license on time and the question of the creditor's losses in case of that. The administrator is calculating the creditors' damage and trying to determine the moment when the head of the company had to submit the application to the court to start the bankruptcy proceeding and analyzing if he did not violate this duty.

The information about the money recovery we will promote in the following administrative activity report.

7. About the estimates of the administrative costs

On the 4th of January of 2011 Vilnius District Court confirmed the interim administration cost estimates for the period until the first creditors' meeting.

The court decided to approve the estimate amount of up to 11 500 € (excluding taxes) per month until the creditors' meeting will approve the new one.

For this purpose there was opened the savings account. Before the meeting date within five months, the administrator has been used (without tax) 25 000 €.

Basic monthly costs are: accounting software lease – 100 €, accounting services – 1200 €, legal services – 1200 €, administration costs – 3 800 € LTL, transport and communication services – 600 € LTL, office expenses – 700 €.

So, used amount of money is about twice lower than the administrative costs, which the court had approved and which the administrator had the right to use. This indicates that the administrator has used the funds rationally and economically, so we propose to approve this used administrative costs estimate.

Since the start of bankruptcy proceedings until the 20th of May the company's savings account was fulfilled by the amount of money, which bigger part was returned from debtors.

8. The final part

The company's "Star1 Airlines" bankruptcy administrator's authorized person had already fulfilled all the duties according to the order of Vilnius District Court and according to the Enterprise Bankruptcy Law for the period from the bankruptcy proceeding start until the first meeting of creditors.

The former company's administration had sent for the administrator the company's financial reporting documents, and other documents, which were necessary to start the bankruptcy proceedings.