



Client Alert

昊理文法律动态

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[Aviation & Shipping/航空与航运]

East Star Bankruptcy Case: Implications for Foreign Investors

On August 26 2009, East Star Airlines (“**East Star**”), a private airline based in central China’s Wuhan City, has officially been declared bankrupt. The bankruptcy came after a restructuring application was rejected by the Intermediate People’s Court of Wuhan (“**Wuhan Intermediate Court**”), making it the first domestic airline bankruptcy. The Wuhan Intermediate Court stated that the restructuring plan submitted by the East Star Group and China Equity Group Inc. was unfeasible. East Star was also held by the Wuhan Intermediate Court to have escaped corporate tax by concealing revenues, and Mr. Lan Shili, chairman

of East Star, was convicted and sentenced to four years in jail for tax evasion.

During the global economic slowdown, it is not surprising to see small private-run airlines, like East Star, go bankrupt when their poor internal management and cost control capability surfaces and no bailment were made by the relevant governments.

One of another challenge facing the China’s private airlines is the policy constraints. For instance, despite the loosening of entry qualification for private investment for many years, it still remains

difficult for these private players to get access to the most lucrative flight route resources, and nearly all the state-owned carriers imposed an exorbitant indemnification requirement to restraint the reasonable personnel flow to the private airlines.

Prior to commencement of East Star bankruptcy proceeding, its operations were suspended by the industry regulator, General Administration of Civil Aviation of China, as of March 15 2009, two days immediately after East Star rejection of a government-initiated take-over by the parent group of national flag carrier Air China. The application for the suspension was submitted by Wuhan municipal government, “in an effort to safeguard the security of people's lives and assets”

From the perspective of foreign investors, access to China market by M&A may be not hindered by legal hurdles. However, foreign airlines need to ponder over the policy concerns as well as liability risks inherent in the targets. As far as state policy is concerned, cooperating with one of the state-owned carriers may be preferred, thus benefiting the preferential treatment in terms of flight routes, to say the least. When acquisition is envisaged with a Chinese private target, vigorous due diligence shall be conducted on such target, which shall at least covers tax liabilities and customs liabilities relevant to aircraft lease arrangements.

*Should you have any questions about this Client Alert, please contact the partner of **HaoLiWen Aviation & Shipping Practice Group:***

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