

Overview of the operations of the national airline Nordica

*Should the state own an airline in order to ensure
flights to and from Estonia?*

Dear reader,

For many years, many people have been asking the question that the National Audit Office is repeating in this report: “Should the state own an airline in order to ensure flights to and from Estonia?” Life itself has provided an answer to this – the dream of flying under our own blue-and-white colours between Tallinn and European centres is probably not possible in the tight competition of the aviation market without the state’s capital injections. Before you is the story of Nordica, which is like flying from one turbulence to another, beyond the original destination. It is a story where a target taken politically does not allow hearing or seeing the pleas of the company’s management board to respond to the actual situation.

By the time the Ministry of Economic Affairs and Communications finally relented in the summer of 2019 that Nordica itself does not necessarily have to fly from Tallinn and regular flights from Tallinn were stopped in autumn of the same year, thus preventing the company from collapsing, the management board of Nordica had already asked the supervisory board to review the business plan nearly ten times to no avail!

From there on, Nordica focused on outsourced flights and achieved – according to the materials presented to the government by the Ministry of Economic Affairs and Communications – a temporary improvement of the economic situation by February 2020. In the aviation crisis triggered by the coronavirus pandemic, Nordica’s health deteriorated. In autumn 2020, Nordica was essentially insolvent.

The termination of regular flights brought up questions – what is the public task performed by Nordica that has transitioned the company from scheduled flights to outsourcing services? And what are the grounds for keeping the company in state ownership? From August 2019 to July 2021, two different Ministers of Finance had on a total of four times recommended the Minister of Economic Affairs and Communications to consider whether the ownership of Nordica and OÜ Transpordi Varahaldus (TVH) is justified. No visible actions of the ministry followed these appeals, and the topic died down. Finally, in October 2021, the Minister of Economic Affairs and Infrastructure brought to the government the idea to establish a holding company based on Nordica and TVH, the privatisation of which could be considered. To date, almost two years later, the holding company has not been founded and the topic has not been discussed further.

In the last couple of years, the National Audit Office has drawn critical attention to indecision in health care. Political scientist Erik Moora has aptly commented on the same topic in *Eesti Päevaleht*. Broadly speaking, it is a very relevant line of thought to be quoted in the Nordica story as well: “The political risk of making a decision is high. Indecisiveness and letting go, however, usually have no political price. And so we have reached an absurd situation where decisions can only be made when an extremely serious crisis is at hand. Then the political price of indecision is higher than that of making a decision.”

It is promising to note that the Minister of Climate who has taken office soon formulated a clear goal to sell the aviation business, which is not strategically necessary for the state. What is important is how to catch that fleeting moment when selling the company makes sense when such unexpected setbacks in its economic activity become apparent, as we learned this summer. The report of the special audit launched by the Minister of Climate will soon reveal what happened in May and June 2023. It is worth patiently waiting for the results. If it proves to be possible to stabilise the company’s activities, there is no reason to deviate from the chosen path and the plan to sell Nordica and TVH should continue. The National Audit Office hopes that the observations in this audit report will also support the Ministry of Climate when making a decision.

In their response regarding the audit report, the Minister of Climate emphasised that it is recommended to pay more attention to supporting Tallinn Airport (AS Tallinna Lennujaam) in order to improve connections. This is certainly a reasonable direction to take. It would also be reasonable to work out ways for the state to ensure necessary air service for Estonia should a failure occur in the aviation market.

Aviation policy should not be driven by crises, but by the government with clear goals and an action plan.

Together with Latvia, Lithuania and other peripheral states of the European Union, Estonia has joined the declaration in which the European Commission has been called upon to amend the regulation of public service contracts in order to simplify the entry into these contracts in aviation and to improve connectivity. It should be assessed how this initiative could be moved forward together with those who share the same opinion.

Janar Holm
Auditor General

In September 2023



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Summary

During the audit, the National Audit Office did not find any significant arguments confirming that state-owned companies AS Nordic Aviation Group (brand name Nordica) and OÜ Transpordi Varahaldus (TVH) in their current state are strategically necessary for the state or that there is understandable public interest for the state's participation in those companies. Audit materials also indicate that the state has not been a sufficiently skilled or interested owner in such a complex business area as aviation. As such, the National Audit Office recommends taking the direction of selling Nordica and TVH once the results of the special audit launched at Nordica become available and economic activity has stabilised.

For your information

The National Audit Office analysed how the state as the owner has for more than seven years directed the activities of Nordica and TVH and what has been expected of the companies, whether Nordica and TVH have succeeded in meeting the goals established by the owner, and whether the state's operating in the aviation business is justified.

In the overview, the National Audit Office focuses primarily on the coverage of Nordica. In the report, the National Audit Office looks at TVH as an important business partner to Nordica whose nearly entire economic activity is the leasing of aircrafts to Nordica and services that support it.

The report of the National Audit Office has been prepared based on written materials as at January 2023 and oral explanations of the auditees as at April 2023. The report refers to information and events revealed in July only in individual, most critical places for readability.

Nordica was founded in autumn 2015 in order to ensure necessary air service for Estonia and service a route network similar to that of AS Estonian Air, but Nordica stopped flying from Tallinn in 2019 as it was unable to compete profitably with international airlines.

The government's expectation that after the closure of regular flights from Tallinn, Nordica must, if necessary, respond to a market failure and organise connections with destinations important to Estonia cannot be met in a reasonable time and/or with reasonable costs because Nordica does not have aircrafts free from commitment. In addition, the European Commission approved the state aid granted to Nordica in 2020 on the condition that Nordica must not operate unprofitable routes, which at least in the current market situation means prohibition to fly to and from Estonia with commercial risk.

In July 2023, it became apparent that Nordica's economic situation had deteriorated sharply since May of this year. The chairman of the company's management board resigned, and international experts were hired to restructure Nordica's economic activities. In addition, the Minister of Climate decided to carry out a special audit in accordance with section 330 of the Commercial Code. According to the minister, the results of the special audit should be available in three months and whether the stabilisation of the company is successful within half a year.

The state has no need to keep an airline in its ownership without public interest or to bear the risks of the company's economic activity as the

owner. Nordica barely made a profit in 2021 and 2022, and although from August 2019, various Ministers of Finance repeatedly raised concerns about the expediency of owning Nordica and TVH, discussions stalled and died down and the Government of the Republic has not reached a decision on the sale of Nordica. Now, due to the deterioration of Nordica's economic situation, the circumstances have changed drastically, and it would make sense to wait for the results of the special audit and stabilisation of the economic activity before the potential sale of the company. In the event of a failure of the aviation market, which the officials of the Ministry of Economic Affairs and Communications have considered highly unlikely, the state would have other options besides owning Nordica to ensure the necessary flight connections.

The National Audit Office recommends the Government of the Republic to decide, after the results of the special audit of Nordica are revealed and the economic activity is stabilised, which method of sale best suits the state's interests – either to sell Nordica and TVH together or separately, partially or in full. If the government decides to continue as the owner of Nordica and TVH, the National Audit Office recommends clearly defining why the companies are strategically necessary for the state and which public interest function they fulfil. It must be determined in which circumstances and on which routes Nordica must open flights from Tallinn again, taking into account Nordica's capacity, commitments to contractual partners and the European Commission's requirements for state aid.

Observations of the National Audit Office with regard to the seven years of operation of Nordica:

The head of Nordica to the state in autumn 2018: find 25 million euros or we are forced to close most of the routes to and from Tallinn

- **In 2015, the state founded Nordica and TVH for 72.7 million euros so that they would essentially continue from where the bankrupt AS Estonian Air left off. The owner's directive to fly from Tallinn turned out to be an economic dead end, and by autumn 2018, Nordica had run out of the funds given by the state.** By the end of 2016, Nordica's total loss was almost 15 million euros, and only 3.2 million euros was remaining of the 40.7 million euros given by the state. In the first half of 2018, competition on the Estonian aviation market intensified further and fuel prices increased. In October 2018, the head of Nordica notified the Ministry of Economic Affairs and Communications and Nordica's supervisory board that the company's bank account was empty.
- **Neither Nordica's supervisory board nor the Minister of Economic Affairs and Communications in charge of the holding went along with the request of Nordica's managers to consider the sustainability of flying from Tallinn.** Since Nordica's foundation, the company had been looking for other earning opportunities to cover the loss of flying from Tallinn and started leasing out its aircrafts and crews to other airlines. As it was economically difficult to meet the owner's expectation of flying from Tallinn, Nordica's management board repeatedly raised the issue of

updating the strategy with the company's supervisory board, but Nordica's new strategy was approved only in autumn 2020 when Nordica was already insolvent.

The European Commission approved the government's allocation of funds but stipulated that Nordica must not operate unprofitable routes.

- **In autumn 2019, Nordica stopped flights from Tallinn. The question arose as to whether the state needs an airline that does not fly from Estonia, but the discussion died down.** According to the representative of the Ministry of Economic Affairs and Communications, Nordica's losses eventually became too great and the company closed all regular flights from Tallinn. In 2019, the Minister of Finance raised the issue of the expediency of owning Nordica and TVH twice at a government session and a cabinet meeting, but no discussion followed.
- **In October 2020, Nordica received 22 + 8 million euros from the state. It is possible that the coronavirus crisis helped to prevent Nordica's bankruptcy, because there was clearer justification and opportunity to ask for money from the state.** In retrospect, due to incomplete data, it is difficult to assess whether Nordica's economic situation improved temporarily after the termination of flights from Tallinn, but the company was struggling already before the coronavirus pandemic. Liquidity problems were magnified by the failed cooperation with the airline Adria Airline in 2016, which ended with a write-off of a 4.6-million-euro claim.
- **Nordica was tasked by the owner to ensure necessary air service for Estonia after the termination of flights from Tallinn, but it is unclear what those routes are. It is also unclear whether and under what conditions Nordica would be able to comply with this directive.** Nordica's aircrafts are busy with outsourcing services to other airlines, and finding new ones would probably take months. Nordica has also not had information about what exactly the owner is expecting in terms of the directive to ensure air service. According to Nordica, the competitive situation would have to change a lot for the company to have the need and opportunity to open flights from Tallinn again.
- **The Ministry of Economic Affairs and Communications in March 2023: The Estonian aviation market is also functional without Nordica; we hope to convince the government and get the permission to sell the company.** While before, Nordica had the task of flying from Tallinn and, after the termination of flights, ensuring air service for Estonia, the ministry no longer sees Nordica having this function. According to the representative of the Ministry of Economic Affairs and Communications, the Estonian aviation market is also functional without Nordica in state's ownership, because competitors closely monitor what is happening here and are operating actively.

Flight routes and departure times critical for Estonia have not been determined. Nor has it been determined under what circumstances Nordica would fly from Tallinn again.

The Ministry of Economic Affairs and Communications has wanted to consolidate Nordica and TVH under a holding company before the possible sale.

- **Discussions regarding the future of Nordica and TVH have so far been general, and it is not certain whether or when the government will reach a fundamental decision regarding the sale of Nordica. Now, due to the deterioration of Nordica's economic situation, the circumstances have also changed drastically, and it would make sense to wait for the results of the special audit and stabilisation of the economic activity before the potential sale of the company.** The officials of the Ministry of Economic Affairs and Communications and the Ministry of Finance have agreed that the ownership of Nordica and TVH is no longer necessary for the state but have seen the preferred method of sale differently. The Ministry of Economic Affairs and Communications had also not put together arguments to convince the government of the appropriateness of its ideas.

Most important recommendations of the National Audit Office to the Minister of Climate¹:

- Once the results of the special audit at Nordica have become clear and Nordica's economic activity has stabilised (and depending on thereof), submit a proposal to the Government of the Republic to make a decision regarding the sale of AS Nordic Aviation Group and OÜ Transpordi Varahaldus or a holding company to be founded on the basis of them.
- (Until the sale of AS Nordic Aviation Group) determine the owner's expectations regarding the circumstances in the event of which Nordica must commence with ensuring air service between Estonia and Europe/the rest of the world. Determine which connections and other parameters related to connectivity (such as departure times) are important for Estonia; identify Nordica's ability to ensure connections alongside the existing commitments and prepare a respective standby action plan.

Response of the Minister of Climate: The Minister of Climate found that the conclusions of the report of the National Audit Office are appropriate in a situation where Nordica no longer flies from Tallinn. The minister also agreed with the recommendations of the National Audit Office but noted that due to the unexpected deterioration of Nordica's economic situation and the emergence of new circumstances in July 2023, the implementation of several recommendations depends on Nordica's fate in the coming months. For example, the minister affirmed that the state does not need to own companies operating elsewhere in the aviation business which do not maintain air service in Estonia and that Nordica and OÜ Transpordi Varahaldus must be privatised. However, given Nordica's situation, including both in terms of management and finance,

¹ During the preparation of the report of the National Audit Office, there were changes in the areas of government of ministries and in the tasks of ministers, as a result of which transport and air traffic became the tasks of the Minister of Climate instead of the Minister of Economic Affairs and Communications.

the minister believes it to be expedient, based on available information, to wait for the results of the work of the international team hired to restructure Nordica in order to then make decisions regarding privatisation. The full response of the Minister of Climate to the report of the National Audit Office on pp 22–24.