

# PRB assessment of the revision of the performance targets during a reference period:

## Estonia

February 2023

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## 1 INTRODUCTION

- 1 In November 2021, Member States submitted draft performance plans as required by the Commission Implementing Regulation (EU) 2020/1627 based on the revised Union-wide targets.<sup>1</sup> These performance plans covered each year of RP3, from 2020 to 2024, taking into account that the effects of the pandemic set in as of March 2020.
- 2 The PRB assessed the performance plans and advised the Commission on their consistency with the Union-wide targets. The performance plan of Estonia was assessed as consistent with the Union-wide targets. Estonia adopted the plan which came into force.
- 3 Article 18(1) of the Commission Implementing Regulation (EU) 2019/317 allows, under specific conditions, Member States to revise during a reference period one or more performance targets contained in the performance plan.
- 4 On the 26<sup>th</sup> of September 2022, Estonia submitted to the Commission a request for revision of the approved plan (hereafter revised performance plan). The submitted revised performance plan includes a revision to the cost-efficiency targets. The reasoning for the request for revision of Estonia during a reference period is detailed in Section 2 of this report.
- 5 The remainder of this report assesses the revised performance plan and presents the PRB's recommendation to the Commission on the consistency of the revised targets.

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<sup>1</sup> With Member States we refer to EU Members plus Norway and Switzerland.

## 2 ASSESSMENT OF THE REASONING FOR THE REQUEST FOR REVISION

- 6 The reasons presented by Estonia for the request for revision of the cost-efficiency targets contained in the approved performance plan are based on the significant impact on the assumptions included in the performance plan caused by Russia's war of aggression against Ukraine.
- 7 Estonia describes that Russia's war of aggression against Ukraine, the related sanctions imposed on Russia, and the counter-sanctions from Russia have a significant impact on the Estonian air traffic (see Section 3.1), as an important part of it related to Europe-Asia and Europe-Russia traffic flows. Estonia noted that the actual traffic decreased by -40% in March 2022, -51% in April 2022, and -47% in July 2022, compared to the STATFOR October 2021 base forecast. According to the STATFOR June 2022 base forecast, the traffic should continue to be significantly lower than in the STATFOR October 2021 base forecast for the remainder of RP3.
- 8 The drastic decrease in traffic in Estonian airspace will have a severe impact on the revenues of the Estonian ANSP and therefore on its liquidity. Estonia estimates to have a negative cashflow of around -9M€ cumulatively by the end of 2022.
- 9 Estonia describes that since Russia's war of aggression against Ukraine, there is no possibility of reducing the level of operational staff as the complexity of the airspace and, therefore, ATCOs' workload has increased sharply due to:
  - The number of military and quick reaction alert (QRA) flights, military exercises and other military activities have increased;
  - Estonia is responsible for providing services in the narrow corridor over the international waters over the Gulf of Finland and Baltic Sea. Following the sanctions imposed on Russia, the air traffic operating in this corridor has increased;
  - Moreover, many Russian military flights do not have a transponder, meaning that radar information cannot be used by Estonia to control these flights; and
  - The ACC of St Petersburg closed online data interchange (OLDI) connections between Tallinn and St Petersburg ACCs. The current connection is therefore done via phone calls.
- 10 Estonia indicated that the planned activities of the FINEST project continued despite a difficult year with Russia's war of aggression against Ukraine. The FINEST project is currently in the final stage in order to be fully implemented. However, since Russia's war of aggression against Ukraine, the completion of the FINEST project has been paused. Some associated security aspects require further consideration before the project proceeds to completion. Estonia does not commit to implement the project by the end of RP3.
- 11 Estonia noted that due to restrictions on Russia, Russian Federation carriers are currently flying over neutral waters between Kaliningrad and mainland Russia, which raises safety concerns. This demonstrates the importance of completing the FINEST project in order to be able to operate at cross-border level while not compromising on safety. Estonia informed that a meeting was planned in October 2022 to define actions to continue with the implementation of the FINEST project and that a FINEST Council at ministerial level has been established to avoid any additional delay of the project.
- 12 Moreover, Estonia describes that there is a pressure to increase the salaries of the employees due to the current inflation rate of 25% in Estonia. To date, Estonia has not increased the salaries at the level of the inflation, which impacts negatively the employees' willingness to compromise in times of crisis. This comes in addition to significant employment law changes in Estonia since July 2020, providing for an increase in parental leave.

### 3 COST-EFFICIENCY

- Estonia requested a revision of cost-efficiency targets due to significant differences of the assumptions caused by Russia’s war of aggression against Ukraine.
- The PRB concludes that the revised cost-efficiency targets proposed by Estonia should not be approved.
- Estonia has been heavily impacted by Russia’s war of aggression against Ukraine.
- Estonia presents details for a possible deviation due to restructuring costs. However, the project is currently paused due to safety issues connected with Russia’s war of aggression against Ukraine. Estonia does not commit to implement the project by the end of RP3. Therefore, the PRB recommends the Commission to not consider the deviation due to restructuring costs.

#### 3.1 En route traffic forecasts overview

- 13 The revised performance plan of Estonia applies the STATFOR June 2022 base forecast. The approved performance plan applied the STATFOR October 2021 base forecast.
- 14 The revised performance plan traffic forecast, the approved performance plan forecast, the STATFOR October 2021 base forecast, and the STATFOR June 2022 base forecast are shown in Figure 1.
- 15 The traffic forecast submitted in the revised performance plan is significantly lower than in the approved performance plan (Table 1). The current situation in Estonia is heavily impacted by Russia’s war of aggression against Ukraine and the

sanctions imposed. As a consequence, the total number of service units in the revised performance plan for the period 2022-2024 is lower compared to the approved plan (from -41% in 2022 to -44% in 2024).

- 16 No major issues have been identified.

	2022 (%)	2023 (%)	2024 (%)
<b>Difference between revised plan vs approved</b>	-41%	-43%	-44%

Table 1 – Service units comparison between revised plan and approved plan.

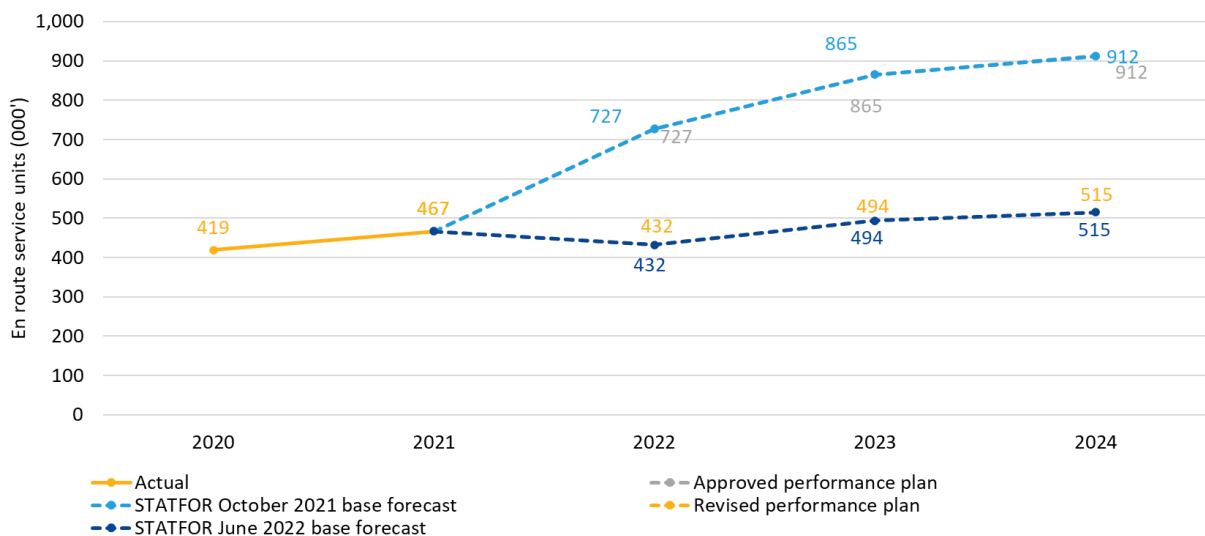


Figure 1 – Comparison of services units from the approved performance plan, the revised performance plan, the STATFOR October 2021 base forecast, and the STATFOR June 2022 base forecast.

### 3.2 En route costs overview

- 17 This section analyses the planned real and nominal total costs of Estonia submitted in the revised performance plan for RP3, in the approved performance plan, and any differences. A summary is shown in Table 2.
- 18 The inflation assumptions in the revised plan for the period 2022-2024 are in line with IMF April 2022 forecast. The inflation in the revised plan is significantly higher compared to the approved plan (overall +14% for the period 2022-2024).
- 19 The real en route revised performance plan determined costs compared to the approved performance plan costs are overall -12% lower for the period 2022-2024. When looking at the total determined costs in nominal terms, the decrease in costs is overall -4.5% for the same period. More than half of the real decrease of the cost base for the period 2022-2024 in the revised plan can be attributed to the higher inflation rates forecasted for the remaining years of RP3.
- 20 When considering the approved plan, total real costs are planned to decrease by -5.1% (-1.5M€<sub>2017</sub>) between 2019 actuals and 2024 planned, while when considering the revised plan, total real costs were planned to decrease by -17% (-4.9M€<sub>2017</sub>). In nominal terms, when considering the approved plan, total costs were planned to decrease by -0.6% (-0.2M€) between 2019 actuals and planned 2024. In the revised plan, the nominal costs are planned to decrease by -5.0% (-1.5M€) between 2019 actuals and planned 2024.
- 21 When analysing total costs at entity level, the following can be observed:
- The total ANSP costs were planned to decrease by -10% (-2.3M€<sub>2017</sub>) in the approved plan between 2019 actuals and planned 2024. When considering the revised plan, the total costs were planned to decrease by -22% (-5.1M€<sub>2017</sub>) between 2019 actuals and planned 2024 (due to decreases in all cost categories).
  - The total NSA costs were planned to increase by +14% (+0.8M€<sub>2017</sub>) in the approved plan between 2019 actuals and planned 2024. When considering the revised plan, the total costs are planned to increase by +4.0% (+0.2M€<sub>2017</sub>) between 2019 actuals and planned 2024 (mostly due to the increase in staff costs).
- 22 No major issues have been identified.

	2020 D	2021 D	2022 D	2023 D	2024 D	2022-2024 D
Revised plan total costs (000'€ nominal)	26,963	26,900	26,101	26,565	28,279	80,945
Approved plan total costs ('000€ nominal)	26,963	26,900	26,786	28,336	29,614	84,736
% Difference between revised and approved	0.0%	0.0%	-2.6%	-6.3%	-4.5%	-4.5%

Revised plan total costs (000'€ <sub>2017</sub> )	26,132	25,830	23,073	22,752	23,949	69,774
Approved plan total costs ('000€ <sub>2017</sub> )	26,132	25,830	25,298	26,447	27,337	79,082
% Difference between revised and approved	0.0%	0.0%	-8.8%	-14%	-12%	-12%

Table 2 – Nominal and real total costs comparison between revised plan and approved plan.

### 3.3 En route cost categories overview

23 This section analyses the determined costs of Estonia by cost category submitted in the revised performance plan for RP3, in the approved performance plan, and any differences. A summary is shown in Table 3 (next page).

#### Staff costs

24 In the revised plan, the staff costs are planned to decrease by -12% (-1.7M€<sub>2017</sub>) between 2019 actuals and determined 2024. This is mainly attributable to the sustained effects of the considerable cost-cutting measures implemented by Estonia in 2020 and 2021, which resulted in a reduction of seven ATCOs FTEs in 2020 and five in 2021. An intake of two additional ATCOs compared to 2021 is foreseen starting as of 2022, however the total ATCOs FTEs is planned to remain below 2019 levels by the end of RP3.

25 Compared to the approved plan, Estonia decreased its staff costs for the period 2022-2024 by -4.5M€<sub>2017</sub> (or overall by -11%).

26 No major issues have been identified.

#### Pension costs

27 As in the approved performance plan, EANS has no defined benefit pension scheme. The contribution rate for state pension contributions and for occupational defined contribution schemes are expected to remain unchanged between 2020 and 2024.

28 According to the information provided in the performance plan "*the contribution rate and law changes are set by the state and there is no means to mitigate this risk by ANSP*". Estonia did not provide any information on actions taken to manage cost-risk (cost increase) associated with occupational defined contribution pension scheme and the impact of the unforeseen changes on the costs to be passed on to airspace users.

29 No major issues have been identified.

#### Other operating costs

30 In the revised plan, other operating costs are planned to decrease by -16% (-1.2M€<sub>2017</sub>) between 2019 actuals and planned 2024. Estonia implemented significant cost savings in 2020 as a result of COVID-19, which are planned to affect the level of operating costs throughout RP3.

31 Estonia decreased its other operating costs for the period 2022-2024 in the revised performance plan compared to the approved one by -2.8M€<sub>2017</sub> (or overall by -13%).

32 No major issues have been identified.

#### Depreciation costs

33 In the revised plan, depreciation costs are planned to decrease by -18% (-1.0M€<sub>2017</sub>) between 2019 actuals and planned 2024. The decrease is due to the postponement of investments to 2022 and onward.

34 Estonia decreased its depreciation costs for the period 2022-2024 in the revised performance plan compared to the approved one by -93K€<sub>2017</sub> (or overall by -0.7%).

35 No major issues have been identified.

#### Cost of capital

36 In the revised plan, the cost of capital is planned to decrease by -52% (-1.0M€<sub>2017</sub>) between 2019 actuals and planned 2024.

37 Regarding the components of the weighted average cost of capital (WACC) of EANS:

- The interest rate assumptions and the explanation for the weighted average interest on debt used to calculate the cost of capital pre-tax rate are duly justified and in line with competitive market practices.
- In the WACC reported in the revised performance plan, the Estonian State decided to reduce the return on equity to 3.5% for the period 2022-2024 (instead of 7.3% in the approved performance plan), the reported WACC has thus been calculated based on this requirement.
- The efficient cost of capital has been computed in line with the maximum risk exposure.
- The embedded return on equity over RP3 varies from a minimum of 2.2% to a maximum of 5.9% of the determined costs for the relevant year. The monetary value of the embedded return on equity is commensurate to the determined costs over RP3.
- No major issues on the WACC of EANS have been identified.

	Approved plan ('000€ <sub>2017</sub> )			Revised plan ('000€ <sub>2017</sub> ) / Difference with the approved plan (%)		
	2022	2023	2024	2022	2023	2024
Staff costs	12,797	13,306	13,741	11,543 / -9.8%	11,750 / -12%	12,079 / -12%
Of which pension	2,543	2,647	2,734	2,284 / -10%	2,325 / -12%	2,391 / -13%
Other operating costs	7,265	7,397	7,536	6,385 / -12%	6,470 / -13%	6,540 / -13%
Depreciation costs	4,290	4,139	4,276	4,413 / +2.9%	3,762 / -9.1%	4,437 / +3.8%
Cost of capital	946	1,605	1,783	732 / -23%	770 / -52%	893 / -50%
Exceptional costs	0	0	0	0	0	0
VFR exempted	0	0	0	0	0	0
<b>Total costs</b>	<b>25,298</b>	<b>26,447</b>	<b>27,337</b>	<b>23,073 / -8.8%</b>	<b>22,752 / -14%</b>	<b>23,949 / -12%</b>

Table 3 – En route determined costs from the revised plan, approved plan, and its difference, by cost category, for the period 2022-2023.

38 Regarding the regulated asset base of EANS:

- The fixed asset base is planned to slightly increase at the end of RP3.
- The net current assets seem excessive compared to the expected cash flow over RP3.
- The RAB does not include adjustments to the total asset base.
- Even though the total asset base decreases in 2022 due to the decrease in the net current assets, it remains overall stable over RP3.

39 In the revised performance plan compared to the approved one, Estonia decreased its cost of capital for the period 2022-2024 by -1.9M€<sub>2017</sub> (or overall by -45%). This can be attributable to the decrease in both the return on equity and the total asset base.

40 The reported cost of capital does not seem to present issues, although it is noted that the net current assets seem excessive compared to the expected cash flow over RP3.

#### Exceptional items

41 Estonia has no exceptional items planned during RP3.

#### 3.4 Methodology for cost allocation between en route and terminal

42 This section analyses the methodology for cost allocation between en route and terminal for RP3.

43 As in the approved performance plan, Estonia did not mention changing the cost allocation methodology with respect to RP2 in the revised performance plan.

44 Despite stating that there are no changes in the cost allocation methodology, Estonia noted that an increase in RP3 terminal staff costs is caused by

cost allocation variation. The allocation variation had no impact on the baseline.

45 Estonia allocates the costs using the Activity Based Costing (ABC) methodology. Costs are distributed to different cost centres, structured in the following groups: ATM, communication, navigation, surveillance, MET, AIS, SAR, and administration. ACC costs are allocated to en route services, TWR costs are allocated to terminal cost base, and APP costs are allocated according to the distance related to close distance around the airport to terminal cost base and the rest to en route cost base. Costs of common services (i.e. administration, AIS, etc.) are allocated to both en route and terminal services, in a proportional way based on the ABC methodology.

#### 3.5 Determined unit cost (DUC) baselines

46 In the revised performance plan Estonia did not modify the 2014 and 2019 traffic baselines compared to the approved performance plan:

- The traffic baselines are calculated on the basis of 2014 and 2019 actual traffic, and adjusted by the M2/M3 CRCO 12-month coefficient (-0.47%).

47 Similarly, in the revised performance plan Estonia did not modify the 2014 and 2019 cost baselines compared to the approved performance plan:

- The 2014 cost baseline has been adjusted to take account of Eurocontrol costs, as Estonia only started to incur Eurocontrol costs from 2015. The amounts added to the 2014 cost baseline correspond to the 2015 actual Eurocontrol costs of Estonia. The adjustment seems justified.
- The 2019 cost baseline is in line with the 2019 actual costs.



48 The determined unit cost baseline as included in the revised performance plan are:

- 25.16€<sub>2017</sub> for the 2014 baseline;
- 32.13€<sub>2017</sub> for the 2019 baseline.

### 3.6 Determined unit cost evolution

49 Despite Estonia having decreased total real costs in its revised plan compared to the approved one, the DUC for the period 2022-2024 increased as a consequence of a drastic lower traffic forecast. The evolution of the unit cost (from 2014 baseline to 2024 planned) is shown in Figure 2.

50 Regarding the DUC consistency from the revised performance plan:

- The DUC is planned to increase on average by +9.7% between 2019 and 2024, which is worse than the RP3 Union-wide trend (+1.0%).

- The DUC is planned to increase by +7.1% between 2014 and 2024, which is worse than the long-term Union-wide trend (-1.3%).
- The 2019 DUC level is 19.8% higher than the average of the comparator group.

51 When considering the STATFOR October 2021 base forecast, the DUC would:

- Decrease on average by -4.9% between 2019 and 2024, which is better than the RP3 Union-wide trend (+1.0%).
- Increase on average by +0.5% between 2014 and 2024, which is worse than the long-term Union-wide trend (-1.3%).

52 Estonia presents details for a possible deviation due to restructuring costs.

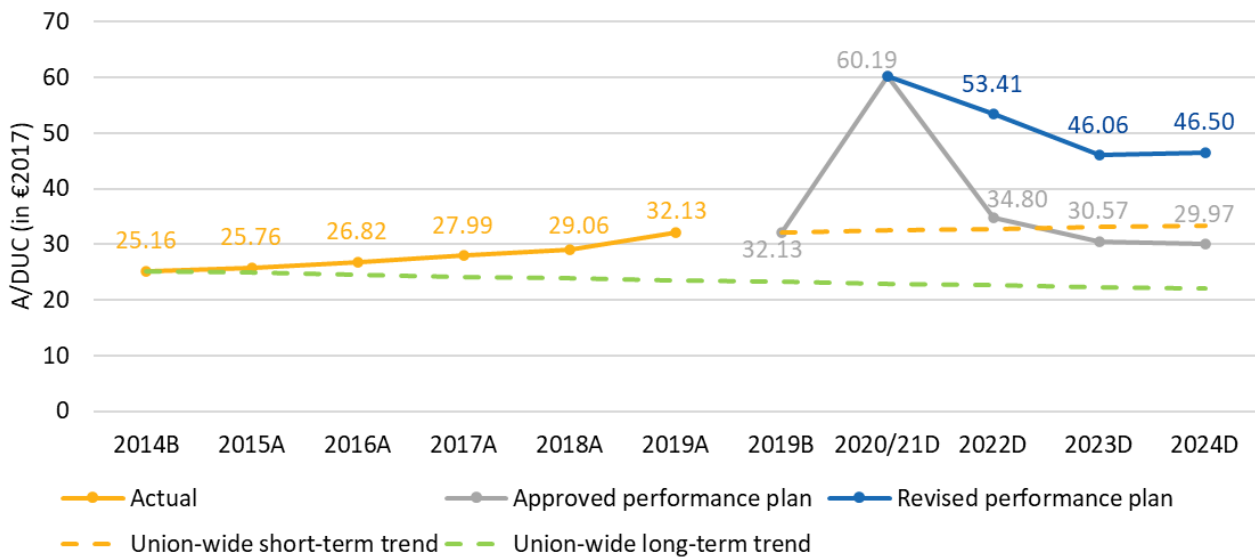


Figure 2 – Actual and determined unit cost overview from 2014 to 2024.

*Analysis of the DUC deviation due to restructuring costs*

- 53 As in the approved performance plan, Estonia presented justifications for the deviation of the DUC due to restructuring costs in respect of the FINEST project.
- 54 The FINEST cooperation project has been initiated between EANS and Fintraffic ANS to provide dynamic cross-border service provision. It is the largest and most advanced cross-border programme which allows for a borderless free route airspace in the provision of EANS and Fintraffic ANS service, and therefore enabling to deliver synergies in the provision of their services.
- 55 The implementation of the FINEST project can be seen as a pilot project in realising the single European airspace system, providing the entire European ATM network with important lessons learnt and best practices. The evidence presented by Estonia shows that the FINEST project will generate a net financial benefit for airspace users. Estonia quantified the benefits for airspace users in a cost-benefit analysis (CBA), with the materialisation of the estimated benefits once the traffic will be back to the pre-pandemic level. Estonia indicated that the benefit of the FINEST project includes, among others, an increase in efficiency, safety, capacity, environment, and will improve market competitiveness among companies.
- 56 The CBA presented by Estonia may underestimate the benefits for airspace users since it has been produced only until 2026 (i.e. middle of RP4). Moreover, the demonstrated calculation in the CBA focuses only on local benefits, whereas the FINEST project represents an important milestone in the implementation of the future ATM architecture and the associated operational model as put forward by the Airspace Architecture Study. Therefore, the network level benefits associated with the project are expected to be even greater than the local benefits as reported by Estonia.
- 57 Estonia clarified that planned activities for the FINEST project have continued in 2022 despite Russia's war of aggression against Ukraine and that the FINEST project is currently in the final stage in order to be fully implemented. However, due to Russia's war of aggression against Ukraine, the completion of the FINEST project has been paused. Some associated security aspects require

further consideration before the project proceeds to completion. In this regard, a joint meeting was planned in October 2022 to define actions to continue with the implementation of the FINEST project and a FINEST Council at ministerial level has been established to avoid any additional delay of the project.

- 58 Despite this, Estonia did not present a commitment in implementing FINEST by the end of RP3. For this reason, the PRB recommends the Commission not to consider a deviation from the cost-efficiency trend for the scope of restructuring costs.

*3.7 Results of the assessment of the cost-efficiency KPA*

- 59 In the approved performance plan, Estonia was consistent with the RP3 DUC trend in terms of average reduction. Estonia was not consistent with the long-term Union-wide DUC trend. However, the deviation from the long-term trend was considered justified by the restructuring costs. Estonia was not consistent with the average DUC baseline of the comparator group.
- 60 In the revised performance plan, Estonia is not consistent with any of the cost-efficiency criteria. However, Estonia has been heavily impacted by Russia's war of aggression against Ukraine. Therefore, the PRB recommends the Commission to consider these external factors when assessing the performance plan by applying the STATFOR October 2021 base forecast when calculating the trend criteria. However, even when considering the STATFOR October 2021 base forecast, Estonia is only consistent with the short-term trend criteria. Estonia presents details for a possible deviation due to restructuring costs connected with the FINEST project. However, the project is currently paused due to safety issues connected with Russia's war of aggression against Ukraine. Estonia does not commit to implement the project by the end of RP3. Therefore, the PRB recommends the Commission to not consider the deviation due to restructuring costs.
- 61 A summary of the results of the assessment of the cost-efficiency KPA is shown in Table 4 (next page).

	Criterion a: Short-term trend (+1.0%)	Criterion b: Long-term trend (-1.3%)	Criterion c: Comparator group	Criterion d i): deviation for capacity	Criterion d ii): deviation for restructuring costs
Approved performance plan	-1.7%	+2.0%*	32.13		X
Revised performance plan	+9.7%	+7.1%	32.13		X
Revised performance plan, considering the STATFOR October 2021 base forecast	-4.9%	+0.5%	32.13		X

Table 4 – Assessment criteria applied to local cost-efficiency KPA targets. \* Passing trend criteria considering a deviation.

## 4 CONCLUSIONS

- 62 The PRB concludes that the revised cost-efficiency targets proposed by Estonia, and therefore its revised performance plan should not be approved.
- 63 Estonia has been heavily impacted by Russia's war of aggression against Ukraine. The PRB recommends the Commission to consider the STATFOR October 2021 base forecast for the calculation of the trend criteria. However, even when considering a different forecast, Estonia is not consistent with the cost-efficiency criteria.
- 64 Estonia presents details for a possible deviation due to restructuring costs connected with the FIN-EST project. However, the project is currently paused due to safety issues connected with Russia's war of aggression against Ukraine. Estonia does not commit to implement the project by the end of RP3. Therefore, the PRB recommends the Commission not to consider the deviation due to restructuring costs.
- 65 The PRB recommends the Commission not to approve the revised cost-efficiency targets proposed by Estonia.