Decision of the European Ombudsman closing his inquiry into complaint 173/2009/(BU)RT against the European Commission

Decision
Case 173/2009/(BU)RT - **Opened on** 16/03/2009 - **Decision on** 21/04/2010

THE BACKGROUND TO THE COMPLAINT

1. The complainant is a small private company in France.

2. The complainant signed three contracts with the Commission's Directorate-General for Maritime Affairs and Fisheries (the former DG FISH, DG MARE). The complainant was awarded grants for research and technological development projects under the Fifth (EC) Research, Technological Development and Demonstration Framework Programme (FP5). In 1999, the first contract was signed ('Contract 1'). In 2001, the second and third contracts were signed ('Contract 2' and 'Contract 3'). The eligible costs of carrying out the research projects covered by Contracts 1 and 2 were co-financed by the Commission (50%, shared costs contracts). As regards Contract 3, the related eligible costs were financed entirely by the Commission (100%, concerted action contract). EU financing was subject to the Rules for financial participation by the Community as set out in Annex IV to the European Parliament and Council Decision 182/1999/EC [1] .

3. The complainant successfully carried out the projects. In October 2005, the Commission's representatives carried out an audit of Contracts 1, 2 and 3 at the complainant's premises.

4. In January 2006, the Commission informed the complainant of the audit findings. It stated that it could not accept the average hourly personnel rates which the complainant declared on the cost statements, since they differed significantly from actual hourly personnel rates. The Commission considered that this contravened the contractual provisions which provided that any such difference should not be significant (Article 23 of Annex II of Contracts 1 and 2). The Commission stated that if the complainant did not respond to the auditors' findings within 30 days of receipt, the Commission would open a recovery procedure for the overpayment.

5. In the exchanges of correspondence which followed, the complainant expressed its disagreement with the audit findings.

6. In December 2006, the Commission sent the complainant the final audit conclusions. It informed it that (i) it considered that, in order to be considered insignificant, the difference between actual costs and average costs should be no more than 5%; (ii) the Commission would proceed with the recovery of the amount EUR 33 557.32 if the complainant did not submit any comments on the costs breakdown by January 2007.

7. In its reply, the complainant reiterated its previous arguments regarding the audit conclusions.

8. In February 2008, following an exchange of correspondence, the Commission informed the complainant that it had decided to launch the procedure for the recovery of EUR 32 541.07 in respect of Contracts 1, 2, and 3. It attached to its letter a summary table which contained calculations for each contract. The table showed the amount to be recovered, calculated on the basis of actual costs. Reference was made to the contractual provisions. The Commission stated that if the complainant failed to respond within 30 days of receipt of the said letter with additional information which might lead the Commission to modify its conclusions, the Commission would send the complainant a debit note.

9. The Commission subsequently recovered the sum of EUR 32 541.07 from the complainant.

10. The complainant then turned to the Ombudsman.

THE SUBJECT MATTER OF THE INQUIRY

11. The complainant alleged that the Commission's recovery claim was unfair.

12. It claimed that the Commission should accept that, taking into account the three research contracts as a group, the complainant used the average personnel cost method in a way that did not make a significant difference to its costs compared to actual costs, particularly where the term "significant" was not defined in the contracts. Therefore, the Commission should repay the complainant at least a part of the recovered amount.

THE INQUIRY

13. On 16 March 2009, the Ombudsman opened an inquiry into the above allegation and claim. The inquiry did not include the complainant's other allegations concerning alleged discriminatory treatment on the basis of the audit results, and avoidable delay in the Commission's administration of the contracts. The Ombudsman informed the complainant of his reasons for not doing so. He considered that there were insufficient grounds for him to conduct inquiries into the complainant's argument concerning alleged discrimination, since the Commission had provided reasonable explanations in this respect in its correspondence with the complainant. As regards the alleged avoidable delay in the Commission's administration of the contracts and in the audit process, the Ombudsman noted that the two-year time limit for submitting a complaint

to him has expired. Therefore, on the basis of Article 2(4) of the Statute of the European Ombudsman [2] , he took the view that he was not entitled to deal with this aspect of the case.

14. The complaint was forwarded to the Commission with a request that it provide an opinion by 30 June 2009. The Commission requested an extension of time, which was granted until 31 July 2009. On 15 September 2009, the Commission sent its opinion, which was forwarded to the complainant with an invitation to make observations. On 28 October 2009, the complainant sent its observations.

THE OMBUDSMAN'S ANALYSIS AND PROVISIONAL CONCLUSIONS

A. Allegation of unfair recovery of the overpayment and related claim

Arguments presented to the Ombudsman concerning the alleged unfairness and related claim

15. The complainant referred to Article 23 of Annex II to Contract 1 and Contract 2 and Article 18 of Annex II to Contract 3. These Articles provide that average personnel costs can be used, provided that they do not differ significantly from the actual costs. It argued that the Commission's interpretation of the words " *do not differ significantly* " to mean that the difference should not be more than 5%, did not appear in the contracts. The Commission imposed this definition on the complainant, the weaker party to the contract, in its final audit conclusions of December 2006. This, the complainant argued, constitutes a legal error and an abuse of power .

16. It also argued that the Commission should have informed it immediately in 2001, when it became aware that the complainant was using the average cost method, of the risks inherent in its use and of the above criterion of the 5% threshold. The complainant considered that the Commission was negligent not to have done so, and for not informing it of the foregoing until after the audit, in December 2006, despite the complainant's repeated requests for an explanation. It had been apparent from the very first costs statement, which was submitted in May 2001, that the complainant had used the average cost method and the Commission had paid the costs in October 2002. Had the Commission alerted the complainant at that time that it should not use average hourly rates, the latter would have taken appropriate action in order to avoid future problems and it would have used actual costs from the outset. Moreover, it was only in December 2006 that the Commission informed the complainant that average rates are often used in enterprises with a high number of employees to facilitate both the planning and the running of projects. It would have been easy for the complainant (as an SME [3]) to use actual hourly rates, as only two to six persons' salaries were charged on the various cost statements.

17. The complainant also referred to the Commission instructions published on its relevant

website, namely, " *Participant's choice of the cost reimbursement system for Research, Demonstration and Combined contracts* " [4] which provides that " *at any time, a legal entity should apply one and the same cost reimbursement system* ". The complainant pointed out that its average costs do not differ significantly from actual costs if the three contracts are considered together and not separately, and if the Commission had not included in its calculations the *cap* on costs foreseen in the third contract. In this respect, it argued that the Commission's reasoning was incorrect and that it was with an eye to its own benefit alone that it had applied the contractual *cap* in order to compare the average and actual personnel costs in the third contract. The complainant claimed that the Commission should accept the complainant's reasoning which was as follows. If the average cost method, in respect of personnel costs, were to be applied to the three research contracts as a group the result in the difference between average costs and actual costs would not be significant. In turn, this would mean that the Commission should repay at least part of the recovered amount to the complainant.

18. In its opinion, the Commission rejected the complainant's arguments and claim. First, it pointed out that EU financial participation under FP5 consists of the partial or full refund of participants' eligible costs. However, these should exclude any profit margin (General Conditions of the contracts in question: Article 22 of Contracts 1 and 2 [5] and Article 17 of Contract 3 [6]). The Commission stated that the EU is not purchasing a service but giving a subsidy, or grant, to organisations carrying out research. The result of their research remains their property. The fundamental rule on grants is that no profit should be generated for the organisations from the grant itself. The Commission further pointed out that any difference between average and actual personnel costs in the complainant's cost statement represents costs which were not really incurred by the complainant but which were, nevertheless, paid from Community funds. This constituted a profit for the complainant and breached the terms of the contracts in question (Article 22 of Annex II to Contracts 1 and 2 [7] and Article 17 of Annex II to Contract 3 [8] , and the provisions of Article 109 (2) of the Financial Regulation [9]).

19. The Commission accepted that the contracts in question do not define the term " *significant difference* " in respect of the difference between average and actual costs. However, the meaning of the term should be determined in light of the principle described above and provided in the contracts in question, namely, that a grant should not generate a profit. Moreover the cost statement form requires the contractor to certify that reported costs reflect costs actually incurred and that all supporting documents are available for the purpose of audit by the Commission.

20. The Commission further stated that its DGs involved in the implementation of research projects systematically use a 5% threshold in order to assess the significance of the difference between average and actual costs.

21. In any event, given that, in Contract 1, the difference between the staff costs actually paid and the staff costs charged by the complainant in the costs statement was more than 30% in favour of the complainant, the 5% test for significance was not pertinent. A difference of more than 30% can only be characterised as significant.

22. The contract clearly prohibited profit being generated from a grant. Prior to the audit, only the complainant knew about the difference in question. The Commission considered that the complainant should have informed the Commission and ceased using average costs. In this respect, the Commission disagreed with the complainant's reliance on the Commission's website instructions as outlined in paragraph 17, and explained that under FP5 the complainant could have switched at any time from average to actual costs, since the purpose of the contracts was to contribute to costs actually incurred. The document to which the complainant referred, entitled " *Participant's choice of the cost reimbursement system for Research, Demonstration and Combined contracts* " concerned the overall reimbursement model applicable to the contract and not the choice made by the contractor for claiming staff costs.

23. The Commission further pointed out that the contracts in question were based on standard terms. Their aim was to facilitate the implementation of the projects, while ensuring sound financial management.

24. In the Commission's view, the fact that between June 2006 and June 2007 it progressively reduced the amount to be reimbursed from EUR 91 694.28 to EUR 32 541.07, indicates that both parties had the possibility to submit their arguments regarding the audit results and the Commission therefore acted fairly towards the complainant. The Commission referred to the fact that, in the absence of satisfactory substantiating material, it agreed to accept the complainant's calculation for the hourly rates of the complainant's two owners in respect of Contracts 1, 2, and 3. The owners claimed to have worked only 300 hours per year, resulting in an hourly rate of EUR 79.91. The remuneration actually paid to the complainant's two owners was documented in the accounts. There were, however, insufficient supporting documents to establish the number of hours per year the owners actually worked for their company, that is, the complainant.

25. As regards the alleged negligent behaviour, the Commission first pointed out that all necessary information and guidelines for the participants in EU-funded projects under FP5 are compiled in a "user-friendly" way on the following websites:

htttp://cordis.europa.eu/fp5 *and*

htttp://cordis.europa.eu/fp5/management/home.html

26. It further stated that, since the cost statements submitted by the complainant contained no information about actual rates, it was not until the audit findings became available that the Commission became aware of the significant difference between actual and average personnel costs in Contract 1. For the complainant, on the other hand, the difference of more than 30% was easily discernible since it was fully aware of what its actual rates were, whilst using average rates to prepare the costs statements.

27. According to the Commission, the complainant was at liberty to choose either the actual cost or the average cost model for reporting costs. The Commission did not, therefore, act

negligently by not informing the complainant of the risks inherent in using the average cost method. Any such risk was entirely within the complainant's control, and it had a responsibility to ensure that the information reported to the Commission was full and complete.

28. As regards the argument and claim related to the contractual *cap* , the Commission referred to the *cap* as the limit for the Commission's commitment to co-finance a partner's eligible costs. Hence, this limit has to be respected when actual and average costs are compared in order to determine the amount a partner may claim under a contract. The comparison should be made between the gross salary costs and not the Community contribution to it. In the Commission's view, the *cap* constitutes an essential contractual parameter for the comparison. The Commission insisted that the contracts should, nevertheless, be considered individually. It considered the complainant's argument concerning the contractual *cap* being applied to all three contracts as not relevant. In the Commission's view, each contract is a legal commitment on its own and should be treated as such. No grant provided under one contract should generate a profit which might be compensated by a hypothetical future contract. Therefore, the calculation of variations in staff costs should not be based on the total salary costs for all three contracts. Moreover, the complainant's approach of having all contracts considered together would discriminate against other contractors because, unlike the complainant, not all contractors have a series of contracts with the Commission, but perhaps only one contract. In addition, it would become impossible, without an audit, to verify whether costs had been overstated if costs assessments depended on future contracts.

29. It follows that the complainant must be treated on the same basis as all parties to contracts of this nature. This means that the *cap* specified in each specific contract must be respected in relation to that contract alone. All calculations should be based on the maximum eligible costs foreseen in each individual contract.

30. In its observations, the complainant stated that it believed it was right to use average rates for all three contracts. It pointed out that the costs incurred in the execution of Contract 1 were balanced by the costs incurred in the execution of Contracts 2 and 3. The issue of treating each contract as a separate commitment does not preclude an understanding of average costs across the various contracts. The complainant emphasised that it had respected the budget *cap* for each of the projects it had carried out.

31. Finally, the complainant pointed out that it had acted in good faith in interpreting the rule "one legal entity-one accounting system". The complainant understood this rule to mean that it had to use the same method of referring to costs for all of its projects with the Commission. It rejected the Commission's statement that it made a profit from the contracts in question. It further argued that the Commission's failure to provide a prior definition of the term " *significant difference* " rendered the relevant contractual provisions meaningless and unenforceable.

The Ombudsman's assessment

32. Article 23, point 1(b) of Annex II, which is the same in Contracts 1 and 2, and Article 18, point 1(b) of Annex II of Contract 3, read as follows:

" *For contractors using the full cost system, personnel costs shall comprise:*

- the actual costs (gross remuneration and related charges)

- average employment costs, where these correspond to the normal practice of the contractor concerned, provided that such costs do not differ significantly from the actual costs and that such practices are regarded as acceptable by the Commission. "

33. The above Articles should be read in conjunction with Article 109 of the Financial Regulation, Article 22 of the General Conditions for Contracts 1 and 2, and Article 17 of the General Conditions for Contract 3. There it is stated that all eligible costs shall be costs that were actually incurred (introduced in the account and paid) during the duration of the projects, excluding any profit margin) [10] .

34. It follows that, pursuant to the contracts, average staff costs are to be provided in the costs statement only under the following conditions: (i) average staff costs do not differ significantly from actual staff costs; (ii) this practice constitutes the normal practice of the contractor; (iii) the Commission considers this practice to be acceptable; and (iv) the beneficiary of the grant does not make a profit as a result of reporting the costs in this way.

35. The Ombudsman considered the question of whether the complainant made a profit as a result of reporting average costs instead of actual costs. The eligible costs agreed in Contract 1 amounted to EUR 282 540. In its cost statement for Contract 1, as a result of using the average costs system for its calculations, the complainant indicated that eligible costs amounted to EUR 281 936.62. The audit, on the other hand, established that the actual costs incurred for the project amounted to EUR 212 540.80. The difference which results from applying the different methods of calculation indicates, in any event, a gain for the complainant, since the EU payment was greater than the costs actually incurred. Although this gain does not necessarily mean " *a profit* " in an economic or accounting sense, it nevertheless appears to constitute a margin of profit for the complainant.

36. The Ombudsman also considered the question of whether the Commission accepted the complainant's way of reporting costs, namely, on the basis of average and not actual costs. The evidence available does not show that the Commission objected to the complainant's average staff costs statement for 2001 in respect of Contract 1. The Ombudsman understands, therefore, that the Commission implicitly considered this to be an acceptable way of reporting costs. Moreover, it appears that this was the complainant's normal practice, of which it informed the Commission in October 1999, during the negotiation of Contract 1 [11] .

37. On the other hand, however, in accordance with the principle of fair dealing of the parties, the Commission's implicit acceptance was justified, since it was entitled to expect that the complainant would comply with the other condition regarding the reporting of average costs, namely, that there was no significant difference between the actual and average costs.

38. As regards Contract 1, however, there was a difference of 30%. The Ombudsman finds it reasonable for the Commission to argue that a 30 % difference is significant. It appears, therefore, that the complainant did not comply with the relevant contractual condition for reporting average costs for staff.

39. The Ombudsman also agrees that ensuring sound financial management requires the Commission to always apply the same criteria when assessing the significance of the difference between staff costs which are reported to it under the various models. The Commission interpreted the wording of the term " *significant difference* " by reference to a threshold. In this respect, it pointed out that the internal practice of its DGs is to consider significant a difference of 5% between staff costs reported under the various models.

40. Likewise, the Ombudsman does not find the Commission's above interpretation unreasonable. The complainant cannot rely on the *contra proferentem* principle, namely, that the term " *significant difference* " should be construed against the party which imposed its inclusion in the contract (in this case, the Commission), in circumstances where this difference amounts to 30%. He thus finds that a difference of 30% should be accepted as representing a significant difference.

41. On the other hand, the Ombudsman finds reasonable the complainant's argument that, in the absence of any definition in the contract, it would certainly have been helpful if the Commission had informed the complainant at the start of their contractual negotiations that it considered 5 % to be the maximum acceptable difference. This is particularly the case when one considers that, as referred to above, the Commission can, unilaterally, change the administrative practice of Commission DGs. It would also have been helpful if the Commission had drawn the complainant's attention to the fact that the average costs system was more suitable for the accounting purposes of large enterprises, and not so suitable for an SME such as the complainant [12] . This would have forewarned the complainant against calculating the costs in the way it had chosen to do so.

42. However, as stated above, the Ombudsman finds it reasonable to consider that the contractual provision concerning a " *significant difference* " cannot be interpreted in such a way as to allow a difference of 30%. Such a difference can only be described as significant, and it is far from the 5% difference which the Commission considered to be acceptable. For that reason the Ombudsman considers that the Commission did not act unfairly by recovering the sum of EUR 32 541.07 from the complainant. He does not, therefore, find any instance of maladministration as regards the complainant's allegation.

43. Moreover, the Ombudsman is not convinced that the complainant's view can be sustained, that is, that this difference could be averaged out if all its personnel costs were processed by taking into account Contracts 1, 2, and 3 jointly. The complainant considers that if all three contracts were assessed together, and if the comparison between average and actual staff costs concerned the Community contribution only, as opposed to the gross salary costs (as the Commission suggested it should), there would be no significant difference . Thus, the complainant argues that the figures for the three contracts should be aggregated . Moreover,

the complainant argued that, when carrying out the comparison, the costs *cap* in Contract 3 should not be taken into account.

44. First, the Ombudsman agrees with the Commission that the complainant's contractual obligations arising from one contract should not be assessed on the basis of other contracts. There is nothing in the contracts in question to indicate any connection between them. Each contract refers to a specific research project which is separate from other contracts. Contract 1, concluded in 1999, does not contain any indication that other contracts would be concluded in 2001. Moreover, the instructions to which the complainant referred, namely, the " *Participant's choice of the cost reimbursement system for Research, Demonstration and Combined contracts* ", whatever their content, cannot prevail over the contracts. Furthermore, there is no reason to consider that such instructions constitute a reliable source of interpretation for the contracts.

45. Nevertheless, the Ombudsman notes that, even if the complainant's method of calculation is applied, whereby staff costs for the three contracts are aggregated, and the contractual *cap* is not applied for the third contract, the overall difference for the three contracts between average staff costs and actual staff costs is 9.39% . However, the difference between average staff costs and actual staff costs resulting from the application of the two models of costs reporting would be approximately 15.3% as opposed to 9.39%, if the *cap* were taken into account in the case of Contract 3 [13] . These two figures (with or without applying the *cap*) may also be considered as constituting a significant difference.

46. As the Commission also rightly pointed out, any comparison of the use of actual and average cost methods must take into account the limited EU contribution which can be claimed. This contribution is established on the basis of the total eligible costs which could be claimed under the contract (in Contract 1, the EU contribution was 50% of the total eligible costs) and constitutes an accountability category independent of the costs. Therefore, the EU contribution is irrelevant when establishing whether the difference between actual and average costs is significant or insignificant.

47. In light of the above, the Ombudsman considers that no further inquiries are justified as regards the allegation. Therefore, the complainant's claim that the Commission should repay to it at least a part of the recovered amount cannot be sustained.

B. Conclusions

On the basis of his inquiry into this complaint, the Ombudsman closes it with the following conclusion.

As regards the complainant's allegation, there has been no maladministration. The complainant's claim cannot be sustained.

The complainant and the Commission will be informed of this decision.

FURTHER REMARK

The Ombudsman suggests that the Commission could consider offering on its website clear guidance to contractors concerning the different accounting methods for reporting the costs of research programmes.

P. Nikiforos DIAMANDOUROS

Done in Strasbourg on 21 April 2010

[1] Decision No 182/1999/EC of the European Parliament and of the Council of 22 December 1998 concerning the fifth framework programme of the European Community for research, technological development and demonstration activities (1998 to 2002).

[2] Article 2.4 of the Ombudsman's Statute reads as follows: " *A complaint shall be made within two years of the date on which the facts on which it is based came to the attention of the person lodging the complaint.* "

[3] Small and Medium Enterprise.

[4] Available on the website http://www.cordis.lu/fp5/cont-admin.htm [Link].

[5] Article 22, point 1 of Annex II to Contracts 1 and 2 reads as follows: " *Eligible costs ... shall fulfil the following conditions: be incurred during the duration of the project... and exclude any margin of profit* ".

[6] Article 17, point 1 of the Annex II to the Contract 3 reads as follows: " *Eligible costs ...shall fulfil the following conditions: be incurred during the duration of the project... and exclude any margin of profit* ".

[7] See footnote 6.

[8] See footnote 7.

[9] Article 109(2) of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, *OJ 2002 L 248, pp. 1–48* provide that: " *The grant may not have the purpose or effect of producing a profit for the beneficiary.* "

[10] See footnotes 5 and 6.

[11] The complainant referred to its letter, in which it stated that: " *Les taux appliqués dans le projet FISHREG … sont les taux en viguer pratiqués par notre société dans le cadre de ce type de programme* ".

[12] As the Commission indicated in its letter sent to the complainant in December 2006.

[13]

Contract

Charged/paid

Accepted

Difference

EU contribution

Contract 1

EUR 281 939.62

EUR 212 540.80

EUR -69 398.82

EUR-34 699.41

Contract 2

EUR 191 089.10

EUR 191 714.17

EUR +625.07

EUR +312.54

Contract 3

EUR 42 802.20

EUR 44 648.00

EUR +1 845.80

EUR +1 845.80

Total

EUR -32 541.07