



Decision in case 721/2015/OV on the European Commission's refusal to consider dividend payments as eligible personnel costs of a project

Decision

Case 721/2015/OV - Opened on 22/07/2015 - Decision on 18/12/2015 - Institution concerned European Commission (No maladministration found) |

The complainant is an SME which participated as a beneficiary in a Commission project. It remunerates its staff partly through dividend payments. When the Commission in 2014 rejected part of the complainant's personnel costs as ineligible, the complainant argued that the Commission had previously approved its remuneration model and that, therefore, it had a legitimate expectation that its personnel costs would be reimbursed accordingly. The complainant turned to the Ombudsman.

After an inspection of the Commission's file, the Ombudsman found that the Commission had not explicitly approved the complainant's remuneration model and that the conditions for legitimate expectations to exist were not fulfilled. The Ombudsman furthermore found that the Commission's position was legally correct and in accordance with the Grant Agreement. However, the Ombudsman also found that the Commission could have been more diligent and have alerted the complainant, when joining the project, that its remuneration model would not be acceptable. In a further letter to the complainant, the Commission expressed its regret to the complainant for how events had developed, but also expressed the hope that the complainant would continue its participation in the project. The Ombudsman found that there was no maladministration by the Commission in its handling of this case though it was unfortunate that the complainant understood that its remuneration model would be accepted by the Commission.

The background to the complaint

- 1.** The complainant is an SME (employing 6 people) which participated, as a member of a consortium and beneficiary, in a project run by the European Commission under the Competitiveness and Innovation Programme (CIP).
- 2.** The Grant Agreement was signed on 23 May 2012 between the Commission and the leader of the consortium, the company X which acted as the coordinator (hereafter "the coordinator"). The project started on 1 September 2012 and was scheduled to run for 3 ½ years (42 months).
- 3.** In early September 2012, the complainant was in contact with the coordinator in order to join the project as a replacement for beneficiary n° 6. In that context, the Commission had



requested the coordinator to obtain from the complainant the required statutory documents. On 3-5 September 2012, the coordinator and the complainant exchanged e-mails in order to prepare the requested documents, including the revised budget. By e-mail of 5 September 2012, the complainant sent its remuneration policy ("*Remuneration and Reimbursement for Project Staff*" [1], dated 31 August 2012) to the coordinator. On 5 September 2012, the coordinator sent to the Commission the revised budget for the project. It pointed out, however, that the complainant's employees are not paid with normal salaries, but with "*success fees*" and asked whether the flat rate used in the budget was acceptable. The coordinator enclosed a copy of the complainant's remuneration policy. On 17 September 2012, the coordinator sent to the Commission a signed copy of the contract amendment together with the "*original documents requested for the integration of [the complainant] to the consortium*" (legal entity form for the complainant, mandate signed by the complainant, several forms and the revised budget, but not including the remuneration policy).

4. On 17 and 26 September 2012, the coordinator and the Commission signed an amendment ("contract amendment No 1") to the Grant Agreement by which the complainant was included as a beneficiary in the project. On 25 September 2012, the coordinator informed the complainant accordingly.

5. The complainant completed the work and subsequently submitted its cost statements for the first period of the project.

6. Between February and April 2014, the complainant, the coordinator and the Commission's Financial Officer exchanged e-mails with regard to the eligibility of the complainant's personnel costs. The Commission pointed out to the complainant that only real salary effectively paid to its staff was eligible as personnel costs. The complainant however explained that its staff is paid by way of dividends: the complainant receives income from its customers in payment for the work carried out by its employees and the earnings derived from this income are then allocated to the employee(s) who carried out the work.

7. In an e-mail of 8 April 2014, the Commission's Financial Officer informed the coordinator that, as regards the complainant's personnel costs, only EUR 70 952.56 of EUR 128 202.15 were eligible.

8. The complainant subsequently had a long e-mail exchange with the Commission's Financial Officer in order to find a solution with regard to the rejected personnel costs. On 16 October 2014, the complainant and the coordinator had a meeting with the Financial Officer and another official from DG Enterprise. At that meeting - according to the complainant - the Financial Officer admitted not having read the data which the complainant had submitted in September 2012 concerning its remuneration model, whereas the other official, still according to the complainant, took the view that the complainant had a legitimate expectation that its remuneration model would be followed and that its project costs should be fully reimbursed, at least up to the date of that meeting. According to the minutes taken by the coordinator, the officials from DG Enterprise would contact DG Budget for a follow-up on the complainant's arguments that i) the dividends paid to its employees cannot be



considered as gain on capital, but as remuneration for work and ii) the Commission in September 2012 had approved the complainant's remuneration model when it joined the project.

9. In an e-mail of 6 November 2014 to the complainant, the Financial Officer replied that he could not confirm that the costs for the first period would be accepted as originally submitted on the basis of the "*legitimate expectation aspect of the communication breakdown between us*". He stated that he "*did not clearly accept [the complainant's] remuneration system, even if I admit that my wording was ambiguous*".

10. On 5 February 2015, the Financial Officer informed the complainant that DG Budget stood by its position which was the following: "*We confirm that dividends are never eligible costs, including under the heading 'staff costs' when distributed to employees. This ineligibility remains valid even though distributing dividends to employees is in line with the usual policy of the beneficiary. Indeed, those dividends are neither 'costs' within the meaning of Title VI FR [Financial Regulation] nor related to the implementation of the action (they are based on the overall performance of the beneficiary entity).*

Our position remains the same even in your specific case, i.e. even if, according to the company's Articles of Association, the amount of dividends to be paid to an employee shareholder depends on the company's income generated by the work of that employee shareholder. As a general rule, operations related to the earnings or profits of a beneficiary (e.g. allocation of net income to reserves, distribution of dividends) do not entail any costs within the meaning of Title VI FR. Dividends are not expenses or costs (thus they will not appear on the profit and loss account), even where distributed to employees. Thus they do not result in any eligible cost".

11. On 16 February 2015, the complainant stated that it was disappointed, but not surprised, by DG Budget's views. However, it argued that it expected the Commission to honour its claim on the personnel costs since it had submitted the information on its remuneration model before obtaining the Commission's approval to join the project. The complainant, referring again to what it considered to be its legitimate expectations, requested the Commission to reimburse its personnel costs for the first year of the project.

12. On 26 February 2015, the Financial Officer informed the complainant that the responsible unit was still exploring the possibility of modifying its position, and that the complainant could turn either to the Ombudsman or start legal proceedings. Not satisfied with the Commission's reply, on 28 April 2015, the complainant turned to the Ombudsman. The inquiry

13. The Ombudsman opened an inquiry into the complaint and identified the following allegation and claim:

Allegation:

The Commission wrongly rejected as ineligible part of the complainant's personnel costs for the project.



Claim:

The Commission should reimburse the complainant's personnel costs in accordance with the complainant's remuneration model, for the period until 16 October 2014, and allow the complainant either i) to change to a new operation model in order to continue with the project or, alternatively, ii) to withdraw from the project with all its costs settled in full.

14. The Ombudsman inspected the Commission's file on 7 September 2015. On 9 September 2015, a report on the inspection was sent to the complainant and to the Commission. On 22 September, 8 and 9 October 2015, the complainant submitted observations on the inspection report. On 20 October 2015, the Ombudsman learned from the complainant that it had been involved in two other (completed) projects running successfully with the Commission. On 4 November 2015, the Ombudsman's services had a further meeting with the Commission's services (Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs - DG GROW) to explore possible solutions to the case. Following that meeting, the Commission on 27 November 2015, sent a letter to the complainant expressing its regret for any misunderstanding which might have occurred. The complainant sent some short comments to the Ombudsman on 1 and 14 December 2015. On 15 December 2015, the Ombudsman learned from the complainant that the project concerned was the first project with EU funding in which it had participated. In conducting the inquiry, the Ombudsman has taken into account the arguments and opinions put forward by the parties.

Allegedly wrongful rejection of personnel costs

Arguments presented to the Ombudsman

15. In support of its allegation, the complainant argued that, prior to joining the project and to signing the amendment to the Grant Agreement, (i) it informed the Commission (through the coordinator) of its staff remuneration model, (ii) the Commission approved this model and (iii) the complainant was therefore entitled to expect that the Commission would reimburse its personnel costs accordingly.

16. At the inspection, the Commission stated that the amounts mentioned by the complainant in its complaint (namely that the Commission had allegedly accepted only EUR 85 000 out of the EUR 122 459) were not accurate and that, following a correction by the complainant, the Commission had agreed to pay EUR 70 952.56 out of EUR 128 202.15 [2]. The Commission also stated that the eligibility of the specific costs is not verified at the moment of the signature of the Grant Agreement, but only later when a beneficiary submits the interim report and a payment request.

17. Given that the complainant had not provided copies of the relevant correspondence (letters/e-mails) to show that its remuneration model had been approved by the Commission, the Ombudsman's services inspected the correspondence on the Commission's file. The Commission observed, however, that not all the e-mails exchanged with the coordinator and the complainant had been registered at the time, but only those that were most relevant for the project in question.



18. In its letter of 27 November 2015 to the complainant, which referred to the discussions with the Ombudsman on the complainant's personnel costs, the Commission expressed *regret* for the fact that the complainant had been under the impression that staff remuneration paid by way of dividends could in any way be considered eligible. The Commission stated that, as part of its application, in September 2012 the complainant had submitted its statutory documents, including its remuneration policy. The Commission stated that under the rules and procedures applying to CIP grants, it is required to verify the legal status of the beneficiary and compliance with the selection criteria, by reviewing the documents submitted by potential beneficiaries. However, the Commission explained that the eligibility of the costs is assessed at a later stage, namely when the actual cost claims are received, and in accordance with the eligibility conditions of the Grant Agreement. The Commission assured the complainant that it had made sincere efforts to thoroughly investigate its claims. It regretted that it could not reach any conclusion other than that remuneration in the form of dividends could not be accepted as an eligible cost under the Grant Agreement. It argued that - in view of the need to ensure equal treatment for beneficiaries of EU funding - it could not depart from the general conditions. The Commission hoped that the complainant would nevertheless continue its participation in the project.

19. In its earlier observations on the Ombudsman's inspection report, the complainant argued that even though neither it nor the coordinator could find a copy of the relevant e-mail, it had been informed by the coordinator that the Commission had agreed that the coordinator should submit an amendment to the Grant Agreement to allow the complainant to join the project. The complainant argued that, in any event, the fact that the amendment to the Grant Agreement was subsequently signed by the Commission was a clear indication that approval was given. The complainant further stated that, since it was not informed that its operating model was not acceptable to the Commission, it was reasonable for it to believe that its inclusion in the Grant Agreement had been done on the basis of the information it had provided. There was therefore more than a reasonable expectation that its personnel costs incurred, based on its remuneration model, would be eligible. In its observations on the Commission's letter of 27 November 2015, the complainant stated that the letter did not address the issue that the Commission had failed to inform it in 2012 that its remuneration model would not be acceptable.

The Ombudsman's assessment

20. The Commission's final position on the matter is set out in its Financial Officer's e-mail of 5 February 2015, in which the complainant was informed that DG Budget maintained its position that dividends as remuneration to employees are not accepted as eligible costs. This was confirmed in the Commission's latest letter to the complainant of 27 November 2015. According to DG Budget, operations related to the earnings or profits of a beneficiary (like the distribution of dividends) do not constitute costs. The Ombudsman, apart from noting that dividends are by definition profits and thus not costs, considers that the Commission's position is correct and in accordance with the Grant Agreement which provides (Article II.14.2



of the Special Conditions) that eligible direct costs include " *the costs of staff assigned to the action, comprising actual salaries plus social security charges and other statutory costs included in the remuneration ...*". Payment of dividends is thus not covered by this provision. Article II.14.4 of the Special Conditions also provides that " *the following costs shall not be considered eligible: return on capital* " which would appear to cover the payment of dividends. It should also be noted that the amendment to the Grant Agreement, which enabled the complainant to become a beneficiary of the project, specifically referred to the eligibility conditions laid down in Article II.14 (see Article 4 of the amendment).

21. However, the complainant's main allegation is that prior to joining the project and signing the amendment to the Grant Agreement, it had already informed the Commission (through the coordinator) of its staff remuneration model, that the Commission had approved its model and that as a result the complainant had the legitimate expectation that the Commission would reimburse its personnel costs accordingly. In the complainant's view, the mistake thus consisted in the Financial Officer not having read (carefully enough) the information which it submitted in September 2012 on its remuneration model.

22. In that regard, the Ombudsman notes that, in his email of 6 November 2014, the Financial Officer - although admitting that the wording he had used earlier had been ambiguous - stated clearly to the complainant that he had not accepted its remuneration model. Despite the Ombudsman's specific request, the complainant did not submit evidence, such as an e-mail, demonstrating that the Financial Officer had at some point in time actually approved its remuneration model. The complainant's argument that the signature of the amendment to the Grant Agreement meant that its remuneration model had been implicitly approved, and that dividend payments would thus be eligible, cannot be upheld. In fact, the amendment to the Grant Agreement does not contain any reference to the complainant's remuneration model; instead it refers to the eligibility conditions of the Grant Agreement which are the relevant provisions to take into account [3] .

23. Furthermore, as explained by the Commission, the eligibility of the costs is assessed after the (partial) completion of the project and the submission by the beneficiary of the relevant reports and financial statements, and not at the moment of the signature of the Grant Agreement or amendments to it. This is because, in order to be eligible, the costs need to have been actually incurred. Thus, the signature of the Grant Agreement does not entitle a beneficiary to the guaranteed reimbursement of certain costs. In the present case, this means that, even if the complainant's remuneration model had been approved by the Commission (which was not the case), the complainant had no entitlement to expect that, in principle, dividend payments would be eligible.

24. The Ombudsman thus takes the view that the conditions *for legitimate expectation* are not fulfilled in the present case. Three cumulative conditions must be satisfied for legitimate expectation to exist. First, precise, unconditional and consistent assurances originating from authorised and reliable sources must be given to the person concerned. Second, the assurances given must comply with the applicable rules. Third, those assurances must be such as to give rise to a legitimate expectation on the part of the person to whom they are addressed.



25. In the present case, the first two conditions, quite clearly, are not fulfilled. First, it has not been established that precise, unconditional and consistent assurances were given to the complainant that it could claim reimbursement of its personnel costs on the basis of dividend payments. Even if the complainant could prove that he had received the implicit approval by the Financial Officer of its remuneration model, such approval could not be characterised as "*precise, unconditional and consistent assurances*".

26. Second, and more importantly, however, the assurances must comply with the applicable rules. In the present case, the sort of assurances that the complainant claims to have received - to the effect that it could obtain reimbursement of its personnel costs on the basis of dividend payments - would clearly be against the applicable rules, namely Article II.14 of the Special Conditions of the Grant Agreement.

27. On the basis of the above, the Ombudsman considers that the Commission's position is legally correct and in accordance with the provisions of the Grant Agreement.

28. However, notwithstanding that the Commission acted legally when rejecting dividends as eligible personnel costs, the Commission could have been more diligent in September 2012, when the complainant, through the coordinator, submitted its statutory documents and its remuneration model to the Commission. This presented an opportunity for the Commission to identify a problem with the remuneration model and to alert the complainant to the existence of that problem. The Ombudsman understands that, in the normal course, the Commission would not have specifically checked the remuneration model at that point. On the other hand the coordinator, on behalf of the complainant, did ask the Commission whether the remuneration model would be acceptable. This suggests that there were doubts as to whether the remuneration model would be acceptable. The Ombudsman discussed this issue with the Commission on 4 November 2015, as a result of which the Commission sent to the complainant a further letter on 27 November 2015. In that letter, the Commission expressed its regret for the fact that the complainant had believed that its staff remuneration model, based on the payment of dividends, would be acceptable. The Commission also regretted that it could not reach a conclusion other than that dividends, as personnel costs, were not eligible.

29. The Ombudsman accepts that the decision of the Commission, to reject personnel costs paid by way of dividends, was legally correct. The Ombudsman regards it as most unfortunate that the misunderstanding regarding the remuneration model occurred. While the Commission might have acted to clarify that the remuneration model was not acceptable, the Ombudsman does not take the view that the Commission was directly responsible for this misunderstanding. There were three parties involved and the Ombudsman does not seek to identify where the primary responsibility for the misunderstanding should lie. While the Commission contributed to the misunderstanding, the Ombudsman does not regard this as a case of maladministration on the part of the Commission. Rather, it appears to have been an unfortunate occurrence for which the parties share responsibility.



30. In fairness to the complainant, the Ombudsman understands that this was its first involvement in such a Commission-funded project, and it is plausible that it was unaware of the normal practices governing the administration of such projects. At the same time, it is also the case that the complainant's primary relationship was with the coordinator and that all issues relevant to the complainant's participation in the project should, in the first instance, be a matter between the complainant and the coordinator.

31. The Ombudsman's overall conclusion is that, while a most unfortunate misunderstanding arose, there was no maladministration on the part of the Commission in its handling of the case.

Conclusion

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

There was no maladministration by the Commission in its handling of this case.

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

Emily O'Reilly

Strasbourg, 18/12/2015

[1] The complainant's employees can choose to receive their remuneration by salary, by dividend, or both. According to the complainant, where the employees choose the dividend option, the dividends received constitute remuneration for the work performed and cannot be considered as gain/remuneration on capital. The complainant points out that it does not have capital.

[2] The Commission's e-mail of 8 April 2014 to the complainant stated that EUR 70 952.56 out of EUR 128 202.15 of the complainant's cost were eligible. However, at the inspection, the Commission referred to 95% of EUR 70 952.56 out of 95% of EUR 128 202.15.

[3] The complainant argued that it had specifically requested the Commission to inform it if its remuneration model was not acceptable so that it could be changed. The complainant referred to its e-mail of 5 September 2012 to the coordinator. The Ombudsman notes that, in that e-mail, the complainant simply sent its remuneration model to the coordinator stating: "*I hope that this will provide the supporting information you need. If not, we will need to continue our discussions to find an approach that works for both of us*". This statement is not entirely clear and does not unequivocally support the conclusion that the complainant specifically requested the Commission to inform it if its remuneration model was not acceptable.