

Decision in case OI/9/2015/NF on the termination of a grant contract by the European Commission

Decision

Case OI/9/2015/NF - **Opened on** 19/05/2015 - **Decision on** 23/03/2016 - **Institution concerned** European Commission (No maladministration found) |

The complainant had a grant contract with the European Commission for the financing of a project in Egypt. Under that contract, the complainant had to provide a financial guarantee from a bank or financial institution established in the EU in order to secure the Commission's pre-financing of the project. After the contract entered into force, it turned out that the complainant was not able to provide the required financial guarantee. For that reason, the Commission terminated the contract.

The Ombudsman found that the Commission had complied with its contractual obligation to consult the complainant before proceeding to the contract termination. In light of the information that the complainant provided to the Commission on its financial capabilities, the Ombudsman also found that the Commission could reasonably understand that the complainant would not have been able to implement the project without any pre-financing and that, therefore, any further consultations were unnecessary.

The Ombudsman concluded that the Commission had acted lawfully and reasonably in terminating the contract with the complainant. However, the Ombudsman suggested that in future contracts the Commission consider including, in the standard contracts terms, a provision entitling the grant beneficiary to renounce the Commission's pre-financing. This would remove the obligation to provide a financial guarantee, should the beneficiary be in a position to prove that it has the financial means necessary to carry out the project. The Ombudsman also asked the Commission to make sure to always state, in a termination letter, the exact legal basis for that decision as well as the options for appealing the decision.

The background to the complaint

1. This own-initiative inquiry is based on a complaint submitted by a company established in Tunisia [1] which, in late 2014, entered into a contract with the European Commission for the implementation of an "action" under the Commission's "Support to Cultural Diversity and Creativity in Egypt" programme.



2. According to the contract, the Commission was to make a pre-financing payment to the complainant. In return, the complainant had to provide a financial guarantee of the same amount as the initial pre-financing. The financial guarantee had to be denominated in Euros and had to be provided by an approved bank or financial institution established in one of the Member States of the European Union.

3. In January 2015, the Commission asked the complainant to lodge the required financial guarantee.

4. In response, the complainant informed the Commission that it deemed it impossible to obtain a financial guarantee from a bank or financial institution established in one of the EU Member States, given that it did not have any professional activity or bank account in the EU. The complainant also stated that its attempts to lodge a financial guarantee with financial institutions in Tunisia were unsuccessful as it was not able to block the relevant amount of money on a bank account or to take out a mortgage. The complainant then asked the Commission to consider one of the following two options: (i) forgoing the provision of a financial guarantee by the complainant or (ii) lowering the initial pre-financing payment.

5. The Commission replied to the complainant. It acknowledged the complainant's difficulties in obtaining a financial guarantee, but confirmed that it required the financial guarantee in compliance with the contract. The Commission requested that the complainant submit the financial guarantee within a maximum period of 30 days or it would terminate the contract according to Article 12.2 of the general conditions of the contract.

6. When the complainant did not provide the financial guarantee within the set timeframe, the Commission, in March 2015, informed the complainant that the contract was terminated.

7. On the same day, and in reaction to the Commission's letter of termination, the complainant informed the Commission that it would renounce the pre-financing payment, so as to do away with any financial risk. The complainant clarified that it was ready to continue implementing the action with its own funds and to ask for reimbursement of eligible costs together with the first interim report.

8. The Commission replied that it was not in a position to consider the complainant's proposal to continue implementing the project with its own funds, given that this proposal was put forward after the termination of the contract.

9. The complainant then turned to the Ombudsman and complained about the way in which the Commission had terminated the contract.

The inquiry

10. Based on the complaint, the Ombudsman opened an inquiry into the following allegation:



The Commission wrongfully terminated the grant contract entered into with the complainant.

In support of its allegation, the complainant put forward the following arguments:

- (i) Before terminating the contract, the Commission failed duly to consult with the complainant to address the solutions proposed by it in relation to the financial guarantee and the pre-financing.
- (ii) The Commission's decision to terminate the grant contract was disproportionate in light of the availability of different options that would have allowed the complainant to continue implementing the action while limiting the financial risk for the EU budget.
- (iii) By making only a general reference to Article 12.2 of the general conditions, the Commission failed to state the exact ground for termination of the contract.
- (iv) In its decision to terminate the grant contract, the Commission failed to outline the appeal possibilities available to the complainant.

11. The complainant also claimed that the Commission should either acknowledge that the grant contract was still in force or enter into a new grant contract with it. Given that the Commission had, as a matter of fact, terminated its contract with the complainant, and given further that the complainant did not explain why the Commission should be obliged to conclude a new contract with it in order to undue the alleged maladministration, the Ombudsman decided that there were insufficient grounds to include these claims in her inquiry.

12. The Commission provided its opinion on the complaint and the complainant submitted comments on the position expressed by the Commission. The Ombudsman's decision takes into account the arguments and views put forward by the parties.

The allegation that the Commission wrongfully terminated the contract

Arguments presented to the Ombudsman

13. The complainant put forward two main arguments. First, it argued that the obligation to provide a financial guarantee was not a **substantial** obligation under the grant contract, but a payment arrangement aimed at supporting it in the implementation of the project. In the complainant's view, its inability to provide a financial guarantee did not therefore entitle the Commission to terminate the contract based on the ground that the complainant had failed to fulfil a **substantial** obligation incumbent on it.

14. Second, the complainant argued that the Commission had failed to apply properly the contract provision on the basis of which it terminated the contract. The complainant argued that



it had provided justifications as to why it could not provide a financial guarantee. The complainant also argued that the Commission had failed to discuss, or in any way address, its justifications and the solutions proposed by it for the continued implementation of the project before proceeding to the termination of the contract. In particular, the complainant reasoned that the Commission's refusal to enter into a dialogue and the absence of any information on how, if at all, the Commission had assessed the complainant's proposals to either forgo the provision of a financial guarantee or to lower the amount of the initial pre-financing payment led it to believe that those proposals were options it could continue to pursue. In the complainant's view, the Commission's termination of the contract was, in any event, disproportionate in light of the available options to continue implementation while limiting the financial risk for the EU budget.

15. In addition, the complainant argued that the Commission had failed to state the precise legal basis for the termination and failed to set out the appeal possibilities available to the complainant.

16. In its opinion, the Commission stressed that the complainant was legally obliged, under the contract, to provide a financial guarantee in order to secure the Commission's initial pre-financing payment. This obligation was included in the contract as the result of a risk assessment carried out by the Commission and of its application of the principle of sound financial management. As a profit-making company, the complainant did not fall within the general exemption from the provision of a financial guarantee for initial pre-financing in relation to a grant exceeding EUR 60 000, which, according to the Commission's rules, applies only to non-profit organisations, organisations having a framework partnership agreement with the Commission, public bodies and certain international organisations. By signing the contract, the complainant accepted its obligations as set out in the contract, including its obligation to provide the relevant financial guarantee.

17. On the point of the proposals made by the complainant, prior to the termination of the contract, the Commission stated that it had, contrary to the complainant's view, assessed these proposals. The assessment led the Commission to conclude that it was not legally possible under the contract to pursue the complainant's first proposal that the Commission make the initial pre-financing payment while forgoing the provision of a financial guarantee. As regards the complainant's second proposal, that the Commission lower the amount of its initial pre-financing payment, the Commission stated that such lowering would not have had any bearing on the complainant's obligation to provide a financial guarantee.

18. The Commission concluded that its termination of the contract was proportionate and in full compliance with the applicable provisions, given that the complainant was unable to fulfil its contractual obligation to provide a financial guarantee and given that it did not put forward a satisfactory and sound justification for this inability. The Commission pointed out that it was the complainant's responsibility to raise potential difficulties in obtaining the financial guarantee, and to propose alternative solutions, in the contract preparation phase.

19. As regards the statement of the ground for termination, the Commission conceded that it had not explicitly set out, in its termination letter, which provision of Article 12.2 of the general



conditions was the legal basis for termination. However, the Commission provided the complainant with the exact legal basis for termination, that is, Article 12.2(a) of the general conditions, in a further exchange of letters that took place shortly after the complainant had turned to the Ombudsman. On the same occasion, the Commission also informed the complainant of the possibilities to appeal the termination decision, which, the Commission acknowledged, it had omitted to do in its termination letter.

The Ombudsman's assessment

20. The complainant and the Commission concluded a contract for the award of a grant by the Commission to finance the implementation of the complainant's project with a maximum amount of EUR 299,518.52 or 80% of the estimated total eligible costs. Article 4.1 of the special conditions provided that the Commission was to make an initial pre-financing payment to the complainant. Article 4.2 of the special conditions provided that the first instalment of pre-financing had to be accompanied by a financial guarantee of the same amount, which had to comply with the requirements of Article 15.8 of the general conditions.

21. According to Article 15.8 of the general conditions, the Commission may request a financial guarantee for the amount of the initial pre-financing payment if a grant exceeds EUR 60 000. By default, this possibility is not resorted to if the grant recipient is a non-profit organisation, an organisation which has a framework partnership agreement with the Commission or a public body. Article 15.8 of the general conditions also specifies that the financial guarantee has to (i) be denominated in euro, (ii) be provided by an approved bank or financial institution established in one of the Member State of the European Union, and has to (iii) remain in force until its release by the Commission when the payment of the balance is made. Article 15.8 of the general conditions is a standard clause in the Commission's grant contracts for external actions financed from the EU budget.

22. Given that the grant awarded to the complainant exceeded EUR 60 000, and given that the complainant, a profit-making organisation, was not, by default, exempt from the provision of a financial guarantee, the Commission carried out a risk assessment based on the complainant's legal status, experience in the management of EU-funded grants and its operations and financial capacities. The exercise of its discretion led it to require that the complainant provide a financial guarantee to secure the initial pre-financing payment. The provision of a financial guarantee was thus made a contractual obligation in the contract's special conditions.

On the complainant's obligation to provide a financial guarantee

23. By signing the contract, the complainant accepted its obligation to provide a financial guarantee from an approved bank or financial institution established in the EU for the amount of the Commission's pre-financing payment.



24. Shortly after the contract entered into force, the Commission requested that the complainant fulfil its obligation to lodge a financial guarantee. The complainant informed the Commission that, since it did not have any business activity or bank account in the EU, it was not in a position to obtain a financial guarantee from a bank or financial institution established in the EU. The complainant also informed that Commission that it was not able to obtain a financial guarantee from a financial institution established in Tunisia. The complainant asked the Commission to consider two options in order to give it the financial support needed to jumpstart the project: (i) to release the initial pre-financing payment without requiring a financial guarantee or (ii) to lower the amount of the initial pre-financing payment.

25. The Ombudsman notes that the complainant thus explicitly informed the Commission that it was not able to fulfil its contractual obligation to provide a financial guarantee complying with the relevant contract provisions.

On the Commission's application of Article 12.2(a) of the general conditions in terminating the contract

26. Article 12.2 of the general conditions provides that the Commission may, after having duly consulted the grant recipient, terminate the contract in eleven different situations set out in letters (a) to (k). According to letter (a), the contract may be terminated if the grant recipient fails, without justification, to fulfil a **substantial** obligation incumbent on it after having been given notice, by letter, to comply with the obligation within 30 days from receipt of the letter (see paragraph 13 above).

27. First, the Ombudsman notes that the termination of the contract on the basis of letter (a) is possible only if the grant recipient fails to fulfil a substantial obligation. Given that the purpose of the grant contract between the Commission and the complainant was the financing of the complainant's project, the Ombudsman takes the view that any obligation related to the mode of financing, such as the obligation to secure the initial pre-financing payment with a financial guarantee, would appear to be a **substantial** obligation. The Ombudsman thus considers that the Commission could rightly consider terminating the contract on the basis of Article 12.2(a).

28. Second, the Ombudsman notes that Article 12.2 of the general conditions requires that the Commission duly consult the grant recipient before terminating the contract. This procedural obligation applies to any of the eleven grounds for termination. While letters (b) to (k) do not set out how precisely the Commission is to consult the grant recipient, letter (a) does. In fact, letter (a) provides that the Commission first request, by letter, that the grant recipient fulfil the relevant substantial obligation within a 30 day deadline. If the grant recipient still fails to do so once the deadline has expired, the Commission is entitled to terminate the contract. In the Ombudsman's view, letter (a) of Article 12.2 thus does not establish an additional procedural obligation for the Commission but specifies how the Commission is to fulfil its obligation to consult the grant recipient. The purpose of that consultation is, the Ombudsman understands, to give the other party the opportunity to clarify or to resolve the issue.



29. In the present case, the Commission fulfilled this procedural obligation. The Commission first contacted the complainant and asked it to provide the financial guarantee. In a second letter sent about one month later, the Commission confirmed to the complainant that it required the provision of the financial guarantee and it asked the complainant to comply with its obligation within 30 days from the date of dispatch of its letter. The Commission stated that it would otherwise proceed to the termination of the contract on the basis of Article 12.2 of the general conditions. Forty days after the dispatch of its second letter, the Commission proceeded to the contract termination. It follows that the complainant was, in fact, given significantly more than 30 days in order to provide the financial guarantee. The Ombudsman therefore finds that the Commission duly consulted the complainant as required by Article 12.2(a).

30. As regards the reasons put forward by the complainant as to why it was not able to provide a financial guarantee, the Ombudsman takes the view that the fact that the complainant did not have any bank account or professional activity within the EU did not constitute a justification or satisfactory explanation in the sense of Article 12.2(a) of the general conditions. What is more, the fact that the complainant was unsuccessful in obtaining a financial guarantee from a financial institution established in Tunisia could not possibly have any bearing on its obligation to provide a financial guarantee, given that the contract obliged the complainant to furnish a guarantee from a bank or financial institution established in the EU.

31. The Ombudsman also shares the Commission's view that neither of the two proposals put forward by the complainant, prior to the contract termination and in order to continue implementing the project, could have been pursued. Neither proposal would have resolved the underlying issue. The first proposal would have required the Commission to agree to making pre-financing payments to the complainant without **any** financial guarantee. The second proposal would not have removed the complainant's obligation to provide a financial guarantee. The view of the Commission was thus reasonable.

32. The Ombudsman also notes that the information provided by the complainant on its financial capabilities, in the context of its unsuccessful attempts to obtain a financial guarantee from a financial institution established in Tunisia, was such that the Commission could reasonably understand that the complainant would not be able to implement the project without any pre-financing.

33. The Ombudsman does not, therefore, find fault with the Commission's conclusion that further consultations with the complainant, beyond the procedural obligation to consult the complainant under Article 12.2 of the general conditions, were unnecessary.

34. Against this background, the Ombudsman concludes that the Commission's termination of the grant contract with the complainant was both lawful and reasonable.

35. The Ombudsman understands that the Commission makes pre-financing payments to grant beneficiaries in order to ensure that they have a certain level of cash flow which is needed for the implementation of the relevant grant project. Pre-financing aims at facilitating, in the interest and to the benefit of the grant beneficiary, the implementation of a grant project. The



Ombudsman therefore agrees that the provision of a financial guarantee by the complainant would not have been required if the complainant had used the opportunity provided during the pre-termination consultation period, to put forward the proposal not to obtain any pre-financing payments. However, the complainant did not make the proposal in good time. Rather, despite the fact that there was a specific period within which any issues would have to be resolved, it only put forward this proposal after the Commission had already terminated the contract. Thus, the Commission did not act unreasonably when it rejected the late proposal.

36. This notwithstanding, the Ombudsman believes that the Commission could, for future contracts, consider including, in the general conditions applicable to grant contracts for external actions financed from the EU budget, a standard provision entitling the grant beneficiary to renounce the initial pre-financing payment so as to remove its obligation to provide a financial guarantee, should the beneficiary be in a position to prove that it has the financial means necessary to carry out the project properly without pre-financing. Such an entitlement, which the Commission may make subject to its assessment that a grant beneficiary will effectively be able to carry out the project, would allow a beneficiary to choose in good time whether it is of greater assistance to its implementation of the project to receive pre-financing from the Commission, coupled with the obligation to provide a financial guarantee, or to be allowed to provide the necessary funds itself from its own resources.

On the statement of the legal basis for termination and the available appeal possibilities

37. The Commission failed to state, in its termination letter, which of the provisions of Article 12.2 of the general conditions it had relied upon for its termination of the contract. It also failed to set out the appeal possibilities available to the complainant to challenge the termination. This failure is clearly regrettable and occurred in breach of Articles 18.1 and 19.1 of the European Code of Good Administrative Behaviour. The Ombudsman notes, however, that the Commission provided this information to the complainant in a further exchange of correspondence. The Ombudsman therefore considers that the Commission has taken steps to settle these matters. In order to help avoid that such omission occurs in the Commission's termination letters in the future, the Ombudsman addresses two further remarks to the Commission.

Conclusion

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

The Ombudsman finds no maladministration by the Commission.

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



Further remarks

The Commission should consider including, in the general conditions applicable to grant contracts for external actions financed from the EU budget, a provision entitling the grant beneficiary to renounce the initial pre-financing payment so as to remove the grant beneficiary's obligation to provide a financial guarantee. The entitlement may be made subject to the Commission's assessment that the grant beneficiary will effectively have the financial means necessary to implement the action properly. To this end, the Commission may require that the grant beneficiary submit, together with the request to renounce the Commission's pre-financing, detailed and convincing explanations of how the beneficiary will practically be able to implement the action without pre-financing from the Commission.

In compliance with Article 18.1 of the European Code of Good Administrative Behaviour, the Commission should make sure to state, in a letter terminating a contract with a third party, the exact legal basis of that decision.

In compliance with Article 19.1 of the European Code of Good Administrative Behaviour, the Commission should make sure to set out, in a letter terminating a contract with a third party, the available appeal possibilities for the third party to challenge that decision.

Emily O'Reilly

Strasbourg, 23/03/2016

[1] Given that the complainant does not reside or have a registered office in the European Union, the Ombudsman could not deal with the complaint as such (see Article 2(2) Statute of the European Ombudsman). She decided, however, to investigate the concern raised in this case by means of an own-initiative inquiry.