

## Scottish Parliament Region: Highlands and Islands

### Case 200401189: Highlands & Islands Enterprise

#### Summary of Investigation

##### **Category**

Scottish Executive and Devolved Administration – Enterprise Bodies, handling of application

##### **Overview**

A solicitor, Mr C, complained that the Company he represents was misled by a local enterprise company giving reassurances that funding would be made available. The application was subsequently refused and Mr C claimed that this led to financial losses for the Company.

##### **Specific complaints and conclusions**

The complaints which have been investigated are that:

- (a) Inverness and Nairn Enterprise (INE) misled the Company by giving a reasonable expectation that the application for grant assistance would be successful and that the Company unjustly incurred costs as a result of the subsequent rejection of the application (*upheld*);
- (b) INE gave assurances that the beginning of preparatory work on site would not prejudice the likely success of the application. The beginning of such work was later used as a reason for rejecting the complaint (*upheld*);
- (c) INE did not alert the Company at the beginning of the application process to issues of displacement and additionality which would later form the basis for the rejection of the application (*upheld*); and
- (d) there were inconsistencies in the reasons offered to the Company for the rejection of the application (*not upheld*).

##### **Redress and recommendations**

The Ombudsman recommends that the Board of HIE:

- (i) apologise to the Company;
- (ii) review the way applications for financial assistance are supported to ensure clarity of expectations;
- (iii) address the need for clear, documented advice to applicants throughout that process; and
- (iv) ensure that all eligibility criteria are clearly addressed at the beginning and

throughout the application process.

## **Main Investigation Report**

### **Introduction**

1. On 24 September 2004, Mr C submitted a complaint about Inverness and Nairn Enterprise (INE) to the Ombudsman on behalf of a leisure company (the Company) which had approached INE for financial assistance. The Company were seeking grant funding to assist a project to develop an existing hotel's facilities to include an enhanced conference capability. Mr C claimed that the Company received assurances from INE that funding would be made available. When the application was finally rejected at a late stage in the project's development, Mr C complained that the Company had already incurred costs on the assumption that funding would be made available.

2. In keeping with normal procedure, Mr C's complaint against INE was considered through the complaints process of the Highlands and Islands Enterprise Network (HIE), of which it was a constituent part.

3. The complaints from Mr C which I have investigated are that:

- (a) INE misled the Company by giving a reasonable expectation that the application for grant assistance would be successful and that the Company unjustly incurred costs as a result of the subsequent rejection of the application;
- (b) INE gave assurances that the beginning of preparatory work on site would not prejudice the likely success of the application. The beginning of such work was later used as a reason for rejecting the complaint;
- (c) INE did not alert the Company at the beginning of the application process to issues of displacement and additionality which would later form the basis for the rejection of the application; and
- (d) there were inconsistencies in the reasons offered to the Company for the rejection of the application.

### *Background*

4. The Company made initial inquiries by telephone to INE on 27 March 2003 about possible assistance with the development of a hotel. The Company leased the hotel from a charitable trust and sought to develop it on behalf of the trust. The development would focus on an upgrade of rooms and the creation of a conference facility. The assistance would come from INE's 'Finance for Business' scheme. The initial inquiry was backed up with further telephone contact on 3 April 2004 leading to a preliminary meeting the following week. At

this meeting, INE indicated that support would be limited to the conference facility and that it would be more appropriate if the facility was larger than originally planned. There is no note of this meeting, however, officers of INE confirmed that they had given this advice when interviewed during the investigation of the complaint.

5. An investigation officer (Officer 1) was assigned to assist the application by offering advice to the applicants and their professional advisers. INE have advised that the key role of the investigating officer is to undertake the project appraisal. Officer 1 has confirmed that his role was to advise the company and their professional advisers about the information that is required for submission with their application for assistance. On receipt of an application, he would then prepare a report and make a recommendation to senior managers of INE. A further meeting took place on 26 May 2003. This was followed up by an application form for financial assistance being sent to the Company with a supporting letter on 28 May 2003. Following further meetings, telephone calls and email correspondence with INE, the Company submitted their application on 10 September 2003 for £200,000 to assist the building of a 400 seat conference facility. The Company's interests were represented during this process by the managing director of the management company which would operate the refurbished hotel (Ms A).

6. Some of the required information was not submitted with INE's application on 10 September 2003 and Officer 1 sought this from the Company to complete the process of determining the application. Following receipt of a formal application, a full investigation was undertaken by the project officer to assess whether or not financial assistance can be justified, and at what level. The required information sought by the project officer included further details about the financing of the project, a fuller assessment of its economic impact and documents relating to building and planning issues. HIE undertook these inquiries to ensure 'due diligence'<sup>1</sup>, as they do in their investigation into all applications for receipt of discretionary public funding. All this information was included in a project appraisal which was prepared in keeping with guidance used across the HIE Network. The appraisal also assessed the project in terms of the ways in which it would contribute to the Network's strategic objectives. The required information was supplied by the Company's surveyors, solicitors

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<sup>1</sup> This term is used to describe the careful scrutiny of proposals for assistance in order to ensure the best use of funds.

and accountants, and by INE's own experts in the two and a half months following the submission of the application.

7. On 9 December 2003, the Company were advised to withdraw their application on the grounds that it was unlikely to be successful. The Company asked for the application to be considered by the Board of INE, which they did on 18 December 2003. The Board agreed with the Chief Executive's recommendation to refuse the funding and this decision was ratified by the HIE management group on 22 December 2003.

### **Investigation**

8. In order to establish the Company's claims, I have reviewed correspondence between officers of INE and representatives of the Company during and following negotiations around the application for financial assistance. In addition, I have examined documentation relating to the application process and evidence submitted in support of the Company's specific application. I made written inquiry of HIE on 9 February 2005 and received a detailed response on 2 March 2005. Interviews were conducted with those most closely involved with the process both from INE and from the Company.

9. I have not included in this report every detail investigated but I am satisfied that no matter of significance has been overlooked. Mr C and the Board of HIE were given an opportunity to comment on a draft of this report.

### **(a) INE misled the Company by giving a reasonable expectation that the application for grant assistance would be successful and that the Company unjustly incurred costs as a result of the subsequent rejection of the application**

10. The Company claimed that INE was supportive of its application, gave a reasonable expectation that it would be successful and assured them that money had already been set aside for the project. In particular, the Company claimed that the decision to build a larger conference facility than originally envisaged was only taken at the suggestion of INE – a suggestion which the Company supported – and in the expectation that this additional work would be funded by a discretionary grant.

11. The Ombudsman office's interview notes and items of correspondence contain recollections from participants from both sides of the negotiation which confirmed that the Company's initial intention had been to build a conference

facility capable of accommodating around 200 guests, but that INE had suggested that support would only be offered to a larger facility for around 400 people [see paragraph 4]. This would be to avoid a displacement<sup>2</sup> effect with another local hotel with a conference capability of a similar size to that initially proposed. It was made clear from the beginning that INE would not be able to award financial assistance for the development of the hotel's bedrooms.

12. The Company maintained that, although they saw the benefits of the larger facility, they only proceeded with this initiative because they had received assurances that INE would grant funding. At interview, officers of INE said that no such assurances were given and that the rigorous process for deciding whether a project merited support precluded this. This position was also asserted by HIE's Chief Executive in his submissions to the Ombudsman's office on 2 March 2005 and 13 October 2005. This is further supported by the caveats contained in HIE's covering letter to the Company when they sent an application form on 28 May 2003 and in the text of the form itself. These caveats state that the applicant cannot assume that funding is secure until a written confirmation of a decision has been received and that costs incurred before that point are at the applicant's risk. HIE stated that they were not in a position finally to determine the eligibility of the application until they had received further information not included with the application form received on 10 September 2003. This information related to the financial position of the Company and building costs for the project and was not received until 3 November and 28 November 2003 respectively. Further assessment was also made of the economic impact of the project by INE at this time.

13. However, at interview on 3 April 2006, Ms A stated that she was reassured that these caveats were formalities and that the application was supported and would be successful. HIE stated that such reassurances were not given by Officer 1. At interview, Officer 1 confirmed that, although he did not regard the project as having the strongest case for support, he considered that it would be supported by the Board. He had consistently recommended that the application be supported and his correspondence indicates this. He made these statements:

'We are proposing assistance to the new function room/conference area'  
(email to a colleague of 17 September 2003).

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<sup>2</sup> See definition in paragraph 25

'We also remain supportive of the plans for [the hotel].' (In a letter of 8 October 2003 to the Company's accountants which explains the need for due diligence in assessing the financial status of the Company.)

14. In addition, HIE's project appraisal document of 10 December 2003 said that '[the Company] have only proceeded [with some of the works] with a reasonable expectation of INE assistance'. This document also confirms earlier indications that INE was satisfied that the development of a conference facility was consistent with the strategic objectives for the economic development of the area.

15. The three officers from INE who were interviewed in the course of the investigation confirmed that it is unusual for an application to be refused at such a late stage of the process. Although the information necessary to make a decision was only available at this late stage, Officer 1 and his manager (Officer 2) confirmed at interview that they were still supportive of the proposals in the light of this information.

16. A further contention of the Company was that they had been assured that money had been set aside for the project. This is contested by officers of INE at interview and by HIE's Chief Executive in his submissions to the Ombudsman's office. According to HIE's processes, funds cannot be allocated until a final decision is made by the appropriate delegated authority. However, in the notes of meeting between officers of INE and HIE and representatives of the Company on 2 February 2004, HIE's Chief Executive acknowledged that:

'From a budgeting perspective funds could well have been allocated internally but this in no way could be construed as a formal financial approval.'

17. The Company claimed that preparatory work to build the larger facility carried costs which they had assumed would be covered by a grant. The value of this grant would have been around £200,000 and this figure formed part of the early discussions between INE and the Company. It is not easy to determine what the additional costs to build a larger facility would have been, as the Company had planned to revert to their original plans in the absence of financial support from INE, but these costs included the purchase of materials and the preparation of the site.

*(a) Conclusion*

18. The evidence provided by INE's officers at interview confirmed that it is unusual for a proposal which it has supported throughout the application process to be refused funding at a late stage (see paragraph 14). These officers stated that the reason this happened in this case was that insufficient detail was provided for a full assessment to be made until late November 2003. However, the Company consistently maintained that they felt reassured that they would receive funding for the project. From the evidence I have received, it is clear that the officers from INE supported the application and had a reasonable expectation that the recommendation for approval would be successful. On consideration, I have no reason to disbelieve the Company's contention that they were reassured in their dealings with INE's officers that their application was likely to be successful. The officers involved were highly experienced in this field and held senior posts within the organisation. Furthermore, despite the caveats which are clearly presented in INE's letter of 28 May 2003, it is possible that there was sufficient ambiguity in references to internal budget allocations to lead to a misunderstanding on the Company's part that funding had been set aside. Although I have not seen any evidence to suggest that INE intended to mislead the Company in any way, it was in support of the application until a late stage in the process and I believe from the evidence that it was reasonable for the Company to have an expectation of success. I conclude that the support offered by INE went beyond the neutral advice that would normally be expected during the application process and it was reasonable for the Company to construe this as support for the funding bid itself.

19. The Company invested in the larger conference facility following advice from INE and having been given a reasonable expectation of funding from INE. This expectation was founded on the consistent support for the project expressed by INE's officers. The expectation was not met when the application was finally refused and, therefore, the Company suffered an injustice. On balance, I uphold this complaint because, while the Company were aware of the caveats given by INE, they reasonably assumed that the support and encouragement of INE's officers for the application would lead to a successful outcome.

*(a) Recommendation*

20. I recommend that the Board of HIE apologise to the Company and reviews the way applications for financial assistance are supported to ensure clarity of



expectations. Because of the clear statement from INE that any costs incurred prior to a final decision are made at the applicant's own risk, I do not believe that the Board should bear any financial liability for such costs in this case. In addition, it was the Company themselves who eventually took the decision to proceed with the building of the larger conference facility.

**(b) INE gave assurances that the beginning of preparatory work on site would not prejudice the likely success of the application. The beginning of such work was later used as a reason for rejecting the complaint**

21. The Company claimed that the support given to their application for funding gave them sufficient confidence to begin some preparatory work on the development site to meet their tight timescales. More specifically, they claimed that INE gave assurances that the application would not be jeopardised by beginning such work.

22. It is clear from internal emails and from interviews with the officers involved that INE were aware that the Company intended to begin work on site. Indeed, the Company stated that they sought INE's views on whether this work would cause problems for the application process. In his interview on 16 January 2006, Officer 1 confirmed that the Company had sought his views. He said that he did not give approval for work to start but that he was not in a position to tell them not to start. In email correspondence with a colleague between 26 and 28 November 2003, he had acknowledged the need to finalise the process quickly because the Company had begun preparatory work on site. In a note of a telephone call to the Company's representative on 9 December 2003, he also wrote that he advised the representative that he had not felt able to ask the Company to await approval before beginning work because of the April 2004 deadline for the project.

23. One of the most important criteria for establishing eligibility for assistance from the HIE Network is 'additionality'. This is described as follows in HIE's guidance for project appraisal:

'In simple terms, this means approving all forms of assistance only when there is reasonable certainty that the project or activity to be assisted would not proceed in the absence of the Network intervention.'

24. When the Board of INE came to consider the completed project appraisal on 18 December 2003, the beginning of work on site was cited as one of five reasons for rejecting the application on the grounds that this demonstrated the

ability of the Company to meet its costs without INE assistance. It should be noted that the merits of INE's judgement about the eligibility of the project for assistance are not under investigation here.

*(b) Conclusion*

25. I have not seen evidence to suggest that INE gave active approval or encouragement for the Company to begin preparatory work. However, nor have I seen evidence that when INE became aware of the intention to start works that the Company were reminded that the application had not been determined and that they were doing so at their own risk. I would have expected such a reminder to be given. I have already concluded that the Company had a reasonable expectation of a successful application for funding. In light of that expectation, the absence of an expression of concern from INE when they were informed of the beginning of work on site reasonably led the Company to conclude that its application would not be jeopardised. Indeed, Officer 1's correspondence suggests that he was concerned about the tight timescales involved, but not about the impact of the work on the processing of the application. In the circumstances, I uphold this complaint.

*(b) Recommendation*

26. I recommend that, when the Board of HIE undertake a review of the process of supporting applications for funding, they should address the need for clear, documented advice to applicants throughout that process.

**(c) INE did not alert the Company at the beginning of the application process to issues of displacement and additionality which would later form the basis for the rejection of the application**

27. The document setting out HIE Network's criteria for assessing applications for funding include additionality, which is described above in paragraph 22, and displacement, which the same document described as:

'... a reduction in economic activity elsewhere caused by new or expanded activity in known location ...'

28. When the project appraisal document was completed, the author concluded that the proposed development did not meet these tests. At his interview on 10 February 2006, INE's Chief Executive cited these as the main reasons for recommending rejection.

29. One of the reasons for concluding that the proposed assistance was not

additional is outlined above (paragraph 21). The other was that INE considered that the financial information provided to them on 3 November 2003 demonstrated that the charitable trust which was largely funding the Company's project had the means to fund the project without assistance. In any case, the financial support was always considered to be only partly additional because it was intended to increase the capacity of the proposed facility rather than fund it in its entirety.

30. The Company complained that the Board should have been aware of the resources available to them, as the director of the Company (who made the initial approach for assistance and signed the application) was already well known to them because of collaboration over another project involving another of his companies. Therefore, they argued that INE should have alerted the applicant to this issue earlier in the process. I have not found evidence to suggest that INE alerted the Company to the possibility that the application may be refused on these grounds and it is reasonable to expect that this could have been highlighted as a potential problem earlier in the process.

31. By contrast, the assessment of displacement by the new development was identified as an issue at the beginning of the process. The suggestion of building a larger facility as a way of reducing displacement was made at initial meetings between the Company and INE in April 2003 (see paragraph 4). In addition, Officer 2 drew attention to this issue in an internal email of 4 April 2003. Further assessment of potential displacement was made as the project appraisal was being concluded in early December 2003 and an independent assessment was made between the consideration of the application by INE's Board on 18 December 2003 and the review of the decision by the HIE management group on 22 December 2003.

32. All of this suggests that, throughout the process, displacement was of ongoing concern to INE. However, there is no evidence of displacement being raised as a concern with the Company between its initial meeting with INE in April 2003 and the Board's final decision in December 2003. Therefore, it was reasonable for the Company to consider that the issue had been addressed by accepting the suggestion of a larger facility so that the refurbished hotel would be competing in a fresh market.

*(c) Conclusion*

33. In relation to the 'additionality' criterion, it is reasonable to conclude that

INE had sufficient cause to be aware of potential problems early in the application process and to expect that this would have been addressed specifically in the course of that process. It is also reasonable to conclude that INE were aware of potential displacement problems at the earliest stage and that the Company were not made aware that this issue was ongoing. Therefore, I uphold this complaint.

*(c) Recommendation*

34. I recommend that, when the Board of HIE undertake a review of the process of supporting applications for funding, they should ensure that all eligibility criteria are clearly addressed at the beginning of the process and throughout.

**(d) There were inconsistencies in the reasons offered to the Company for the rejection of the application**

35. In a further statement of the Company's complaint, sent to the Ombudsman's office on 4 August 2005, Mr C complained there were inconsistencies in the reasons offered by INE for the rejection of the application. In particular, he complained that some of these reasons were not relevant and that some were unreasonable and unfair. He referred to INE's project appraisal, to a memo which introduced it to the Board, and to minutes from the Board meeting and that of HIE's management group.

36. HIE's Chief Executive, in his letter to the Ombudsman's office of 13 October 2005, explained that the contents of the memo, and elements of the project appraisal were not given as reasons for rejection but as background to these reasons. The reasons were stated clearly in the appraisal document and were reiterated by INE's officers during their interviews.

*(d) Conclusion*

37. HIE and INE have consistently maintained that the principal reasons for rejecting the application were that the proposal did not meet criteria relating to additionality and displacement. I have not seen any inconsistencies and I do not, therefore, uphold this complaint.

23 May 2007

**Explanation of abbreviations used**

Mr C	The complainant, a solicitor acting on behalf of the Company
INE	Inverness and Nairn Enterprise – a local enterprise company which was part of the Highlands and Islands Enterprise Network.
The Company	A leisure company which owned the hotel which was the subject of the grant application.
HIE	Highlands and Islands Enterprise Network
Officer 1	The officer of the local enterprise company assigned to the case
Ms A	The managing director of the company which would manage the refurbished hotel on behalf of the Company.
The Board	The Board of Inverness and Nairn Enterprise. When the Board of Highlands and Islands Enterprise is referred to, it is called ‘the Board of HIE’.
Officer 2	The officer of the local enterprise company who lead the customer facing team