



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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B-159451

OCTOBER 4, 1979

The Honorable Harold Brown
The Secretary of Defense

Dear Mr. Secretary:

Subject: Improper Blocking of U.S. Funds by
Office of Foreign Assets Control
(ID-79-52)

AKC 1236

We are reviewing the blocking of the assets of foreign governments and nationals during times of war or national emergency by the Department of Treasury's Office of Foreign Assets Control. In the course of our review, we have discovered what we believe to be an improper blocking of more than \$6,000,000 plus interest in Department of Defense (DOD) appropriated funds. We recommend that you take immediate action to recover these funds for the United States.

The funds in question were prepayments for undelivered commodities under a DOD scheme to circumvent the 1973 Arab oil embargo in order to continue furnishing petroleum, oil and lubricants to the Republic of Vietnam. DOD furnished these supplies out of appropriated funds as part of the residual supply and support activities on behalf of Vietnam after withdrawal of U.S. military forces. These activities were conducted by a largely civilian force of Americans employed by the Defense Attache Office in Saigon. These prepaid amounts were blocked effective April 30, 1975, under the Foreign Assets Control Regulations and have remained so to the present time.

Enclosure I explains in detail the origin and implementation of the embargo circumvention scheme and the absence of any Vietnamese interest in the blocked funds and shows that the moneys were at all times public funds of the United States.

AKC 2023

Recommendations

We recommend that you:

- Investigate this matter and verify the information provided in this report.



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*Financial
Fund Management
Bank deposits*

*fuel supplies
fuel sales
Foreign sales
Questionable
payments
Foreign military
assistance
Purchase agreements
International
agreements*

IMPROPER BLOCKING OF U.S. FUNDS BY
OFFICE OF FOREIGN ASSETS CONTROL

BACKGROUND

Before October 1973, DOD supplied petroleum, oil, and lubricants (POL) to the Republic of Vietnam directly by open market purchases from major international suppliers out of appropriated funds under Defense Supply Agency contracts. When the fourth Arab-Israeli war broke out in October 1973, the Arab oil-producing countries embargoed POL sales and shipments to the United States and other Western nations. The Republic of Vietnam was not an embargoed country.

In November 1973, as a result of the embargo, the three major Vietnam suppliers, Caltex Asia Ltd., Shell, and Esso Eastern exercised the "force majeure" clauses in their Defense Fuel Supply Center contracts. The Defense Attache Office in Saigon was temporarily able to meet Vietnam's requirements from U.S. Pacific Command War Reserve stocks. Congress, however, put an end to this practice of using U.S. Defense stocks by including the following language in the 1974 DOD Appropriation Act (Public Law 93-238, §746, 87 Stat. 1046, Jan. 2, 1974):

"None of the funds contained in this Act shall be used to furnish petroleum fuels produced in the continental United States to Southeast Asia for use by non-United States nationals."

On November 9, 1973, the Secretary of Defense communicated with the Defense Attache Office in Saigon concerning possible methods of circumventing the Arab oil embargo, and after a series of messages, a plan for doing so was established.

The POL suppliers were willing to go along with the embargo circumvention scheme only on condition that (1) the sales could not be traced back to the United States, (2) payment in U.S. dollars be made in advance, and (3) they not be required to negotiate directly with Vietnam. Initially, some consideration was given to simply making a grant of money to Vietnam to buy its own supplies. However, the conditions imposed by the oil companies made such an approach unworkable, and it was determined that the best interests of the United States required retention of fund control.

A plan was therefore carefully designed to conceal the fact that the POL contracts were negotiated by a U.S.

employee and funded by the U.S. Government. This was accomplished by means of an elaborate subterfuge whereby purchases were ostensibly made in the name of the Republic of Vietnam armed forces. There was never any doubt that U.S. Government funds were underwriting the contracts. A paramount consideration in evolving the plan was a desire to ensure that neither Vietnam nor its armed forces exercised any control over the funds. Instructions from the Secretary of Defense specifically required that well-defined audit trails be established and that the contracts and other pertinent documents be maintained for a period of not less than 3 years for inspection and audit by U.S. Government personnel.

The entire plan was considered extremely sensitive and information was limited to a strictly need-to-know basis. Although much of this information is now declassified, the details have been obscured by the passage of time and lack of existing documentation. We have, however, been able to reconstruct what we believe to be the essential elements of the plan as actually put into practice.

THE EMBARGO CIRCUMVENTION SCHEME

The Chief of the Defense Attache Office's Petroleum Section, Army Division, was designated as the "representative of the United States for POL Procurement" (RUSPOL). He then obtained from the Vietnamese Lieutenant General, who served as both the Commander of the Vietnamese armed forces' central logistics command and deputy chief of staff for logistics, a letter purporting to appoint him to negotiate, consummate and order against POL contracts on behalf of Vietnam. The Vietnamese officer was fully aware that the letter was a cover only. RUSPOL was at all times a U.S. Civil Service employee acting exclusively on behalf of the U.S. Government and received no compensation from Vietnam.

RUSPOL (in the guise of Vietnamese armed forces' Representative for Petroleum Affairs) negotiated and signed the necessary POL contracts. Initially, the only contract negotiated was with Shell, through its Hong Kong subsidiary South East Asia Services Limited. Later, Esso Eastern and Caltex also entered into POL supply contracts.

Since payment was required to be made monthly in advance, RUSPOL would prepare a supply plan showing, by product, the quantities to be delivered during the following month. The plan was forwarded to the commercial POL supplier, who prepared a provisional pricing estimate or "pro forma invoice"

indicating the price to be paid for the proposed deliveries. (Actual prices were those applicable on the date of POL delivery.)

Upon receipt of the pro forma invoices, RUSPOL would request from the Defense Attache Office "Programs Branches" of the respective U.S. service divisions (e.g., "Army Division") in Saigon the fund cites to cover the prepayments. Upon receipt of the fund citation, RUSPOL would issue a draft disbursement voucher to the Defense Attache Office Comptroller. Upon approval by the Comptroller, the Disbursing Officer would prepare a final disbursement voucher. The payee on the voucher was the National Bank of Vietnam. Accordingly, a U.S. Treasury check would be issued payable to that bank. RUSPOL would then prepare and sign (as Vietnam armed forces Representative for Petroleum Affairs) a letter addressed to the bank directing it to deposit the appropriate amounts into specific accounts of each POL supplier and to "[A]cknowledge receipt of the attached cheques by your endorsement hereon." (Emphasis added.)

RUSPOL would hand-carry the U.S. Treasury check, together with the letter of instruction specifying how and to whom the total amount of the check was to be disbursed, to the bank's foreign affairs department. Thereafter, a bank officer would endorse the U.S. Treasury check "For Deposit to the Account of the National Bank of Vietnam with the Chase Manhattan Bank in New York."

Although the check was made payable to and was endorsed by the National Bank of Vietnam, the Chase Manhattan Bank in Saigon did not credit the money to the Vietnamese bank's account. ^{1/} Thus, the funds never were paid to the National Bank of Vietnam or to other Vietnamese public or private parties. Rather, Chase Manhattan in Saigon would debit immediately the account of the Treasurer of the United States on its books and would then cable Chase Manhattan in New York instructions to make the appropriate transfers to the POL suppliers on the same day by debiting the account of the Chase Manhattan in Saigon on its books. (It should be noted that the cost of these cables was borne by the U.S. Government.)

^{1/}This procedure differed from instructions set forth by the Office of the Secretary of Defense, which provided for an exchange of checks between RUSPOL and the Republic of Vietnam.

Also on the same day, Chase Manhattan in Saigon would send a cable to the U.S. Treasury in Washington, D.C., to advise that Treasury's Saigon account was overdrawn (by the amount transferred to the POL suppliers). In accordance with a prearranged procedure, Treasury would then replenish its Saigon account by remitting funds to Chase Manhattan in New York for credit to the Saigon account on the same day.

To complete the transaction, Saigon would mail the U.S. Treasury check that had been issued payable to the National Bank of Vietnam to the U.S. Treasurer in Washington under cover of a form for Transcript of the General Account of Treasurer of the United States. In other words, the check was never negotiated in the traditional manner; rather it was a mere cover to cloak the fact that U.S. funds were being disbursed by the Chase Manhattan Bank in New York at U.S. Government instruction.

After the POL suppliers obtained the agreed upon payment from New York (ostensibly from the Saigon U.S. account), they would ship the POL products to the Vietnam armed forces. To ensure that the suppliers actually delivered the POL products to Vietnam, RUSPOL was to obtain a receipt documenting delivery of the quantity appearing in the supplier's invoice.

BLOCKING OF SOUTH VIETNAM AND SUBSEQUENT
PCL PREPAYMENT RELATED DEVELOPMENTS

On May 2, 1975, the Department of the Treasury's Foreign Assets Control Regulations (40 Fed. Reg. 19202) were made applicable to South Vietnam, effective April 30, 1975. This resulted in the blocking of all accounts under U.S. jurisdiction in which Vietnam or any of its nationals had an interest.

On May 19, 1975, the Residual Saigon Defense Attache Office in Hawaii requested in writing that Esso Eastern Products and Trading Company, Houston, Texas, (Esso Eastern) return to DOD the POL prepayments made before April 30, 1975, under the embargo circumvention scheme. (For reasons of convenience, the scheme had been continued even after the embargo was lifted.) A formal demand for return of the prepayments, however, was not made.

A similar request for return of prepayments was made to Shell on June 2, 1975. Shell responded by letter of June 5, 1975, and enclosed a check for \$573,015.62. This

amount was arrived at in a reconciliation of accounts undertaken by Shell and Defense personnel. Based upon the information available to us, Caltex was no longer supplying POL to Vietnam and thus no prepayments were outstanding.

By letter of May 28, 1975, Esso Eastern refused to return its POL prepayments. It interpreted the Foreign Assets Control Regulations as prohibiting any transaction involving the advance payments, since "it would necessarily affect an interest of the Republic of Vietnam, a designated national." Esso Eastern further stated that, apart from the impact of the regulations, it would not be in a position to release the funds until it had "more complete knowledge of the various rights and obligations relating to [Esso Eastern's] business in Vietnam."

Representatives of Esso Eastern did, however, consult with the Residual Defense Attache Office to reconcile accounts. A total of seven Esso Eastern contracts for POL and related services to the Vietnam armed forces were reviewed, and it was determined that a net amount of \$6,054,759.06 in prepayments had been received.

This amount was determined by setting off amounts due on certain incountry contracts with Esso Eastern, Vietnam Branch, against prepayments made on account for POL contracts with Esso Eastern, Houston, Texas, negotiated in accordance with the embargo circumvention scheme. Also included were prepayments made on account for an incountry service contract for receipt, storage, and delivery of POL. The remaining incountry supply contracts were not prepayment type contracts and, as a consequence, moneys for supplies already delivered were due Esso Eastern at the time Saigon fell. The setoff is shown below.

| | |
|--|------------------------------|
| U.S. Government prepayments to Esso for products and services | \$7,108,887.84 |
| U.S. Government amounts due Esso for delivery of products and services | <u>-1,054,128.78</u> |
| Net | <u><u>\$6,054,759.06</u></u> |

ENCLOSURE I

All the contracts were taken into consideration at the time of reconciliation of the accounts because they were negotiated and signed by RUSPOL. Thus, both the prepayment and post payment contracts were, in reality, contracts of the U.S. Government for POL and related services to Vietnam.

It is important to note that the reconciliation of accounts was undertaken by the Residual Defense Attache Office because the funds in question were the property of the U.S. Government. Indeed, if the funds were properly subject to blocking, the setoff in favor of Esso Eastern was unauthorized under the Foreign Assets Control Regulations. Thus, all the prepayments, or \$7,108,887.84, would have been subject to blocking rather than the net amount.

The relevant prepayments were primarily made on account of two distinct contracts entered into by Esso Eastern for supplying POL to the Vietnam armed forces. One of these contracts was for motor gasoline, turbo fuel, and diesel fuel and specified that "Title to products shall pass to RVNAF [Republic of Vietnam armed forces] at the ship's permanent hose connection as product is pumped into Esso's Nha Be Terminal." The other relevant contract was for the supply of "drummed asphalt" and provided that "The title to the goods and risk of loss shall pass to the Buyer at the ship's rail at the unloading port."

On July 7, 1975, Esso Eastern requested permission from the Office of Foreign Assets Control (OFAC) to transfer the \$6,054,759.06 into an interest bearing account. OFAC's Acting Director met with Esso Eastern representatives on September 7 to discuss the request. In a subsequent letter to OFAC on September 25 containing additional information, Esso Eastern expressed fear of a potential "double recovery" against it. The letter further stated that

"an essential condition of payment from the foreign account is our receipt of legally enforceable indemnification * * *. It also seems necessary to provide for the possibility that Esso Eastern itself might be entitled to reimbursement from the funds in certain contingencies * * *."

In an October 2, 1975, telephone conversation with an attorney in the Department of Justice's Foreign Litigation Unit, the OFAC Acting Director expressed the view that, since the money had been blocked as an asset of Esso Eastern,

little could be done pending a congressional decision on how the funds would be distributed. The Acting Director stated that "the United States would just have to stand in line like any other claimant."

On October 8, 1975, OFAC issued a license to Esso Eastern authorizing transfer of the \$6,054,759.06 into an interest-bearing, blocked account in a domestic bank. This transfer of funds was actually accomplished on December 29, 1975, when the funds were invested in a non-negotiable, 180-day certificate of deposit of a major New York Bank.

On September 21, 1978, the Assistant Attorney General for the Department of Justice's Civil Division wrote to the OFAC Acting Director requesting that OFAC unblock the \$6,054,759.06, plus accumulated interest, or license its release to the United States. Attached to that letter was a detailed memorandum setting forth the origins of the moneys and demonstrating that they were at all times public funds of the United States.

To date, OFAC has failed to either unblock the funds or license their release to the United States. As of December 26, 1978, the funds plus accumulated interest amounted to \$7,297,878.81.

CONCLUSION

The \$6,054,759.06 plus interest now held by Esso Eastern Inc., of Houston, Texas, and blocked by OFAC was at all times the property of the United States. The facts demonstrate the absence of any Vietnamese interest in the moneys, and the moneys therefore should be returned to the U.S. Government without further delay.

The moneys represent prepayments made from U.S. public funds for the purchase of POL products to be shipped to the Republic of Vietnam armed forces, whose only interest in these transactions was that title to the POL products would pass to them upon "the ship's permanent hose connection as product is pumped into Esso's Nha Be Terminal" or "at the ship's rail at the unloading port." No POL for which the prepayments in question were made was ever delivered to the Vietnam armed forces. The scheme under which the funds came into the hands of Esso Eastern was a mere sham designed to cloak U.S. financing of the transactions.

It bears emphasis that the sole intent of the U.S. Government in implementing the embargo circumvention scheme

outlined above was to continue supplying POL products to Vietnam. The funds to pay for these products were and always remained U.S. Government funds, under disbursement control of a U.S. Civil Service employee. The National Bank of Vietnam acted as a mere diversionary conduit, providing a means for transferring the funds from the U.S. Treasury to the POL suppliers.

Sworn statements from those at the Defense Attache Office in Saigon with knowledge of the scheme, as well as from the Vietnam armed forces officer involved in the operation of the scheme, demonstrate that there was unanimous agreement and awareness that the funds were owned by the U.S. Government. The Vietnamese officer also stated that the entire arrangement for the transfer of the funds through the National Bank of Vietnam was possible only because the funds were U.S. Government funds. The laws of the Republic of Vietnam in force at the time prohibited the unlicensed use of dollars; consequently, its use of dollars for purchase of the POL products was legally impermissible.

*AAC 101
AAC 304*

- Request that Treasury unblock or license the release to the United States of the \$6,054,759.06, plus accumulated interest.
- Make a formal demand on Esso Eastern for return of the moneys.
- Refer the matter promptly to the Department of Justice for initiation of legal action to recover the funds for the U.S. Government.

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We are sending copies of this report to the Chairmen of the House Committee on Government Operations, Senate Committee on Governmental Affairs, and House and Senate Committees on Appropriations and Armed Services; the Secretary of the Treasury; and the Attorney General of the United States.

Section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving a copy of these statements.

The matters contained in this report have been previously discussed with officials in your Department and those of other agencies as applicable. If you desire, the supporting documentation for our facts and conclusions is available for your examination.

Sincerely yours,

James A. Harte

Comptroller General
of the United States

*Also -
Vietnam, South*

Enclosure