



OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 10, 2016

OIG- CA-17-006

The Honorable Orrin Hatch
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Hatch:

This responds to your letter dated September 13, 2016, which requested our review of the Department of the Treasury's (Treasury) January 19, 2016 payment to the Islamic Republic of Iran (Iran). In brief, one payment, of approximately \$1.3 billion, was made from the Judgment Fund, which is administered by Treasury's Bureau of the Fiscal Service (Fiscal Service). Fiscal Service did not disburse 13 separate payments of \$99,999,999.99 and one payment of \$10,390,236.28 as shown in the results of the Judgment Fund Payment Search.¹ Instead, Fiscal Service processed a single claim from the Department of Justice (DOJ), the submitting agency on behalf of the Department of State (State).² Because of system limitations, DOJ divided the amount of this claim into 14 smaller amounts in the Judgment Fund system. These smaller amounts were then processed by Fiscal Service through several information technology applications and the requests were aggregated such that only one payment of approximately \$1.3 billion was made. This single payment was made by Fiscal Service through the Federal Reserve Bank of New York (FRBNY) to De Nederlandsche Bank (DNB). We were able to confirm this single payment through review of source documents. DNB was provided instructions to convert the \$1.3 billion into Euro banknotes and

¹ See the Judgment Fund Payment Search at:

<https://jfund.fms.treas.gov/jfradSearchWeb/JFPymtSearchAction.do>

² According to the *Treasury Financial Manual*, the responsible agency must submit the required forms and supporting documentation to request certification of payments from the Judgment Fund. In regard to this payment, DOJ submitted the claim, including the required forms and supporting documentation on behalf of State.

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disburse up to three payments to an agent of Central Bank of Iran (CBI) on or before specified dates. Source documents providing evidence of the transactions between DNB, and CBI and its agent were not available to us and therefore not reviewed by our Office.

When we asked why the claim was divided into 14 smaller amounts when only one payment was ultimately made from FRBNY to DNB, Fiscal Service personnel told us that its Judgment Fund Internet Claims System (JFICS), where requests for payment from the Judgment Fund are required to be entered, has a technical limitation that prevents it from processing requests over 14 characters in length.³ This system limitation is documented in Fiscal Service's Judgment Fund *Business Rules*⁴ and we observed Judgment Fund Branch personnel demonstrate the entry of test cases into JFICS, which further confirmed the existence of the technical limitation.

On January 17, 2016, State executed the *Partial Settlement Agreement in Case No. B1 (Claims 2&3)* between Iran and the United States (hereinafter referred to as the "partial settlement agreement"). The partial settlement agreement resolved certain claims in a dispute regarding a 1979 Memorandum of Understanding (MOU) between the Department of Defense (DOD) and Iran concerning ██████████ Foreign Military Sales letters of offer and acceptance (hereinafter referred to as the "1979 MOU") before the Hague Tribunal.⁵ The settlement amount was a negotiated sum designed to settle a dispute regarding whether and how much interest was owed to Iran related to the balance of the Iran Foreign Military Sales account held by the United States, among other issues. The United States Attorney General determined that the partial settlement agreement was in the best interest of the United States after reviewing the agreement and related documents and taking into account the risk of a significantly higher award by the tribunal. We note that the 1979 MOU states that the United States would establish an interest-bearing account to earn interest for Iran on those expended funds reimbursed to Iran not required in the Foreign Military Sales account to meet remaining obligations of Iran. The 1979 MOU did not provide additional details regarding an acceptable interest rate. ██████████

³ A letter from Treasury Legislative Affairs to the Honorable Sean Duffy on September 9, 2016 states that a technical limitation prevents the system from processing individual claims over ten digits in length. The September 9, 2016 letter and our letter are consistent in referring to the maximum claim that can be processed as being \$99,999,999.99. However, the actual limitation is 14 characters, as it includes the dollar sign and commas as characters.

⁴ The Judgment Fund *Business Rules* captures the business needs of the Judgment Fund Branch program area and translates those into the Information Technology requirements for the JFICS. The document serves as a reference document for the program area, capturing and documenting any system changes over time.

⁵ The Hague Tribunal was created in 1981 when the United States and Iran entered into the Algiers Accords. The Tribunal has jurisdiction over claims arising out of contractual arrangements between the two governments.

[REDACTED]

In preparing our response, we (1) reviewed applicable Federal laws and regulations and Treasury policies and procedures relevant to Fiscal Service's Judgment Fund payment responsibilities; (2) reviewed relevant documentation received and produced by Treasury related to the payment; and (3) interviewed key Treasury officials and personnel with responsibilities related to the payment. As a courtesy, we provided Treasury, DOJ, and State officials with a draft of this letter to review the information enclosed for accuracy.

Responses to your questions, as well as additional relevant information are provided below.

(1) Identify whether Treasury fully complied with the Treasury Financial Manual, Volume 1, Part 6, Chapter 3100 in connection with the payment made out of the Judgment Fund on January 19, 2016.

Fiscal Service fully complied with its *Treasury Financial Manual* (TFM),⁶ which supplements 31 Code of Federal Regulations (CFR) Part 256, *Obtaining Payments From the Judgment Fund and Under Private Relief Bills*, in regards to the approximate \$1.3 billion Judgment Fund payment. In order to certify settlement payments from the Judgment Fund, the TFM requires the following: (1) settlements are final; (2) settlements are monetary, requiring payment of a specific sum awarded against the United States; (3) one of the authorities specified in 31 U.S.C. § 1304 (a)(3) provides for payment of the settlement; and (4) payment may not legally be made from any other source of funds.

As to the first and second requirements of the TFM, the partial settlement agreement between Iran and the United States was signed on January 17, 2016, and notes the stipulated monetary payment of approximately \$1.3 billion, which represented a negotiated compromise of the dispute as to whether and how much interest was owed.

As to the third requirement of the TFM, DOJ submitted to Fiscal Service Chief Counsel several standard forms describing the claim and certifying that all pertinent criteria required by law for approval of the claim had been satisfied. In particular,

⁶ TFM, Volume 1, Part 6, Chapter 3100, *Certifying Payments And Recording Corresponding Intragovernmental Receivables In The Federal Government's Judgment Fund*.

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DOJ stated that the claim was payable under 28 U.S.C. § 2414, *Payment of judgments and compromise settlements*.⁷

DOJ also provided the Fiscal Service Chief Counsel with an internal memorandum that explained the basis for its conclusions. DOJ has identified that this memorandum, entitled *Memorandum for the Attorney General: Request for Authority to Certify Payment of Tribunal Settlement to Judgment Fund* (hereinafter referred to as the “authorization memorandum”), implicates certain Executive Branch confidentiality interests and privileges, including the attorney-client privilege.

DOJ certified under 28 U.S.C. § 2414 that this payment was in the best interest of the United States. It should be noted that the authorization memorandum was contingent on the settlement agreement being finalized and [REDACTED] [REDACTED] having determined that the settlement comports with the Victims of Trafficking and Violence Protection Act of 2002 (VTVPA). As of the date of this letter, we confirmed that the settlement agreement was finalized. On November 3, 2016, we were provided verbal assurances [REDACTED] [REDACTED] [REDACTED] that the settlement comports with the VTVPA. We requested documentation to support DOJ’s assertion. As of the date of this letter we have not received this documentation. The VTVPA contingency is further discussed in our response to questions (2) and (3).

As to the fourth requirement of the TFM, DOJ’s authorization memorandum further asserted that the payment could not legally be made from any other source of funds. DOJ’s authorization memorandum asserted that State has no source of funding and that State represents that DOD and Treasury have no source of funding to pay interest from the Iran Foreign Military Sales account. We note that DOJ’s authorization memorandum did not contain documentation signed by either a DOD or a State representative certifying that their agency had no other source of funds available to make the requested payment. However, Treasury officials provided supporting documentation of a State representative certifying that their agency had no other source of funds available to make the payment. On November 4, 2016, we sent a letter to DOD Office of Inspector General requesting confirmation from its department that no other source of funds was available to make the interest payment. As of the date of this letter we received a response from the DOD Office of Inspector General that they are working on responding to our request.

⁷ 28 U.S.C. § 2414 is listed as one of the authorities specified in 31 U.S.C. § 1304 (a)(3).

28 U.S.C. § 2414 requires that payment of final judgments rendered by a State or foreign court or tribunal against the United States, or against its agencies or officials upon obligations or liabilities of the United States, shall be made on settlements by the Secretary of the Treasury after certification by the Attorney General that it is in the interest of the United States to pay the same.

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While we found that Fiscal Service complied with its TFM regarding the approximate \$1.3 billion payment, we noted that Judgment Fund Branch personnel did not follow the Judgment Fund *Standard Operating Procedures* (SOP) to review the settlement agreement before approving the payment, and Fiscal Service legal review for the payment was not documented. The SOP is a guideline that describes standard processes to ensure quality analysis and review in a reliable and standardized way.

We found that while the TFM requires that Fiscal Service review a copy of the settlement agreement, it does not specify that the review be done by Judgment Fund Branch personnel.⁸ However, the SOP provides for the review of the settlement agreement by the Judgment Fund Branch. Fiscal Service's Chief Counsel told us that the settlement agreement was not provided to Judgment Fund Branch personnel due to its sensitive nature and, legally, the Judgment Fund Branch is not required to review the settlement agreement. Fiscal Service's Chief Counsel told us, and a Judgment Fund Branch employee confirmed, that the Chief Counsel verbally notified the Judgment Fund Branch employee that the settlement agreement was final, as authorization for the Judgment Fund Branch to approve the payment. In addition, Fiscal Service's Chief Counsel also told us that the documentation DOJ provided in support of its claim contained all of the necessary information for the Judgment Fund Branch to approve and certify the payment according to statutes. This verbal communication between Fiscal Service's Chief Counsel, who reviewed the settlement agreement, and the Judgment Fund Branch employee was not documented in the file. While Judgment Fund Branch personnel did not review the settlement agreement, it should be noted that a Judgment Fund Branch employee told us that he reviewed DOJ's documentation. This documentation included the award amount, cited the settlement was payable under 28 U.S.C. § 2414, and certified and approved the use of the Judgment Fund to make the payment.

The Judgment Fund SOP also provides for legal review of claims like the one submitted in this matter. Fiscal Service's Chief Counsel told us, and Judgment Fund Branch personnel corroborated, that the Chief Counsel reviewed DOJ's claim, but he did not document the review. We reviewed emails related to the legal review of Judgment Fund transactions and noted frequent communication between attorneys at Treasury's Departmental Offices, Fiscal Service, and Office of Foreign Assets Control (OFAC); the Judgment Fund Branch personnel; and State and DOJ.

⁸ TFM requires responsible agencies to submit all supporting documentation required by Treasury regulations at 31 CFR Part 256. Part 256 requires the submitting agency to submit a copy of the judgment or settlement agreement, as applicable, to the Financial Management Service. In 2012, the Department of the Treasury consolidated the Financial Management Service with the Bureau of the Public Debt and re-designated it as the Bureau of the Fiscal Service.

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(2) And (3) Provide a copy of any certification and/or payment request to Treasury in connection with the 13 payments of \$99,999,999.99 and the single payment of \$10,390,236.28 that State requested from the Judgment Fund, including supporting documentation submitted.

As noted previously, DOJ submitted one claim for approximately \$1.3 billion in 14 smaller amounts due to a JFICS technical system limitation. DOJ submitted this request to Fiscal Service through the JFICS, which is documented by the JFICS Case Report. A DOJ official also submitted the claim to Fiscal Service via email submission, documented in a transmittal letter. The transmittal letter lists a Judgment Fund Branch employee as the recipient of the submission. However, according to Fiscal Service's Chief Counsel, the submission was sent to and received by him. This submission included standard forms for processing payments from the Judgment Fund, Form 194, *Judgment Fund Transmittal*, Form 196, *Judgment Fund Award Data Sheet*, and Form 197, *Judgment Fund Voucher for Payment*. Additionally, the submission included the partial settlement agreement. Representatives of Treasury, Iran, and the Government of the Kingdom of the Netherlands (the Netherlands) agreed to and signed the *Memorandum of Understanding Regarding Payment Under the Partial Settlement Agreement in Case No. B1 (Claims 2&3)* and its addendum (hereinafter referred to as the "payment instructions"), which outline the responsibilities and directions for DNB to issue payments to an agent of CBI. Treasury officials told us that you have copies of the following sensitive but unclassified documents mentioned in this paragraph.⁹ Specifically, Treasury officials told us that the following documents are located in the Senate and House Security Offices: (1) JFICS Case Report (redacted document); (2) DOJ Judgment Fund transmittal letter (redacted document); (3) Form 194, Form 196, and Form 197 (redacted documents); (4) Partial Settlement Agreement (including annex A and B); and (5) payment instructions.

We also reviewed DOJ's authorization memorandum. Fiscal Service Chief Counsel received DOJ's authorization memorandum via email. As we had read-only access to this document, we are unable to provide a copy. The DOJ authorization memorandum is marked sensitive but unclassified, and DOJ officials told us that this document implicates certain privileges, including attorney-client.

The authorization memorandum referenced various attachments, though Treasury was not provided the attachments with the memorandum. Treasury nevertheless received, through other classified email traffic, documents that appear to be some of the attachments. We reviewed the documents that were available to Treasury. We did not review four attachments that Treasury did not receive from DOJ. These attachments were referred to as (1) Secretary of State requesting the Attorney

⁹ As we had read-only access to these documents, and neither created nor control them, we are unable to provide copies.

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General to certify the settlement; (2) a document materially identical to the partial settlement agreement; (3) an accompanying letter from State addressing the availability of funding; and (4) a document [REDACTED] addressing the Victims of Trafficking and Violence Protection Act of 2002. On November 4, 2016, we sent letters to State and DOJ Inspectors General requesting all of these documents from their departments. As of the date of this letter we received a response from DOJ and State Offices of Inspector General that they are working on providing the documents requested.

The receipt of [REDACTED] confirmation that the settlement agreement comports with the VTVPA is of particular importance because the DOJ authorization memorandum is contingent on DOJ receiving this confirmation. On November 3, 2016, we were provided verbal assurance [REDACTED] [REDACTED] [REDACTED] that the settlement comports with the VTVPA. We requested documentation to support DOJ's assertion, however as of the date of this letter, DOJ has not provided us with [REDACTED] confirmation.

(4) Provide a complete description of what particular foreign claim the single payment of \$10,390,236.28 was made to cover.

As stated above, there was no single foreign payment of \$10,390,236.28. Rather, there was one transfer from FRBNY to DNB totaling approximately \$1.3 billion to pay to Iran the portion of the settlement representing a compromise on the issue of interest. On January 17, 2016, the partial settlement agreement was executed resolving a dispute related to the 1979 MOU between DOD and Iran. Among the issues was a dispute regarding whether and how much interest was owed to Iran related to the Foreign Military Sales account, among other issues. [REDACTED]

[REDACTED] Treasury officials told us that a copy of the partial settlement agreement is located in the Senate and House Security Offices and is marked sensitive but unclassified.

(5) Determine and detail why the "Interest Amount" was listed as \$0.00 and the "Interest Citation Code Description" field was left blank for each payment, if the roughly \$1.3 billion payment is representing what Secretary Kerry referred to as a "compromise on the interest claim".

The settlement amount representing a compromise on the issue of interest was not recorded in the interest column on Form 196, instead it was recorded in the principal column. The TFM and the SOP do not describe how the settlement of a claim for interest should be entered into JFICS. In this matter, DOJ entered the

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settlement amount into JFICS as “principal amount” and left the “interest amount” field blank. A Judgment Fund Branch employee told us that had the settlement amount been entered in the interest section in JFICS, a start date, an end date, and an interest rate percentage would have also been required, and JFICS would have calculated the interest as a larger amount than stipulated in the partial settlement agreement.

State provided Treasury with a document including the interest calculation based on the United States annual prime lending rate and using a simple interest method. The State document included annual balances in the Iran Foreign Military Sales account for each year between 1979 and 2015. We were unable to independently verify the annual balances of the Iran Foreign Military Sales account. Treasury officials and employees told us that Treasury was not involved in the decision to use the annual prime lending rate. Treasury officials and employees told us that they relied on the certification provided from DOJ to approve the amount of approximately \$1.3 billion. Treasury officials told us that the document detailing the interest payment calculation by year is located in the Senate and House Security Offices.

(6) Provide evidence that no individual or entity on the Specially Designated Nationals (SDN) and Blocked Persons list received payments made from Treasury’s Judgment Fund Branch.

Treasury officials told us that the payment was made under the authority of 31 CFR 560.510(d)(2), *Transactions related to the resolution of disputes between the United States or United States nationals and the Government of Iran*.¹⁰ Additionally, they told us that this payment was not made to an individual or organization, instead was a government to government transaction, as the claim was made payable to Iran. OFAC officials stated that 31 CFR 560.510(d)(2) authorized all transactions necessary for the United States to make payments to settle the Iranian claim. OFAC officials considered this authorization to be a general license and no documentation or other authorization from OFAC was required.

OFAC issued “comfort letters” to the FRBNY and DNB to provide assurances that the settlement payment was authorized in accordance with the general license 31 CFR 560.510(d)(2). The comfort letters stated it was OFAC’s understanding that no individual or entity associated with the payment was on either list. OFAC officials told us that this was based on information provided by State during discussions around the payment. We reviewed the SDN and Blocked Persons Lists, dated January 16, 2016 and September 20, 2016, and the individuals receiving

¹⁰ 31 CFR 560.510 (d)(2) authorized all transactions necessary to the payment and implementation of awards in a legal proceeding to which the United States Government is a party, or to payments pursuant to settlement agreements entered into by the United States Government in such a legal proceeding.

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the payment and signing the payment instructions on behalf of Iran, were not on the list. Treasury officials told us that these comfort letters are located in the Senate and House Security Offices.

(7)

- a. ***Which Financial institution(s) or central bank(s) or individual(s) were the 13 payments and single payment sent to?***
- b. ***Were there any instructions accompanying or associated with the payments out of the Judgment Fund to convert the electronic balances that were sent into hard currency to be delivered to agents of Iranian government?***

One payment of approximately \$1.3 billion was made from Fiscal Service through FRBNY to DNB. We were able to confirm this single payment through review of source documents. Per the payment instructions DNB was to convert the \$1.3 billion into Euro banknotes and disburse up to three payments to an agent of CBI on or before specified dates. Source documents providing evidence of the transactions between DNB, and CBI and its agent were not available to us, and therefore not reviewed by our Office. The individual involved in receiving the payments from DNB on behalf of Iran was Iran's attorney for the Hague Tribunal. The individual that signed the payment instructions on behalf of Iran was the Vice Governor for Iran's International Affairs.

The payment instructions were signed by all parties on January 16, 2016, and an addendum was signed by the United States and Iran on January 21, 2016, and by the Netherlands on January 25, 2016. Treasury officials told us that the payment instructions are located in the Senate and House Security Offices.

We sent a copy of this letter to the House Committee on Financial Services.

We would be pleased to brief you or members of your staff on this response or any other work under our jurisdiction. If you have any questions you may contact me at (202) 622-1090 or Deborah Harker, Assistant Inspector General for Audit, at (202) 927-5400.

Sincerely,

Eric M. Thorson
Inspector General
Department of the Treasury