

GAO

Report to the Chairman, Legislation and
National Security Subcommittee,
Committee on Government Operations,
House of Representatives

September 1988

STATE
DEPARTMENT

U.S. Involvement in
the American Club in
Greece



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National Security and
International Affairs Division

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The Honorable Jack Brooks
Chairman, Legislation
and National Security Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

In response to your December 10, 1987, request, we have reviewed the State Department's involvement with the now-defunct "American Club" in Greece.

We found that (1) the U.S. Embassy had established the American Club as an employee association in accordance with the Foreign Affairs Manual (FAM), (2) Embassy staff had not monitored the activities of the American Club as required in the FAM, (3) a former Embassy economic officer had personally cosigned a loan for the club, which is prohibited by the FAM, and (4) the Greek courts are now holding the U.S. government responsible for the club's debts in several separate cases. Moreover, although State regulations do not allow diplomatic immunity to be used to help employees avoid personal debts, the Embassy implied to Greek authorities that the cosigner had diplomatic immunity.

State and Justice Department officials believe that the U.S. government will ultimately pay the debts of the American Club, and former Greek employees of the club have agreed, in principle, to an out-of-court settlement that U.S. officials believe would be favorable to the United States. However, disagreement between State and Justice officials over the source of funding to settle the claims has delayed resolution of the cases.

The Department of State has instituted some procedures to reduce the possibility of the U.S. government being held responsible for debts of similar clubs in the future; however, we do not believe it has done enough. Appendix I provides details about our findings and contains a number of recommendations to the Secretary of State.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

for 
Frank C. Conahan
Assistant Comptroller General

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Assessment of U.S. Involvement in the American Club in Greece

At the request of the Chairman of the Legislation and National Security Subcommittee, House Committee on Government Operations, we reviewed U.S. involvement with the now-defunct American Club in Greece. Our review showed that (1) the U.S. Embassy had not adequately monitored the American Club's activities; (2) the Greek courts are currently holding the U.S. government responsible for the club's debts in several separate cases and an out-of-court settlement favorable to U.S. interests is possible, but disagreement between State and Justice officials over the source of funding has delayed settlement; and (3) State has initiated actions to reduce the risks of being held liable for future debts of other clubs, but more could be done.

Background

The American Club, originally organized in 1948 as an employee association under the auspices of the U.S. Embassy in Athens, was located in Kastri, Greece, until June 1985 when it closed. At that time, many debts were left unpaid, including severance payments to 10 Greek employees, payments to the Greek social security system, bank and other loans, and utility bills.

As a result of the closure and the unpaid debts, 9 of the 10 Greek employees filed three lawsuits for about \$80,000 in severance payments. They filed the suits against the American Club, the U.S. Embassy, and the U.S. government. However, during the proceedings, the club was dropped as a defendant, presumably because it was insolvent. Since the suits were not properly served, the United States did not appear in court as a defendant, and subsequently default judgments were issued against the U.S. government.

Why the United States Has Delayed Settling Claims

According to Justice and State Department officials, the judgments had not been paid as of August 1, 1988, primarily because (1) they believe the United States is not liable for debts of the American Club and (2) the United States does not honor default judgments. Justice and Embassy officials recently told the State Department that the cases should be settled out of court and the claims paid without wasting time and money on appeals.

Although State Department officials agreed that in all probability the U.S. government would pay the claimants, concerns about where the funds would come from and whether such a settlement would create improper precedents have delayed the final resolution of these claims. A private company also filed a lawsuit against the American Club and the

U.S. government for repayment of a loan that had been cosigned by a former Embassy economic officer. According to a Justice Department official, this suit was not appropriately served on the U.S. government, and the case is pending.

The American Club's Status Never Formally Changed

The U.S. Embassy and the State Department currently assert that the American Club was not affiliated with the U.S. government. However, it was originally created as an employee association and was approved by the Ambassador. Over the years, the relationship between the American Club and the Embassy was reaffirmed in writing. For example:

- In 1977, the Embassy issued a general statement directed "to whom it may concern" affirming that the American Club fell into the category of semiofficial clubs authorized by the Foreign Service Act (22 U.S.C. 2703).
- In 1979, the Embassy assured the Greek Ministry of Foreign Affairs that the Embassy wished to bring the American Club under tighter Embassy supervision.
- A 1983 letter from the Embassy's economic officer (also the president of the club), directed "to whom it may concern" and notarized by the vice consul at the Embassy, stated that the club was, in fact, an employee association of the U.S. Embassy.
- A September 1985 Embassy cable to the State Department stated that the most recent constitution of the club, signed in 1977, indicated that the club had been formed under the guidelines contained in the Foreign Service Act. The cable also pointed out that under the club's bylaws, if the club were to close, its unobligated funds and property would be disposed of by the U.S. Ambassador in Greece. The cable went on to say that the club was set up by members of the Embassy under State Department regulations as an official Embassy entity with the full knowledge and approval of the Greek government. In addition, the cable said that no official communication of any change in this status had been made to the Greek government; rather, it appeared that the relationship had been reaffirmed several times over the years.
- An October 1985 Embassy cable said that the Greek Ministry of Foreign Affairs had sent a diplomatic note to the Embassy quoting the club's constitution and bylaws and indicating that the club was the Embassy's responsibility. The cable went on to say that "the quotes are accurate...as are, we believe, the inferences they have drawn from them."

Officials from the Departments of State and Justice now agree that the club was originally established under the FAM, and State Department

officials cannot provide any documents to prove any disassociation from the club.

U.S. Policy Against Honoring Default Judgments

According to a Justice Department official, the U.S. government strives to appear, when properly served, and defend itself in every case held before a foreign court and will honor foreign judgments if it is accorded the right of due process of law. A State Department cable indicates that the U.S. government will not honor default judgments that have been issued by foreign tribunals without providing the U.S. government with adequate notice and opportunity to prepare and present a defense.

Regardless of local law, U.S. officials believe that default judgments, without adequate service, are a violation of basic due process required by international law in asserting jurisdiction over a foreign sovereign. They believe that such judgments must be challenged on that basis, even if the U.S. liability appears likely.

According to a Justice official and State Department documents, the four lawsuits concerning the American Club were never formally served on the U.S. government. Under Greek law, when a suit is brought against an alien domiciled abroad, the suit is served to the prosecutor of the court, who is obligated to forward it immediately to the Greek Ministry of Foreign Affairs. The Ministry in turn forwards it to the sued party.

According to Embassy records, after the documents were provided by the prosecutor of the courts, the Ministry sent the documents to be translated; however, the Ministry never forwarded the translations to the U.S. Embassy. As a result, the U.S. government was not represented at the hearing in May 1986, and default judgments were issued against the United States. In October 1986 the U.S. government hired a Greek attorney to represent the United States when it learned of the default judgments. The attorney was to ask the Greek court to have the default judgments set aside; however, the attorney died in March 1987 before this could be accomplished.

Legal Actions Are Still Pending

A Justice Department official told us that the United States had taken no action concerning these cases from the time the Greek attorney died in March 1987 until we inquired about these cases in January 1988. Justice is currently in the process of appealing the three severance pay default judgments. The fourth case is pending a hearing.

A Justice official advised us that the U.S. government will continue to (1) appeal the default judgments, insisting that it had not been served and given the opportunity to present a defense, and (2) concurrently seek a practical way to settle the original cases, thus conserving further time and expense. He explained that if the default judgments were rescinded, the U.S. government would then have to present its case in the Greek courts. He said that another Greek lawyer, hired in 1988 to represent the U.S. government, had reviewed the evidence and had advised Justice that the chance of the United States prevailing on the merits of the case under Greek law was limited.

Disagreement Over Source of Funds to Settle Claims

At the Justice Department's request, the new Greek attorney recently contacted the plaintiffs in the three severance pay lawsuits to determine the possibility of settling the cases out of court. According to a Justice official, the attorney was successful in obtaining their agreement, in principle, to out-of-court settlements that would be very favorable to the U.S. government. However, State and Justice officials have not been able to agree on the source of funding to be used to pay the settlements. They have considered three possible sources: the Permanent Indefinite Fund, the Central Commissary and Recreation Fund, and State Department appropriations.

Permanent Indefinite Fund

The Permanent Indefinite Fund was created under 31 U.S.C. 1304 and 28 U.S.C. 2414 in part to pay judgments against the United States brought by foreign courts. For monies to be paid out of this fund, the Department of Justice must certify that it would be in the interest of the United States to pay these judgments. While a State Department official believed that the fund was the best source from which to pay these debts, the Department of Justice did not agree because the American Club was a nonappropriated fund organization.

Central Fund

The Department of State has a Central Commissary and Recreation Fund (known as the Central Fund), which it created under 6 FAM 514 to assist in establishing, maintaining, and operating nongovernment-operated employee support services or facilities abroad. In a letter to State, a Justice official said that State could use the Central Fund if the U.S. government decides to pay the debts. However, State officials assert that the American Club was not an employee association and that they have a fiduciary responsibility to the associations to protect the

Central Fund from being used to pay the debts of an outside organization like the American Club. They have continued to make this assertion, even though the American Club was originally established as an employee association under the FAM and they cannot document any disassociation from the American Club.

State Department Appropriations

The Justice Department official believes that if the severance pay cases (three of the four) are paid, the money could come from State Department appropriations. He said that, in several cases, other federal agencies had provided severance pay from appropriations. However, State Department officials do not want to use appropriated funds to settle the cases because of general budgetary constraints.

Inadequate Embassy Controls

Our review showed that a lack of internal management controls contributed to the U.S. government's financial entanglement in the debts of the American Club. Embassy officials did not comply with the FAM in that

- they did not monitor club activities,
- an Embassy official inappropriately cosigned a loan, and
- by implying to the Greek government that it would not waive diplomatic immunity, the Embassy helped one of its officials evade settlement of a debt.

U.S. Embassy Should Have Monitored the Club's Activities

According to 6 FAM 520, the ambassador, or a designee, is required to (1) monitor employee association activities to ensure that they are managed prudently and in accordance with Department regulations and (2) ensure that employee association activities and facilities do not adversely affect relations with host countries, cause financial embarrassment in the local business community, or violate local customs and labor laws.

In a letter to the U.S. Embassy in Athens dated April 9, 1985, the State Department's Deputy Assistant Secretary for Operations stated that "it is truly unfortunate that the Embassy, knowing of the existing charter and the perceived affiliation, did not take a greater interest in the financial welfare of the Club." It appears that, since the club's bylaws and constitution had not been formally changed, the U.S. Ambassador should have monitored the club's activities. However, according to a March 1988 Embassy cable, because the Embassy did not consider the

American Club an employee association, Embassy officials were not performing these functions.

**Official Inappropriately
Cosigned Loan for Club**

State regulation 6 FAM 527 says that U.S. government personnel should not use their official title or position nor should they personally assume responsibility for the obligations of an association or imply that they are acting on behalf of the U.S. government. Nevertheless, in 1984 an economic officer at the Embassy (and then president of the club) personally cosigned a loan of \$20,000 for the club.

It appears that the economic officer acted against the regulations and has not been held accountable for the \$20,000 loan because the U.S. Embassy implied to the Greek government that he would have diplomatic immunity in this case. A State Department lawyer told us that State would seek repayment of the \$20,000 from the former economic officer if the United States paid the Greek court judgment.

**State Department Did Not
Waive Diplomatic
Immunity**

According to State regulations 2 FAM 221.5(b.)(1) and 2 FAM 225.1, (1) a representative of the United States is not to take advantage of the protection afforded by reason of an official position or evade the settlement of just obligations and (2) diplomatic immunity of an employee can be waived if there is evidence that a waiver is essential to protect the interests of innocent third parties, the U.S. government, or both. However, it appears the waiver option was not exercised to protect the interests of the third party in this case and a U.S. official was able to evade the settlement of his financial obligations.

When the company that loaned the club \$20,000 tried to obtain satisfaction from the cosigner of the loan, the U.S. Embassy did not waive his diplomatic immunity, even though, according to a cable, Embassy officials were concerned that innocent third parties and the U.S. government could be hurt.

Embassy officials advised us that they had not used the shield of diplomatic immunity to allow the employee involved in this matter to avoid paying his debt. However, a 1985 memorandum indicates that the Embassy had informed the Greek Ministry of Foreign Affairs that the cosigner of the loan enjoyed "immunity from the Greek courts and requested that the information be forwarded to the court." We discussed this with a State Department official, who said that the Greek courts did not specifically ask the Embassy to waive his immunity. However, the

information supplied to the Greek Ministry implies that immunity would not be waived.

Efforts to Limit U.S. Liability for Other Clubs

To reduce the possibility of future legal problems with private clubs, the Department issued the following statement:

“Any support given to private American Clubs and/or other private clubs must terminate. Support such as space, utilities, properties and services is not authorized by statute or regulation and is therefore improper. Any continued, unauthorized support of these organizations may result in claims and other liabilities asserted against the posts and/or associations for the debts or other obligations of such private clubs.”

Since the American Club in Greece closed in 1985, State has annually requested information about the private clubs. Pursuant to 6 FAM 528, the posts are asked, among other things, whether they are supporting any private clubs such as American Clubs. If they are, a State Department official directs them to discontinue such support or make arrangements for the private club to become an employee association or come under an existing employee association.

According to State officials, there were 144 official State Department employee associations as of July 1988. Employee associations may provide, but are limited to, such services as commissaries (groceries and dry goods), “class VI” sales (liquor and tobacco products), recreation facilities, social clubs, library services, day care centers, or other family and community services.

According to 6 FAM 527, the U.S. government assumes no liability for the obligations of such commissary, mess, and recreation activities to third parties or local governments. However, general requirements for associations include provisions that (1) any profits be used for welfare and recreational activities or be donated to the Central Commissary and Recreation Fund controlled by the State Department; (2) association facilities be located on U.S. government property, whenever feasible; (3) associations provide monthly financial statements to the embassy or consulate; and (4) upon liquidation of any employee association, any surpluses (which are over and above the deposits of employees and outstanding indebtedness) be transferred to the Central Commissary and Recreation Fund.

In addition, the employee associations are considered U.S. government instrumentalities for U.S. tax purposes because of official U.S. government control over their establishment and operations, according to State's Office of Legal Adviser. A State Department document, dated October 1983, indicates that the Legal Adviser's opinion was founded on substantial precedent, namely a 1964 Internal Revenue Service ruling that the elements of control retained by the government, including general authority to terminate activities and limitation of membership to government-connected personnel, made the employee association an agency of the U.S. government for federal income tax purposes.

Conclusions

The U.S. Embassy did not carry out its responsibility for monitoring the activities of the American Club and should not have implied to the Greek government that the cosigner of the loan for the club had diplomatic immunity in this case.

State and Justice officials believe that the U.S. government will ultimately pay the claims and that a favorable out-of-court settlement is now possible. But they have delayed the prompt settlement because they could not reach agreement on which funds to use to settle the claims. A State official did indicate that if the U.S. government pays the claim for \$20,000 they would attempt to recoup the money from the cosigner.

State has initiated efforts to reduce the risk of being held liable for future debts of private clubs. However, host governments and other parties could surface a number of factors to raise doubts as to State's unequivocal denial of fiscal affiliation with employee associations, as set forth in the FAM.

Recommendations

We recommend that the Secretary of State take the following actions:

- Resolve with the Attorney General which funds will be used to pay the out-of-court settlements of the specific cases involving the American Club in Greece.
- Hold ambassadors or their designees responsible for monitoring employee associations, as provided in the FAM, and ensure that such activities are operating in a financially responsible manner.
- Remind specifically involved employees that the Department of State will waive their diplomatic immunity if they attempt to evade personal

debts or other personal liability that may accrue to them in their capacity as officers in embassy associations.

Objectives, Scope, and Methodology

From January through August 1988, we reviewed the U.S. government's involvement with the Athens American Club's legal liability in judgments arising from Greek lawsuits concerning the club and one of its former officials. Specifically, we (1) determined the causes of the delay in settling judgments, (2) identified the possible sources of funds to pay these and any future judgments, and (3) determined whether the State Department has adequate controls over its employee associations to prevent similar problems from arising in the future. In addition, we reviewed the Embassy's use of diplomatic immunity to protect one of its officials from personal liability in this case.

Our work was performed at the State Department headquarters in Washington, D.C. We interviewed officials from the Departments of State and Justice and the employee who cosigned the loan. We also obtained and reviewed records from the U.S. Embassy in Athens and the Departments of State and Justice.

As requested, we did not obtain the Department's official comments on this report. Our review was conducted in accordance with generally accepted government auditing standards.

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