

DATE: July 3, 2001

In Re:

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SSN: -----

Applicant for Security Clearance

ISCR Case No. 00-0430

**APPEAL BOARD DECISION**

**APPEARANCES**

**FOR GOVERNMENT**

Michael H. Leonard, Esq., Department Counsel

**FOR APPLICANT**

V. Rock Grundman, Esq.

Administrative Judge Elizabeth M. Matchinski issued a decision, dated February 13, 2001, in which she concluded it is not clearly consistent with the national interest to grant or continue a security clearance for Applicant. Applicant appealed. For the reasons set forth below, the Board affirms the Administrative Judge's decision.

This Board has jurisdiction on appeal under Executive Order 10865 and Department of Defense Directive 5220.6 (Directive), dated January 2, 1992, as amended.

Applicant's appeal presents the following issues: (1) whether the government had an obligation to make further investigation of Applicant's credibility; (2) whether the government met its burden of proving that Applicant engaged in insider trading; (3) whether the Administrative Judge erred by making adverse findings and conclusions regarding Guideline E and Guideline F; and (4) whether the Administrative Judge erred by referring to Applicant's conduct as being criminal and imputing criminal conduct to the person who gave Applicant the tip.

**Procedural History**

The Defense Office of Hearings and Appeals issued a Statement of Reasons (SOR) dated September 21, 2000 to Applicant. The SOR was based on Guideline F (Financial Considerations) and Guideline E (Personal Conduct).

Applicant submitted an answer to the SOR, in which he stated "I would like to resolve this matter without a hearing." A File of Relevant Material (FORM) was prepared. Applicant was given a copy of the FORM, and he submitted a response to the FORM. The case was then assigned to the Administrative Judge for disposition.

The Administrative Judge issued a written decision, dated February 13, 2001, in which she concluded it is not clearly consistent with the national interest to grant or continue a security clearance for Applicant. The case is before the Board on Applicant's appeal from the Judge's adverse decision.

On appeal, the Board received letters from several people writing on Applicant's behalf. Those letters constitute new evidence, which the Board cannot consider. Directive, Additional Procedural Guidance, Item E3.1.29. Apart from the prohibition of Item E3.1.29, the Board notes Applicant had the opportunity to present documentation for consideration by the Administrative Judge when he responded to the FORM. The letters submitted on Applicant's behalf during appeal

could have been submitted in connection with Applicant's response to the FORM. By failing to submit such letters during the proceedings below, Applicant waived his right to have them considered in his case. *See, e.g.*, ISCR Case No. 00-0250 (February 13, 2001) at p. 3.

### Statement of Case

On September 30, 1999, the Securities and Exchange Commission (SEC) filed in federal district court a civil complaint (hereinafter "Complaint") against Applicant and other named individuals, alleging they had engaged in insider trading in violation of federal securities law. On the same day, Applicant filed a Stipulation and Consent (hereinafter "Stipulation and Consent"). In the Stipulation and Consent, Applicant admitted: (a) service of the Complaint, and (b) the district court had personal jurisdiction over Applicant and subject matter jurisdiction over the case. Furthermore, "[w]ithout admitting or denying any of the allegations of the Complaint," Applicant consented to entry of a Final Judgment and Order of Permanent Injunction and Other Equitable Relief. On October 4, 1999, the district court filed its Final Judgment and Order of Permanent Injunction and Other Equitable Relief (hereinafter "Final Judgment"). In the Final Judgment, the district court: (1) permanently enjoined Applicant from directly or indirectly violating Section 10 (b) of the Securities Exchange Act [15 U.S.C. Section 78j(b)] and Rule 10b-5 (17 C.F.R. 240.10b-5); (2) ordered Applicant to "pay disgorgement in the amount of \$13,750.00 representing his profits from the purchases and sales of securities specified in the Complaint, plus pre-judgment interest thereon in the amount of \$2,955.47"; and (3) imposed on Applicant "a civil penalty in the amount of \$13,750.00."

When answering the SOR in this security clearance case, Applicant sought to explain the facts and circumstances of his involvement in the securities transactions that were the subject of the SEC action against him. In response to the FORM, Applicant asserted "I did not knowingly violate an insider trading law when I participated in the stock trades. I do not deny that I violated such a law. But at the time I purchased [the stock] I had [a] misunderstanding of the law regarding trading in stocks." Applicant's response to the FORM went on to elaborate his explanation of the facts and circumstances surrounding the securities transactions that were the subject of the Complaint and the Final Judgment.

The Administrative Judge concluded: (a) Applicant was involved voluntarily in illegal insider trading; (b) it was not reasonable for Applicant to believe that the tip he received from a friend was mere rumor and not insider information; (c) Applicant's involvement was motivated primarily by the potential for financial gain, not concern for his friend's spouse; (d) Applicant's conduct in the matter was not extenuated by the fact that he had no guarantee of a return on his investment; (e) Applicant's conduct, which occurred in 1996, was not recent; (f) Applicant no longer associates with the person who provided him with the inside information; (g) Applicant's involvement in insider trading was "very serious" because he was of mature age at the time, he had prior experience in stock trading, and fraud or deceit was involved; (h) although the passage of four years without recurrence weighs in Applicant's favor, "doubts persist as to Applicant's rehabilitation because of his recent efforts to downplay the seriousness of, if not justify, his behavior"; and (i) Applicant's contributions to the defense effort "are not sufficient to overcome the lingering doubts for his security worthiness engendered by his insider trading for profit."

### Appeal Issues

1. Whether the government had an obligation to make further investigation of Applicant's credibility. Applicant argues DOHA and the Administrative Judge should have directed further investigation because: (a) the Stipulation and Consent and the Final Judgment were insufficient to prove that Applicant had engaged in insider trading; (b) Applicant has never admitted he is guilty of engaging in insider trading, and to the contrary, has contended he believed his conduct was legal; and (c) Applicant's response to the FORM placed the Administrative Judge on notice of the need for further investigation in this case.

Neither the Administrative Judge nor the Board has authority or supervisory jurisdiction over security clearance investigations. Accordingly, neither the Judge nor the Board has any duty or obligation to rule on the sufficiency of a security clearance investigation, or the jurisdiction or authority to order further or additional investigation of an applicant's case. *See, e.g.*, ISCR Case No. 00-0140 (September 19, 2000) at p. 2; ISCR Case No. 99-0293 (May 5, 2000) at p. 4; ISCR Case No. 96-0311 (December 12, 1996) at p. 2; ISCR Case No. 95-0594 (August 30, 1996) at p. 3.

Applicant chose to have his case adjudicated without a hearing. Having decided to waive a hearing in his case, Applicant cannot complain that he was denied the opportunity to have the Judge assess his credibility.

2. Whether the government met its burden of proving that Applicant engaged in insider trading. Applicant argues: (a) the SOR and Department Counsel erroneously treated the Stipulation and Consent and the Final Judgment as if they were a judgment entered on a guilty plea; and (b) the Administrative Judge drew unwarranted conclusions about Applicant's culpability from those documents.

(a) Applicant's argument misperceives the role of an SOR. It is not the function or purpose of an SOR to prove anything. Rather, an SOR is an administrative pleading that is supposed to place an applicant on reasonable notice of the basis for the government's proposed denial or revocation of security clearance. *See, e.g.*, ISCR Case No. 99-0710 (March 19, 2001) at p. 2. <sup>(1)</sup>

Furthermore, Applicant conflates the function of an SOR and Department Counsel's burden of proof. Department Counsel must present evidence to support controverted allegations. *See* Directive, Additional Procedural Guidance, Item E3.1.14. Whether or not Department Counsel meets its burden of proof is factually, legally, and logically distinct from whether an SOR is legally sufficient to place an applicant on reasonable notice of the allegations against him or her. Accordingly, whether Department Counsel relied on a factually or legally deficient theory of what constitutes proof that Applicant was involved in insider trading is irrelevant to the legal sufficiency of the SOR issued to Applicant. <sup>(2)</sup>

(b) Applicant correctly notes that the Stipulation and Consent (FORM, Item 7) and the Final Judgment (FORM, Item 8) do not prove that Applicant admitted he had engaged in insider trading or that there had been an adjudication on the merits that he had engaged in insider trading. The Administrative Judge's decision does not purport to treat the Stipulation and Consent and the Final Judgment as proving Applicant admitted he had engaged in insider trading or that there had been an adjudication on the merits by a federal court that Applicant had engaged in insider trading.

Applicant's argument also implicitly relies on the untenable premise that his statements about his motivations, intentions, or state of mind are binding or conclusive on the Administrative Judge. Applicant's statements about his motivations, intention, or state of mind are relevant and material information, but they are not binding or conclusive on the Judge. *See, e.g.*, ISCR Case No. 00-0277 (May 9, 2001) at p. 3. Furthermore, nothing in Executive Order 10865 or the Directive precludes the Judge from making an adverse security clearance decision unless the person affected expressly admits guilt or culpability for his or her conduct. Nor is there any general principle or rule of federal administrative law that precludes a federal department or agency from making an adverse decision unless the affected party expressly admits guilt or culpability for his or her conduct. *Cf. Foster v. Dalton*, 71 F.3d 52, 56 (1st Cir. 1995) ("Notwithstanding a person's disclaimers, a contrary state of mind may be inferred from what he does and from a factual mosaic tending to show that he really meant to accomplish what he professes not to have intended.") [quoted in ISCR Case No. 99-0194 (February 29, 2000) at p. 3]. The Judge gave a rational explanation for why she did not find credible certain disclaimers made by Applicant concerning his knowledge, state of mind, and beliefs about

the stock trading that was the focus of the SEC action against him. The Judge's findings reflect a plausible, reasonable interpretation of the record evidence in this case. Applicant's strong disagreement with the Judge's findings on this aspect of the case does not demonstrate the Judge's findings are arbitrary, capricious, or contrary to law.

3. Whether the Administrative Judge erred by making adverse findings and conclusions regarding Guideline E and Guideline F. Applicant argues the Administrative Judge's adverse findings and conclusions regarding Guideline E and Guideline F are erroneous because: (a) the state of the law on insider trading is in flux; (b) there has been no showing that Applicant had a fiduciary relationship with the companies involved, and absent such a fiduciary relationship, Applicant cannot be found guilty of insider trading; (c) Applicant had a reasonable belief that the insider trading law did not apply to his situation; (d) it would be violative of the Due Process and *Ex Post Facto* Clauses of the Constitution to deny Applicant a security clearance based on a theory of liability that was adopted by the Supreme Court in a decision issued a year after Applicant engaged in the conduct covered by the SOR in this case; and (e) the Judge erred by dismissing the mitigating effect of Financial Considerations Mitigating Condition 1 (E2.A6.1.3.1.).

Appellant's argument concerning the Due Process and *Ex Post Facto* Clauses of the Constitution is not persuasive. The

*Ex Post Facto* Clause does not apply to security clearance adjudications. *See* ISCR Case No. 99-0424 (February 8, 2001) at p. 7. Apart from reciting the Due Process Clause in a conclusory manner, Applicant fails to articulate how his reliance on the Due Process Clause is separate or independent of his argument concerning the *Ex Post Facto* Clause. To the extent Applicant's Due Process Clause argument implicitly assumes he has a right to a security clearance, it lacks merit. *See* ISCR Case No. 99-0424 (February 8, 2001) at pp. 7-8.

The Board need not resolve Applicant's arguments concerning the state of the law on insider trading. Even if the Board were to assume solely for the sake of deciding this appeal that the Administrative Judge erred by finding Applicant engaged in insider trading in violation of federal securities law, such an error would not warrant remand or reversal in this case. Separate and apart from the Stipulation and Consent and the Final Judgment, Applicant admitted that the stock trading which formed the basis of the SEC complaint against him involved "a lapse of good judgement" and "my lapse of investing judgment" (Answer to SOR). Furthermore, in response to the FORM, Applicant stated "my actions were questionable" and indicated that he had "second thoughts" about his involvement in the stock trading because he knew he "was participating in a deception that was occurring between a husband and his wife." Moreover, the record in this case provided a rational basis for the Judge to conclude that Applicant had sufficient experience in stock trading to know that the circumstances of the particular stock trading at issue in this case were questionable, that Applicant had an obligation to ensure his stock purchases were legal, and that it was not reasonable for Applicant to equate the information provided to him by the tipper to "mere rumor." Regardless of whether Applicant's conduct constituted illegal insider trading in violation of federal securities law, the record evidence provided a sufficient basis for the Judge to conclude Applicant's conduct demonstrated questionable judgment and dishonesty within the meaning of Guideline E (Personal Conduct).<sup>(3)</sup>

Applicant's argument about Financial Considerations Mitigating Condition 1<sup>(4)</sup> fails to demonstrate the Administrative Judge erred. The Judge noted that Applicant's conduct occurred in 1996 and had not been repeated since then. However, the Judge explained why she concluded the passage of time did not mitigate Applicant's conduct. The Judge's explanation is not arbitrary, capricious, or contrary to law.

4. Whether the Administrative Judge erred by referring to Applicant's conduct as being criminal and imputing criminal conduct to the person who gave him the tip. The Administrative Judge concluded Applicant's conduct was deceptive or illegal under Financial Considerations Disqualifying Condition 2 (E2.A6.1.2.2.)<sup>(5)</sup> and that Applicant's purchase of stock based on insider information warranted consideration of Personal Conduct Considerations Disqualifying Condition 6 (E2.A5.1.2.6).<sup>(6)</sup> Applicant concedes that the Judge had the power to find that he engaged in criminal conduct, but argues that the Judge erred by doing so in this case because: (a) Applicant was not criminally charged or convicted, and he has never been adjudicated to have violated any civil or criminal law; (b) the law on insider trading is in flux; and (c) given the fact that the law on insider trading is in flux, it was an abuse of discretion for the Judge to impute criminal conduct to both Applicant and the person who tipped him.

Given the limited record in this case, the Administrative Judge did not have a sufficient basis to decide whether the conduct of the person who gave Applicant the tip constituted a criminal violation of federal securities law.<sup>(7)</sup> Accordingly, the Judge did not have a sufficient basis to rely on Personal Conduct Disqualifying Condition 6 in this case. However, Applicant was not prejudiced in any meaningful way by the Judge's application of Personal Conduct Disqualifying Condition 6. The Judge's reference to Personal Conduct Disqualifying Condition 6 was, for all practical purposes, offset by the Judge's application of Personal Conduct Mitigating Condition 7.<sup>(8)</sup> Accordingly, this error was harmless.

The Administrative Judge did not act in an arbitrary or capricious manner by relying on Financial Considerations Disqualifying Condition 2. That disqualifying condition pertains to "[d]eceptive or illegal financial practices." Even assuming solely for the purposes of deciding this appeal that Applicant's conduct was not technically illegal (civilly or criminally), it involved acts of deception and dishonesty that are sufficient to justify the Judge's application of Financial Considerations Disqualifying Condition 2.

## Conclusion

Applicant has failed to meet his burden of demonstrating error that warrants remand or reversal. Accordingly, the Board affirms the Administrative Judge's adverse security clearance decision.

Signed: Emilio Jaksetic

Emilio Jaksetic

Administrative Judge

Chairman, Appeal Board

Signed: Michael Y. Ra'anan

Michael Y. Ra'anan

Administrative Judge

Member, Appeal Board

Signed: Jeffrey D. Billett

Jeffrey D. Billett

Administrative Judge

Member, Appeal Board

1. Applicant's conclusory argument that the SOR was not as detailed and comprehensive as the national security permits lacks merit. In this case, the SOR placed Applicant on reasonable notice of what conduct the government was alleging Applicant had engaged in.

2. Department Counsel correctly notes the SOR issued to Applicant did not allege criminal conduct under Guideline J. However, it is untenable for Department Counsel to contend "the SOR did not specifically allege that Applicant violated insider-trading laws." Given the wording of the SOR and the Discussion section of the FORM (where Department Counsel specifically characterized Applicant's conduct as "illegal insider trading"), it is understandable that Applicant believes the government has sought to deny or revoke his access to classified information based on an allegation that he engaged in illegal insider trading.

3. An SOR is an administrative pleading that is not held to the strict requirements of a criminal indictment, and it is not an end in itself, but rather a means to assist the disposition of a case on the merits instead of pleading niceties. *See, e.g.*, ISCR Case No. 99-0710 (March 19, 2001) at p. 2. Furthermore, an applicant can be found to have engaged in lesser included conduct covered by an SOR allegation. *See, e.g.*, ISCR Case No. 99-0554 (July 24, 2000) at p. 5.

4. "The behavior was not recent."

5. "Deceptive or illegal financial practices such as embezzlement, employee theft, check fraud, income tax evasion, expense account fraud, filing deceptive loan statements, and other intentional financial breaches of trust."

6. "Association with persons involved in criminal activity."

7. The Administrative Judge erred (in footnote 3 of the decision below) by asserting that conduct which was "against the law" is criminal. That error was harmless under the particular facts of this case.

8. "Association with persons involved in criminal activities has ceased."