DATE: April 27, 2005

In Re:

SSN: ----------

Applicant for Security Clearance

ISCR Case No. 01-07018

DECISION OF ADMINISTRATIVE JUDGE

ELIZABETH M. MATCHINSKI

APPEARANCES

FOR GOVERNMENT

Daniel F. Crowley, Esq., Department Counsel

FOR APPLICANT

Pro Se

SYNOPSIS

Applicant was convicted of felony scheme to defraud in 1996 for his conduct in the mid-1980s as vice president of an investment company that engaged in illegal sales practices, including failing to inform clients of commissions and providing unreasonably high projections of investments' future worth. After various appeals, his conviction was upheld and he was sentenced in July 2001 to a conditional discharge with $2,237,300 in restitution, which he has sought to have discharged in bankruptcy. Criminal conduct and personal conduct concerns persist due to the absence of clear rehabilitation. Clearance is denied.

STATEMENT OF THE CASE

On March 22, 2004, the Defense Office of Hearings and Appeals (DOHA) issued a Statement of Reasons (SOR) to the Applicant which detailed reasons why DOHA could not make the preliminary affirmative finding under the Directive that it is clearly consistent with the national interest to grant or continue a security clearance for the Applicant.[(1)] DOHA recommended referral to an administrative judge to determine whether his clearance should be granted, continued, denied, or revoked. The SOR was based on criminal conduct (Guideline J) and personal conduct (Guideline E).

On May 18, 2004, Applicant filed his response to the SOR allegations, and requested a hearing before a DOHA administrative judge. The case was assigned to me on September 15, 2004, and pursuant to formal notice of that date, a hearing was held as scheduled on October 8, 2004. At the hearing, seven government exhibits and four Applicant exhibits were admitted into the record, and Applicant testified, as reflected in a transcript received on October 19, 2004.

The record was held open until October 22, 2004, for Applicant to submit evidence of state court relief from disabilities, a post-conviction remedy. Applicant timely forwarded a certificate of relief from disabilities, dated October 14, 2004, with the state statutory authority for such relief. On November 5, 2004, Department Counsel argued that the certificate of relief does not negate the conviction, constitute a pardon, or relieve him from his criminal restitution obligation, but

he filed no objection to inclusion of the certificate in evidence. The certificate of relief with statutory authority was marked and admitted as Applicant exhibit E.

FINDINGS OF FACT

DOHA alleges criminal conduct (Guideline J) concerns related to Applicant's conviction for felony scheme to defraud in October 1996, later upheld on appeal, and personal conduct (Guideline E) concerns because Applicant sought discharge in bankruptcy of $2,237,300 in court-ordered restitution from his conviction. In his Answer, Applicant did not deny his conviction, but cited in mitigation that the trial judge vacated his conviction, the criminal conduct was isolated and not recent, and he was granted a conditional discharge on reinstatement of his conviction. Applicant asserted he acted on the advice of legal counsel in including the restitution obligation in his chapter 7 filing. After a complete and thorough review of the evidence of record, I make the following findings of fact:

Applicant is a 47-year-old computer software engineer who has been employed by a defense contractor since mid-November 1998. Applicant held an interim secret-level security clearance from February 1999 to February 2004 without adverse incident until it was withdrawn.

In 1982, Applicant became vice president of a financial planning and investment company (company X) owned by his father. Originally incorporated as a real estate firm, the company branched out in the early 1980s as Applicant's father began to market real estate through financial planning. By the time Applicant came on board in 1982, company X was facilitating investments in hard assets such as real estate condominiums, numismatic coins, and works of art, as well as in securities (stocks and bonds), as part of an overall individualized financial plan for its clients.[(2)] Applicant, who has a degree in fine arts, managed the art department and handled the art procurement (primarily imported fine art glass) for company X. Applicant was responsible for identifying artwork for purchase and determining a reasonable investment price. He met with investment clients to determine their specific preferences with respect to investing in art, and dealt directly with the artists, some of whom were managed by company X. Those artists and company X split 50/50 the proceeds of any sales of their art to company X's financial planning clientele, but those artists also then paid company X a third of their share back to company X. Applicant was paid a base salary of $50,000, and he received a commission for this work, which he maintains was known to his clients.

In 1986, the state attorney general launched an investigation into the sales practices of company X on complaints from investors that they had not been informed of the large commissions paid to the company on the sales of tangible assets, of the relative non-liquidity of the investments, or of the volatility and risk associated with the markets in rare coins, art work and real estate, and that the company had provided investors unrealistically high projections of the future worth of investments. The company was enjoined from operating. In about April 1991, Applicant, along with his father (president and chief operating officer), the general manager/chairman of the financial planning board, the chief financial officer, and three salesmen, were charged with scheme to defraud in the first degree, a class E felony under state law.[(3)] The defendants were alleged to have acted in furtherance of an ongoing scheme to obtain money from the public by offering for sale and selling real estate, coins, and art work. The state's case against Applicant was based, in part, on Applicant's attendance at company sales meetings where salespersons were instructed in what to tell clients about commissions and projections of future values of investments.

On motion of the defendants, a judge of the county court dismissed the scheme to defraud count of the indictment. The state appealed, and in July 1994, the appellate court reinstated the charge,[(4)] a decision upheld by the state's highest court.[(5)] Following a jury trial in October 1996, Applicant was convicted of scheme to defraud, a class E felony. Prior to sentencing, the judge granted a motion to set aside the verdict and dismiss the charge against him, from which the state appealed. In July 1999, the appellate court reinstated Applicant's conviction. While his knowledge may not have extended to every detail of company X's business, the trial evidence sufficiently established his willful participation in the alleged scheme with the intent to defraud. His conviction was affirmed on appeal in October 2000. In late July 2001, he was sentenced to a conditional discharge, to expire in July 2004 on compliance with the following conditions, *i.e.*, refrain from criminal conduct or illegal activity, refrain from employment as a financial planner or investment advisor, pay restitution of $2,237,000 in affordable monthly installments as recommended by the probation department after investigation and approval by the court, and maintain with the probation department current home and business address

and telephone information. In September 2001, Applicant agreed in writing to abide by the conditions of his conditional discharge. He made no effort to pay any of the restitution at that time as he had financial problems.

Having overextended himself on credit and unable to refinance the mortgage on his residence because of a lien placed against it by a creditor owed a judgment debt in excess of $9,000 for a loan default in 1986, Applicant filed for chapter 7 bankruptcy on November 26, 2001. His bankruptcy counsel advised him to include the restitution debt in his bankruptcy, while informing him that the debt might not be discharged. Accordingly, Applicant listed in nonpriority unsecured claims $2,291,800 in debt, $54,500 in unpaid credit card debt and the remainder his criminal restitution. The county probation office did not appear at the meeting of creditors, but by letter dated January 24, 2002, Applicant's bankruptcy counsel and the U.S. bankruptcy court were notified that the county intended to oppose any action to discharge Applicant's criminal restitution obligation. On February 21, 2002, Applicant was granted a chapter 7 bankruptcy discharge of the debts dischargeable under law. He was notified by the court that as a general rule, debts, penalties, forfeitures, or criminal restitution obligations are not discharged in a chapter 7 bankruptcy. On January 29, 2003, the bankruptcy judge notified the bankruptcy trustee that a hearing would be held on February 28, 2003, to discuss why the case had not been closed due to inactivity for more than six months. On February 1, 2003, the chapter 7 trustee filed a report of no distribution, and the case was closed on April 7, 2003.

Applicant earned a computer engineering certificate from a local community college in 1998, and went to work for his present employer that November. On his security clearance application executed on December 2, 1998, Applicant disclosed that he had been charged with felony scheme to defraud in October 1991, but the charge had been dismissed by the judge.

On June 20, 2003, Applicant was interviewed by a Defense Security Service (DSS) about his felony conviction for scheme to defraud and the financial issues that led to his bankruptcy filing. Applicant denied any direct involvement in the financing of art purchases or in explaining to clients how their art purchases fit into their overall investment plan. He maintained salespersons had been instructed to comply with applicable state regulations on disclosure of commissions, and they had been told projections did not guarantee return. Applicant claimed that no one testified that he had behaved illegally or improperly and the trial judge overturned his conviction because of insufficient evidence. He admitted that his conviction was reinstated on appeal and he was ordered to pay more than $2 million in restitution, with the county requesting around the time of his bankruptcy and again in May 2003 that he repay it at $200 per month.[(6)] Applicant acknowledged he had not made any payments on that legal obligation, he had included it in his bankruptcy, and he was awaiting legal resolution on whether his restitution can be discharged in bankruptcy. Applicant expressed his belief the county probation office's request for $200 per month was premature because the county had not talked to him to arrange for a fair payment.[(7)]

As of October 8, 2004, Applicant had not made any restitution payments despite a base annual salary of $60,000 from his work with the defense contractor. He did not intend to commence repayment of the debt until he is ordered to do so by court order. Applicant continued to maintain that he had not provided any information to his art clients as to the likely return on their investments. While he had given company X sales representatives numbers as to likely appreciation of art assets, he denied knowing of any obviously unethical or illegal conduct by company X employees. Applicant asserted that those projections he knew of "didn't seem out of line to [him]" because of the market at the time, and he had no intent to deceive investors.

On October 14, 2004, on verified application by Applicant, the court issued a certificate of relief from disabilities. The legal effect of this post-conviction relief is that Applicant was relieved of all disabilities and bars to employment because of his felony conviction, excluding the right to be eligible for public office.[(8)]

POLICIES

"[N]o one has a 'right' to a security clearance." *Department of the Navy v. Egan*, 484 U.S. 518, 528 (1988). As Commander in Chief, the President has "the authority to . . . control access to information bearing on national security and to determine whether an individual is sufficiently trustworthy to occupy a position . . . that will give that person access to such information." *Id.* at 527. The President has authorized the Secretary of Defense or his designee to grant applicants eligibility for access to classified information "only upon a finding that it is clearly consistent with the

national interest to do so." Exec. Or. 10865, *Safeguarding Classified Information within Industry* § 2 (Feb. 20, 1960). Eligibility for a security clearance is predicated upon the applicant meeting the security guidelines contained in the Directive. An applicant "has the ultimate burden of demonstrating that it is clearly consistent with the national interest to grant or continue his security clearance." ISCR Case No. 01-20700 at 3.

Enclosure 2 of the Directive sets forth personnel security guidelines, as well as the disqualifying conditions (DC) and mitigating conditions (MC) under each guideline. In evaluating the security worthiness of an applicant, the administrative judge must also assess the adjudicative process factors listed in ¶ 6.3 of the Directive. The decision to deny an individual a security clearance is not necessarily a determination as to the loyalty of the applicant. *See* Exec. Or. 10865 § 7. It is merely an indication that the applicant has not met the strict guidelines the President and the Secretary of Defense have established for issuing a clearance.

Considering the evidence as a whole, the following adjudicative guidelines are most pertinent to this case:

Criminal Conduct. A history or pattern of criminal activity creates doubt about a person's judgment, reliability and trustworthiness. (E2.A10.1.1)

Personal Conduct. Conduct involving questionable judgment, untrustworthiness, unreliability, lack of candor, dishonesty, or unwillingness to comply with rules and regulations could indicate that the person may not properly safeguard classified information. (E2.A5.1.1.)

CONCLUSIONS

Having considered the evidence of record in light of the appropriate legal precepts and factors, I conclude the Government established its case with respect to Guideline J, criminal conduct, and Guideline E, personal conduct. Notwithstanding the passage of 18 years since his participation in the scheme to defraud, doubts persist about his reform.

Applicant was convicted following a jury trial in 1996 of one count of felony scheme to defraud in the first degree, stemming from his involvement as vice president and investment advisor in the procurement of art for company X's clients from 1982 to 1986. Applicant bears an especially heavy burden to overcome the security concerns engendered by criminal conduct that was fraudulent in nature, systematic and ongoing for about four years, and a clear breach of fiduciary duty to his clients. Under Guideline J, disqualifying conditions (DC) E2.a.10.1.2.1. *Allegations or admission of criminal conduct, regardless of whether the person was formally charged*, and DC E2.A10.1.2.2. *A single serious crime or multiple lesser offenses*, apply.

Even crimes involving fraud can be mitigated where they are not recent (*see* E2.A10.1.3.1.), and it has been 18 years since Applicant served on the board of his father's company. However, the DOHA Appeal Board has consistently held that even when a disqualifying or mitigating condition is applicable, the judge should not consider it in isolation and without regard to the record evidence as a whole. (*See, e.g.*, ISCR Case No. 98-0803, August 17, 1999). The trial judge, who vacated Applicant's felony conviction only to have it reinstated on appeal, issued in October 2004 a certificate of relief from civil disabilities. Under state law, that post-conviction remedy relieves Applicant of all disabilities and bars to employment, excluding the right to be eligible for public office. The relief is discretionary on the part of the judge, but it is not to be issued unless the court is satisfied it is consistent with the rehabilitation of the eligible offender and with the public interest. This certificate was issued notwithstanding Applicant has not paid any of the more than $2 million in restitution ordered by the judge. While state law provides that the court may request an investigation of the applicant for the purpose of determining whether relief from civil disabilities is appropriate, it is not clear that the trial judge requested any report from the probation office through which Applicant was ordered to pay restitution. In any event, I am not bound by any state-granted post-conviction remedy when determining whether it is clearly consistent to grant an applicant access to classified information. I conclude SOR ¶ 1.a. against him.

Failure to comply with court-ordered restitution or other criminal sanction may preclude a finding of successful rehabilitation and generally raises serious personal conduct concerns. Under the personal conduct guideline of the Directive, conduct involving questionable judgment, untrustworthiness, unreliability, lack of candor, dishonesty, or unwillingness to comply with rules and regulations could indicate that the person may not properly safeguard classified

information. While Applicant was clearly associated with others involved in criminal activity, including his father (*see* DC E2.A5.1.2.6.), the primary concern at present is his failure to address his criminal restitution obligation. Applicant included the criminal restitution debt on his bankruptcy on the advice of his lawyer. Yet, Applicant also has reason to believe the debt may not be discharged. The county probation office objected to discharge of the debt, and the chapter 7 discharge indicates criminal penalties are not generally discharged. In May 2003, Applicant received a second demand for repayment of the restitution at $200 per month from the probation office. Applicant has chosen to respond by shifting blame to the probation department, who he submits did not work with him to determine a fair and reasonable monthly repayment amount. While Applicant was ordered to pay reparation in monthly installments in an amount he could afford, it was "as recommended by the Probation Department after investigation and approval by the Court." (Ex. 5) There is nothing in the sentencing conditions which required the probation office to negotiate the payment terms with Applicant. Applicant also submits there has been no legal resolution reached as to whether his restitution obligation has been discharged under chapter 7. (Tr. 125) In the absence of any efforts by Applicant to seek a legal ruling as to the dischargeability of his restitution debt, the delay in settling this restitution reflects adversely on him.

It is noted that under federal bankruptcy law in effect as of Applicant's filing, an individual is not discharged from any debt that is for the violation of any of the federal securities laws, any of the state securities laws, or any regulation or order issued under such federal or state securities laws, or common law fraud, deceit, or manipulation in connection with the purchase or sale of any security, and results from any court or administrative order for any "damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor" (11 U.S.C. § 523(a)(19)). Even if Applicant were legally relieved from repayment of his restitution obligation, he has failed to show any remorse for his conduct. Instead, he attributes his conviction to overly stringent state securities laws, to an overzealous prosecutor that asserted a fiduciary responsibility that wasn't clear (Tr. 106), to an appeals court that got the evidence wrong, and to inadequate legal representation on appeal (Tr. 114). Unable to conclude that Applicant is fully rehabilitated from his very serious violations of the fiduciary relationship he had with his investment clients, I resolve SOR ¶ 2.a. against him.

FORMAL FINDINGS

Formal Findings as required by Section 3. Paragraph 7 of Enclosure 1 to the Directive are hereby rendered as follows:

Paragraph 1. Guideline J: AGAINST THE APPLICANT

Subparagraph 1.a.: Against the Applicant

Paragraph 2. Guideline E: AGAINST THE APPLICANT

Subparagraph 2.a.: Against the Applicant

DECISION

In light of all the circumstances presented by the record in this case, it is not clearly consistent with the national interest to grant or continue a security clearance for Applicant. Clearance is denied.

Elizabeth M. Matchinski

Administrative Judge

1. The SOR was issued under the authority of Executive Order 10865 (as amended by Executive Orders 10909, 11328, and 12829) and Department of Defense Directive 5220.6 (Directive), dated January 2, 1992 (as amended by Change 4).

2. Applicant did not specify at the hearing the type of real estate included in the overall financial plan purchased by a client. The appellate court decision of July 1994 indicates it involved condominiums.

3. Section 190.65 of the state's penal laws provides as follows:

§190.65 Scheme to defraud in the first degree. 1. A person is guilty of a scheme to defraud in the first degree when he: (a) engages in a scheme constituting a systematic ongoing course of conduct with intent to defraud ten or more persons or to obtain property from ten or more persons by false or fraudulent pretenses, representations or promises, and so obtains property from one or more of such persons; or (b) engages in a scheme constituting a systematic ongoing course of conduct with intent to defraud more than one person or to obtain property from more than one person by false or fraudulent pretenses, representations or promises, and so obtains property with a value in excess of one thousand dollars from one or more such persons. 2. In any prosecution under this section, it shall be necessary to prove the identity of at least one person from whom the defendant so obtained property, but it shall not be necessary to prove the identity of any other intended victim. Scheme to defraud in the first degree is a class E felony.

Applicant was also charged with a violation for selling art (an investment commodity) without a license. That charge was subsequently dismissed. Applicant's father and a financial officer of company X were also charged with grand larceny in connection with the company's investment deals involving real estate and coins.

4. The state's highest court affirmed in November 1995 the count in the indictment that charged Applicant and the other defendants with participating in a fraudulent investment scheme. The court decided the investors' funds were placed in one of three highly leveraged investments, was not facially duplicitous because the crime was a continuing offense involving numerous false or fraudulent pretenses, representations and promises over time and, therefore, could be charged in a single count. The court directed the trial jury be instructed that all must agree on the existence of the same single scheme to defraud, and must be unanimous as to each defendant found guilty, and that Applicant participated in the same overall fraudulent scheme alleged in the indictment.

5. Department Counsel did not seek the admission in evidence of the respective appellate court decisions, but cited these decisions in closing as legal authority pertinent to resolution of the case.

6. Applicant testified at his hearing in October 2004 that he had received no notices from the state seeking repayment of the restitution since his bankruptcy discharge in February 2002. (Tr. 124-25) Yet, in June 2003, he executed a sworn statement admitting he received in May 2003 another letter from the county probation office requesting the $200 per month repayment and notifying him of arrearage. (Ex. 2) His account of June 2003 is viewed as more credible given it was contemporaneous with the demand for payment.

7. The judge specified with respect to repayment of restitution (*see* Ex. 5):

Make reparation in the amount of $2,237,300.00. Said reparation to be paid in monthly installments to the Probation Department in an amount you can afford to pay, as recommended by the Probation Department after investigation and approval by the Court.

8. Section 702 of the state's correction law state law provides for certificates of relief from disabilities issued by a court, as follows:

1. Any court of this state may, in its discretion, issue a certificate of relief from disabilities to an eligible offender for a conviction that occurred in such court, if the court either (a) imposed a revokable sentence or (b) imposed a sentence other than one executed by commitment to an institution under the jurisdiction of the state department of correctional services. Such certificate may be issued (i) at the time sentence is pronounced, in which case it may grant relief from forfeitures as well as from disabilities, or (ii) at any time thereafter, in which case it shall apply only to disabilities.

2. Such certificate shall not be issued by the court unless the court is satisfied that:

(a) The person to whom it is to be granted is an eligible offender, as defined in section seven hundred;

(b) The relief to be granted by the certificate is consistent with the rehabilitation of the eligible offender; and

(c) The relief to be granted by the certificate is consistent with the public interest.