DATE: April 7, 2003

In Re:

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

Applicant for Security Clearance

ISCR Case No. 01-15837

DECISION OF ADMINISTRATIVE JUDGE

JOHN G. METZ, JR.

APPEARANCES

FOR GOVERNMENT

Jonathan A. Beyer, Esquire, Department Counsel

FOR APPLICANT

Jill Davis, Esquire

SYNOPSIS

Applicant's arms-length business transaction with his past employer did not violate any recognized code of professional responsibility, business ethics, or general moral code. Clearance granted.

STATEMENT OF THE CASE

On 16 August 2002, the Defense Office of Hearings and Appeals (DOHA) issued a Statement of Reasons (SOR) to Applicant, stating that DOHA could not make the preliminary affirmative finding[(1)] that it is clearly consistent with the national interest to grant or continue a security clearance for Applicant. On 9 September 2002, Applicant answered the SOR and requested a hearing. The case was originally assigned to a different Administrative Judge, but was reassigned to me on 8 January 2003 because of case load considerations, and received by me the same day. I set the case on 15 January 2003 and on 17 January 2003 I issued a notice of hearing for 7 February 2003.

At the hearing, the Government presented six exhibits--three admitted without objection, one admitted over objection, and two excluded as stated below--and no witnesses; Applicant presented no exhibits--and the testimony of two witnesses, including himself. DOHA received the transcript on 21 February 2003.

PROCEDURAL ISSUES

At the hearing, I excluded Government's Exhibits 4 and 6 because they were sworn statements adverse to the Applicant on a controverted issue and thus inadmissible under the Directive, Paragraph E.3.1.22 (18-32). Although I admitted Government's Exhibit 5 as a business record otherwise required to be admitted in accordance with Directive, Paragraph E.3.1.20., I accord it less weight to the extent that it is based not on the direct observations of the investigating officers, but the recorded statements excluded as G.E. 4 and 6.

FINDINGS OF FACT

On 13 March 1998, Applicant entered into a proposed purchase contract for a piece of specialized equipment that would allow Applicant's company to perform required calibration on its machine products. The machine cost $10,000.00; the proposed date of sale was 17 March 1998 (G.E. 5). On 16 March 1998, Applicant was paid his company bonus for 1997, $24,000.00 less withholding (G.E. 5).[(2)] On 17 March 2003, Applicant purchased the machine. The same day, Applicant's company gave him a check for $24,000.00 for purchase of the machine (G.E. 5).[(3)] On or about 19 May 1998, the company president confronted Applicant about the president's recent discovery that Applicant had paid $10,000.00 for the machine, not $24,000.00. The president demanded Applicant refund the $14,000.00 difference. Applicant refused and was fired. He later won his case for unemployment compensation before the state unemployment commission. However, he only collected one employment check as he was quickly hired by his current defense employer.

The company president accused Applicant of theft. The case was investigated (G.E. 3) and brought before a grand jury. Applicant testified before the grand jury, which refused to indict him. The company president did not testify at the first grand jury. He managed to get the prosecutors to reopen the case to permit him to testify. He testified at the second grand jury proceeding, Applicant did not. However, the grand jury still refused to indict Applicant.[(4)]

This case hinges on the factual determination whether the $24,000.00 payment to Applicant was reimbursement for the putative price of the machine (with Applicant owing a fiduciary duty to the company to seek reimbursement only for the amount he actually paid) or an arms-length transaction between Applicant and his employer in which Applicant sold the machine (which he owned) to the company for a fair price. I find Applicant sold the machine he had purchased legitimately to his company at a fair price.[(5)]

Applicant denied the allegations of the SOR. The SOR alleges a single incident as cognizable under both Guidelines F and E:

You engaged in deceptive financial practices by knowingly representing to your employer, [named], that the coordinate measuring machine you purchased for the company was in good working condition and cost $24,000.00 when in fact the machine did not work and cost $10,000.00. You did not pay back the $14,000.00 difference in price and you were subsequently terminated from your

employment.

Applicant vehemently denied the allegation in his answer:

I informed [named company owner] that I had found a Shieffeld Coordinate Measuring Machine and that I would like to purchase the machine and lease it to his company [named] Manufacturing Corp. This arrangement would give [the company] the utility of the machine without the burden of cash outlay for capital equipment and provide a tax deferment for myself. [Named company owner] was agreeable.

After purchasing the coordinate measuring machine with my own money and making arrangements to have the machine delivered to [named] Corporation, I approached [Named company owner] to formalize a lease agreement. It was at this time that [named company owner] informed me he wanted to add a caveat too our previous agreement. The caveat would allow [named company owner] to exercise an option to purchase the machine at any time during the lease. I informed him that the purpose of the lease was to provide me a tax deferment, and that the caveat was not in my best interest and if his intent was to own the machine, I would sell it for $24,000.00, a fair market value. He did not hesitate in accepting my offer. He had a [named] Corporate check for $24,000.00 issued to [me] to purchase the coordinate machine. Two different [named] County Grand Juries found no probable cause that deceptive financial practices were committed by me. . .

Although [named company owner] and I had a business dispute which eventually was resolved in my favor, my judgment has been reviewed by two properly empaneled grand juries and no dishonesty, lack of candor, or deceptive financial practices were found on my behalf.

Applicant's Answer is completely consistent with his 19 July 2000 sworn statement to the Defense Security Service

(DSS)(G.E. 2):

I was employed by [named] Manufacturing, [city, state], from March 96 to May 98, as General Manager. The owner of the company was [name]. The events that occurred that led to my termination are as follows.

I purchased a Coordinate Measuring Machine (CMM) with my own money with the sole intent of leasing it to [named] Manufacturing. I purchased the machine from [another company] for $10,0000. After I had purchased the machine I was discussing the terms of the lease with [the owner] with the intent to get the terms and conditions in a written agreement. [The owner] wanted to add a caveat to our previous verbal agreement. The caveat being that he would have right to purchase the machine at any time. I responded that if he was interested in owning the machine then he could purchase it at that time. He had [company employee] write a check to me for $24,000.

Weeks later, after the machine had been delivered to [the company], and a separate office space had been remodeled to accommodate the machine, [the owner] became enraged when he discovered that I had profited from the sale. He demanded that I return the profits to him. I refused his demand and he terminated my employment.

When I purchased the machine from [another company], I purchased the machine "as is" and knew that it was in good shape and had been properly disassembled, packaged, and protected. It did need certification and inspection after it was reassembled at [the company]. An employee later told me that it took about $100 to repair a feedback mechanism to get the machine back into working condition. I never misrepresented the condition or the age of the machine to [the owner] or any other employees of [the company].

[The owner] filed theft charges against me with the [city] Police Department alleging that I stole moneys. The case was forwarded to the [named] County District Attorneys Office, [city, state]. A grand jury heard the case and "No Billed" the case. [The owner] appealed the decision, because he was not available to give his testimony. An appeal was granted and a new grand jury was convened and heard. The case and the second grand jury was again "No Billed".

In addition to the above circumstance, [the owner] initially denied my claim for unemployment compensation. I appealed the denial and there was a tribunal hearing convened between an attorney of fact for the State of Texas Employment Commission, [the owner] and myself. The outcome of the hearing was that the [state] Employment Commission ruled in my favor for unemployment compensation.

I have never hid the circumstances concerning my termination from [the company] from any employers or on my security questionnaire. My current employer and supervisors are aware of the circumstances. [The owner] called [my current company], Government Affairs Office after I began my employment and made allegations about the circumstances concerning my dismissal from [the company]. I believe he was trying to cause problems for me, I don't know what was said but I believe the intent was to cause problems for me.

To the best of my knowledge there have not been any other actions or civil matters concerning my dismissal from [the company]. The situation with my termination from [the company] does not in anyway make me susceptible to blackmail or coercion concerning classified information.

On 28 September 1998, Applicant executed a Security Clearance Application (SCA)(SF 86)(G.E. 1) on which he truthfully disclosed the circumstances of his termination from the manufacturing company.

Applicant--a 54-year-old employee of a defense contractor--seeks reinstatement of the access to classified information that he previously had with this employer. He is a machinist by rearing, a businessman by education (Tr. 161-164).[(6)]

Before Applicant went to work for the company that is the focus of the SOR, he was employed to manage a company coming out of bankruptcy. Applicant had been employed by the company owners when the bankruptcy judge would not let them come out of bankruptcy unless the company was being run as efficiently as possible. Applicant turned the company around to the point where it was making a profit.

The owner of Applicant's learned of his success and wanted to hire Applicant to perform similar work for his company. The owner was a prominent state legislator whose nominal job was running his manufacturing company. The company

owned no capital assets. It rented the building it occupied, as well as all its manufacturing equipment, from the owner. It was losing money, and had been losing money for some time.

Applicant was reluctant to go to work for this company, but finally agreed to become the general manager; his compensation package provided he would be paid a bonus in any month when the company made money, with a year-end bonus of 15% based on net profits.

When Applicant went to work for the company, he discovered--contrary to the owner's claims--that the company essentially did not have any contracts for machine parts, and had fallen off the list of approved vendors for those defense-contract buyers who had previously provided the company with work. Nevertheless, Applicant turned the company around to where it was making money, and at the end of 1997, the company owed Applicant $24,000.00 in bonus money.

Applicant wanted to invest the bonus in a way that would provide tax benefits to him. At the same time the company's business was growing and they need specialized equipment to calibrate the machine products they made so they could be certified for sale to the defense-contract buyers. Those certifications were available on a piece rate (prohibitively expensive) or by leasing a less satisfactory piece of equipment for $500.00 per month, the lowest rate Applicant was able to find. However, Applicant found a more comprehensive piece of equipment that had been surplussed by another manufacturing company. Because of Applicant's expertise in manufacturing, he knew the equipment had been well-maintained and properly packaged for storage. He also knew the asking price ($10,000.00) was a below-market bargain.

He approached the owner of his company about buying the equipment himself and leasing it to the company (for $500.00 per month). Given his past dealings with the owner, he had no reason to believe the owner wanted to buy the equipment himself or have the company buy it. The owner was originally agreeable to Applicant's proposal and paid Applicant his bonus so he could buy the equipment. However, when Applicant went to formalize the lease, the owner wanted a provision that would give him the right to purchase the machine from Applicant at any time during the lease. Applicant was unwilling to give up his contemplated tax benefits of owning the equipment, but offered to sell the equipment for a price he thought would provide a reasonable profit on his purchase, given that he would lose the income-producing potential of the machine. The owner quickly agreed to Applicant's asking price of $24,000.00. He never asked Applicant what Applicant had paid for the machine. Not until the owner learned that Applicant paid $10,000.00 for the machine did the owner become incensed, demanding "refund" of the excess "reimbursement." He retaliated as described above. He did not, however, pursue any civil action against Applicant. The company never made money again, and is now out of business (Tr. 253).

Applicant's expert witness testified credibly that Applicant had violated no business ethics or moral code in his transaction with the owner of the company and that Applicant had engaged in an arms-length transaction by selling a capital asset to the company for a fair price given his acquisition costs and his prospective loss of income from the lease of the machine to the company (Tr. 183-251).[(7)] The government produced no code of professional responsibility, business ethics, or general moral code violated by Applicant's conduct.

POLICIES

Enclosure 2 of the Directive sets forth adjudicative guidelines to be considered in evaluating an individual's security eligibility. The Administrative Judge must take into account the conditions raising or mitigating security concerns in each area applicable to the facts and circumstances presented. Each adjudicative decision must also assess the factors listed in Section 6.3. and in Enclosure (2) of the Directive. Although the presence or absence of a particular condition for or against clearance is not determinative, the specific adjudicative guidelines should be followed whenever a case can be measured against this policy guidance, as the guidelines reflect consideration of those factors of seriousness, recency, motivation, *etc*.

Considering the evidence as a whole, the following adjudication policy factors are most pertinent to this case:

FINANCIAL CONSIDERATIONS (GUIDELINE F)

E2.A6.1.1. The Concern: An individual who is financially overextended is at risk of having to engage in illegal acts to

generate funds. Unexplained affluence is often linked to proceeds from financially profitable criminal acts.

E2.A6.1.2. Conditions that could raise a security concern and may be disqualifying include:

E2.A6.1.2.2. 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 breaches of trust;

E2.A6.1.3. Conditions that could mitigate security concerns include:

E2.A6.1.3.1. The behavior was not recent;

E2.A6.1.3.2. It was an isolated incident.

PERSONAL CONDUCT (GUIDELINE E)

E2A5.1.1. The Concern: 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. A5.1.2. Conditions that could raise a security concern and may be disqualifying include:

E2.A5.1.2.1. Reliable, unfavorable information provided by associates, employers, coworkers, neighbors, and other acquaintances;

E2.A5.1.2.3. A pattern of dishonesty or rule violations. . .

E2.A5.1.3. Conditions that could mitigate security concerns include:

E2.A5.1.3.1. The information was unsubstantiated or not pertinent to a determination of judgment, trustworthiness, or reliability;

Burden of Proof

Initially, the government must prove controverted facts alleged in the SOR. If the government meets that burden, the burden of persuasion then shifts to the applicant to establish his security suitability through evidence of refutation, extenuation or mitigation sufficient to demonstrate that, despite the existence of disqualifying conduct, it is nevertheless clearly consistent with the national interest to grant or continue the security clearance.

A person who seeks access to classified information enters into a fiduciary relationship with the government predicated upon trust and confidence. Where facts proven by the government raise doubts about an applicant's judgment, reliability or trustworthiness, the applicant has a heavy burden of persuasion to demonstrate that he or she is nonetheless security worthy. As noted by the United States Supreme Court in *Department of the Navy v. Egan*, 484 U.S. 518, 531 (1988), "the clearly consistent standard indicates that security-clearance determinations should err, if they must, on the side of denials."

CONCLUSIONS

The government has not established its case under guideline F. To conclude that it had, I would have to accept the version of the transaction contained in G.E. 3, which I do not. The facts described in G.E. 3 cannot be reconciled with Applicant's more credible version.

Applicant was a professional machinist in the process of making his company into a profitable business. He had succeeded, as evidenced by his bonus, and had every intention of making more money both for himself and the company. He knew the company owned no capital assets and the owner was unwilling to tie up more of his money in capital assets for the company. He also knew the company would require the use of calibrating equipment if it was to continue to grow. He found a suitable piece of equipment in good condition that would do a better job than the lowest-

priced alternate and saw an opportunity to help himself and the company. He discussed his plan with the owner who agreed: Applicant would buy the machine and lease it to the company for the same monthly cost as the quote for the less-satisfactory machine. Applicant would get the income from the lease, as well as the tax advantage of depreciating the machine. The company would get a better piece of equipment for the same money and continue its growth.

The owner changed the terms of the agreement before it could be reduced to writing, and Applicant preferred to sell the machine outright rather than give the owner an option to buy. The owner readily agreed to the asking price without inquiring about the equipment. His retaliatory actions after discovering what Applicant paid for the machine bespeak frustration at being outsmarted or outmanuevered in an arms-length business transaction and having the means as a state legislator to make more than a little trouble for Applicant. None of this obscures the fact that the original lease proposed by Applicant was a good deal for the company or the fact that the sale price on what amounted to a compelled sale was fair given Applicant's income and tax expectations. Applicant considers himself a straight-shooter, and I found him to be so in his testimony. He violated no ethical standard know to me, known to Department Counsel, known to the expert, nor any cited to me by any of the parties or witnesses. There was nothing about the transaction that was either illegal or deceptive. Accordingly, I resolve Guideline F. for Applicant.

In a similar fashion, the government has not established its case under Guideline E. Applicant engaged in no unethical or immoral conduct in his business dealings with his employer. I resolve Guideline E. for Applicant.

FORMAL FINDINGS

Paragraph 1. Guideline F: FOR THE APPLICANT

Subparagraph a: For the Applicant

Paragraph 2. Guideline E: FOR THE APPLICANT

Subparagraph a: For the Applicant

DECISION

In light of all the circumstances presented by the record in this case, it is clearly consistent with the national interest to grant or continue a security clearance for Applicant.

John G. Metz, Jr.

Administrative Judge

1. Required by Executive Order 10865, as amended, and Department of Defense Directive 5220.6, dated January 2, 1992--and amended by Change 3 dated 16 February 1996, and by Change 4 dated 20 April 1999 (Directive).

2. Applicant was employed on a contract where he was paid only if the company made money, $1,000.00 per month plus a year-end bonus of 15% of net income. The bonus was due in January 1998, but not paid because of the company's financial situation. The original check stub contains notations showing that the check was for Applicant's bonus, less withholding. A hand-written notation on the photocopy of the check (but not on the original four-corners of the check and stub) reflects "bonus check." However, there is no evidence when that notation was made.

3. The check stub indicates only that the check was for the machine at issue. A hand-written notation on the photocopy of the check (but not on the original four-corners of the check and stub) reflects "reimbursement for CMM." However, there is no evidence when that notation was made either.

4. The above facts are essentially undisputed.

5. The only evidence to the contrary is G.E. 3. I give this evidence less weight for a number of reasons. First, the evidence against Applicant consists almost exclusively of the hearsay statements--filtered through the investigating

officers--of the complaining witnesses, including the company president, whose statements were excluded under Paragraph E.3.1.22. Each of those witnesses had a vested interest in supporting the story of the company president and owner, whose goodwill they needed to stay employed. Second, the version of the transaction contained in G.E. 3 has been rejected--implicitly or explicitly--by two grand juries and a state unemployment commission. Both grand juries would have had access to more evidence than was produced at this hearing; one of them had the president's live testimony subject to cross-examination, something missing here. Third, Applicant's version of events is more consistent with the documentary evidence of the transaction (the checks and sales contract) than is G.E. 3. I give no weight whatsoever to the handwritten annotations on either of the two checks. Were I to give them any weight, I would find them evidence of the owner's attempt to make the record comport with his version of the transaction and not reflective of the actual facts.

6. Applicant's father owned one of the largest machine shops in the state and thought Applicant should learn the business from the ground up before he ever tried to run a plant.

7. Although the expert was hired in anticipation of the clearance hearing, I found his testimony particularly credible for a number of reasons. First, the expert did not meet Applicant until the day of the hearing and had no knowledge of the particulars of the case until Applicant's counsel retained him to review the record (Tr. 189). Second, Applicant's counsel prepared the expert by having him read all the government's exhibits first before giving him the Applicant's side of the case (Tr. 240-241). Finally, the expert had the opportunity--as did I--of observing Applicant's testimony at the hearing and finding it credible (Tr. 243-250).