

DATE: March 10, 2003

In Re:

SSN: -----

Applicant for Security Clearance

ISCR Case No. 01-18048

DECISION OF ADMINISTRATIVE JUDGE

JOHN G. METZ, JR.

APPEARANCES

FOR GOVERNMENT

Jonathan A. Beyer, Esquire, Department Counsel

Erin C. Hogan, Esquire, Department Counsel

FOR APPLICANT

Jed L. Babbin, Esquire

SYNOPSIS

Although Applicant's finances and his company's finances were essentially the same, the company's financial issues had no security significance where they were due largely to the actions of one dishonest employee and two incompetent ones, and where Applicant had taken effective steps to reorganize the company and resolve the debts as soon as he became aware of them. Applicant did not wilfully fail to file state and federal tax returns. Clearance granted.

STATEMENT OF THE CASE

On 1 April 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 7 June 2002, Applicant an Answer and requested a hearing. The case was assigned to me on 27 August 2002 while I was out of the country on military duty, and received by me upon my return on 9 September 2002. On 9 October 2002, I set the case for hearing and issued a Notice of Hearing (NOH) the same day, for a hearing on 13 November 2002.

At the hearing, the government submitted 32 exhibits--admitted without objection--and no witnesses. The Applicant submitted 27 exhibits and the testimony of four witnesses, including himself. DOHA received the transcript on 21 November 2002.

FINDINGS OF FACT

Applicant admitted the financial allegations of the SOR, except for subparagraphs l.a., o., p., q., and r. While he admitted not filing the state and federal income tax returns alleged in paragraph 2, he denied doing so with the wilfulness alleged.

Applicant--a 33 year-old founder, chairman of the board, and majority stockholder of a small firm doing business as a defense contractor--seeks access to classified information. He is a highly-skilled computer engineer with an impressive array of extremely technical qualifications.

Applicant founded his company in approximately 1990 as a sole proprietorship, and incorporated in approximately 1992 as the sole stockholder. During the early years of the company, when Applicant was the sole employee, he had company and personal financial matters--including company and personal taxes--taken care of by an outside Certified Public Accountant. By 1996, when the company had grown to 5-6 employees and hoped to grow bigger, Applicant realized that he needed more help managing the company so he could focus on the technical end of the business. He hired an individual to serve as Chief Executive Officer (CEO) and Chief Financial Officer (CFO), a man he knew in high school who came to the job with an impressive set of business and legal credentials. Shortly after hiring the CEO/CFO, Applicant hired a CPA recommended by the CEO/CFO to serve as the company's CFO. Applicant was to serve as the Chief Technical Officer (CTO) and execute the contracts with the client agencies. The CEO would generate new business. The CFO would keep the books, including the corporate taxes and Applicant's personal taxes.⁽²⁾

Applicant had, through no fault of his own, hired badly. Expected additional contracts did not materialize. By December 1998--when the company had grown to about 12 employees--Applicant became sufficiently concerned about the state of the company that he hired an outside attorney who later became corporate counsel (CC) to review the company's operations and recommend improvements. CC began his review of the company in January 1999, and by February 1999 had reached his tentative conclusions, hampered by the fact that the company's financial books were not complete. The CFO was either unable or unwilling to perform the work he had been hired to do. As a CPA, he considered himself above performing the basic bookkeeping functions required by his position. The CFO spent company funds on personal items, failed to close any of the "big" contracts that were pending, and apparently locked the company into a long-term computer lease which had no escape clauses for business downturns.

Because of the largely unknown financial status of the company, CC recommended that Applicant fire the CEO and CFO for their malfeasance and lay off the remaining employees until CC could get the books in order and have a firm understanding of the company's financial standing. Applicant took this advice. However, CC made one bad recommendation himself: the hiring of a CPA (that he had used himself) to get the company's financial records in shape. The CPA succeeded in getting the books into better shape, and actually prepared Applicant's state and federal income tax returns as required. However, she failed to get a handle on the company's state withholding tax obligations and she failed to mail Applicant's income tax returns after Applicant had signed them. In 1999-2000, the tax side of the company's financial picture began to fall apart, but Applicant was not aware of the problem until the company began to receive deficiency notices from numerous state taxing authorities and the IRS. The CPA was let go in approximately March 2000 and a new CPA hired.

Except for the business debts in subparagraph 1.a. and r., all the debts alleged in the SOR are company obligations for corporate business taxes (to the IRS and the state where the company is incorporated) or state withholding taxes (for employees residing in the state where the company is incorporated as well as two other states). Except for the debt to the IRS, all the tax accounts have been paid, several before the issuance of the SOR.⁽³⁾ Applicant submitted an offer in compromise to the IRS in September 2001 (G.E. 7; AE. N) for the remaining tax debts (1.d.-m., s; G.E. 14-17); however the IRS changed the required submission forms, and the company is preparing to resubmit the offer in compromise.⁽⁴⁾ The company is also arranging commercial lines of credit to pay the debt if the IRS refuses the offer in compromise.

When Applicant cut back the company's business operation in 1999, he attempted to void the computer lease negotiated by the former CEO. That company sued for breach of contract in September 1999, but settled with Applicant's company in February for a lower total figure than the original lease (1.a.; G.E. 3, 4). By the time the SOR was issued in April 2002, Applicant's company had made all the required payments and reduced the outstanding balance to \$920.00, which was paid in May 2002 (A.E. B).

On 12 October 1999, Applicant executed the Security Clearance Application (SCA)(SF-86)(G.E. 1) to begin the background investigation for the clearance at issue in this case. Applicant truthfully disclosed the existence of financial issues related to his company finances as well as the name and address of the attorney he had hired to resolve those financial issues. On 31 March 2000, Applicant detailed the progress he had made sorting through the company's financial issues to the Defense Security Service (G.E. 2).

When Applicant and CC were attempting to rebuild the company in 2000, they entered into a contract with a corporate headhunter (1.r.) that

required Applicant's company to pay the headhunter a portion of the first-year salary for any employee the headhunter located. The headhunter located an employee, who failed to generate any business for Applicant's company, and was quickly let go. The headhunter demanded payment, Applicant's company refused; the headhunter sued for breach of contract, but settled for a much lower figure in June 2001. (S)

Applicant's company will gross \$3.5-4.0 million in revenue in 2002, and expects 2003 revenues to reach \$6.0 million. The company was 3-4 employees in the wake of the 1999 cutbacks, but is now 25-35 strong. Several user agencies are completely satisfied with the company's performance on their contracts, and with Applicant's competence and character.

Applicant was extremely credible when he testified that he took action to cure the company's financial shortcomings as soon as he became aware of them. His witnesses were equally credible in describing their part in the company's turn-around, and corroborating Applicant's efforts. Applicant has changed the corporate structure so that he is no longer the sole stockholder, and has hired a more professional management team to grow the company. He acquired a smaller company in approximately 2001 (in order to protect his company's access to needed software); the founder of that company now serves as the President of Applicant's company. The President opined that the company had sufficient revenues to make the tax payment required in 1999-2000 but for the CPA's failure to keep good financial records.

Applicant recalls signing his personal state and income tax returns in a timely fashion (Tr. 106, 115). He acknowledged that his progress in getting complete control over his company's finances was complicated by the fact that he was diagnosed with a rare form of thyroid cancer in 1994, the required annual or semi-annual treatments for which are extremely debilitating, taking him out of the picture 8-10 weeks at a time.

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 F.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.A6.1.2.1. A history of not meeting financial obligations;

E2.A6.1.2.3. Inability or unwillingness to satisfy debts;

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

E2.A6.1.3.3. The conditions that resulted in the behavior were largely beyond the person's control (e.g. loss of employment, a business downturn. . .);

E2.A6.1.3.4. The person has received or is receiving counseling for the problem and there are clear indications that the problem is being resolved or is under control;

E2.A6.1.3.6. the individual initiated a good-faith effort to repay overdue creditors or otherwise resolve debts.

CRIMINAL CONDUCT (CRITERION J)

A history or pattern of criminal activity creates doubt about a person's judgment, reliability and trustworthiness.

Conditions that could raise a security concern and may be disqualifying include:

None.

Conditions that could mitigate security concerns include:

None.

Burden of Proof

Initially, the Government must prove controverted facts alleged in the Statement of Reasons. 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 established its case under Guideline F. However, Applicant has mitigated the security concerns. Having carefully examined the evidence in this case, it appears that the government only marginally established its case under Guideline F. Although Applicant (and his company) were the victims of a dishonest employee, and two incompetent ones, it does not appear that Applicant (or his company) was either unwilling or unable to meet his financial obligations at the time they arose. Even if I conclude that the government has established its case--insofar as the dishonest employee placed Applicant and the company in the position of having to come up with large sums of past-due payments--I conclude that the financial issues have been mitigated by the circumstances of the financial difficulties and Applicant's response. Once Applicant became aware of the financial disruption caused by his employees, he took reasonable steps to address those issues. The interim step--hiring the bookkeeper--was not completely effective because the complexity of the financial issues exceeded her level of expertise. Still, Applicant persevered, hiring an attorney and bringing in additional company staff to resolve the financial issues. The company has continued to grow, has an enviable revenue stream, and is meeting its current financial obligations. While the IRS debt is still pending, Applicant's company has contingencies in place whatever way the IRS rules

In similar fashion, the government has not established its case under Guideline J. Although Applicant admitted that he did not file the state returns in 1997-2000 and federal returns in 1997, 1998 and 2000, he credibly denied doing so willfully as alleged in the SOR. Wilful failure is a requirement under both the state and federal statute cited in the SOR. Nevertheless, to have security significance, there must be something about the conduct to suggest Applicant lacks the judgment, reliability, or trustworthiness required of those with access to classified information. Applicant testified credibly that he hired someone at the company to be responsible for preparing and filing his state and federal income tax returns consistent with rule governing declaration of income from sole proprietorship or small business, and that he recalled being asked by the person preparing the tax returns to sign them. He was not aware that the returns had not been filed until the IRS and state tax authority contacted him about the missing tax returns. Further, while not necessarily dispositive of the issue, the fact that neither the IRS nor the state tax authority have pursued criminal sanctions against Applicant suggests that neither views Applicant's failures to file as a criminal matter. I resolve Guideline J for Applicant.

FORMAL FINDINGS

Paragraph 1. Guideline F: FOR THE APPLICANT

Subparagraph a: For the Applicant

Subparagraph b: For the Applicant

Subparagraph c: For the Applicant

Subparagraph d: For the Applicant

Subparagraph e: For the Applicant

Subparagraph f: For the Applicant

Subparagraph g: For the Applicant

Subparagraph h: For the Applicant

Subparagraph i: For the Applicant

Subparagraph j: For the Applicant

Subparagraph k: For the Applicant

Subparagraph l: For the Applicant

Subparagraph m: For the Applicant

Subparagraph n: For the Applicant

Subparagraph o: For the Applicant

Subparagraph p: For the Applicant

Subparagraph q: For the Applicant

Subparagraph r: For the Applicant

Subparagraph s: For the Applicant

Paragraph 2. Guideline J: FOR THE APPLICANT

Subparagraph a: For the Applicant

Subparagraph b: For the Applicant

Subparagraph c: For the Applicant

Subparagraph d: For the Applicant

Subparagraph e: For the Applicant

Subparagraph f: For the Applicant

Subparagraph g: 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. As the sole stockholder at the time, the companies finances were essentially indistinguishable from Applicant's finances.
3. The tax withholding deficiency at l.o. was noticed to Applicant's company in September 2001 (G.E. 10, 11) and paid by judgment garnishment served on Applicant's bank the same month (A.E. J). The tax withholding deficiencies for two other states (1.p. and q.) were paid in December 2001, shortly after they were discovered (G.E. 12, 13). Tax withholding deficiencies in the state of incorporation (1.b. and c.) were filed in November and July 2001 (G.E. 5, 6) and paid in May and January 2002 respectively (A.E. C, D). The state corporate tax deficiency (1.n.) was filed in December 2001 (G.E. 8; A.E. I), resolved by a settlement agreement in May 2002, and liquidated by the payment of \$3,200.00 per month between April and November 2002 (G.E. 9)
4. The offer in compromise is for Applicant to pay the correct amount of corporate taxes owed, and have IRS waive penalties and interest because of the extenuating circumstances of the company's failure to pay.
5. The required monthly payments paid the agreed figure by January 2002.