DATE: December 19, 2005

In Re:

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

Applicant for Security Clearance

CR Case No. 01-25258

DECISION OF ADMINISTRATIVE JUDGE

JOAN CATON ANTHONY

APPEARANCES

FOR GOVERNMENT

James D. Norman, Esq., Department Counsel

FOR APPLICANT

Richard J. Bednar, Esq.

SYNOPSIS

Applicant rebutted Guideline E allegations that his conduct as principal officer of a small defense contracting company revealed questionable judgment or unwillingness to comply with rules and regulations when a co-officer, who was accountable to him, knowingly provided false information to the government in 1992 and the company was cited for violating 18 U.S.C. § 1001, the Truth in Negotiations Act, and the False Claims Act. Clearance is granted.

STATEMENT OF THE CASE

The Defense Office of Hearings and Appeals (DOHA) declined to grant or continue a security clearance for Applicant. On December 17, 2003, under the applicable Executive Order[(1)] and Department of Defense Directive,[(2)] DOHA issued a Statement of Reasons (SOR), detailing the basis for its decision-security concerns raised under Guideline E (Personal Conduct) of the Directive. On January 23, 2004, Applicant answered the SOR in writing and elected to have a hearing before an administrative judge. On July 21, 2005, the case was assigned to me. I convened a hearing on October 5, 2005, to consider whether it is clearly consistent with the national interest to grant or continue a security clearance for Applicant. The Government called no witnesses and introduced eleven exhibits, identified as Government's Exhibits (Ex.) 1 through 11. Applicant called no witnesses and introduced fourteen exhibits, identified as Applicant's Ex. A through N. Applicant submitted a summary memorandum and an additional exhibit, identified as Ex. O, after the close of the hearing.

Applicant objected to the admission of the Government's Ex. 6 and Ex. 8. After postponing a decision on the admissibility of these exhibits until a foundation could be laid, I overruled Applicant's objection and admitted Ex. 6 and Ex. 8 as relevant and material. The Government's Exs. 1 through 5, 7, and 9 through 11 were admitted without objection. The Government objected to the admission of Applicant's Ex. H and Ex. J. Applicant withdrew Ex. H. I sustained the Government's objection to Ex. J, a letter to Applicant's counsel by Applicant's previous counsel, who offered commentary on the observations and actions of a judge in a proceeding at which he represented Applicant's business. In lieu of Ex. J, Applicant agreed to submit a transcript of the proceeding referenced in the letter. The

Government did not object to the Applicant's proffer of the transcript, identified as Applicant's Ex. O, or to Applicant's post-hearing summary memorandum. Additionally, Applicant's Exs. A through G, I, and K through N were admitted to the record without objection.

DOHA received the transcript (Tr.) of the proceeding October 26, 2005.

FINDINGS OF FACT

The SOR contains seven allegations of disqualifying conduct under Guideline E, Personal Conduct. In his answer to the SOR, Applicant denied any disqualifying conduct under Guideline E and offered additional information which he claimed explained, refuted, extenuated, or mitigated the allegations set forth in each of the seven subparagraphs of the SOR.

Applicant is 69 years old and president and chief executive officer of a privately-held corporation which has been a defense contractor since 1979. (Ex. 1; Ex. L; Tr. 63-64) After graduating from high school in 1954, Applicant served in the U.S. Air Force for four years. He then studied electronic engineering for three years at a university. (Ex. 1.) From 1959 through 1978, he worked for defense contractors in senior electronics and management positions. (Tr. 41-42.) In 1979 he and a partner established their own small company, specializing in the manufacture of specialized electronic devices used by the U.S. military. As prime government contractors and as subcontractors, the company has designed, developed, and produced over $90,000,000 in equipment since 1979. Beginning in 1986, the company entered into a number of contracts to produce electronic devices for the military. (Ex. 4, at 2.) The company is currently selling approximately $3 million in military equipment to the Government each year. (Ex. L; Tr. 72-73.) While the company employed as many as 70, 80, or 90 individuals in the past, it currently employs about 25 people. (Ex. L; Tr. 68; 92.) As a government contractor, Applicant has held a security clearance continuously since 1960. (Answer to SOR, at 2.)

Applicant has known his business partner since 1973, and they are personal friends. (Tr. 94) On his security clearance application (SF-86), Applicant listed his partner as a person who knew him and could attest to where Applicant had lived from 1989 to 2001. (Ex. 1, at 1.) Together, Applicant and his partner own the building where they carry out their business, and their company leases the building from them. (Tr. 69-70.)

In developing their business, the two partners divided duties according to their respective strengths and experience. Applicant used his technical and marketing background to seek out new customers and, from the company's inception to the present time, has served as the company's chairman and chief executive officer. His partner carried out administrative and financial duties for the company. (Tr. 65; 90.) From approximately 1990 to 1995, the partner served as president of the company. During that time, Applicant focused his energies on marketing and developing business, and he spent approximately one-half of his time in travel away from the office. Some of his financial and administrative duties were delegated to the company's general manager and to his business partner. (Tr. 89-90.) Applicant had overall responsibility for program review but did not certify periodic payment requests. (Tr. 78-80)

In March 1991, the Government awarded the company a delivery order, identified as Y302, under a firm-fixed price contract in the amount of approximately $4,590,000.00 for the fabrication, test, and delivery of 23 military electronic devices. The period of performance of the contract was from March 12, 1991 to November 1992. The unit price for labor, materials and profit for each electronic device was $199,564. (Ex. 11, at 1-2.)

After the contract was awarded, the project manager for the contract became aware that the actual costs for labor and materials required to complete the contract were less than the parties had bargained for in the contract, thereby resulting in a large un-bargained-for projected profit for the company. (Ex. 11, at 1-4.) In arch 1991, this information was brought to the attention of Applicant's partner, who was, at that time, the president of the company. Internal company documents quoted in the Government's Memorandum in Support of Offer of Proof[(3)] indicated the company considered using the excess profits--estimated to be approximately $1.7 million--to build company assets. (Ex. 11, at 3.) In June 1991, Applicant's partner and Applicant were each awarded a bonus of $150,000 (to be paid over three years) based on the award of delivery order Y302. (Ex. 11, at 4.) In December 1992, Applicant's partner and Applicant were awarded bonuses of $325,000 and $330,000 respectively and $35,715 each in dividends on their company stock holdings. (Ex. 11, at 4, fn 1.)

In July 1992, Applicant's partner signed, for the company, a progress payment request (SF-1443), identified as Progress Payment 16. In signing the SF-1443, he certified the information on the form was correct and it was based on the books and records of the company, even though he knew the actual manufacturing costs to the company were far below those originally negotiated, the amount requested exceeded actual costs, and the amount requested was not a good faith estimate of actual costs. (Ex. 11, at 8-9.) Neither the company nor Applicant's partner denied making a material false statement to the Department of Defense in July 1992 when the partner, representing the company, signed and filed the SF-1443 requesting Progress Payment 16. (Ex. 11, at 9.)

In 1994, the Defense Contract Audit Agency conducted a review of the contracts awarded to Applicant's company (Tr. 84.) Applicant reviewed the company's response to the audit. (Tr. 85.) In September 1995, the Inspector General, Department of Defense, (IGDoD), began an investigation to determine whether the company withheld any material information from or made any false statements to the Government in connection with the negotiation and subsequent award of firm fixed price Delivery Order Y302.

In July 2000, the partner pled guilty to one criminal charge of making a false statement to the Government (18 U.S.C. § 1001), was assessed $50, fined $5,000, and awarded supervised probation of 12 months. Pursuant to the provisions of 10 U.S.C. 2408 and 48 CFR 203.570-2, he was barred for five years from working for the company as a member of its Board of Directors, or as an officer, supervisor, or manager.[(4)] (Ex. 6; Ex. 8.)

In July 2000, the company also pled guilty to one criminal charge of making a false statement to the Government (18 USC § 1001). While Applicant was not personally charged with the crime, he appeared and entered a guilty plea on behalf of the company. (Ex. 7.) The company was assessed $200, fined $20,000, and awarded supervised probation of two years. [(5)] (Ex. 7; Ex. 9.) The criminal fine was paid in full by the company. (Tr. 58.) Special conditions of probation required the company to submit to regular or unannounced examinations of its books and records and interrogation of knowledgeable persons within the organization. Additionally, the company was required to notify the court of any adverse changes in its business or financial condition or prospects, the commencement of any bankruptcy proceedings, the initiation of any major civil litigation, criminal prosecution, or administrative proceedings against it, or any investigation or formal inquiries by governmental entities of violations of criminal law. The company was also required to give notice of its criminal conduct to its employees and shareholders and to inform them of its program to prevent and detect violations of law. (Ex. 9, at 3.)

As a result of the IG DoD's investigation, the United States alleged the company made false statements and failed to disclose material information in connection with Delivery Order Y302, thereby violating the Truth in Negotiations Act, 10 U.S.C. § 2306a, 41 U.S. C. § 254b, and the False Claims Act, 31 U.S.C. §3729, et. seq. Additionally, the United States alleged that, as a result of its false statements, the company was subject to civil liability under the provisions of 31 U.S.C. § 3729, et. seq.

The United States also alleged that, between 1988 and 1995, the company made false representations as a part of its contract negotiations with the Government for design and production of specialized military electronics equipment and that the Government made payments on the negotiated contracts based on the company's false representations. The United States further alleged the company did not provide accurate, current or complete cost data for labor hours charged, and it overcharged on labor hours even when it had prior contract production information showing that fewer labor hours were required. The United States also alleged the company overcharged the Government over $900,000 on material costs on the several contracts. (Ex. 4, at 2-4.)

Applicant was not personally charged in the civil matter. He acknowledged an awareness of a disagreement between the company's managers and the government auditors on issues of pricing, but asserted such disagreements were common in the administration of government contracts. (Answer to SOR, at unnumbered page 4.) As president of the company, Applicant assumed responsibility for admitting unlawful conduct and paying penalties assessed. (Tr. 55-57.) While the company did not admit liability for the actions alleged by the United States, it signed a Consent Decree on July 24, 2000, in which it agreed to pay the United States $2,500,000.00 in full settlement and satisfaction of the claims raised by the United States. (Ex. 4.) Applicant personally guaranteed $100,000 toward satisfaction of the indebtedness. (Answer to SOR, at unnumbered page 3.) At his hearing, Applicant affirmed that all payments under the Consent Decree and civil settlement were timely made. (Tr. 58.)

Because the company's admitted conduct raised the prospect of contract debarment, the company and a military department within the Department of Defense entered into a three-year administrative agreement to ensure the company carried out acceptable contracting practices and established and implemented a program of compliance reviews, audits, and reports. The company developed a written code of ethics and appointed an ethics and compliance administrator who was responsible for identifying and investigating violations of the company's code of ethics. (Ex. G; Tr. 58-61.) During the three-year period in which the company was under the compliance agreement, the company was reviewed and audited several times, and no improper conduct was found. The company was released from the administrative agreement in March 2003. (Ex. D.) It was never suspended or disbarred from government contracting and continues to receive government contracts. (Tr.52;59; 61.) As president, Applicant has directed that the ethics and compliance program remain a part of the company's contracting policy. (Tr. 60.)

Applicant acknowledged the difficulties his partner's conduct had caused the company. He also acknowledged his partner's technical and engineering strengths and their importance to the quality of the company's products. (Tr. 98-99.) He affirmed his continuing respect for his partner and his confidence in his ability to perform his duties. (Tr. 94-95.)

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 restricted eligibility for access to classified information to United States citizens "whose personal and professional history affirmatively indicates loyalty to the United States, strength of character, trustworthiness, honesty, reliability, discretion, and sound judgment, as well as freedom from conflicting allegiances and potential for coercion, and willingness and ability to abide by regulations governing the use, handling, and protection of classified information." Exec. Or. 12968, *Access to Classified Information* § 3.1(b) (Aug. 4, 1995). Eligibility for a security clearance is predicated upon the applicant meeting the security guidelines contained in the Directive.

Enclosure 2 of the Directive sets forth personal 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.

Initially, the Government must establish, by substantial evidence, conditions in the personal or professional history of the applicant that disqualify, or may disqualify, the applicant from being eligible for access to classified information. *See Egan*, 484 U.S. at 531. The Directive presumes a nexus or rational connection between proven conduct under any of the disqualifying conditions listed in the guidelines and an applicant's security suitability. *See* ISCR Case No. 95-0611 at 2 (App. Bd. May 2, 1996).

Once the Government establishes a disqualifying condition by substantial evidence, the burden shifts to the applicant to rebut, explain, extenuate, or mitigate the facts. ISCR Case No. 01-20700 at 3 (App. Bd. Dec. 19, 2002); *see* Directive ¶ E3.1.15. 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.

CONCLUSIONS

Guideline E - Personal Conduct

In the SOR, DOHA alleged Applicant was president and chief operating officer of a government contracting company, which was investigated by the IG DoD, pursuant to findings by the Defense Contract Audit Agency that the company had failed to disclose accurate cost and pricing data while negotiating a contract with the Department of Defense (¶ 1.a.); that the IG DoD disclosed evidence that the company engaged in defective pricing and labor mischarging (¶ 1.b.);

that in July 2000 the company pled guilty to one count of making a false statement and was sentenced to 24 months probation and fined $40,000 (¶ 1.c.); that the company entered into a civil settlement with the Government in July 2000 and agreed to pay $2,500,000 to the United States for violations of the Truth in Negotiations Act and the False Claims Act (¶ 1.d.); that Applicant, as Guarantor, was liable for $100,000 to be paid in satisfaction of a $2,500,000 settlement between the company and the United States (¶1.e.); that prior to the investigation by the IG DoD, Applicant was aware of complaints about the inaccuracy of labor hours charged to a government contract by the company (¶ 1. f.) that prior to the investigation by the IG DoD, Applicant was aware of complaints about the correctness of pricing on a DoD delivery order by the company (¶ 1.g.) Applicant admitted the facts alleged in ¶¶ 1.a., 1.b., 1.d., 1.e., 1.f., and 1g. were true or partially true but denied they were evidence of disqualifying conduct under Guideline E, Personal Conduct. He denied that part of the allegation in ¶ 1.c. which stated the fine paid by the company for its admitted violation of 18 U.S.C. § 1001 was $40,000. Record evidence established the fine was $20,000.

Conduct involving questionable judgment, untrustworthiness, unreliability, lack of candor, dishonesty, or unwillingness to comply with rules and regulations could indicate that an applicant may not properly safeguard classified information. Directive ¶ E2.A5.1.1.

The Government argued that Applicant's failure as chief executive officer to exercise adequate oversight demonstrated disqualifying conduct under Guideline E even if he had no actual knowledge of his partner's personal criminal conduct and the wrongdoing and criminal conduct imputed to the company. Applicant presented evidence that he was working to develop new business for the company and was therefore absent from the daily operations of the company during the time his partner, who was the president of the company from approximately 1990 to 1995, engaged in criminal conduct and wrongdoing. Applicant also presented evidence that he took strong steps to admit the company's wrongdoing and criminal conduct when he learned of it, to comply with all penalties levied upon the company for criminal conduct, and to impose policies to remedy the ethical and managerial weaknesses that gave rise to the wrongdoing and criminal conduct. Applicant was never charged personally with criminal conduct or wrongdoing.

The Government expressed concern that Applicant retained his business relationship and personal friendship with his partner in spite of the partner's wrongdoing and criminal conduct. The record shows Applicant complied with statutory requirements limiting his partner's role in the company's management. While acknowledging his partner's wrongdoing, he also affirmed his confidence in his partner's rehabilitation and his capacity to do vital work for the company.

The record is less clear about Applicant's knowledge of excess labor and materials costs which the company charged the Government. Applicant acknowledged he was aware of differences of opinion between the company's program managers and the Government's contract monitors. However, the record does not specify how these differences of opinion may have been related to conduct later identified as dishonest or deceptive dealing by the company. The record does show Applicant signed a consent decree acknowledging the company's commitment to pay $2,500,000 in full settlement and satisfaction of claims by the Government that the company had overcharged on material costs and labor. Applicant guaranteed payment of $100,000 of the settlement, and he ensured full payment of the total amount within the deadlines set by the agreement.

Applicant's partner's certification of a false payment request, which resulted in criminal charges against him personally and against the company, occurred in 1992. The conduct which resulted in civil penalties to the company occurred between 1988 and 1995. The record evidence shows the company complied with all remedial instructions and timely paid all fines and penalties deriving from the criminal and civil charges. The company has submitted to scrutiny and review by governmental entities that oversee contracting practices. In his capacity as chief executive officer and president of the company, Applicant has established ethical standards and operating policies to ensure that such disqualifying conduct does not occur again. The company has not been disbarred from contracting and has subsequently been awarded contracts by governmental entities. After nearly being derailed, the company appears solidly back on track, thanks in no small part to Applicant's leadership and good judgment.

I have evaluated Applicant's credibility and I have considered the record as a whole. I have weighed the evidence of Applicant's conduct against the whole person standard specified in Enclosure 2, Section E2.2.1. of the Directive. I conclude the record does not sustain the Guideline E allegations in the SOR that Applicant personally engaged in conduct involving questionable judgment, untrustworthiness, unreliability, lack of candor, dishonesty, or unwillingness

to comply with rules and regulations. The record shows that Applicant's business partner and associate admitted to disqualifying conduct when he was president of the company that he and Applicant founded. During the period of his partner's malfeasance, Applicant was focused on engineering questions and seeking new markets. Financial issues were delegated to the business partner. While it could be argued that in 1992 Applicant should have been more attentive to the details of contract management within his small company, it cannot be convincingly argued that his conduct demonstrates questionable judgment or an unwillingness to comply with rules and regulations. Accordingly, the Guideline E allegations in the SOR are concluded for the Applicant.

FORMAL FINDINGS

The following are my conclusions as to each allegation in the SOR:

Paragraph 1. Guideline E.: FOR APPLICANT

Subparagraph 1.a.: For Applicant

Subparagraph 1.b.: For Applicant

Subparagraph 1.c.: For Applicant

Subparagraph 1.d.: For Applicant

Subparagraph 1.e.: For Applicant

Subparagraph 1.f.: For Applicant

Subparagraph 1.g.: For Applicant

DECISION

In light of all of 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. Clearance is granted.

Joan Caton Anthony

Administrative Judge

1. Exec. Or. 10865, *Safeguarding Classified Information within Industry* (Feb. 20, 1960), as amended and modified.

2. Department of Defense Directive 5220.6, *Defense Industrial Personnel Security Clearance Review Program* (Jan. 2, 1992), as amended and modified.

3. Filed July 12, 2000, in the United States District Court for the District of New Hampshire, Criminal Action No. CR 99-135-B.

4. The Secretary of Defense may waive the five year prohibition against employment as a corporate officer, manager, or supervisor can be waived in the interest of national security. *See* 10 USC § 2408(a)(3). No claim of waiver was made in this case.

5. The SOR incorrectly alleged the fine was $40,000. *See* Ex. *9.)*