



**DEPARTMENT OF DEFENSE  
DEFENSE OFFICE OF HEARINGS AND APPEALS**



In the matter of: )  
)  
) ISCR Case No. 11-04697  
)  
Applicant for Security Clearance )

**Appearances**

For Government: Ray T. Blank, Jr., Esq., Department Counsel  
For Applicant: Joseph A. Velez, Esq.

03/29/2013

**Decision**

NOEL, Nichole L., Administrative Judge:

Applicant contests the Defense Department's intent to deny his eligibility for a security clearance to work in the defense industry. Applicant mitigated the security concerns raised by the failure of his real estate investments. Applicant established that he is not responsible for the SOR debt by operation of his state's anti-deficiency statute and that he has paid \$70,000 of non-SOR debt related to his real estate venture. Clearance is granted.

**Statement of the Case**

On October 11, 2012, DOD issued a Statement of Reasons (SOR) detailing security concerns under the financial considerations guideline.<sup>1</sup> DOD adjudicators were unable to find that it is clearly consistent with the national interest to grant or continue

<sup>1</sup> This case is adjudicated under Executive Order (EO) 10865, *Safeguarding Classified Information within Industry*, signed by President Eisenhower on February 20, 1960, as amended; as well as DOD Directive 5220.6, *Defense Industrial Personnel Security Clearance Review Program*, dated January 2, 1992, as amended (Directive). In addition, the *Adjudicative Guidelines for Determining Eligibility for Access to Classified Information* (AG), effective within the Defense Department on September 1, 2006, apply to this case. The AG were published in the Federal Register and codified in 32 C.F.R. § 154, Appendix H (2006). The AG replace the guidelines in Enclosure 2 to the Directive.

Applicant's security clearance and recommended that the case be submitted to an administrative judge for a determination whether to revoke or deny Applicant's security clearance.

Applicant timely answered the SOR and requested a hearing. At the hearing convened on December 12, 2012, I admitted Government's Exhibits (GE) 1 through 8 and Applicant's Exhibits (AE) A through G, without objection. After the hearing, Applicant timely submitted AE H through L, which I admitted without objection. I received the transcript (Tr.) on December 20, 2012.

### **Administrative Notice Documents**

Applicant offered documents regarding State 1's anti-deficiency statute, case law interpreting the statute, as well as information from the Internal Revenue Service (IRS) regarding the treatment of foreclosures on federal taxes for administrative notice. These documents are appended to the record as Hearing Exhibits (HE) A through F. The Government did not object, but requested permission to file a post-hearing submission briefing its position on the applicability of the anti-deficiency statute. Department Counsel failed to submit a post-hearing submission within the time allotted.<sup>2</sup>

### **Procedural Issues**

Applicant received less than 15 days written notice of the time and place of the hearing as required under Directive ¶ E.3.1.8. Applicant's counsel waived the notice requirement, electing to proceed with the hearing as scheduled.<sup>3</sup>

### **Findings of Fact**

Applicant, 36, is an engineer employed by a federal contractor. He has held a security clearance since 2001, without incident. Since he began working with his current employer in 2004, Applicant has been consistently rated as an employee who exceeds expectations. His performance has been recognized on several occasions by the government agency he supports. Between 2008 and 2012, Applicant received bonus awards from his employer in recognition for his outstanding work. The security concerns in this case arise from the 2010 foreclosures of two rental properties Applicant owned.<sup>4</sup>

In 2004, Applicant received a \$70,000 windfall from the sale of a home in another state. Upon moving to State 1, Applicant decided he needed to invest the money. After researching and comparing other investment opportunities, Applicant decided to invest the majority of the \$70,000 in State 1's then-booming real estate market. He investigated comparable home sales, researched the local rental market, and consulted

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<sup>2</sup> Tr. 42-44.

<sup>3</sup> Tr. 9-10.

<sup>4</sup> GE 1; AE I – K.

real estate and mortgage professionals. Between October and December 2005, Applicant purchased two properties: Alpha, a single-family home situated on .05 acres for \$235,000; and Beta, a single-family home situated on .21 acres for approximately \$236,000. He contracted to buy a third property during the pre-construction phase: Charlie, a brownstone sitting on 1 acre of land. Applicant financed Alpha and Beta using 80/10/10 financing, securing a primary mortgage for 80% of the purchase price, a second mortgage for 10% of the purchase price, and paying the remaining 10% of the purchase price in cash. The primary mortgages on Alpha and Beta were secured by separate deeds of trusts, which allowed the mortgage holder to foreclose on the respective property and sell it to recover the unpaid balance of the loan in the event Applicant defaulted.<sup>5</sup>

Applicant's long-term plan was to live in Charlie upon its 2007 delivery date, and maintain Alpha and Beta as rental properties. In the meantime, he lived in Alpha and decided to remodel the Beta property. Applicant believed that remodeling Beta would make it more attractive to renters and make it easier to sell, if necessary. He anticipated that the Beta renovation would cost \$40,000 and take six months to complete. Applicant expected to have renters in Beta by April 2006 and was prepared to financially maintain Alpha and Beta until then, using his savings and income. However, the Beta remodel took two years longer and \$40,000 more to complete than Applicant estimated. By late 2006, Applicant realized that he could not afford to maintain both properties without any rental income. In an effort to reduce his financial obligations, Applicant tried to sell Alpha in September 2006. Around the same time Applicant listed the house for sale, the police searched the home of Applicant's neighbor and charged the neighbor with a series of sexual assaults and murders that terrorized the city for some time. As the case, and Applicant's street, received extensive media coverage, interest in Applicant's property declined and the house did not sell. As a result, Applicant installed renters in the property, but the rent did not cover all of the property's expenses. Even though he was having financial difficulty maintaining the properties, Applicant decided not to renege on the Charlie purchase because it did not have any recurring monthly costs during the construction phase and he did not want to lose the \$15,000 down payment he made on the property. Applicant also believed he could salvage the situation with the other two properties before the Charlie's 2007 delivery date.<sup>6</sup>

In May 2007, Applicant refinanced Alpha, replacing the 80/10/10 financing with a traditional loan secured by a deed of trust. He withdrew the equity in the home and used the proceeds to fund some of the Beta remodeling costs. He also paid the closing costs on Charlie and moved into the property as planned. By the time Applicant completed the Beta renovation in late 2007, he had exhausted his savings, borrowed from his 401(k), and began relying on credit cards to pay his living expenses as well as the expenses related to the Alpha and Beta properties, which totaled approximately \$4,000 each

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<sup>5</sup> Tr. 51-53, 55, 82, 88, 112, 124-125; GE 4-5; AE E.

<sup>6</sup> Tr. 54, 56, 60, 84-86, 89-92, 102, 108-113; GE 5.

month. Applicant listed Beta for sale in early 2008. Unable to sell Beta, Applicant also rented the property for an operating loss.<sup>7</sup>

In 2008, Applicant was living in Charlie and renting the other two properties as planned. However, with his savings exhausted and his credit card debt high, he still struggled to support the three properties. Applicant attempted to refinance Charlie to secure a lower interest rate and withdraw equity from the property, but he could not afford the closing costs on the loan. In the fall of 2008, he negotiated lower interest rates on the Alpha and Beta properties, but according to Applicant, the modification was too little, too late. He tried selling Alpha again in 2008 and Charlie in 2010, but the real estate market had already started its decline, and Applicant could not convince the mortgagors to accept short sales on either property.<sup>8</sup>

By 2009 Applicant was financially overwhelmed. Although he was current on all of his financial obligations, Applicant realized that he could not maintain the three properties and the \$100,000 in credit card debt he accumulated trying to manage them. In addition, Applicant's 2009 marriage and resulting higher income tax bracket, caused a less favorable tax treatment of the operating losses generated by the Beta and Alpha properties. Applicant consulted his tax accountant for advice. The tax accountant referred him to a real estate attorney, who advised Applicant that his properties were covered by State 1's anti-deficiency law, which states:<sup>9</sup>

If a trust property of two and one-half acres or less which is limited to and utilized for either a single one-family or a single two-family dwelling is sold pursuant to the trustee's power of sale, no action may be maintained to recover any difference in the amount obtained by the sale and the amount of the indebtedness and any interest, costs, and expenses.<sup>10</sup>

In enacting the statute, State 1's legislature intended to protect certain homeowners from the financial disasters of losing their homes to foreclosure plus all of their other non-exempt property on the execution of a judgment for the balance of the purchase price. As long as the subject property fits the description in the statute, the protection applies to primary residences and investment properties. State 1's Supreme Court, guided by this statutory intent, held that this deficiency protection applies to second mortgages, even if the second mortgage holder did not exercise its rights under the second deed of trust. The courts have also extended to the protection to cash-out refinance mortgages under certain circumstances.<sup>11</sup>

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<sup>7</sup> Tr. 57-59, 61, 88-89, 93-95, 103-105, 114, 117-118, 123-124; GE 5.

<sup>8</sup> Tr. 52, 63-66, 95, 118; GE 5.

<sup>9</sup> Tr. 67-71, 107; GE 5.

<sup>10</sup> HE A.

<sup>11</sup> HE B-D.

Before making a decision, Applicant informed his facility security officer (FSO), in writing, about the financial problems he was having related to the rental properties. He informed the FSO that he would try to dispose of the properties by short sale or strategic default, if necessary. After evaluating his options, Applicant decided to strategically default on the mortgages for all three properties. He stopped making mortgage payments in February 2010. Each of the primary mortgage holders for Charlie, Alpha, and Beta foreclosed on the properties and exercised their rights under the deed of trust to sell their respective property. Beta sold in October 2010 for \$96,200. Alpha sold in December 2010 for \$157,000 and Applicant received an IRS Form 1099-C Cancellation of Debt (1099-C) from the creditor. Charlie sold in November 2011 for \$134,500. In March 2012, Applicant disputed the past-due amounts being reported for the Alpha and Beta mortgages with the credit reporting agencies. He also filed a dispute directly with the holder of the Beta second mortgage. The September 2012 credit report provided by the Government shows a zero balance due for the Alpha mortgage (§ 1.b) and the primary mortgage on Beta (§ 1.c). The secondary mortgage on Beta (§ 1.a) is reported as a charged off account with a zero balance. In response to Applicant's dispute, the creditor indicated that the account would be reported as charged off as of the date of the trustee sale in October 2010. None of the creditors have contacted Applicant to collect the deficiency balances.<sup>12</sup>

Since losing the properties, Applicant has focused his efforts on resolving his \$100,000 in credit card debt. According to the September 2012 credit report provided by the Government, Applicant has only three open credit cards with a total balance of approximately \$40,000. As of the hearing, Applicant had reduced the balance of his credit cards to \$30,000, paying off a total of \$70,000 in credit card debt. Applicant has not reduced his credit card debt using settlement; he has committed himself to paying every dollar he owes. He applies \$2,850 or 25% of his monthly income to credit card debt reduction. Following this schedule, Applicant plans to have his credit card debt paid in full by 2014.<sup>13</sup>

Applicant and his wife earn over \$134,300 annually. They rent their home and drive older model cars. Their primary goal is to pay off the credit card debt Applicant accumulated between 2005 and 2010. Applicant lives within his means and has not opened any new consumer credit accounts. He has no plans to purchase real estate until he pays off his credit card debt and is able to accumulate a sizeable down payment. Aside from the negative information associated with the three properties, Applicant has a positive credit history and a strong credit score.<sup>14</sup>

## **Policies**

When evaluating an applicant's suitability for a security clearance, the administrative judge must consider the adjudicative guidelines. In addition to brief

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<sup>12</sup> Tr. 72-78, 97-101, 118-119; GE 2-7; AE A-D.

<sup>13</sup> Tr. 79-80, 120-122; GE 8; AE A.

<sup>14</sup> Tr. 45, 80-81; AE L.

introductory explanations for each guideline, the adjudicative guidelines list potentially disqualifying conditions and mitigating conditions, which are to be used in evaluating an applicant's eligibility for access to classified information.

These guidelines are not inflexible rules of law. Instead, recognizing the complexities of human behavior, administrative judges apply the guidelines in conjunction with the factors listed in the adjudicative process. The administrative judge's overarching adjudicative goal is a fair, impartial, and commonsense decision. According to AG ¶ 2(c), the entire process is a conscientious scrutiny of a number of variables known as the "whole-person concept." The administrative judge must consider all available, reliable information about the person, past and present, favorable and unfavorable, in making a decision.

The protection of the national security is the paramount consideration. AG ¶ 2(b) requires that "[a]ny doubt concerning personnel being considered for access to classified information will be resolved in favor of national security." In reaching this decision, I have drawn only those conclusions that are reasonable, logical, and based on the evidence contained in the record.

Under Directive ¶ E3.1.14, the Government must present evidence to establish controverted facts alleged in the SOR. Under Directive ¶ E3.1.15, the applicant is responsible for presenting "witnesses and other evidence to rebut, explain, extenuate, or mitigate facts admitted by the applicant or proven by Department Counsel." The applicant has the ultimate burden of persuasion to obtain a favorable security decision.

A person who seeks access to classified information enters into a fiduciary relationship with the Government predicated upon trust and confidence. This relationship transcends normal duty hours and endures throughout off-duty hours. The Government reposes a high degree of trust and confidence in individuals to whom it grants access to classified information. Decisions include, by necessity, consideration of the possible risk the applicant may deliberately or inadvertently fail to safeguard classified information. Such decisions entail a certain degree of legally permissible extrapolation of potential, rather than actual, risk of compromise of classified information.

Section 7 of EO 10865 provides that adverse decisions shall be "in terms of the national interest and shall in no sense be a determination as to the loyalty of the applicant concerned." See *also* EO 12968, Section 3.1(b) (listing multiple prerequisites for access to classified or sensitive information).

## **Analysis**

### **Guideline F, Financial Considerations**

Unresolved delinquent debt is a serious security concern because failure to "satisfy debts [or] meet financial obligations may indicate poor self-control, lack of judgment, or unwillingness to abide by rules and regulations, all of which can raise

questions about an individual's reliability, trustworthiness and ability to protect classified information."<sup>15</sup> Similarly, an individual who is financially irresponsible may also be irresponsible, unconcerned, or negligent in handling and safeguarding classified information within the defense industry.

The SOR alleges that Applicant is indebted to three creditors totaling approximately \$61,000 for the past-due balances on the primary and second mortgage on the Beta property (¶¶ 1.c and 1.a, respectively) and the Alpha mortgage (¶1.b). Applicant admits that he strategically defaulted on the mortgages to avail himself of the protection offered under State 1's anti-deficiency law. Applicant's admission is sufficient evidence of his unwillingness to repay his debts and his history, albeit a brief one, of not paying his debts.<sup>16</sup> Applicant's decision to purchase three properties between 2005 and 2007 and subsequently default on the mortgages also impugns his judgment and overall security worthiness.

However, the record contains evidence that mitigates these concerns. Citing state law, Applicant denies that he is legally responsible for the deficiency balances alleged in the SOR. Applicant argues that State 1's anti-deficiency statute and the interpretation of the statute by State 1's Supreme Court provides a reasonable basis for him to dispute the legitimacy of the debts alleged in the SOR.<sup>17</sup> The Government did not offer a position on the applicability or operation of the statute. While resolving issues of state law is not ideal in the context of security clearance cases, in cases such as this one where the statutory language is clear on its face, and the case law interpreting the statute is also clear, the speculation or conjecture regarding the applicability of the statute is absent.

Applicant owned three properties, each being a single family home sitting on less than two and a half acres that were sold under a trustee's power of sale. Each property was sold at a price less than the amount owed on the loan. Under the plain language of the statute, Applicant's creditors cannot recover the deficiency balances on the properties from him. Although the statute is quiet on whether or not the protection applies to second mortgages and refinanced mortgages, State 1's highest court addressed both issues, holding that the anti-deficiency protection applies. Accordingly, Applicant is not responsible for the debts as alleged in SOR ¶¶ 1.a through 1.c. The record supports a finding that the mortgage lenders have acquiesced to the statute. The mortgagor for the Alpha property issued a 1099-C on the remaining balance of the loan and the creditor is reporting a zero balance to the credit reporting agencies.<sup>18</sup> Although the primary and secondary mortgage holders on the Beta property (¶¶ 1.a and 1.c) have not issued 1099-Cs to Applicant, his most recent credit report shows that the primary

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<sup>15</sup> AG ¶ 18.

<sup>16</sup> AG ¶¶ 19(a), (c).

<sup>17</sup> AG ¶ 20(e).

<sup>18</sup> Because the Alpha mortgagor cancelled the entire deficiency balance on the refinanced loan obligation, any question of whether the withdrawn equity was covered under the statute is moot.

mortgage holder reports a zero balance on the account and the holder of Beta's second mortgage reports the debt as charged off<sup>19</sup> as of the date of the trustee sale of the property. Furthermore, none of the creditors have attempted to collect the deficiency balances from Applicant.

A finding that the SOR debts are legally uncollectible does not end the inquiry into Applicant's security worthiness; the facts and circumstances surrounding an applicant's conduct in incurring and failing to satisfy the debt in a timely manner must also be examined.<sup>20</sup> Because of his lack of experience as a real estate investor, Applicant underestimated the time and money required to maintain the three properties. However, this does not mean that Applicant's strategy, while ambitious, was reckless, irresponsible, or indicative of impaired judgment that negatively reflects on his security worthiness. Before entering the real estate arena as investor, Applicant conducted reasonable due diligence. He also had capital. At the time of his investment, Applicant believed that his \$70,000 in savings would be sufficient to help him enter the market and provide enough of a cushion, allowing help him to manage the properties comfortably. He also built a time-safety net into his plan; giving himself at least a year before he was responsible for managing all three properties. Applicant also believed that given the strength of the market, his plan had an exit strategy – he could sell the properties if circumstances required him to do so.

Applicant attempts to execute the fail-safes in his business plan were thwarted by events beyond his control: including the arrest of a serial killer on the same street as the Alpha property and the unanticipated and unprecedented downturns in the real estate market.<sup>21</sup> He acted responsibly in response to his financial difficulties by exhausting all of his available resources and options, and by seeking professional advice.<sup>22</sup> Only as a last resort did Applicant take advantage of State 1's anti-deficiency statute. Given his dire financial situation, Applicant's decision was a reasonable one. He could not continue to pay the mortgages and expenses on the properties, his credit card debt, and his living expenses. To do so would have guaranteed financial ruin. Applicant made the best choice available in a difficult situation.<sup>23</sup> Availing himself of the protection offered under the anti-deficiency statute allowed Applicant to address his other financial issue, namely his \$100,000 in credit card debt. He has reduced his credit card debt by

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<sup>19</sup> The term charge off means a declaration by a creditor "[t]o treat (an account receivable) as a loss or expense because payment is unlikely; to treat as a bad debt." *Black's Law Dictionary* 266 (Bryan A. Garner ed., 9th ed., West 2009).

<sup>20</sup> See, e.g., ISCR Case No. 01-09691 at 3 (App. Bd. Mar. 27, 2003).

<sup>21</sup> AG ¶ 20(b).

<sup>22</sup> AG ¶ 20(c).

<sup>23</sup> See ISCR Case No. Case No. 07-06482.



\$70,000 in almost three years. Accordingly, Applicant has demonstrated a meaningful track record of debt reduction.<sup>24</sup>

I have no doubts or reservations about Applicant's current reliability, trustworthiness, and ability to protect classified information. In reaching this conclusion, I have also considered the whole-person factors at AG ¶ 2(a). Applicant exposed himself to the risk of starting a business. Despite Applicant's best laid plans and intentions, the business failed. He was overly optimistic about his timeline and his abilities and undercapitalized when faced with unexpected changes in the real estate market. The purpose of a security clearance case is not to assign guilt or blame and then punish or sanction a person for their past actions. Likewise a security clearance case is not aimed at collecting debts. Rather the purpose is to make "an examination of a sufficient period of a person's life to make an affirmative determination that the personal is an acceptable security risk."<sup>25</sup> Applicant confronted his financial problems directly and when his financial issues became acute he reported them to his FSO. In doing so, he raised awareness to a potential area of vulnerability. Applicant has acted in a way to eliminate his business-related financial issues as a source of exploitation. Clearance is granted.

### **Formal Findings**

Formal findings for or against Applicant on the allegations set forth in the SOR, as required by section E3.1.25 of Enclosure 3 of the Directive, are:

Paragraph 1, Guideline F:	FOR APPLICANT
Subparagraphs 1.a – 1.c:	For Applicant

### **Conclusion**

In light of all of the circumstances presented, it is clearly consistent with the national interest to grant Applicant a security clearance. Eligibility for access to classified information is granted.

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Nichole L. Noel  
Administrative Judge

<sup>24</sup> See ISCR Case No. 07-06482 (App. Bd. May 21, 2008) (the concept of a meaningful track record of repayment must include evidence of actual debt reduction through the payment of debt. This finding does not require that the SOR debts be resolved first.

<sup>25</sup> AG ¶ 2(a).