



In the Matter of:

THOMAS S. INMAN,

ARB CASE NO. 08-060

COMPLAINANT,

ALJ CASE NO. 2007-SOX-047

v.

DATE: June 28, 2011

FANNIE MAE,

RESPONDENT.

BEFORE: THE ADMINISTRATIVE REVIEW BOARD

Appearances:

For the Complainant:

Michael D. Kohn, Esq., *Kohn, Kohn and Colapinto, LLP*, Washington, District of Columbia; Richard R. Renner, Esq., *Tate & Renner*, Dover, Ohio

For the Respondent:

Madonna A. McGwin, Esq., Anne M. English, Esq., *Fannie Mae*, Washington, District of Columbia

BEFORE: Paul M. Igasaki, *Chief Administrative Appeals Judge*; E. Cooper Brown, *Deputy Chief Administrative Appeals Judge*; Joanne Royce, *Administrative Appeals Judge*

DECISION AND ORDER OF REMAND

This case arises under Section 806, the employee protection provision, of the Sarbanes-Oxley Act of 2002 (SOX) and its implementing regulations. 18 U.S.C.A. § 1514A (Thomson/West 2010); 29 C.F.R. Part 1980 (2010). On August 14, 2006, Thomas S. Inman filed a complaint alleging that Fannie Mae violated the SOX when it discharged him from employment. Fannie Mae filed a Motion for Summary Judgment (Motion) seeking dismissal of

the complaint. On March 5, 2008, a Department of Labor Administrative Law Judge (ALJ) granted Fannie Mae's Motion and dismissed the complaint. For the following reasons, we remand the case to the ALJ.

BACKGROUND

Fannie Mae is a publicly-traded company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C.A. 781), and is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)). It is a government-sponsored enterprise (GSE) that purchases mortgage loans from mortgage lenders. It repackages these loans into mortgage-backed securities or retains them in its portfolio. In 1992, Congress established the Office of Federal Housing Enterprise Oversight (OFHEO) to oversee and ensure the financial soundness of Fannie Mae.¹ Motion at 5.

OFHEO informed Fannie Mae in July 2003 that it intended to conduct a special examination of some of the company's practices, including its accounting policies and internal controls. Fannie Mae engaged the accounting firm of Deloitte & Touche to assist in the review of its accounting policies. Motion at 5-6.

In September 2004, OFHEO delivered an Interim Report to Fannie Mae's Board of Directors identifying weaknesses in Fannie Mae's internal controls and practices that did not conform to Generally Accepted Accounting Principles (GAAP). Motion at 6. The report raised concerns regarding Fannie Mae's use of "Financial Accounting Standard No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases" ("FAS 91") and "Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). Motion, Exhibit (RX) 6 (Federal National Mortgage Association, Form 8-K, filed Dec. 22, 2004).

In response to the Interim Report, the Board of Directors established a Special Review Committee of independent directors to review OFHEO's findings, and to oversee an independent investigation of issues raised in the report. Motion at 6. On September 27, 2004, Fannie Mae agreed to maintain a capital surplus of thirty percent over its minimum capital level requirement. The company also asked the Securities and Exchange Commission's (SEC) Office of the Chief Accountant (OCA) to review its accounting practices with respect to the problems identified in the Interim Report. Motion at 6-7; RX 2 (Affidavit of David Hisey), para. 6.

According to Fannie Mae, OFHEO concluded that Fannie Mae's Amortization Integration Modeling System (AIMS) and its modeling process caused the majority of the company's internal control weaknesses. RX 2, para. 3. In late 2004, OFHEO concluded that Fannie Mae could not rely upon AIMS to produce accurate information. Fannie Mae and

¹ On July 30, 2008, the Housing and Economic Recovery Act of 2008 combined OFHEO with the Federal Housing Finance Board (FHFB) and the GSE mission office at the Department of Housing and Urban Development (HUD) to form the Federal Housing Finance Agency (FHFA). Pub. L. 110-289, 122 Stat. 2654 (July 30, 2008).

OFHEO agreed to eliminate AIMS and restate the FAS 91 accounting information on a new accounting system.

In December 2004, Fannie Mae announced that the public should not rely upon its financial statements and auditors' reports issued from January 2001 through the second quarter of 2004, because OCA had determined that Fannie Mae had prepared those statements and reports using practices that did not comply with GAAP. OCA directed Fannie Mae to restate the financial statements it had filed with the SEC for that period (the "restatement period"). RX-6.

On March 17, 2005, Fannie Mae and OFHEO supplemented the September 27, 2004 agreement to address "issues that arose after September 27, 2004, including concerns at OFHEO with internal controls and resolution of other organizational problems, determinations by the SEC, public filings by Fannie Mae, reclassification of the capital position of Fannie Mae and actions taken by Fannie Mae's Board of Directors." *Id.*, Exhibit 99.1.

According to Fannie Mae, OFHEO relied on Deloitte & Touche, Fannie Mae's external auditor, to report accurate information regarding Fannie Mae's financial condition during the restatement period. Fannie Mae also asserts that it was unable to file any reliable financial statements until the restatement was complete, which occurred in December, 2006. Deposition of David Hisey at 56; Deposition of Gregory Kozich at 10; Motion at 7-8.

In June 2005, Fannie Mae commissioned John Lankenau, a contractor, to prepare a memorandum known as the "FAS 91 Amortization White Paper" (White Paper). The purpose of the White Paper was to provide information regarding Fannie Mae's FAS 91 amortization practices from 2001 to 2004. Complainant's Memorandum in Opposition to Fannie Mae's Motion for Summary Decision (Memorandum in Opposition), Exhibit (CX) 23 ("FAS 91 Amortization – Description of Errors in Fannie Mae's Process during the Restatement Period") at 4. The White Paper indicated that the processes, models, and assumptions used for amortization calculations contained deficiencies that warranted the creation of a new amortization engine. *Id.* at 10-12.

Fannie Mae hired Inman on November 28, 2005 to serve as an FAS 91 Senior Manager. His position description indicates that he was responsible for managing activities related to Fannie Mae's FAS 91 accounting, establishing and maintaining "appropriate internal controls with SOX team in Controllers," and developing an updated FAS 91 accounting and reporting process "that keeps pace with the current and future business needs." CX 3 at 1. Fannie Mae continued using AIMS to close its books during the period of Inman's employment. According to Inman, the decision to scrap the AIMS system was not made until June 2005, and this decision did nothing to correct the data fed into the AIMS system. Petition for Review, para. 3.

In January 2006, Inman concluded that AIMS had generated an error that overstated an amortization expense. Affidavit of Thomas S. Inman (Inman Aff.), paras. 2-4. He concluded that the source of the error was not the AIMS system calculations, but instead the result of "flawed original balance data and post-acquisition changes in that data." Inman Aff., para. 10. Inman documented a \$52.4 million expense overstatement and concluded that a \$51.9 million

expense AIMS produced should have been an estimated \$500,000 in income. Memorandum in Opposition at 13; Inman Aff., para. 10.

Inman reported the \$52.4 million error to Fannie Mae management in a memorandum and bullet point presentation. Complaint at 3; Inman Aff., para. 12. In response to Inman's report, management instructed Inman to cease analyzing unreconciled balances. Memorandum in Opposition at 14; Inman Aff., para. 13. Fannie Mae recorded the \$52.4 million item in the general ledger without any change reflecting the error. Complaint at 3; Deposition of Alison Herrick at 118.

In or around March 2006, Inman concluded that AIMS had produced a \$2.4 billion anomalous income result. Inman Aff., para. 20. Inman reported the \$2.4 billion error to Marcus Lee, one of his supervisors. Lee requested materials documenting the error, and after receiving them he concurred with Inman's recommendations. *Id.*, para. 22. He also told Lankenau that, due to the magnitude of the errors, the White Paper should be revised. *Id.*, para. 23. Inman states that, when he told Alison Herrick, another Fannie Mae supervisor, that he had discussed his concerns with others, "she became agitated and criticized me for having done so." *Id.*, para. 21. According to Inman, "[t]he quarterly cumulative adjustment data was corrected so that the error would not be recorded on Fannie Mae's books and records." RX-12 (Written Statement of Thomas S. Inman) at TI000044.

Fannie Mae was required to provide Inman with a Mid-Point Review of his performance half way through his 180-day probationary period, but Inman did not receive any review until he had worked for 129 days. Complaint at 4. Fannie Mae gave him an unfavorable performance review, and according to Inman, "[his] protected activity and ability to detect accounting problems . . . produced a false and retaliatory assessment of [his] job performance." *Id.* Fannie Mae discharged Inman on May 16, 2006. According to Fannie Mae, it discharged Inman "due to his poor management skills." Motion at 22. Inman indicates that Fannie Mae gave him no termination letter or written notice of the reasons for his firing. Complaint at 4.

Inman asserts that "both Deloitte and Touche and OFHEO were relying on Fannie Mae management representations concerning the accuracy of current production accounting records and the capital computation." Petition for Review, para. 7. Inman also states that Fannie Mae "filed that capital computation with OFHEO and then certified to OFHEO the accuracy of the statements." *Id.*, para. 6.

Inman filed his SOX complaint on August 14, 2006. He alleges that Fannie Mae discharged him from employment because he "discovered several irregularities in financial records that he attempted to correct or report to his superiors." He states that his discharge "occurred just five days after a meeting with his supervisor Allison Herrick in which he made a protected disclosure of accounting errors in a data file being prepared pursuant to an OFHEO request." Complaint at 5. The Occupational Safety and Health Administration (OSHA) investigated the complaint and found that "there is no reasonable cause to believe that Respondent violated the SOX." Inman then requested a hearing before an ALJ.

Prior to any hearing, Fannie Mae filed its Motion for Summary Judgment. In the Motion, Fannie Mae argued that Inman “never raised any issues to Fannie Mae that fall under the SOX whistleblower protection provisions prior to his termination.” Motion at 3. Inman responded to the Motion by stating that he engaged in SOX-protected activity when he “uncovered unreconciled account balances and identified additional forms of financial inaccuracies and indicators of fraud none of which he believed to have been reported to [OFHEO].” Memorandum in Opposition at 1.

Both parties submitted documents to support their arguments. But according to Inman, Fannie Mae has refused to provide specific information “material to the issue of protected activity raised by [R]espondent’s [M]otion, including all of the revised versions of the White Paper and electronic data and spreadsheets sought by Complainant.” Response to the Motion at 27.

On March 5, 2008, the ALJ granted Fannie Mae’s Motion and dismissed Inman’s complaint. The ALJ concluded that, “[s]ince engaging in protected activity is an essential element of Inman’s SOX complaint, and the undisputed material facts set forth herein fail to demonstrate that Inman engaged in such activity, Fannie Mae is entitled to judgment as a matter of law.” Order at 22. The ALJ also held that Inman was not entitled to additional discovery to respond to the Motion. *Id.* at 21-22. Inman appealed the ALJ’s ruling to the Administrative Review Board (ARB or Board).

JURISDICTION AND STANDARD OF REVIEW

Congress authorized the Secretary of Labor to issue final agency decisions with respect to claims of discrimination and retaliation filed under the SOX, 18 U.S.C.A. § 1514A(b). The Secretary has delegated that authority to the Administrative Review Board. Secretary’s Order No. 1-2010 (Delegation of Authority and Assignment of Responsibility to the Administrative Review Board), 75 Fed. Reg. 3924 (Jan. 15, 2010). *See* 29 C.F.R. § 1980.110(a).

We review a grant of summary decision *de novo*, i.e., under the same standard that ALJs employ. Derived from Rule 56 of the Federal Rules of Civil Procedure, that standard permits an ALJ to “enter summary judgment for either party if the pleadings, affidavits, material obtained by discovery, or matters officially noticed show that there is no genuine issue as to any material fact and that a party is entitled to summary decision.” 29 C.F.R. § 18.40(d) (2010).

DISCUSSION

Section 806, the SOX’s employee-protection provision, prohibits covered employers and individuals from retaliating against employees for providing information or assisting in investigations related to certain fraudulent acts. That provision states:

- (a) Whistleblower Protection For Employees Of Publicly Traded Companies.— No company with a class of securities registered under

section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341 [mail fraud], 1343 [wire, radio, TV fraud], 1344 [bank fraud], or 1348 [securities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

(A) a Federal regulatory or law enforcement agency; (B) any Member of Congress or any committee of Congress; or (C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

18 U.S.C.A. § 1514A.^[2]

The legal burdens of proof set forth in the employee protection provision of the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR 21) govern SOX Section 806 actions. Accordingly, to prevail on a SOX claim, a complainant must prove by a preponderance of the evidence that: (1) he or she engaged in activity or conduct that the SOX protects; (2) the respondent took unfavorable personnel action against him or her; and (3) the protected activity was a contributing factor in the adverse personnel action.³

² During the pendency of this appeal, on July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111-203, 124 Stat 1376 (2010). Sections 922 and 929A of the Dodd-Frank Act amended SOX Section 806, but those amendments are not relevant to this case.

³ 49 U.S.C.A. § 42121; *see* 18 U.S.C.A. § 1514A(b)(2)(C).

The ALJ erred in concluding that the undisputed facts demonstrate that Inman did not engage in SOX-protected activity. He held that “Inman’s complaint must fail because he never complained ‘definitively and specifically’ to anyone at Fannie Mae or elsewhere about conduct covered by any of the six enumerated categories set forth in 18 U.S.C. § 1514A.” Order at 18. But the “definitive and specific” standard employed in prior ARB cases, and applied by the ALJ in this case, is inconsistent with the statutory language of Section 806. *See Sylvester v. Paraxel Int’l*, ARB No. 07-123, ALJ Nos. 2007-SOX-039, -042, slip op. at 17 (ARB May 25, 2011) (en banc). As the majority of the en banc Board in *Sylvester* recently noted, this standard “presents a potential conflict with the express statutory authority of § 1514A, which prohibits a publicly traded company from discharging or in any other manner discriminating against an employee for providing information regarding conduct that the employee ‘reasonably believes’ constitutes a SOX violation.” *Id.*

The ALJ stated that Inman’s complaint should be dismissed because he did not specify that “the events he was reporting constituted evidence of fraud.” Order at 20. This constitutes error because an employee can engage in SOX-protected activity without mentioning or complaining about “fraud.” Again, as we recently explained in *Sylvester*, Section 806 prohibits an employer from retaliating against an employee who complains about *any* of the six enumerated categories of misconduct. A reasonable belief about a violation of “any rule or regulation of the Securities and Exchange Commission” could encompass a situation in which the violation, if committed, is completely devoid of any type of fraud. Thus, an allegation of fraud is not a necessary component of protected activity under Section 806 of the SOX. *Sylvester*, ARB No. 07-123, slip op. at 19-20.

Likewise, a SOX complainant may be afforded protection for complaining about violations that do not relate to shareholder fraud. *See, e.g., id.* at 20 (the phrase “relating to fraud against shareholders” does not apply to all of the categories listed in Section 806). The ALJ therefore erred by concluding that Inman’s complaint should be dismissed because he did not inform Fannie Mae that its actions “could adversely affect . . . member[s] of the investing public.” Order at 20.

The ALJ’s Order also appears to indicate that Inman could not prevail in a hearing because Fannie Mae was already aware of the concerns he was raising. *See, e.g., id.* at 22 (“Fannie Mae, OFHEO, the SEC, and Deloitte & Touche, among others, knew during all relevant times that: Fannie Mae’s . . . amortization engine was being used during Inman’s period of employment and was generating inaccurate information that could not reasonably be relied upon by OFHEO, the SEC, or the investing public . . .”). But neither the SOX nor its implementing regulations indicate that an employee does not engage in protected activity when he informs his employer about violations of which the employer is already aware.

The record before us also indicates that a genuine issue of material fact exists as to whether Inman provided information to Fannie Mae regarding conduct that he reasonably believed constituted one or more of the violations listed in Section 806. As described above, Inman states that he provided information to Fannie Mae about serious accounting errors, amounting to billions of dollars, which Fannie Mae ignored. He also asserts that he believes

these errors may have been the result of Fannie Mae's attempt to improperly manipulate its earnings. According to Inman, Fannie Mae's conduct violated "SEC Regulation § 240.13b2-1 . . . and § 13(b)(2) of the Securities Exchange Act." Memorandum in Opposition at 6.⁴

Inman asserts that, in mid-January 2006, he told Herrick and Lankenau that Fannie Mae needed to inform OFHEO of his concerns. He also states that he told them he was concerned that "unreconcilable [sic] differences exceeded the estimate established in the White Paper." Inman Aff., para. 11. And he asserts that "Fannie Mae was obligated to determine whether the purpose behind the reallocation of original balances [generated by AIMS] was fraudulent activity related to Fannie Mae's attempt to improperly manipulate its reported earnings during the period covered by the OFHEO examination." *Id.*, para. 18.

In responding to the Motion for Summary Judgment, Inman states that a report issued by one of Fannie Mae's consultants after his discharge confirmed his suspicions. The report indicates that "[i]t was not clear from this investigation what OFHEO knew about the flaws of the AIMS System and the errors that resulted in the amortization calculations." Memorandum in Opposition at 7, citing CX 8 (Grant Thornton Draft Report, November 3, 2006) at FM007355. And he states that Fannie Mae's failure to provide the SEC with "the most accurate representation of its finances it could produce based on an evaluation of the AIMS flaws Fannie Mae management knew to exist" constituted violations of "SEC Regulation § 240.13b2-1" and "[Section] 13(b)(2) of the Securities Exchange Act." Memorandum in Opposition at 5-6.

In sum, we conclude that a genuine issue of material fact exists as to whether Inman provided information to Fannie Mae regarding conduct that he reasonably believed constituted one or more of the violations listed in SOX Section 806.

Finally, Inman argues on appeal that the ALJ erred in disallowing requested discovery.⁵ Rather than address the merits of the parties' respective arguments on this matter, we direct the ALJ to afford the parties sixty (60) days to renew and complete any discovery warranted in light of this decision.

CONCLUSION

The ALJ erred by granting Fannie Mae's Motion for Summary Judgment. Accordingly, we **REVERSE** the ALJ's Order Granting Respondent's Motion for Summary Judgment and

⁴ SEC Regulation § 240.13b2-1 provides that "[n]o person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A) of the Securities Exchange Act." 17 C.F.R. § 240.13b2-1 (2010). Section 13(b)(2) of the Securities Exchange Act provides that certain companies shall "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." 15 U.S.C.A. § 78m(b)(2) (Thomson Reuters 2009).

⁵ Complainant's Motion to Supplement the Record, filed with the Board on March 1, 2011.

REMAND the case for further proceedings consistent with this opinion and our ruling in *Sylvester*.

SO ORDERED.

E. COOPER BROWN
Deputy Chief Administrative Appeals Judge

PAUL M. IGASAKI
Chief Administrative Appeals Judge

JOANNE ROYCE
Administrative Appeals Judge