In the Matter of:

KEITH KLOPFENSTEIN,

COMPLAINANT,

v.

PCC FLOW TECHNOLOGIES HOLDINGS, INC.

and

ALLEN PARROTT,

RESPONDENTS.

ARB CASE NO. 07-021
07-022

ALJ CASE NO. 2004-SOX-011

DATE: August 31, 2009

BEFORE: THE ADMINISTRATIVE REVIEW BOARD

Appearances:

For the Complainant:
Marc E. Grossberg, Esq., Stephen F. Fink, Esq., *Thompson & Knight L.L.P.*, Houston, Texas

***For the Respondents*:**
Samuel E. Hooper, Esq., *Neel & Hooper, P.C.*, Houston, Texas

FINAL DECISION AND ORDER FOLLOWING REMAND

Keith Klopfenstein filed a complaint alleging that "his former employer … and its representative, Allen Parrott" retaliated against him in violation of the whistleblower protection provisions of the Sarbanes-Oxley Act (the Act or the SOX), 18 U.S.C.A. §

1514A (West Supp. 2005). Following our remand, a Department of Labor Administrative Law Judge (ALJ) issued a [Recommended] Decision and Order on Remand (R. D. & O. R.) dismissing Klopfenstein's complaint. For reasons we now explain, we affirm.

BACKGROUND AND PROCEDURAL HISTORY

In his initial Recommended Decision and Order (R. D. & O.) and in his R. D. & O. R., the ALJ made detailed findings of fact. We summarize them briefly.

Klopfenstein began employment with Flow Products, Inc., in Brookshire, Texas, near Houston, in May 2001. He went from shipping operations to business planning. In November 2002, he became vice president of strategic operations and oversaw three business units that made pumps.

Flow Products (Flow Products or Flow) was a division of PCC Flow Technologies, LP, a limited partnership wholly owned by PCC FT I LLC and PCC FT II LLC, which in turn were wholly-owned subsidiaries of PCC Flow Technologies Holdings, Inc. (Holdings), a respondent herein. Holdings was a wholly owned subsidiary of Precision Castparts Corp. (PCC). PCC was a company with a class of securities registered under Section 12 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78*l*. In this corporate structure, only PCC was a publicly held company. Allen Parrott, the other named respondent, was Flow's Vice President of Finance when Klopfenstein's employment was terminated.

In 2002, Klopfenstein noticed a discrepancy in the in-transit inventory balances at PACO Pumps (PACO), one of the three business units he oversaw. The balance sheets showed more prepaid inventory in transit from overseas than did the shipping documents. Overstating prepaid inventory would therefore overstate the company's assets. He asked an assistant to investigate, and while the matter was being resolved, footnoted the discrepancy in inventory reports prepared for weekly management meetings. Holdings President Wayne Robbins, who was also Executive Vice President of PCC, attended those meetings. In February 2003, Flow's finance department performed a "true-up" to reconcile the accounts. The process matched inventory ordered with inventory received, which resulted in a loss of $204,000 worth of inventory that had been incorrectly reported as inventory in transit. Eventually, $9,715.66 could not be accounted for. Klopfenstein would later contend that his disclosure of the overstatement of company assets was the activity that entitled him to whistleblower protection.

Meanwhile, a controversy erupted over Klopfenstein's apparent violation of PCC's revenue recognition policy, which applied to its subsidiaries. The policy recognized revenue only when title and risk of loss passed to a customer. Put simply, sale of a pump could not be counted until it was shipped. However, an employee in PCC's finance department learned that some Flow Products inventory was being sent to and held off-site at an affiliated crating company to remove the items from the premises so that revenue (i.e., sales) could be recognized at the end of the month. Following an

investigation, Parrott prepared a report that described multiple shipments that appeared to violate the revenue recognition policy: e.g., shipments just before midnight of the end of the fiscal period that returned a few days later, including a shipment to and from a trucker's home; shipments sent to couriers on the last night of the fiscal period when those couriers would not be able to process the shipments until the next period; and shipments on which revenue was recognized upon their leaving the plant even though additional final packing was still needed. *Klopfenstein v. PCC Flow Techs. Holdings, Inc.*, ARB No. 04-149, ALJ No. 2004-SOX-011, slip op. at 6 (ARB May 31, 2006). The overall effect was to inflate the sales numbers for Klopfenstein's operations.

Following Parrott's investigation and report, Robbins met with Michael Jasperson, Holdings CFO; John Lilla, Holdings Vice President for Human Resources and Risk Management; and other senior managers. Robbins conferred with PCC CEO Mark Donegan and PCC CFO Bill Larsson. Lilla held Klopfenstein responsible for the revenue recognition violations, and, upon Jasperson's recommendation, Robbins fired Klopfenstein on April 7, 2003.

Klopfenstein filed a complaint against Holdings and Parrott with the Occupational Safety & Health Administration (OSHA) on July 3, 2003. The complaint contended that the revenue recognition issue was a pretext for the real reason the company fired him, his reporting the in-transit inventory discrepancy. After investigation, OSHA determined that the complaint lacked merit. Klopfenstein objected to OSHA's findings and requested a hearing before an ALJ.

The ALJ held an evidentiary hearing on April 5 and 6, 2004. His initial R. D. & O. noted that Klopfenstein did not bring his complaint against Flow, his employer, or PCC, the publicly held company, but against Holdings, a subsidiary of a publicly held company. R. D. & O. at 12. He found that the SOX did not specifically provide that subsidiaries were covered employers under the Act, and, although SOX did extend to "agents" of publicly held companies, the facts did not support an agency relationship between PCC and Holdings. Therefore, Holdings was not a proper party. *Id.* Likewise, as an employee of Flow, who took no adverse action against Klopfenstein, Parrott was not an officer or agent of PCC. Thus, the ALJ held that Parrott, too, was not a proper respondent to Klopfenstein's action. *Id.* at 13.

The ALJ went on to find that Klopfenstein did not prove that he was fired because of his concerns over in-transit inventory discrepancies. Rather, the evidence established a legitimate, non-discriminatory reason for his termination; Klopfenstein violated PCC revenue recognition policies by prematurely taking credit for product shipments. And he would have been fired even if he had not raised the in-transit inventory issue. *Id.* at 15, 18. The ALJ did not find it necessary to address other elements of a successful SOX complaint, whether the in-transit inventory discrepancies involved securities violations or fraud, and whether Robbins and other decision makers were actually aware of his concerns.

Klopfenstein then appealed to the ARB. The Board held that, under the Act, a SOX complainant need not name a publicly held company as respondent, so long as the complainant names an officer or agent of the company. *Klopfenstein*, slip op. at 13. Applying the common law of agency and depending upon the facts, a subsidiary such as Holdings or an individual, such as Parrott, could be an agent. *Id.* at 15-6. Under that guidance, we requested the ALJ to determine whether Holdings and Parrott were PCC's agents in Klopfenstein's whistleblower retaliation claim. *Id.* at 16.

The ARB also asked the ALJ to clarify his holding on causation. *Id.* at 21. Under the SOX, Klopfenstein had to prove that his claimed protected activity (expression of concern over in-transit inventory) was a contributing factor in his termination, but the Respondents could avoid liability by proving by clear and convincing evidence that they fired Klopfenstein even if he had not engaged in protected activity (i.e., because he violated the revenue recognition policy). *Id.* at 12, 19-20.

Following our remand, the ALJ issued his R. D. & O. R. dated October 13, 2006, again dismissing Klopfenstein's complaint. The ALJ affirmed his prior findings of fact. R. D. & O. R. at 1. Applying the ARB's guidance on the agency doctrine, he ruled that Holdings was PCC's agent with regard to the termination of Klopfenstein's employment. *Id*. at 4-6. "PCC made the ultimate decision to terminate Complainant though Holdings lead [sic] the investigation into possible revenue recognition violations and it was Holdings' employees that actually informed Complainant of his termination." *Id*. at 5. However, applying agency principles, the ALJ held that Parrott was not PCC's agent with regard to Klopfenstein's discharge. *Id*. at 6-8. Parrott investigated the revenue recognition violation and prepared a report, but he was not a decision maker with regard to Klopfenstein's discharge. *Id.* at 7.

On the issue of causation, the ALJ held that Klopfenstein's in-transit inventory concerns were not a contributing factor in his termination, and that Holdings provided clear and convincing evidence that Klopfenstein's violation of the revenue recognition police was the sole reason for his discharge. *Id*. at 9, 12. In so doing, the ALJ addressed and rejected several categories of circumstantial evidence that Klopfenstein contended proved his case. *Id*. at 9-12. The ALJ again found it unnecessary to determine whether Klopfenstein's expression of concern about in-transit inventory was protected activity under the SOX. *See id.* at 13.

Holdings and Klopfenstein appealed the ALJ's decision on remand to this Board. Holdings seeks review of the ALJ's decision that it was an agent of PCC in the adverse action taken against Klopfenstein. Klopfenstein, on the other hand, appeals the balance of ALJ's decision, namely that Parrott was not a PCC agent and that Klopfenstein did not prove that his alleged protected activity was a contributing factor in his termination.

JURISDICTION AND STANDARD OF REVIEW

The Secretary of Labor has delegated her authority to issue final agency decisions under the SOX to the ARB. Secretary's Order 1-2002 (Delegation of Authority and Responsibility to the Administrative Review Board), 67 Fed. Reg. 64,272 (Oct. 17, 2002); 29 C.F.R. § 1980.110 (2007). Pursuant to the SOX and its implementing regulations, the Board reviews the ALJ's fact findings under the substantial evidence standard. *See* 29 C.F.R. § 1980.110(b). Substantial evidence is that which is "more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Clean Harbors Envtl. Servs., Inc. v. Herman*, 146 F.3d 12, 21 (1st Cir. 1998). We must uphold an ALJ's factual finding that is supported by substantial evidence even if there is also substantial evidence for the other party and even if we "would justifiably have made a different choice had the matter been before us de novo." *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951).

In reviewing the ALJ's conclusions of law, the Board, as the Secretary's designee, acts with "all the powers [the Secretary] would have in making the initial decision . . . ." 5 U.S.C.A. § 557(b) (West 1996). Therefore, the Board reviews an ALJ's conclusions of law de novo. *See Getman v. Sw. Secs., Inc.*, ARB No. 04-059, ALJ No. 2003-SOX-008, slip op. at 7 (ARB July 29, 2005).

DISCUSSION

1. The Agency Issue

We first address whether the ALJ properly held that Holdings was a PCC agent and Parrott was not under the SOX.

a. The statutory framework

The SOX whistleblower protection provision prohibits certain covered employers from discharging, demoting, suspending, threatening, harassing, or in any other manner discriminating against employees who provide information to a covered employer or a Federal agency, or Congress regarding conduct that the employee reasonably believes constitutes a violation of 18 U.S.C.A. §§ 1341 (mail fraud), 1343 (wire, radio, TV fraud), 1344 (bank fraud), or 1348 (securities fraud), or any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders. Employees are also protected against discrimination when they have filed, testified in, participated in, or otherwise assisted in a proceeding filed or about to be filed relating to a violation of the aforesaid fraud statutes, SEC rules, or federal law. 18 U.S.C.A. § 1514A(a).

SOX complaints are governed by 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), 49 U.S.C.A. § 42121 (West Supp. 2005). 18 U.S.C.A.

§ 1514A(b)(2)(C). To prevail, a SOX complainant must prove by a preponderance of the evidence that: (1) he engaged in a protected activity or conduct (i.e., provided information or participated in a proceeding); (2) the respondent knew of the protected activity; (3) he suffered an unfavorable personnel action; and (4) the protected activity was a contributing factor in the unfavorable personnel action. *Cf*. 29 C.F.R. §§ 1980.104(b), 1980.109(a). *See* AIR 21, § 42121(a)-(b)(2)(B)(iii)-(iv). If the complainant establishes by a preponderance of the evidence that his protected activity was a contributing factor in the adverse action, then the respondent can only avoid liability by providing by clear and convincing evidence that it would have taken the same unfavorable personnel action in the absence of the protected activity. *Cf*. 29 C.F.R. § 1980.104(c). *See* § 49 U.S.C.A. § 42121(a)-(b)(2)(B)(iv).

Although AIR 21 established the burdens of proof for SOX complaints, it did not establish who is an appropriate respondent. AIR 21 provides that "[n]o air carrier or contractor or subcontractor of an air carrier" may take adverse action against a covered employee. § 49 U.S.C.A. § 42121(a). When Congress modeled the SOX whistleblower protection provision after AIR 21, it added the words "any officer, employee, . . . or agent" to the categories of permitted respondents. The SOX says that "[n]o 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 take adverse action against a covered employee. Under the SOX implementing regulations, an employee is defined as "an individual presently or formerly working for a company or company representative . . . or an individual whose employment could be affected by a company or company representative." 29 C.F.R. § 1980.101. A "company representative" is defined as "any officer, employee, contractor, subcontractor, or agent of a company." *Id.*

Where Congress has modeled the whistleblower burdens of proof for SOX after similar provisions in AIR 21, and added "any officer, employee, . . . or agent," we have been reluctant to presume that Congress also intended to include "subsidiaries" of publicly held companies in the categories of permitted respondents. We have said in our earlier decision in this case that subsidiaries can be held liable as agents of publicly held companies for SOX purposes; and that an ALJ can apply the common law of agency to the facts in making the determination. *Klopfenstein*, slip op. at 13-15. We need not go beyond that statement or define the degree of congruence required between a subsidiary and an agent to reach the proper resolution of this case.

b. The ALJ's decision with regard to Holdings and Parrott

It is desirable as a first order of business for an adjudicator to determine whether the putative whistleblower has engaged in activity that the statute at issue protects. If he or she did not, that ends the case. Here, the ALJ did not determine whether Klopfenstein's expression of concern about in-transit inventory was protected activity under the SOX. Because the ALJ decided against Klopfenstein on other grounds, we do

not address the question here. Instead, we address and affirm the ALJ's decision that Holdings was a PCC agent and Parrott was not under the SOX.

Substantial evidence supports the conclusion that Holdings was PCC's agent for the purpose of discharging Klopfenstein. R. D. & O. R. at 3-6. The revenue recognition policy that Klopfenstein is said to have violated was a PCC policy that it applied to its subsidiaries. An employee in PCC's finance department learned of the violation. Robbins was both President of Holdings and Executive Vice President of PCC. Following an investigation and report of the PCC revenue recognition violation, Robbins met with senior managers, including Holdings CFO Jasperson and Holdings Vice President for Human Resources and Risk Management Lilla, and other senior managers. Robbins also conferred with PCC CEO Donegan and PCC CFO Larsson. Lilla held Klopfenstein accountable for the revenue recognition violations. Upon Jasperson's recommendation, Robbins then fired Klopfenstein. Thus, Holdings officials became the instrumentality for enforcing a violation of PCC policy.

However, we agree that Parrott was not a PCC agent in Klopfenstein's discharge. R. D. & O. R. at 6-8. Although a Flow Vice President of Finance, he held no other offices. Although he investigated the revenue recognition issue and prepared a report, he was not a decision maker in the termination of Klopfenstein's employment.

2. The Causation Issue

On causation, Klopfenstein had to prove that his protected activity was a "contributing factor" in his discharge. If he did, Holdings could avoid liability only through "clear and convincing evidence" that it would have discharged Klopfenstein even if he had not engaged in protected activity. On remand, the ALJ found Klopfenstein's circumstantial evidence "insufficient to support the conclusion that [Klopfenstein's] in-transit inventory concerns were a contributing factor in his termination." *Id.* at 9.

On appeal to us after remand, Klopfenstein makes the same arguments that he made to the ALJ with regard to what he says the circumstantial evidence shows. *See* Complainant's Initial Brief After Remand (Initial Brief). However, substantial evidence supports the ALJ's findings.

First, Klopfenstein claims temporal proximity between his reporting the in-transit inventory discrepancy and his firing "within weeks." *Id.* at 17-19. However, as the ALJ points out, between the expression of the in-transit inventory concern and the firing was an independent event, disclosure of the revenue recognition problem. R. D. & O. R. at 9-10. The intervening event was the employer's reason for Klopfenstein's discharge and helps defeat the inference of causation. *See Keener v. Duke Energy Corp.*, ARB No. 04-091, ALJ No. 2003-ERA-012, slip op. at 11 (ARB July 31, 2006).

Second, Klopfenstein claims disparate treatment because other employees were not disciplined over the revenue recognition issue. Initial Brief at 19-22. However, the ALJ accepted Jasperson's and Robbins's testimony that Klopfenstein acknowledged that

he had changed the revenue recognition policy without authorization. The ALJ also accepted Lilla's testimony that one of the two other employees was not in charge of shipping and did not understand the implication of the transactions. The other was not directly involved with shipping. Both claimed lack of understanding and training. R. D. & O. R. at 10-11. In contrast, Lilla concluded that Klopfenstein "directed and fostered an attitude, and atmosphere that allowed a violation of the revenue recognition policy." *Id.* at 11.

Next, Klopfenstein contends that Parrott's report was pretextual. Specifically, he asserts that Parrott's investigative report was false and in an addendum erroneously claimed that Klopfenstein himself was responsible for the in-transit inventory problem. Initial Brief at 23-24. Parrott had concluded that Klopfenstein bullied subordinates into moving inventory to phantom locations to inflate his fiscal period revenue numbers. In support of Parrott's findings, the ALJ relied on testimony of Klopfenstein's subordinates that he directed them to move inventory and to post job close-outs at month's end that were neither billed nor shipped. R. D. & O. R. at 11. The evidence on this issue supports the ALJ's findings.

Finally, Klopfenstein makes a generalized, overlapping statement about "pretext, misrepresentations and contradictions." Initial Brief at 23-24. He suggests that statements Lilla made to the Texas Workforce Commission regarding Klopfenstein's management style and termination for failing to follow company policy were contradictory and evidence of pretext. However, it is clear from the evidence that Klopfenstein had bullied subordinates into carrying out violations of PCC's revenue recognition policy, and his contention that Holdings shifted explanations is without merit.

In contrast to Klopfenstein's circumstantial evidence, the ALJ gave weight to the testimony of Robbins, Jasperson and Lilla. Although Robbins attended weekly management meetings where the inventory reports with Klopfenstein's footnote about the inventory discrepancy were reported, the ALJ found that Robbins, Jasperson, and Lilla had no knowledge of Klopfenstein's concerns at the time of his termination. He credited their testimony, and concluded that the evidence was "clear and convincing" that "the sole reason for [Klopfenstein's] termination was the violation of PCC's revenue recognition policy." He added, "No other activity on [Klopfenstein's] part (specifically his in-transit inventory concerns) was a contributing factor that affected in any way that decision." R. D. & O. R. at 12.

Substantial evidence supports the ALJ's findings of fact, and he correctly applied the legal standard in holding that that Klopfenstein failed to prove that his complaints about the in-transit inventory were a contributing factor in the decision to discharge him. We affirm that holding. Because Klopfenstein failed to meet his burden of proof, we need not proceed to the next sequential step, whether Holdings demonstrated by clear and convincing evidence that it would have taken the same adverse action in the absence of protected activity.

CONCLUSION

On remand from the ALJ, we have made the following rulings. We have **AFFIRMED** the ALJ that Holdings, but not Parrott, was an agent of PCC, and therefore a proper respondent under the facts as found in this case. We have also **AFFIRMED** the ALJ's ruling that Klopfenstein's complaints about in-transit inventory were not a contributing factor in his discharge. Accordingly, we **DENY** Klopfenstein's complaint.

SO ORDERED.

WAYNE C. BEYER
Chief Administrative Appeals Judge

OLIVER M. TRANSUE
Administrative Appeals Judge