

**IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

SECURITIES AND EXCHANGE	:	CIVIL ACTION
COMMISSION,	:	
	:	NO. 02-8048
Plaintiff,	:	
	:	
v.	:	
	:	
WILLIAM J. PARDUE,	:	
	:	
Defendant.	:	

**MEMORANDUM**

**ROBERT F. KELLY, S.J.**

**APRIL 1, 2005**

The Securities and Exchange Commission (“Commission”) brings this securities enforcement action against William J. Pardue (“Pardue”) for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder. The Commission seeks the disgorgement of profits acquired by Pardue from a 1999 stock transaction, as well as various forms of injunctive relief and civil penalties.

A one-day, non-jury trial was held in this case on January 18, 2005. At trial, the Commission called two witnesses, Pardue, and Mr. George Meyer, Pardue’s bother-in-law and then president of Central Sprinkler Corporation. Pardue, acting *pro se*, called two witnesses, his wife Mariah Pardue, and his brother-in-law Stephen Meyer. The following twelve exhibits were admitted into evidence:

1. September 1, 1998 memorandum to “All Department Managers” with attachment “Central Sprinkler Corporation Policy Statement on Trading in Central Sprinkler Corporation Securities by Directors and Executive Officers.”
2. October 14, 1998 press release from the U.S. Consumer Product Safety Commission entitled “CPSC, Central Sprinkler Recall Omega Fire

- Sprinklers; Settle Lawsuit.”
3. February 22, 1999 press release entitled “Central Sprinkler Announces Judge’s Final Approval of Class Action Settlement.”
  4. May 27, 1999 press release entitled “Central Sprinkler Corporation Reports EPS of \$0.67 in Fiscal Second Quarter 1999.”
  5. “Separation of Employment Agreement and General Release” between Pardue and Central Sprinkler.
  6. Monthly statements for Pardue’s brokerage account at Janney Montgomery Scott for January 1999 through June 1999.
  7. Chart entitled “William Pardue’s Trading in Central Sprinkler Stock (Jan. 1, 1999 to June 30, 1999).”
  8. June 16, 1999 press release entitled “Tyco International to Acquire Central Sprinkler Corporation.”
  9. Transcript of Pardue’s investigative testimony before the Commission on November 9, 2001.
  10. March 4, 1999 press release entitled “Central Sprinkler Corporation Reports 155% EPS Increase in Fiscal First Quarter 1999.”
  11. April 19, 1999 new item entitled “Central Sprinkler Names Mathias Barton Financial Chief.”
  12. Transcript of Pardue’s deposition on September 29, 2004.

After consideration of the evidence presented at trial. I enter the following findings of fact and conclusions of law.

### **FINDINGS OF FACT**

1. Defendant William J. Pardue is a resident of Devon, Pennsylvania. (Ans. ¶ 7).
2. Central Sprinkler Corp. (“Central Sprinkler”) is a manufacturer of fire protection systems, and at all relevant times, its offices were located in Lansdale, Pennsylvania. (Ans. ¶ 8).
3. Beginning in 1985 with its initial public offering, and until its acquisition by Tyco International (“Tyco”) on August 26, 1999, the common stock of Central Sprinkler was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934, 15 U.S.C. § 78k(g), and was traded on the NASDAQ National Market System. (Ans. ¶ 8, N.T. 7-8 1/18/05).

4. At all relevant times, Central Sprinkler had a written policy prohibiting directors, executive officers, family members, and other related persons from trading in Central Sprinkler stock while in the possession of material, non-public information about the company. Pardue was aware of the policy and that it applied to him. (Ex. 1; N.T. 14, 73 1/18/05).
5. In 1976, Pardue married Mariah Meyer, the daughter of William Meyer, then president and an owner of Central Sprinkler. (N.T. 49-50 1/18/05).
6. In 1977 or 1978, Pardue began working for Central Sprinkler as quality control manager. After a series of promotions, he became the company's executive vice president of operations. In 1996 or 1997, Pardue was transferred to the position of executive vice president for administration. (Ans. ¶ 7; N.T. 54-55 1/18/05).
7. Several other members of the Meyer family also worked at Central Sprinkler while Pardue was employed there, including George Meyer, Stephen Meyer, John Meyer, and Marilyn Thomas, who are children of William Meyer, as well as Stephen Billow and Andrew Post, who were sons-in-law of William Meyer. (N.T. 10 1/18/05).
8. In January 1999, Pardue resigned as executive vice president of Central Sprinkler. Pursuant to his separation agreement, Pardue was employed by Central Sprinkler as an "employee/consultant" until June 30, 1999. Pardue received severance benefits from June 30, 1999, to December 31, 1999. The benefits were equal to Pardue's salary and benefits for the 1999 calendar year. (Ans. ¶ 7; Ex. 5; N.T. 59 1/18/05).
9. In late 1998, Tyco approached E. Talbott Briddell, Central Sprinkler's chief executive officer, and expressed an interest in acquiring the Company. In response to that offer,

Central Sprinkler engaged the services of an investment bank to assist with its evaluation of the Tyco offer as well as solicit other potential bidders in an auction process. (N.T. 17-18 1/18/05).

10. On or about May 10, 1999, Tyco presented an offer of \$30 per share to Central Sprinkler's senior management. (N.T. 21-22 1/18/05).
11. At all relevant times in 1999, William Meyer, George Meyer, and Stephen Meyer were members of Central Sprinkler's board of directors. Although, William Meyer served in a diminished capacity, George and Stephen Meyer were active members of the board and officers. George Meyer was the company's president and Stephen Meyer was the company's executive vice president of research and development. (Ans. ¶ 12; N.T. 12, 22-23 1/18/05).
12. The negotiations between Central Sprinkler and Tyco were confidential, and access to information about the negotiations was limited to a small circle within the company. However, George and Stephen Meyer were included in the group of people updated on the status of the negotiations, including Tyco's offer of \$30 per share. (N.T. 23-24 1/18/05).
13. George Meyer informed William Meyer regularly of the status of the Tyco negotiations. (N.T. 22-23 1/18/05).
14. Neither George Meyer nor Stephen Meyer deliberately told Pardue anything about the confidential negotiations between Central Sprinkler and Tyco. (N.T. 25, 116 1/18/05).
15. Before the stock market opened on June 16, 1999, Central Sprinkler announced that its board had accepted Tyco's offer to purchase the company for \$30 per share. That day,

the price of Central Sprinkler stock rose 26%, from \$22.375 per share to \$28.1875 per share. (Ans. ¶ 15; Ex. 8; N.T. 85 1/18/05).

16. Pardue traded in Central Sprinkler stock while negotiations were taking place with Tyco:
- a. As of February 26, 1999, Pardue owned 32,161 shares of Central Sprinkler common stock and had not traded in the security for at least three months. Pardue purchased the stock in 1980 or 1981 as part of the Meyer family's purchase of Central Sprinkler. (Ex. 6; N.T. 68-72 1/18/05).
  - b. Between March 17 and 23, 1999, Pardue sold 16,000 shares of Central Sprinkler stock, approximately one-half of his holdings, and began purchasing other securities. (Ex. 6; Ex. 7; N.T. 75-76 1/18/05).
  - c. Pardue sold the stock because he felt that the price of Central Sprinkler stock was "going to languish where it was based upon the problems that it had" and because he wanted to buy other stocks. (N.T. 76-77; Ex. 12 at 54, 62).
  - d. On May 17, 1999, Pardue told his stockbroker to purchase as many shares of Central Sprinkler stock as possible. Between May 17 and 24, 1999, Pardue purchased 13,100 shares of Central Sprinkler stock at a total cost of \$226,325.10, financing the transaction by liquidating all of his other holdings. By May 31, 1999, Pardue owned 29,261 shares of Central Sprinkler stock, valued at \$17 per share, for a total value of \$497,437.00. (Ex. 6; N.T. 80-81 1/18/05).
  - e. Between June 17 and 24, 1999, Pardue sold his entire holding of Central Sprinkler stock for a total of \$910,864.40, using the proceeds to purchase stock in seven other companies, most of which were in the technology sector. (Ex. 6; Ex. 7; N.T.

82-83 1/18/05).

17. Pardue offered the following explanations to the Commission for his decision to re-purchase Central Sprinkler common stock in May 1999:
  - a. because he had just missed a favorable quarterly earnings announcement, and he expected another favorable earnings report would encourage the stock price to continue to rise. (N.T. 86-87 1/18/05; Ex. 9 at 58-60).
  - b. because there had been “much fanfare” when Central Sprinkler announced the appointment of Mathias Barton as chief financial officer. (N.T. 89 1/18/05; Ex. 9 at 59).
  - c. because the company had resolved certain legal problems concerning its Omega fire sprinklers. (N.T. 91, 96-97 1/18/05; Ex. 9 at 59; Ex. 12 at 57).
  - d. because Mr. Briddell, Central Sprinkler’s CEO, purchased 100,000 shares of Central Sprinkler. (N.T. 94-96 1/18/05; Ex. 9 at 59; Ex. 12 at 57-58, 64).
18. Pardue’s explanations fail to explain his conduct:
  - a. Pardue admitted that his prior testimony regarding favorable earnings announcements was untrue. (N.T. 87-88, 97 1/18/05).
  - b. Central Sprinkler announced its first quarter earnings on March 4, 1999, which were positive, two weeks before Pardue sold half of his Central Sprinkler holding. (Ex. 10; N.T. 87-88 1/18/05).
  - c. Pardue admitted that his prior testimony regarding the appointment of Mr. Barton was also untrue. (N.T. 91 1/18/05).
  - d. Central Sprinkler announced the appointment of Mathias Barton as CFO on April

- 19, 1999. (Ex. 11; N.T. 91 1/18/05).
- e. Potential liability regarding the Omega sprinkler line was resolved by February 22, 1999, with Central Sprinkler's announcement of the settlement of a private class action lawsuit. Furthermore, settlement of the administrative action pursued by the Consumer Product Safety Commission was announced on October 14, 1998. (Ex. 2; Ex. 3; N.T. 31, 92 1/18/05).
  - f. Pardue learned about Mr. Briddell's stock purchase in January or February 1999. (N.T. 95, 97-98 1/18/05; Ex. 9 at 86-87).
  - g. All of Pardue's previous explanations were either disavowed as untrue or took place before his decision to sell one-half of his Central Sprinkler holding in March 1999. They therefore fail to explain his conduct in May 1999.
19. Pardue had access to members of the Meyer family in possession of material, non-public information regarding Central Sprinkler:
- a. During May 1999, Pardue saw William, George, and Stephen Meyer at family gatherings at William Meyer's home and at a hospital where William Meyer's wife was a patient. Mrs. Meyer was in and out of the hospital during the Spring of 1999 and eventually passed away in early June 1999. (N.T. 24, 103 1/18/05; Ex. 12 at 85, 88).
  - b. In his September 2004 deposition, Pardue admitted that he had been observing William, George, and Stephen Meyer involved in discussions related to Central Sprinkler at the hospital. (N.T. 100-03 1/18/05).
  - c. From those observations, Pardue concluded that Central Sprinkler's financial

performance from the second quarter 1999 was going to be positive. (N.T. 100-103 1/18/05). Pardue testified in September 2004 that William, George, and Stephen Meyer were “rejoicing,” that “a great weight had been taken off of his [William Meyer] shoulders,” and that based on his observations, Pardue “knew things were going well.” (Ex. 12 at 83-85, 87-88).

d. Pardue testified in November 2001 that based upon his observation of George and Stephen Meyer’s conduct at the hospital, he concluded that they knew about the Tyco negotiations. (N.T. 105-108 1/18/05; Ex. 9 at 97-98).

e. Pardue testified in his September 2004 deposition that he was so confident in Central Sprinkler’s performance that he would have bet Mr. Huntington’s (the questioner) house on it. (Ex. 12 at 93).

20. Pardue denied being in possession of material, non-public information about Central Sprinkler when started buying Central Sprinkler stock on May 17, 1999. (N.T. 99, 109-10 1/18/05).

### **CONCLUSIONS OF LAW**

1. This Court has jurisdiction over both the subject matter, Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa, and the parties in this action. Fed. R. Civ. P. 4. Venue is proper in this District as Pardue resides here. 15 U.S.C. § 78aa.

2. Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security no so registered, any

manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Commission] may prescribe as necessary or appropriate in the public interest for the protection of investors.

15 U.S.C. § 78j(b).

3. Rule 10b-5, promulgated under Section 10(b) of the Exchange Act provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

4. Trading in securities based on material, non-public information by a person who has a duty of confidentiality and who does not disclose the material, non-public information is a violation of Section 10(b) of the Exchange Act and Rule 10b-5. U.S. v. O'Hagan, 521 U.S. 642, 652-53 (1997).

5. Information is material if there is a substantial likelihood that the information would be significant to a reasonable investor in making his or her investment decisions. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

6. Information about earnings estimates, SEC v. Mayhew, 121 F.3d 44, 52 (2d Cir. 1997), or the likelihood of a potential merger, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), is material.

7. A person who inadvertently overhears material, non-public information may be liable for

- insider trading if the person breaches a duty of confidentiality with respect to the information. SEC v. Switzer, 590 F. Supp. 756, 765-66 (W.D. Okla. 1984).
8. The Commission need not show direct evidence of the transmission of material, non-public information in order to establish that a defendant engaged in insider trading. Circumstantial evidence (such as contacts between the trader and persons with possession of the material, non-public information, the suspicious timing of the trades, and the offering of implausible reasons for the trades) may support an inference that insider trading has, in fact, occurred. U.S. v. McDermott, 245 F.3d 133, 138 (2d Cir. 2001); SEC v. Singer, 786 F. Supp. 1158, 1164 (S.D.N.Y. 1992); SEC v. Musella, 578 F. Supp. 425, 441 (S.D.N.Y. 1984).
  9. In order to establish liability for insider trading, the Commission must prove scienter, the intent to deceive, manipulate or defraud. Aaron v. SEC, 446 U.S. 680, 695-98 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976).
  10. In an insider trading case, scienter is established by proof that the defendant was aware of his duty of confidentiality and had actual knowledge of the material, non-public information. SEC v. Musella, 748 F. Supp. 1028, 1038-40 (S.D.N.Y. 1989), *aff'd*, 898 F.2d 138 (2d Cir. 1989).
  11. Scienter may be inferred from circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390-91 n.30 (1983).
  12. Based upon Pardue's contacts with members of the Meyer family in possession of material, non-public information regarding Central Sprinkler; the suspicious nature of his trading activities in Central Sprinkler stock; the failure of his explanations to the

Commission to explain his trading activities; Pardue's admission that he was observing George and Stephen Meyer; and his admission that he was attempting to beat an expected favorable earnings announcement, the Court finds that Pardue traded in Central Sprinkler stock while in the possession of material, non-public information.

13. Furthermore, as Pardue knew that Central Sprinkler's insider trading policy applied to him, he knew he had a duty not to purchase Central Sprinkler stock while in possession of material, non-public information about the company. Accordingly, the Court finds that Pardue violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

## **DISCUSSION**

As noted above, the Court finds that Pardue traded in Central Sprinkler stock while he was bound by the company's insider trading policy and in the possession of material, non-public information about the company. He is, therefore, in violation of Section 10(b) of the Exchange Act.

Pardue argues that the Commission has brought forth no direct evidence that Pardue had actual knowledge of material, non-public information. However, there is strong circumstantial evidence that he did. The timing of Pardue's trades in Central Sprinkler stock was highly suspicious. Pardue sold half of his Central Sprinkler holding in March 1999. He then, within a week of Tyco's \$30 bid, ordered his stockbroker to buy as much Central Sprinkler as possible. He liquidated his other holdings to make the purchase; several of his liquidations appear to have been taken at losses. The suspicious timing and pattern of Pardue's stock trades leads to the conclusion that the Tyco offer triggered his decision to purchase Central Sprinkler.

Furthermore, none of Pardue's alternative explanations has supported his conduct. Many of the events upon which he relied occurred before his decision to sell. The rest have been disavowed. When Pardue's proximity to William, George, and Stephen Meyer during the events in question is added, the Court is left with no other explanation of Pardue's conduct other than his possession of material, non-public information. As a result, the Commission has established by a preponderance of the evidence that Pardue violated the Act.

I will, accordingly, enter an Order as to liability. However, as the Court wishes to further evaluate Pardue's financial condition to determine the appropriateness of the various forms of requested relief, an additional hearing will be held for the purpose of determining relief.

An appropriate Order follows.

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SECURITIES AND EXCHANGE	:	CIVIL ACTION
COMMISSION,	:	
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Plaintiff,	:	
	:	
v.	:	
	:	
WILLIAM J. PARDUE,	:	
	:	
Defendant.	:	

**ORDER**

**AND NOW**, this First day of April, 2005, upon consideration of the evidence presented at trial, the Court hereby **FINDS** the Defendant, William J. Pardue, liable for violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

**IT IS THEREFORE ORDERED** that a hearing will be held on **Friday, April 15, 2005 at 9:30 a.m.**, for the purpose of evaluating the financial condition of the Defendant through the taking of evidence and hearing of argument on the requested forms of relief.

BY THE COURT:

/s/Robert F. Kelly  
ROBERT F. KELLY Sr. J.