

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

JOSEPH C. TAFURI, on behalf of
himself and others similarly
situated,

Plaintiffs,

v.

AIR PRODUCTS AND CHEMICALS, INC.,
et al.,

Defendants.

Civil Action
No. 97-3413

Gawthrop, J.

October , 1997

M E M O R A N D U M

Before the court is Defendants' Motion to Dismiss for failure to state a claim upon which relief can be granted. In this securities action, plaintiffs allege that defendants misrepresented the nature of the stock options granted to "key employees." Specifically, defendants allegedly concealed that such employees would forfeit certain stock options upon death, disability, or retirement and deceived them regarding the applicability of a discretionary policy to reinstate such options. By these acts, plaintiffs maintain, defendants violated federal securities laws. In addition, plaintiffs' Complaint includes state claims of fraud, breach of fiduciary duty, negligent misrepresentation, constructive fraud, unjust enrichment and imposition of a constructive trust, breach of contract, and violation of state securities laws. Defendants counter that plaintiffs have not stated a claim under the federal

securities laws and, thus, cannot sustain an action in this court based upon subject matter jurisdiction. The only issue before the court is whether the alleged misconduct occurred "in connection with" the purchase or sale of securities. Upon the following reasoning, I shall deny defendants' motion.

I. Background

Plaintiff Joseph C. Tafuri has filed a class action complaint against his former employer, Air Products and Chemicals ("Air Products"), and certain of its officers and directors, on behalf of himself and others similarly situated. The complaint concerns a Long-Term Incentive Plan adopted by Air Products to provide stock option awards to executives and key employees. The stock options in question vested in annual installments, one-third each year, beginning one year after the date of the grant. Tafuri claims that the text of the Plan, as well as the oral and written representations of defendants, never informed the participants that they would forfeit these stock options upon death, disability, or retirement. In addition, Tafuri claims that the administrator of the Plan, the Management Development and Compensation Committee, fraudulently represented that it might nevertheless use its discretion, even after one of the above forfeiture triggers had occurred, to reinstate stock options that had not yet vested. He claims that, instead, it applied this discretionary policy only to elite executives, not to key employees. Tafuri retired in April 1995 and claims money

damages stemming from his inability to exercise all or part of the stock options granted to him from 1992-1994.

II. Standard of Review

In deciding a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), the court must accept the factual allegations in the complaint as true. Rocks v. City of Philadelphia, 868 F.2d 644, 645 (3d Cir. 1989). Dismissal is appropriate only if it is clear that no relief could be granted under any set of facts that could be consistent with the allegations. Conely v. Gibson, 355 U.S. 41, 45-46 (1957).

III. Discussion

Plaintiffs assert that all defendants violated § 10(b) of the Securities and Exchange Act of 1934 and its companion, Securities and Exchange Commission Rule 10b-5, by deliberately misrepresenting that defendants would transfer stock in accordance with stock options granted to plaintiffs during their employment with Air Products. Defendants maintain that plaintiffs cannot prove the elements of their securities fraud claims. Federal securities laws prohibit the misrepresentation or omission of material facts "in connection with" the purchase or sale of securities. See Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b);¹ Securities Exchange Commission Rule

1. Section 10(b) provides:

(continued...)

10b-5, 17 C.F.R. § 240.10b-5.² This circuit has articulated three key elements necessary to maintain a § 10(b) cause of action. Ketchum v. Green, 557 F.2d 1022 (3d Cir. 1977), cert. den., 434 U.S. 940, 98 S.Ct. 431, 54 L.Ed.2d 300 (1978). "First, there must be misrepresentation or fraud; second, a purchase or sale of a security must occur; and third, such misrepresentation or fraud must have been rendered 'in connection with' the purchase or sale of a security." Ketchum, 557 F.2d at 1025.

(...continued)

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-- . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not 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 or for the protection of investors.

2. Rule 10b-5, promulgated under § 10(b) of the Securities Exchange Act of 1934, states:

It shall be unlawful for any person, directly or indirectly . . .

(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 or any security.

Defendants' motion, then, challenges whether the plaintiffs' Complaint fulfills the third Ketchum requisite.

Defendants first argue that the stock options do not constitute a purchase of securities. Even though plaintiffs did not, and apparently could not, exercise their stock options, this does not necessarily preclude their cause of action under the federal securities laws. See, e.g., Marine Bank v. Weaver, 455 U.S. 551, 554 n.2 (1982) ("A pledge of stock is equivalent to a sale for purposes of the antifraud provisions of the federal securities laws."); Yoder v. Orthomolecular Nutrition Inst., Inc., 751 F.2d 555, 559 (2d Cir. 1985) (holding that an alleged agreement between the employer and employee "constituted a sale of stock under the securities statutes even though the employer's stock was not in fact sold").

So also, a number of judges of this court have held that an employment agreement containing stock options can constitute a sale under Rule 10b-5. See Campbell v. National Media Corp., No. 94-4590, 1994 WL 612807, at *3 (E.D.Pa. Nov. 3, 1994); Rudinger v. Insurance Data Processing, Inc., 778 F.Supp. 1334, 1338-39 (E.D.Pa. 1991) ("An agreement exchanging a plaintiff's services for a defendant corporation's stock constitutes a 'sale' under the terms of the Securities Exchange Act."); Sanzone v. Phoenix Tech., No. 89-5397, 1990 WL 50732, at *14 n.9 (E.D.Pa. Apr. 19, 1990) (noting that "if established at trial, the purported agreement exchanging plaintiff's services as an employee for defendant corporation's stock constitutes a

'sale' under the terms of the Securities Exchange Act"). At this stage, I cannot find that the stock option plan does not similarly qualify as a purchase of securities.

Defendants also argue that plaintiffs' allegations do not constitute fraud causally related to a securities transaction, but merely state a breach-of-contract action, improperly styled as a § 10(b) claim. See Hunt v. Robinson, 852 F.2d 786, 787 (4th Cir. 1988) (declining to find a causal connection in employer's failure to pay promised stock options and sustaining district court's dismissal of plaintiff's complaint). To prevent plaintiffs from using the Securities Act to transform breach-of-contract claims into federal securities actions, this circuit has construed the "in connection with" requirement as mandating "a causal connection between the alleged fraud and the purchase or sale of stock." Tully v. Mott Supermarkets Inc., 540 F.2d 187, 194 (3d Cir. 1976); accord., Ketchum, 557 F.2d at 1026-30 (finding alleged fraud "occurred, if at all, in connection with a struggle for control of the corporation" not a securities transaction). Here, however, plaintiffs allege more than the breach of contract in Air Product's failure to deliver stock as purportedly promised under the terms of the stock option plan. They also say that in numerous communications, both oral and written, the defendants knowingly concealed the forfeiture provisions in the plan and misrepresented the applicability of the discretionary reinstatement policy. Cf. Hunt, 852 F.2d at 787 (finding alleged

fraud was "not in the actual sale of the stock, but rather in defendants' refusal to tender the shares as required by the terms of the contract."). Thus, the plaintiffs allege fraud directly relating to the terms of the stock option plan and the defendants' intentions to transfer stock to plaintiffs. See Sanzone, supra, 1990 WL 50732, at *5 (citing Fenstermacher v. Philadelphia National Bank, 493 F.2d 333, 340 and n.3) ("For example, proof that a party entered into a contract with limited intention of performing demonstrates both the fraud, rising over and above mere breach of contract, and the failure to disclose an intention contrary to that manifested by that party in dealing with the plaintiff.").

Given the broad construction of the "in connection with" requisite under the 1934 Act, I find plaintiffs have established a sufficient causal connection to satisfy this requirement. See Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971)("Section 10(b) must be read flexibly, not technically and restrictively.").

Accordingly, I find that the plaintiffs' allegations, that the defendants knowingly defrauded them of stock options previously granted in recognition of their services as employees, do state a federal cause of action under § 10(b). I thus conclude that their federal securities claim should not be dismissed.

An order follows.

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O R D E R

AND NOW, this day of October, 1997, Defendants'
Motion to Dismiss is DENIED.

BY THE COURT

Robert S. Gawthrop, III, J.