# KNIGHTS OF COLUMBUS COUNCIL 3152 ET AL., APPELLANTS, V. KFS BD, INC., A NEBRASKA CORPORATION, ET AL., APPELLEES.

791 N.W.2d 317

Filed December 10, 2010. No. S-09-225.

1. **Motions to Dismiss: Pleadings: Appeal and Error.** An appellate court reviews a district court's order granting a motion to dismiss de novo. It accepts all the factual allegations in the complaint as true and draws all reasonable inferences for the nonmoving party.
2. **Motions to Dismiss: Pleadings.** To prevail against a motion to dismiss for failure to state a claim, a plaintiff must allege sufficient facts, accepted as true, to state a claim for relief that is plausible on its face.
3. ____: ____. When a plaintiff does not or cannot allege specific facts showing a necessary element, the factual allegations, taken as true, are nonetheless plausible if they suggest the existence of the element and raise a reasonable expectation that discovery will reveal evidence of the element or claim.
4. **Securities Regulation: Federal Acts: Courts: Jurisdiction.** Federal courts have exclusive jurisdiction over private suits brought for violations under the Securities Exchange Act of 1934. And they also have exclusive jurisdiction over suits in equity or in law to enforce any liability or duty created by the act or the rules and regulations thereunder. But except for specified actions, the rights and remedies provided under the act are in addition to any and all other rights and remedies that may exist at law or in equity.
5. **Actions: Securities Regulation: Federal Acts: Pleadings.** Investors cannot plead around the lack of a private cause of action for violations of federal securities law by captioning their claim as a common-law claim.
6. **Securities Regulation: Federal Acts: Damages.** The broker-dealer record-keeping requirements under the Securities Exchange Act of 1934 do not provide a private damage remedy for violations.
7. **Negligence: Fraud: Proof.** For both negligent and fraudulent misrepresentation, the plaintiff must be a recipient of the misrepresentation to show reliance.
8. **Contracts: Fraud.** A person has a duty to disclose information to another in a transaction when necessary to prevent his or her partial or ambiguous statement from being misleading. But a plaintiff must have received the representation before the plaintiff can show that a defendant had a duty to disclose additional facts.
9. **Fraud.** Mere silence cannot constitute a misrepresentation absent a duty to disclose information.
10. ____. When a party makes a partial or fragmentary statement that is materially misleading because of the party's failure to state additional or qualifying facts, the statement is fraudulent.
11. ____. Fraudulent misrepresentations may consist of half-truths calculated to deceive, and a representation literally true is fraudulent if used to create an impression substantially false.

12. ____. To reveal some information on a subject triggers the duty to reveal all known material facts.
13. **Fraud: Intent.** An ambiguous statement is fraudulent if made with the intent that it be understood in its false sense or with reckless disregard as to how it will be understood.
14. **Fraud: Proof.** To prove fraudulent concealment, a plaintiff must prove these elements: (1) The defendant had a duty to disclose a material fact; (2) the defendant, with knowledge of the material fact, concealed the fact; (3) the material fact was not within the plaintiff's reasonably diligent attention, observation, and judgment; (4) the defendant concealed the fact with the intention that the plaintiff act or refrain from acting in response to the concealment or suppression; (5) the plaintiff, reasonably relying on the fact or facts as the plaintiff believed them to be as the result of the concealment, acted or withheld action; and (6) the plaintiff was damaged by the plaintiff's action or inaction in response to the concealment.

Appeal from the District Court for Otoe County: PAUL W. KORSLUND, Judge. Affirmed in part, and in part reversed and remanded for further proceedings.

J.L. Spray and Randall V. Petersen, of Mattson, Ricketts, Davies, Stewart & Calkins, for appellants.

James M. Bausch and Andre R. Barry, of Cline, Williams, Wright, Johnson & Oldfather, L.L.P., for appellee KFS BD, Inc.

Joseph E. Jones and Timothy J. Thalken, of Fraser Stryker, P.C., L.L.O., for appellee Mutual of Omaha Insurance Company.

Daniel E. Klaus, of Rembolt Ludtke, L.L.P., for appellees Reid D. Houser and Jeffrey N. Sime.

Gail S. Perry and Derek C. Zimmerman, of Baylor, Evnen, Curtiss, Grimit & Witt, L.L.P., for appellees Richard A. Witt and Kenneth R. Cook.

HEAVICAN, C.J., CONNOLLY, GERRARD, MCCORMACK, and MILLER-LERMAN, JJ.

CONNOLLY, J.

The appellants are former customers of Rebecca Engle, a stockbroker formerly employed by Kirkpatrick Pettis, the predecessor of KFS BD, Inc. The appellants sued KFS BD, a

Nebraska corporation and Mutual of Omaha company; Mutual of Omaha Insurance Company; and officers of these two firms (collectively the defendants). The appellants alleged claims of vicarious liability, breach of contract, fraudulent misrepresentation, negligent misrepresentation, and fraudulent concealment. Their theories of recovery hinged on the following allegations: (1) Kirkpatrick Pettis misrepresented to them and to federal regulators why Kirkpatrick Pettis terminated Engle's employment; and (2) the defendants concealed that Engle was discharged because she violated state and federal securities laws.

The district court sustained the defendants' motions to dismiss all of the claims for failure to state a claim upon which relief could be granted. We affirm in part, and in part reverse.

## I. BACKGROUND

### 1. Complaint's Allegations

#### (a) General Allegations

Because Kirkpatrick Pettis filed a securities industry form on December 22, 2000, we assume that all of the appellants' allegations are directed at actions taken by Kirkpatrick Pettis. To avoid confusion, we will refer to Kirkpatrick Pettis' conduct. And in analyzing the court's order sustaining the motion to dismiss, we must accept as true the factual statements and reasonable inferences from the appellants' complaint and attached exhibits.[1]

We glean the following from the appellants' complaint. From January 1998 to November 29, 2000, Engle was employed by Kirkpatrick Pettis, a Mutual of Omaha company and KFS BD's predecessor. KFS BD is a wholly owned subsidiary of Mutual of Omaha.

Engle worked in Kirkpatrick Pettis' Nebraska City and Syracuse, Nebraska, offices with Brian Schuster. Kirkpatrick Pettis received numerous customer complaints against her. In the spring of 2000, Kirkpatrick Pettis experienced a "catastrophic

[1] See, *Doe v. Board of Regents, ante* p. 492, 788 N.W.2d 264 (2010); Neb. Ct. R. Pldg. § 6-1110(c).

failure" of its compliance and supervisory obligations. It led to the eventual collapse of the business. Mutual of Omaha's chairman, chief executive officer, and board of directors took "heightened" control of Kirkpatrick Pettis and the supervision of Engle.

Because Engle was difficult to manage and they no longer wished to support the type of business she was doing, Kirkpatrick Pettis discharged her. Engle then affiliated with First Union Securities, and Schuster elected to follow her. Kirkpatrick Pettis decided to close the Nebraska City and Syracuse offices because of Engle's discharge and Schuster's decision to follow her. November 29, 2000, was Engle's last day of employment and the day that Kirkpatrick Pettis closed its offices in Nebraska City and Syracuse.

Engle—while still employed with Kirkpatrick Pettis and with its knowledge—falsely represented to customers that the offices were being closed because of a reduction in the sales force. On November 28, 2000, the day before Engle's discharge, Kirkpatrick Pettis sent a letter to its customers. It stated that it would be closing its Nebraska City and Syracuse offices on November 29. It informed its customers that they would soon be receiving information from Engle and Schuster announcing their affiliation with First Union Securities. The letter did not state a reason for its closing the offices or the reason for Engle's new affiliation. It included a number to call if the customers wished to maintain their business with Kirkpatrick Pettis.

On November 29, 2000, Engle and Schuster sent a letter to customers announcing their affiliation with First Union Securities. The letter stated that although Kirkpatrick Pettis had chosen to close the Nebraska City and Syracuse offices, Engle and Schuster would be keeping them open as their own business: Engle & Schuster Financial Advisory Group of First Union Securities. The letter had the new business name in the letterhead and stated that Kirkpatrick Pettis had been very helpful in making Engle and Schuster's transfer as smooth as possible.

On December 22, 2000, Kirkpatrick Pettis filed a "Form U-5" with the National Association of Securities Dealers (NASD),

now known as the Financial Industry Regulatory Authority, Inc. (FINRA).[2] The Form U-5 is the "Uniform Termination Notice for Securities Industry Registration." The Form U-5 stated that Kirkpatrick Pettis had discharged Engle and stated the reason as a "reduction in sales force." When Kirkpatrick Pettis filed the Form U-5, the defendants knew that Engle had violated securities law and had pending customer complaints. They also knew that these violations were reportable events that Kirkpatrick Pettis should have disclosed on the form.

(b) Allegations Supporting Separate Claims

*(i) Fraudulent Misrepresentation*

The appellants alleged that in November 2000 and thereafter, Kirkpatrick Pettis knowingly made false statements in its filing with NASD and in letters it sent to the appellants. The false statements were that Engle had left its employment because of a reduction in its workforce and that Engle left its employment because Kirkpatrick Pettis was closing the Nebraska City office. The real reasons were that she was discharged because of customer complaints and her failure to adhere to company, industry, and state standards of conduct. The appellants alleged the defendants intended that the appellants rely on letters sent to them that falsely stated they were closing the Nebraska City office because of a reduction in its sales force. The defendants also intended that the securities regulators rely on these misrepresentations and not commence an investigation. Finally, the defendants intended that the appellants rely on the representations and information made public by regulators.

*(ii) Negligent Misrepresentation*

This claim rested solely upon the appellants' allegations that Kirkpatrick Pettis supplied false information to NASD on the Form U-5. They alleged that the defendants provided this false information with knowledge that it was intended for the guidance of others and that the following groups would rely on it: current and future investors, securities regulators, and future

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[2] See *Siegel v. S.E.C.*, 592 F.3d 147 (D.C. Cir. 2010).

broker-dealers. The defendants had a public duty to give accurate information and failed to exercise due care or competence to do so. And the appellants were within the class of persons intended to benefit from their duty and had reasonably relied on the information.

*(iii) Breach of Contract*

The appellants alleged that the defendants breached the new account agreements that each appellant signed when starting an account. Each new account agreement required the defendants to comply with all federal and state securities laws and all NASD bylaws and rules. The defendants breached the agreements when they failed to follow rules requiring them to file a truthful Form U-5 and to supplement information regarding Engle's discharge. Furthermore, the defendants breached their covenant of good faith and fair dealing with the appellants.

*(iv) Fraudulent Concealment*

The appellants alleged that the defendants owed a duty to their customers to report the true reason for Engle's discharge—her misconduct. Instead, KFS BD "fraudulently concealed the true reason Engle was discharged." Specifically, the appellants alleged that members of Kirkpatrick Pettis' executive committee sent "false and misleading letters" to its customers regarding Engle's discharge and filed the false Form U-5. And they allowed their agents to conceal and misrepresent the true facts. The defendants made these representations with knowledge of the true facts. Because of their concealment, the appellants continued to do business with her.

The appellants alleged that the defendants knew or should have known that because of their conduct, the appellants would be deceived to their detriment through two means. First, as a consequence of their sending letters with false statements to their customers and permitting their agents to conceal and misrepresent facts, the appellants would be unable to ascertain the truth about Engle's conduct. Second, as a consequence of their filing the false Form U-5, NASD and Nebraska's Department of Banking and Finance would not investigate Engle and the appellants would not ascertain the truth about her conduct.

### 2. District Court's Order Sustaining Defendants' Motions to Dismiss

Each defendant moved to dismiss all the appellants' claims for failure to state a cause of action or because the claim was barred by the applicable statute of limitations. The district court sustained the motions against each claim for failure to state a cause of action.

Regarding the fraudulent misrepresentation claim, the court found that neither the letter Kirkpatrick Pettis sent to customers nor the letter Engle and Schuster sent to customers included a false assertion. The court stated that neither letter gave a reason for Kirkpatrick Pettis' closing of the offices. The court also dismissed the appellants' fraudulent concealment claims. It found that the appellants could not show that the defendants concealed a material fact with the intent that the appellants act in response to the concealment. It reasoned that Kirkpatrick Pettis' letter invited the appellants to maintain their relationship with it, instead of pushing them to follow Engle. The court also concluded that the appellants' fraudulent concealment claim failed because they had not alleged having access to or seeing the Form U-5.

Regarding the negligent misrepresentation claim, the court concluded that the appellants failed to identify any justifiable reliance. It concluded that the appellants had to show that they acted or refrained from acting because of a false representation. And it determined that the claim failed because they failed to allege that they took any action based on the information in the Form U-5.

Finally, the court concluded that the appellants' breach of contract claim failed for two reasons. First, federal courts have held NASD rules and securities exchange rules do not confer a private cause of action for violations. And the appellants had attempted to circumvent these holdings by couching the violation of NASD rules as a breach of contract claim. Second, the appellants had failed to recite or attach the relevant portion of the agreements. Thus, it was impossible to determine whether the new account agreements had merely incorporated securities rules or conferred additional rights and obligations.

## II. ASSIGNMENTS OF ERROR

The appellants assign that the district court erred in dismissing, with prejudice, their claims of breach of contract, negligent misrepresentation, fraudulent misrepresentation, and fraudulent concealment.

## III. STANDARD OF REVIEW

[1-3] An appellate court reviews a district court's order granting a motion to dismiss de novo. It accepts all the factual allegations in the complaint as true and draws all reasonable inferences for the nonmoving party.[3] To prevail against a motion to dismiss for failure to state a claim, a plaintiff must allege sufficient facts, accepted as true, to state a claim for relief that is plausible on its face.[4] When a plaintiff does not or cannot allege specific facts showing a necessary element, the factual allegations, taken as true, are nonetheless plausible if they suggest the existence of the element and raise a reasonable expectation that discovery will reveal evidence of the element or claim.[5]

## IV. ANALYSIS

### 1. Breach of Contract

The district court dismissed the appellants' breach of contract claim. It relied on cases that held NASD rules and securities exchange rules do not confer a private cause of action for violations. It concluded that the appellants had attempted to circumvent these holdings by couching a violation of NASD rules as a breach of contract claim. The court also concluded that it was impossible for it to determine whether the new account agreements had merely incorporated securities rules or expressly conferred rights and obligations. It stated that the appellants had failed to recite or attach the relevant portion of the agreements.

The appellants contend that it was sufficient to allege that the defendants (1) agreed in the new customer agreements to

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[3] See *Doe, supra* note 1.

[4] See *id.*

[5] See *id.*

comply with all federal and state laws and NASD bylaws and rules and (2) breached these contracts when they failed to comply with these laws.

"NASD is a non-profit, self-regulatory organization registered with the Securities and Exchange Commission as a national securities association."[6] NASD, now FINRA, "is the primary regulatory body for the broker-dealer industry,"[7] subject to control of the Securities and Exchange Commission (SEC).[8] Congress has delegated to it authority "to promulgate and enforce rules governing the conduct of its members," also subject to SEC's approval and changes.[9]

[4] Federal courts have exclusive jurisdiction over private suits brought for violations under the Securities Exchange Act of 1934 (Securities Exchange Act).[10] And they also have exclusive jurisdiction over suits in equity or in law to enforce any liability or duty created by the act or "the rules and regulations thereunder."[11] But except for specified actions not involved here,[12] the rights and remedies provided under the Securities Exchange Act are in addition to "any and all other rights and remedies that may exist at law or in equity."[13]

In its order, the court cited federal cases in which the court held that plaintiffs cannot seek redress for a defendant's violation of NASD rules or securities exchange rules.[14] In those

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[6] *MM&S Financial v. National Ass'n of Securities*, 364 F.3d 908, 909 (8th Cir. 2004).

[7] *Sparta Surgical v. Nat. Ass'n of Sec. Dealers*, 159 F.3d 1209, 1210 (9th Cir. 1998).

[8] See, *id.*; *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49 (2d Cir. 1996).

[9] *Barbara, supra* note 8, 99 F.3d at 51. See, also, *Sparta Surgical, supra* note 7.

[10] 15 U.S.C. § 78a et seq. (2006).

[11] See 15 U.S.C. § 78aa.

[12] See 15 U.S.C. § 78bb(f).

[13] 15 U.S.C. § 78bb(a).

[14] See, *Jablon v. Dean Witter & Co.*, 614 F.2d 677 (9th Cir. 1980); *Baden v. Craig-Hallum, Inc.*, 646 F. Supp. 483 (D. Minn. 1986).

cases, however, the investors sought recovery for the broker-dealers' violations of such rules. Common-law securities suits can be independent of duties or liabilities created by federal statutes or rules.[15]

For example, in *Zannini v. Ameritrade Holding Corp.*,[16] we held that a subscriber's class action negligence claim against an online brokerage service was not preempted by a federal statute. That statute authorized the SEC to establish the standards for a broker-dealer's operational capacity. Relying on federal cases, we concluded that absent preemptive federal regulations, courts generally permitted investors' state law claims if they involved the relationship between investors and their brokers; the bargains struck between investors and their brokers; and efficacy of the broker's trading system, especially as compared to its representations about the system.[17]

[5] But investors cannot plead around the lack of a private cause of action for violations of federal securities law by captioning their claim as a common-law claim. For example, federal courts do not permit a common-law breach of contract claim against NASD or a securities exchange for violating or failing to enforce its own rules. These courts have precluded these claims because the statute requiring compliance with securities statutes and rules does not grant a private right of action.[18] Similarly, the Seventh Circuit rejected a common-law claim for breach of fiduciary duty based on the violation of an exchange rule when the governing statute did not provide a private cause of action.[19]

[6] The U.S. Supreme Court has held that the broker-dealer recordkeeping requirements under the Securities Exchange Act

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[15] See *Barbara, supra* note 8.

[16] *Zannini v. Ameritrade Holding Corp.*, 266 Neb. 492, 667 N.W.2d 222 (2003).

[17] *Id.*

[18] See, e.g., *MM&S Financial, supra* note 6; *Sparta Surgical, supra* note 7.

[19] See *Indemnified Capital Inv. v. R.J. O'Brien & Assoc.*, 12 F.3d 1406 (7th Cir. 1993). See, also, *In re Series 7 Broker Qualification Exam Scoring*, 548 F.3d 110 (D.C. Cir. 2008).

do not provide a private damage remedy for violations.[20] And many federal courts have accordingly held no private right of action exists for violations of rules promulgated by a securities exchange or self-regulatory organization.[21] On point here, the Second Circuit has specifically held that a contract's implied incorporation of rules and regulations that govern a broker-dealer's dealings with an investor will not support a private cause of action when the rules and regulations themselves provide no private cause of action.[22]

We agree with these authorities. Permitting the appellants to proceed with a breach of contract claim for the defendants' alleged violation of federal recordkeeping duties would be inconsistent with Congress' intent to (1) give federal courts exclusive jurisdiction over such violations and (2) preclude private remedies for violations of recordkeeping requirements. We conclude that the district court did not err in dismissing the appellants' breach of contract claim.

### 2. The Appellants Must Show That They Received a Representation Under Any of Their Deceit Claims

The appellants argue that for their misrepresentation and concealment claims, we should recognize their theory of reliance on the integrity of the financial industry's regulatory system. They argue that the defendants had a public duty to provide this information and that they wrongfully manipulated the system by supplying inaccurate or false information or by concealing the truth about Engle's discharge in the Form U-5. They do not claim that they received or learned of the statements in the Form U-5. But they contend that the court erred in requiring them to show direct reliance on the Form U-5 statements, because they relied on the consequences of the

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[20] See *Touche Ross v. Redington*, 442 U.S. 560, 99 S. Ct. 2479, 61 L. Ed. 2d 82 (1979).

[21] See 5 Thomas Lee Hazen, The Law of Securities Regulation § 14.26[2] (6th ed. 2009).

[22] *Gurfein v. Ameritrade, Inc.*, 312 Fed. Appx. 410 (2d Cir. 2009). See, also, *Appert v. Morgan Stanley Dean Witter, Inc.*, No. 08-CV-7130, 2009 WL 3764120 (N.D. Ill. Nov. 6, 2009).

false filing: the lack of regulatory action against Engle and her employment by a reputable firm after she left Kirkpatrick Pettis. Thus, it was reasonable for them to conclude that she was a reputable broker in whom they could trust.

The appellants argue that *Bank of Valley v. Mattson*[23] supports their theory of reliance because it illustrates that a plaintiff can rely on an indirect misrepresentation even if the defendant did not intend this result. Instead, they argue that the defendants had reason to expect that the appellants would rely on their misrepresentation. We disagree with the appellants that *Bank of Valley* applies here.

In *Bank of Valley*, we recognized an exception to the requirement that a plaintiff show the maker of a misrepresentation intended the plaintiff to rely on his or her misrepresentation. We held that a claim of fraudulent misrepresentation did not fail because the person relying on the misrepresentation learned of it through a third party. In that case, the appellant was told the false facts by a third party who repeated what the maker of the misrepresentation had stated to the third party. The appellant then made a loan to the maker in reliance on the false facts. In concluding that the appellant could rely on the information relayed to him by the third party, we quoted applicable provisions of the Restatement (Second) of Torts. First, we stated that § 531 provides:

> "One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced."[24]

We agree that this section extends liability to plaintiffs that the defendant had "reason to expect" would rely on the false representation. We note, however, that this class of plaintiffs does not include every plaintiff that a reasonable person should

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[23] *Bank of Valley v. Mattson*, 215 Neb. 596, 339 N.W.2d 923 (1983).

[24] *Id.* at 601, 339 N.W.2d at 927, quoting Restatement (Second) of Torts § 531 (1977).

have recognized as being a possible recipient of a false representation.[25] In *Bank of Valley*, we also relied on § 533 of the Restatement, which imposes liability for indirect misrepresentations through a third party. The comments to § 533 clarify that the maker of a misrepresentation must intend that it be repeated to others to influence them or must have information that gives the maker "special reason to expect that [the misrepresentation] will be communicated to others, and will influence their conduct."[26]

In sum, a plaintiff can rely on the third-party communication of a defendant's fraudulent misrepresentation if the plaintiff shows that the defendant intended the plaintiff to learn of and rely on it in the transaction or type of transaction involved, or had a particular reason to believe that the plaintiff would do so.[27] But in *Bank of Valley*, we specifically analyzed whether the hearer had justifiably relied on the misrepresentation. So while the third-party communication exception provides a limited exception to the intent element, *Bank of Valley* did not hold that a plaintiff need not show actual reliance on a misrepresentation.

Moreover, we have required plaintiffs to show that they received a misrepresentation. In *Brummels v. Tomasek*,[28] we held that the plaintiff's fraudulent misrepresentation claim failed because the plaintiff did not allege that the misrepresentation was made to him or her. But the plaintiff never received the misrepresentation. So in the context of the facts in that case, we clearly meant that the plaintiff failed to allege that he received the representation.

The principle that a plaintiff must have received the information before the plaintiff can show reliance is reflected in the Restatement's § 533. That section limits liability for misrepresentations made through a third party to those that "the maker

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[25] See Restatement, *supra* note 24, comment *d*.

[26] See *id.*, § 533, comment *d*. at 73.

[27] See, *Bank of Valley, supra* note 23; Restatement, *supra* note 24, § 531.

[28] *Brummels v. Tomasek*, 273 Neb. 573, 731 N.W.2d 585 (2007), citing *Foiles v. Midwest Street Rod Assn. of Omaha*, 254 Neb. 552, 578 N.W.2d 418 (1998).

intends or has reason to expect its terms will be repeated or its substance *communicated* to the other, and that it will influence his conduct in the transaction or type of transaction involved."[29] Similarly, the Restatement permits the "recipient" of a fraudulent misrepresentation to recover against its maker if the recipient justifiably relied on it.[30] These provisions illustrate that plaintiffs cannot show reliance on a misrepresentation that never reached them and of which they had no knowledge.[31]

[7] Similarly, for negligent misrepresentation claims, we have stated that "[b]y its terms, § 552 contemplates liability to third parties only if the supplier intends for the misinformation to ultimately reach the third party or if the supplier knows that the recipient will pass the misinformation on to the third party."[32] We specifically declined to extend the defendant's liability to third parties who were not recipients of the defendant's negligent misrepresentation. So for both negligent and fraudulent misrepresentation, the plaintiff must be a recipient of the misrepresentation to show reliance.

[8] Also, whether the appellants received the alleged misrepresentations is relevant to their concealment claim. A person has a duty to disclose information to another in a transaction when necessary to prevent his or her partial or ambiguous statement from being misleading.[33] But a plaintiff must have received the representation before the plaintiff can show that a defendant had a duty to disclose additional facts.[34] So this type of concealment claim also depends upon whether the appellants received the defendants' partial or ambiguous representations.

But the appellants counter that reliance can be shown by their reliance on the integrity of the financial industry's regulatory

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[29] Restatement, *supra* note 24, § 533 at 73 (emphasis supplied).

[30] See *id.*, § 537 at 80.

[31] *Slakey Brothers Sacramento, Inc. v. Parker*, 265 Cal. App. 2d 204, 71 Cal. Rptr. 269 (1968).

[32] *Brummels, supra* note 28, 273 Neb. at 580, 731 N.W.2d at 592.

[33] See *Streeks v. Diamond Hill Farms*, 258 Neb. 581, 605 N.W.2d 110 (2000), citing Restatement, *supra* note 24, § 551(2).

[34] Restatement, *supra* note 24, § 551(2)(b), comment *g*.

system. They analogize to the fraud-on-the-market doctrine, which the U.S. Supreme Court recognized in a decision under rule 10b-5[35] of the SEC's regulations.[36]

When involving the purchase or sale of a security, rule 10b-5 prohibits making any untrue statement of a material fact or omitting any material fact necessary to prevent a statement from being misleading.[37] The rule is authorized by a provision of the Securities Exchange Act. That statute prohibits manipulative or deceptive practices in buying or selling securities registered on a national securities exchange.[38] The U.S. Supreme Court has held there is a narrow exception to the reliance requirement for actions brought under rule 10b-5. For these claims, the Court recognized a rebuttable presumption of reliance on a material misrepresentation reflected in the market price of a traded security that has been fraudulently distorted.[39] But the presumption is limited to situations in which investors trade securities relying on the integrity of a well-established securities market. The appellants ask us to apply this presumption here. We decline to do so.

Here, the rationale does not exist for applying the fraud-on-the-market doctrine. The reliance presumption is based on efficient market theory. That is, in an open securities market, "'the price of a company's stock is determined by the available material information,'"[40] and affected by misrepresentations or the withholding of material information.[41] Moreover, the presumption depends upon the existence of a public statement that reflects the alleged misrepresentations.[42] Here, the appellants

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[35] See 17 C.F.R. § 240.10b-5 (2010).

[36] See *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988).

[37] See 17 C.F.R. § 240.10b-5(b).

[38] See 15 U.S.C. § 78j(b).

[39] See *Basic Inc., supra* note 36.

[40] *Id.*, 485 U.S. at 241.

[41] See *Basic Inc., supra* note 36.

[42] See *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627 (2008).

did not allege, or show through exhibits, that any information in the Form U-5 was publicly disclosed by NASD. Even if we assumed that the report were publicly available, it would not be a public statement of collective information that was influenced by market forces. Instead, the appellants are relying on the absence of regulatory action taken because of the filing; failure to regulate is not an appropriate application for the reliance presumption.

The fraud-on-the-market doctrine has generally been limited to securities fraud claims brought under rule 10b-5. Rule 10b-5 limits claims to those involving the buying and selling of securities, for which an efficient market theory makes sense. Further, Congress designed the Securities Exchange Act to protect investors against the manipulation of stock prices, where investors must rely on market integrity in securities markets because millions of shares are traded daily.[43]

As noted, in contrast to transactions involving the buying or selling of securities, the U.S. Supreme Court has held that the broker-dealer recordkeeping requirements under the Securities Exchange Act do not provide a private damage remedy for violations.[44] Neither the Form U-5 filing nor the letters to customers were transactions involving the trading of securities. We conclude that the reliance presumption is not appropriate in this context. Thus, we reject the appellants' argument that they can premise their misrepresentation or concealment claims through their alleged reliance on the absence of regulatory action against Engle or her subsequent employment by another broker-dealer.

### 3. Negligent Misrepresentation

As noted, the appellants' negligent misrepresentation claim rested solely upon their allegations that Kirkpatrick Pettis supplied false information to NASD on the Form U-5. The appellants contend that the court erred in dismissing this claim because they could not show that they had relied on statements in the Form U-5.

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[43] See *Basic Inc., supra* note 36.

[44] See, *Touche Ross, supra note* 20; 5 Hazen, *supra* note 21.

As explained, the appellants must show they were recipients of the defendant's negligent misrepresentation.[45] But the appellants counter that under the Restatement (Second) of Torts § 552(3), the defendants had a public duty to provide information to NASD disclosing the circumstances of Engle's discharge. They contend that as investors, they were within the class of persons for whom this duty existed. We do not reach the public duty issue, because we have already determined that they cannot show reliance on the Form U-5 when they did not receive statements made in the filing.

We have adopted the Restatement's § 552 for claims of negligent misrepresentation.[46] That section provides:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
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> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
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> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
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> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
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> (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.[47]

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[45] See *Brummels, supra* note 28.

[46] See *Gibb v. Citicorp Mortgage, Inc.*, 246 Neb. 355, 518 N.W.2d 910 (1994).

[47] Restatement, *supra* note 24, § 552 at 126-27.

As the North Carolina Court of Appeals explained, the elements of a negligent misrepresentation claim are set out under subsection (1) of the Restatement's § 552.[48] Subsections (2) and (3) only define the class of plaintiffs who can recover.[49] Subsection (3) extends liability to a larger class of persons than the class defined under subsection (2). But more important to our analysis, it does not eliminate the requirement that the extended class of beneficiaries must have received and relied upon the misinformation.

Further, comment *a.* of § 552 applies to the entire section and states that liability extends to the "users" of commercial information "in which the maker was manifestly aware of the use to which the information was to be put and intended to supply it for that purpose."[50] And the illustrations in the comments to subsection (3) also show that a plaintiff must have relied on the representation.[51] So the appellants' reliance on subsection (3) of the Restatement's § 552 does not change our holding that in negligent misrepresentation claims: The plaintiff must receive and rely on the commercial misinformation supplied by the defendant.[52]

The appellants did not allege that they received or were aware of the statements in the Form U-5. We conclude that the court did not err in dismissing their negligent misrepresentation claim for failure to allege reliance.

### 4. Fraudulent Misrepresentation Claim

The appellants contend that by filing the Form U-5 and sending letters to the appellants, the defendants "attempted to 'assuage' and 'alleviate' any concerns [the appellants] may have had regarding Engle's competency."[53] We have already

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[48] See *Brinkman v. Barrett Kays & Associates, P.A.*, 155 N.C. App. 738, 575 S.E.2d 40 (2003).

[49] See *id.*

[50] Restatement, *supra* note 24, § 552, comment *a.* at 128.

[51] See *id.*, comment *k*.

[52] See, *Hollywood Trucking, Inc. v. Watters*, 385 Ill. App. 3d 237, 895 N.E.2d 3, 324 Ill. Dec. 3 (2008); *Brinkman, supra* note 48; *Taylor v. Stevens County*, 47 Wash. App. 134, 732 P.2d 517 (1987).

[53] Brief for appellants at 24.

rejected their argument that they could show reliance on the Form U-5 through the absence of regulatory activity against Engle and her employment with a different broker-dealer. Because they did not allege that they received or were aware of statements in the Form U-5, the court also did not err in dismissing their fraudulent misrepresentation claim to the extent that it was based on the Form U-5 statements. We next address their argument that the court erred in dismissing their claim to the extent it was based on letters to customers from Kirkpatrick Pettis and from Engle and Schuster.

The court determined that the letters to customers from Kirkpatrick Pettis and Engle and Schuster did not contain a fraudulent misrepresentation, because neither letter specified a reason for closing the Nebraska City and Syracuse offices. But the court failed to consider whether the letters were intended to create a false impression, even if literally true.

To state a claim for fraudulent misrepresentation, a plaintiff must allege (1) that a representation was made; (2) that the representation was false; (3) that when made, the representation was known to be false or made recklessly without knowledge of its truth and as a positive assertion; (4) that the representation was made with the intention that the plaintiff should rely on it; (5) that the plaintiff did so rely on it; and (6) that the plaintiff suffered damage as a result.[54]

[9-13] It is true that mere silence cannot constitute a misrepresentation absent a duty to disclose information.[55] But we need not consider whether Kirkpatrick Pettis owed fiduciary duties to the appellants. When a party makes a partial or fragmentary statement that is materially misleading because of the party's failure to state additional or qualifying facts, the statement is fraudulent.[56] "Fraudulent misrepresentations may consist of half-truths calculated to deceive, and a representation literally

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[54] *Brummels, supra* note 28.

[55] See *Moyer v. Richardson Drug Co.*, 70 Neb. 190, 97 N.W. 244 (1903).

[56] See, *State ex rel. NSBA v. Douglas*, 227 Neb. 1, 416 N.W.2d 515 (1987); *Johnson v. Richards*, 155 Neb. 552, 52 N.W.2d 737 (1952); Restatement, *supra* note 24, § 529. See, also, *State v. Douglas*, 217 Neb. 199, 349 N.W.2d 870 (1984).

true is fraudulent if used to create an impression substantially false."[57] "'To reveal some information on a subject triggers the duty to reveal all known material facts.'"[58] Consistent with imposing liability for half-truths, the Restatement (Second) of Torts § 527 provides that an ambiguous statement is fraudulent if made with the intent that it be understood in its false sense or with reckless disregard as to how it will be understood.

It is true that Kirkpatrick Pettis' letter did not give an explanation for its closing of the Nebraska City and Syracuse offices. But in the next sentence, it stated that its customers would shortly be receiving information from Engle and Schuster announcing their new affiliation with First Union Securities. The letter did not disclose to customers, as the appellants' allegations and exhibits suggest, that Kirkpatrick Pettis was closing the offices because (1) it had discharged Engle for misconduct and (2) Schuster had elected to follow her.

We conclude that the court erred in dismissing the appellants' fraudulent misrepresentation claim without considering whether statements in the letters from Kirkpatrick Pettis and Engle and Schuster, while literally true, were sufficient to create a false impression. But in our de novo review, we conclude that the appellants plausibly claimed that Kirkpatrick Pettis sent or authorized letters fraudulently implying that Engle and Schuster were leaving Kirkpatrick Pettis' employment because Kirkpatrick Pettis was closing its Nebraska City and Syracuse offices for reasons unrelated to Engle's conduct. Whether the appellants can ultimately prove that the impression was false is not the issue in considering a motion to dismiss. Accepting all the factual allegations in the complaint as true and drawing all reasonable inferences in favor of the appellants, the complaint is sufficient to survive a motion to dismiss.

### 5. Fraudulent Concealment

The appellants alleged that Kirkpatrick Pettis fraudulently concealed the true reason for Engle's discharge in its Form U-5

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[57] See *Johnson, supra* note 56, 155 Neb. at 563, 52 N.W.2d at 744.

[58] *State ex rel. NSBA, supra* note 56, 227 Neb. at 26, 416 N.W.2d at 531.

filing and in the letters that they sent to customers. Their claim regarding the Form U-5 is twofold. First, they alleged that Kirkpatrick Pettis' failure to report the true reason for Engle's discharge was "a material fact to the NASD, SEC, [the appellants,] and the State of Nebraska, in their decision to allow her to do business with the [appellants]." Second, they alleged that the concealment was material to the appellants' decision to continue to do business with her.

To the extent that the appellants' concealment claim relied on the Form U-5 and securities regulators' response, permitting the claim would be inconsistent with federal securities law. As discussed, Congress excluded a private remedy for a violation of filing requirements under the Securities Exchange Act.[59] We do not consider whether the appellants could base their concealment claim upon an omission within the Form U-5 under other circumstances. As explained above, this part of the claim fails because they did not allege that they received any statements in the filing. But their allegation that the letters to them from Kirkpatrick Pettis and Engle constituted a fraudulent concealment was unrelated to any duty to file reports with securities regulators. Because it does not rely upon the violation of duties for which a remedy does not exist, it is not precluded.

We note that an overlap exists between fraudulent concealment claims and misrepresentation claims based on half-truths or ambiguities. That is, if a defendant's partial or ambiguous representation is materially misleading, then the defendant has a duty to disclose known facts that are necessary to prevent the representation from being misleading.[60]

As noted, on November 28, 2000, Kirkpatrick Pettis sent a letter to its customers stating that it would be closing its Nebraska City and Syracuse offices on November 29. It did not give any reason for the closings or for Engle's new affiliation. But it informed its customers that they would soon be receiving information from Engle and Schuster announcing

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[59] See, *Touche Ross, supra* note 20; 5 Hazen, *supra* note 21.

[60] See, *Streeks, supra* note 33; Restatement, *supra* note 24, § 551(2)(b).

their affiliation with First Union Securities. It included a number to call if the customers wished to maintain their business with Kirkpatrick Pettis or had any questions regarding their account.

The district court found that Kirkpatrick Pettis' letter invited the appellants to maintain their business with it, instead of pushing them to follow Engle. So the court determined that the claim failed because the defendants did not conceal any material fact with the intent that the appellants act in response to the concealment. But the court failed to consider whether the defendants concealed the information with the intent that the appellants refrain from acting.

In *Streeks v. Diamond Hill Farms*,[61] we quoted and relied on the Restatement's § 551[62] to address the appellant's argument that he had no duty to disclose information in a fraudulent concealment case. Subsection (1), which sets out the elements of the claim, provides:

> (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act *or refrain from acting* in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.[63]

The Restatement rule obviously includes a defendant's intent to induce another person to refrain from acting. But in *Streeks*, we also quoted an earlier case as properly setting out the elements of fraudulent concealment. Unfortunately, those elements did not include a defendant's intent to induce another person to refrain from taking action:

> "to prove fraudulent concealment, a plaintiff must show that (1) the defendant had a duty to disclose a material fact; (2) the defendant, with knowledge of the material fact, concealed the fact; (3) the material fact was not

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[61] *Streeks, supra* note 33.

[62] See Restatement, *supra* note 24, § 551.

[63] *Id.* at 119 (emphasis supplied).

> within the plaintiff's reasonably diligent attention, observation, and judgment; (4) the defendant concealed the fact with the intention that the plaintiff *act in response to the concealment or suppression*; (5) the plaintiff, reasonably relying on the fact or facts as the plaintiff believed them to be as the result of the concealment, acted or withheld action; and (6) the plaintiff was damaged by the plaintiff's action or inaction in response to the concealment."[64]

We have been imprecise in setting out the intent element for fraudulent concealment cases. And the intent element cannot be read consistently with the reliance and damage elements. Those elements require a plaintiff to show that he or she acted *or refrained from acting* in response to a concealment and sustained damages as a result. In contrast, a defendant's intent to induce the plaintiff to act in response to a concealment cannot include the plaintiff's *choosing* not to act. Instead, when a plaintiff's inaction in response to a concealment causes damages, it is because the concealment of material information induced the plaintiff's *false belief* that action was not needed.[65] The concealment deprives the plaintiff of making an intelligent choice to act or refrain from acting.

By comparison, in fraudulent misrepresentation cases, we have stated that a plaintiff must show that the defendant intended the plaintiff *to rely* on a false representation.[66] That requirement is broad enough to include a plaintiff's action or inaction in reliance upon a defendant's misrepresentation, which is consistent with Restatement principles.[67] And many courts either apply the same elements for all fraud and deceit claims, i.e., fraudulent misrepresentations or concealments, or have specifically stated in fraudulent concealment cases that

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[64] *Streeks, supra* note 33, 258 Neb. at 589, 605 N.W.2d at 118 (emphasis supplied).

[65] See, e.g., *Security Inv. Co. v. State*, 231 Neb. 536, 437 N.W.2d 439 (1989). Compare *Mogensen v. Mogensen*, 273 Neb. 208, 729 N.W.2d 44 (2007).

[66] See *Brummels, supra* note 28.

[67] Compare Restatement, *supra* note 24, § 531.

the defendant must have intended to induce the plaintiff to either act or refrain from action.[68]

[14] Because of our inconsistency, the district court failed to consider whether the defendants intended the appellants to refrain from acting. To avoid further mistakes, we hold that to prove fraudulent concealment, a plaintiff must prove these elements: (1) The defendant had a duty to disclose a material fact; (2) the defendant, with knowledge of the material fact, concealed the fact; (3) the material fact was not within the plaintiff's reasonably diligent attention, observation, and judgment; (4) the defendant concealed the fact with the intention that the plaintiff act *or refrain from acting* in response to the concealment or suppression; (5) the plaintiff, reasonably relying on the fact or facts as the plaintiff believed them to be as the result of the concealment, acted or withheld action; and (6) the plaintiff was damaged by the plaintiff's action or inaction in response to the concealment.

Unsurprisingly, the intent element that we first set out in *In re Estate of Stephenson*[69] has been repeated in other published opinions besides *Streeks*. To ensure that the incorrect intent element does not resurface, we overrule the following opinions only to the extent that they can be read as precluding a plaintiff from showing that a defendant fraudulently concealed a material fact with the intent that the plaintiff refrain from acting in response: *Brummels v. Tomasek*[70]; *Streeks v. Diamond Hill Farms*[71]; *In re Estate of Stephenson*[72]; *Ord v. AmFirst*

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[68] See, e.g., *Stephenson v. Capano Development, Inc.*, 462 A.2d 1069 (Del. 1983); *ASC Const. Equip. v. City Commercial Estate*, 303 Ga. App. 309, 693 S.E.2d 559 (2010); *Gouge v. McNamara*, 586 N.W.2d 710 (Iowa App. 1998); *Francis v. Stinson*, 760 A.2d 209 (Me. 2000); *7979 Airport Garage v. Dollar Rent A Car*, 245 S.W.3d 488 (Tex. App. 2007).

[69] *In re Estate of Stephenson*, 243 Neb. 890, 503 N.W.2d 540 (1993).

[70] *Brummels, supra* note 28.

[71] *Streeks, supra* note 33.

[72] *In re Estate of Stephenson, supra* note 69.

*Invest. Servs.*[73]; *Kramer v. Eagle Eye Home Inspections*[74]; and *Precision Enters. v. Duffack Enters*.[75]

Having clarified the elements of a fraudulent concealment claim, we turn to the sufficiency of the appellants' complaint on the intent element. As the trial court realized, Kirkpatrick Pettis' letter failed to explain to its customers the reason for Engle's discharge. Additionally, the letter also failed to disclose to customers that it had discharged Engle and was closing the offices because of that action, as suggested by the complaint. Because the letter failed to state any reason, the appellants could have reasonably believed that the offices were being closed for an innocuous reason that did not concern them and that Engle and Schuster were leaving Kirkpatrick Pettis because of the closings.

Further, Kirkpatrick Pettis stated in its letter that customers would shortly be receiving information from Engle and Schuster about their new affiliation. And a letter from Kirkpatrick Pettis' general counsel to Engle's attorney suggests that Kirkpatrick Pettis knew Engle would likely represent her discharge as a voluntary termination. In fact, Engle and Schuster—on Engle's last day of employment with Kirkpatrick Pettis—sent a letter to their customers the day after Kirkpatrick Pettis sent its letter. In that letter, Engle and Schuster stated that customers would be receiving paperwork in a couple of days to transfer their accounts to First Union Securities. They also stated that Kirkpatrick Pettis was "being very helpful in making this transfer as smooth as possible."

The letters in the attached exhibits, coupled with the complaint's allegations that Kirkpatrick Pettis approved them, are sufficient to support a claim that Kirkpatrick Pettis knew some of its customers were about to transfer their accounts to

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[73] *Ord v. AmFirst Invest. Servs.*, 14 Neb. App. 97, 704 N.W.2d 796 (2005).

[74] *Kramer v. Eagle Eye Home Inspections*, 14 Neb. App. 691, 716 N.W.2d 749 (2006), *abrogated on other grounds, Tracy Broadcasting Corp. v. Telemetrix, Inc.*, 17 Neb. App. 112, 756 N.W.2d 742 (2008).

[75] *Precision Enters. v. Duffack Enters.*, 14 Neb. App. 512, 710 N.W.2d 348 (2006).

Engle and Schuster's new firm absent any disclosure regarding Engle's discharge.

Although the court concluded that Kirkpatrick Pettis' letters were intended to persuade customers to keep their accounts with Kirkpatrick Pettis after it closed its Nebraska City and Syracuse offices, that intent did not preclude any other purpose. The appellants specifically alleged that because of the defendants' approval of these letters and their agents' concealments, they were unable to ascertain the truth about Engle's conduct. So another plausible purpose for concealing information about Engle's discharge was to ensure that the appellants did not question investment activity in their accounts or Kirkpatrick Pettis' ability to supervise its agents.

Accepting all the factual allegations in the complaint as true and drawing all reasonable inferences in favor of the appellants, we conclude that the appellants' complaint was sufficient to survive a motion to dismiss. The appellants' complaint and exhibits allege that (1) by failing to disclose Engle's discharge or the reason for her discharge and (2) by allegedly permitting Engle and Schuster to solicit customers with Kirkpatrick Pettis' apparent cooperation, the defendants intended that the appellants not question Engle's misconduct. We therefore reverse the district court's order dismissing this claim only as it relates to Engle's and Kirkpatrick Pettis' letters to customers.

The district court dismissed the appellants' complaint solely upon their failure to allege sufficient facts regarding the defendants' intent in these letters. The remaining elements raise factual issues which are not properly before us. Also, because the court concluded that the appellants had failed to state a claim, it did not reach their other theories of liability, and we similarly do not reach those issues.

## V. SUMMARY

In conclusion, we hold the following:

• We affirm the court's dismissal of the breach of contract claim, because the rules the defendants allegedly violated do not provide a private remedy and federal courts have exclusive jurisdiction over private suits brought for the alleged violations.

• We affirm the court's dismissal of the appellants' negligent misrepresentation claim. This claim, which was based solely on statements in a securities regulations filing, fails because the appellants did not allege that they received the statements.

• We reverse the court's dismissal of the appellants' fraudulent misrepresentation claim to the extent that it is based on statements made in letters Kirkpatrick Pettis sent or authorized Engle to send to its customers. The appellants plausibly claimed that the letters created a false impression about Engle's leaving her employment with Kirkpatrick Pettis.

• We reverse the court's dismissal of the appellants' fraudulent concealment claim that was also based on these letters. The appellants plausibly claimed that they would not have transferred their business to Engle's new broker-dealer if material facts regarding her discharge had been disclosed.

AFFIRMED IN PART, AND IN PART REVERSED AND REMANDED FOR FURTHER PROCEEDINGS.

WRIGHT and STEPHAN, JJ., not participating.

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ALLEN ROOS AND DEAN ROOS, COTRUSTEES OF THE LESLIE D. ROOS AND RUBY S. ROOS TRUST, ET AL., APPELLANTS, V. KFS BD, INC., A NEBRASKA CORPORATION, AND MUTUAL OF OMAHA INSURANCE COMPANY, A NEBRASKA CORPORATION, APPELLEES.

799 N.W.2d 43

Filed December 10, 2010. No. S-09-477.

1. **Motions to Dismiss: Pleadings: Appeal and Error.** An appellate court reviews a district court's order granting a motion to dismiss de novo. It accepts all the factual allegations in the complaint as true and draws all reasonable inferences for the nonmoving party.
2. **Motions to Dismiss: Pleadings.** To prevail against a motion to dismiss for failure to state a claim, a plaintiff must allege sufficient facts, accepted as true, to state a claim for relief that is plausible on its face.
3. ____: ____. When a plaintiff does not or cannot allege specific facts showing a necessary element, the factual allegations, taken as true, are nonetheless plausible if they suggest the existence of the element and raise a reasonable expectation that discovery will reveal evidence of the element or claim.