No. 13-13081-CC

IN THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

QUENTIN WALTER and WELDON J. STOUT,

Plaintiffs-Appellants,

v.

FRANK J. AVELLINO and NANCY CARROLL AVELLINO,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of Florida, Fort Pierce Division
Case No. 2:12-cv-14411, Hon. Donald L. Graham

APPELLANTS' BRIEF

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CERTIFICATE OF INTERESTED PERSONS AND CORPORATE DISCLOSURE STATEMENT

Pursuant to Eleventh Circuit Rules 26.1-1 and 26.1-3, the following is an alphabetical list of the trial judges, attorneys, persons, and firms with any known interest in the outcome of this case.

1. Avellino, Frank J. – Defendant-Appellee;
2. Avellino, Nancy Carroll – Defendant-Appellee;
3. Burns, P.A. – Counsel for Plaintiffs-Appellants Quentin Walter and Weldon Stout;
4. Burns, Thomas A. – Counsel for Plaintiffs-Appellants Quentin Walter and Weldon Stout;
5. Graham, Hon. Donald L. – Senior United States District Judge;
6. Haile, Shaw & Pfaffenberger, P.A. – Counsel for Defendants-Appellees Frank J. Avellino and Nancy Carroll Avellino;
7. Lynch, Hon. Frank J. – United States Magistrate Judge;
8. Stout, Weldon J. – Plaintiff-Appellant;
9. Walter, Quentin – Plaintiff-Appellant;
10. Woodfield, Gary A. – Counsel for Defendants-Appellees Frank Avellino and Nancy Avellino.

November 1, 2013

/s/ Thomas Burns
Thomas A. Burns

STATEMENT REGARDING ORAL ARGUMENT

Plaintiffs-Appellants Quentin Walter and Weldon J. Stout do not request oral argument. This appeal involves a routine failure to apply controlling Supreme Court and Eleventh Circuit precedent. Moreover, Ms. Walter and Mr. Stout are an elderly couple of limited means who cannot afford to pay counsel's travel expenses if this Court orders oral argument. If, however, the Court orders oral argument, Ms. Walter and Mr. Stout respectfully request that it be held in Jacksonville, Florida, to minimize their counsel's travel expenses. (Counsel could then drive from his Tampa home and stay with his Jacksonville friends.)

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TABLE OF ABBREVIATIONS

Avellinos	Frank J. Avellino and Nancy Carroll Avellino.
Elderly Investors	Quentin Walter and Weldon J. Stout.
Madoff Securities	Bernard L. Madoff Investment Securities LLC.
SIPA	Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq.*
Tello I	*Tello* v. *Dean Witter Reynolds, Inc.*, 410 F.3d 1275 (11th Cir. 2005).
Tello II	*Tello* v. *Dean Witter Reynolds, Inc.*, 494 F.3d 956 (11th Cir. 2007).

STATEMENT OF SUBJECT-MATTER AND APPELLATE JURISDICTION

This is a direct appeal from final decisions without proper entry of final judgment. *See* Docs. 45, 52, 61. The District Court had subject-matter jurisdiction under 28 U.S.C. § 1331 and 28 U.S.C. § 1367 because, liberally construed, the *pro se* Amended Complaint (Doc. 26) stated a federal securities claim and state common law and statutory claims. This Court has appellate jurisdiction under 28 U.S.C. § 1291 because the District Court entered final decisions dismissing the action (Doc. 45) and denying reconsideration (Doc. 52), which Plaintiffs-Appellants Quentin Walter and Weldon J. Stout timely appealed (Doc. 57). *See Fogade* v. *ENB Revocable Trust*, 63 F.3d 1274, 1286 (11th Cir. 2001) (litigants "safely may defer the appeal until Judgment Day if that is how long it takes to enter" final judgment on a separate document).

STATEMENT OF THE ISSUES

1. Was the District Court's statute-of-limitations dismissal based on "inquiry notice" analysis incorrect on its own terms or contrary to *Merck & Co.* v. *Reynolds*, 559 U.S. 633, 130 S. Ct. 1784 (2010)?

2. Did the *pro se* pleadings, liberally construed, adequately state a federal securities fraud claim?

3. If not, should the District Court have given the *pro se* litigants leave to amend any pleading deficiencies in their federal securities claim, which was dismissed for failure to state a claim only once?

STATEMENT OF THE CASE

Course Of Proceedings

This litigation concerns an elderly couple, Plaintiffs-Appellants Quentin Walter and Weldon J. Stout ("the Elderly Investors"), who lost their reverse mortgage retirement savings when Defendants-Appellees Frank J. Avellino and Nancy Carroll Avellino ("the Avellinos") invested them through their Bernie Madoff feeder fund called Kenn Jordan Associates. After the Elderly Investors expressly raised a federal securities claim for the first time in a *pro se* Amended Complaint (Doc. 26), the District Court dismissed the entire action with prejudice, ruling it was time barred and failed to comply with heightened pleading requirements. Doc. 45. Thereafter, the District Court denied the Elderly Investors' motion for reconsideration. Doc. 52. This appeal followed. Doc. 57.

Statement Of Facts

A. The *Pro Se* Complaint

Proceeding *pro se*, the Elderly Investors filed a Complaint against the Avellinos on November 16, 2012. Doc. 1.

The *pro se* Complaint alleged Mr. Stout had taken out a reverse mortgage because he had "out-lived" his retirement funds. Doc. 1 at 2. Given his "relationship of trust" with Mr. Avellino, Mr. Stout "sought advice" from "his old investor friend" and asked "where to safely invest a portion of his reverse mortgage money." Doc. 1 at 2. Mr. Avellino falsely responded he "was no longer in the investment business," but wished to include Mr. Stout "as part of the family." Doc. 1 at 3. Accordingly, Mr. Avellino "offered to invest" Mr. Stout's reverse mortgage money "with Kenn Jordan Associates." Doc. 1 at 3. Contrary to his representation that he was no longer involved with the investment business, Mr. Avellino never disclosed that in fact "he alone operated" Kenn Jordan Associates. Doc. 1 at 6.

Thereafter, Mr. Avellino opened two accounts at Kenn Jordan Associates: one for Mr. Stout holding $135,000, and one for Ms. Walter that eventually held $50,000. Doc. 1 at 3. In calendar years 2007 and 2008, Mr. Stout withdrew $21,350 from his account. Doc. 1 at 4.

On October 1, 2008, Mr. Avellino wrote Mr. Stout a letter that stated "all was well at Kenn Jordan Associates." Doc. 1 at 4. This letter, however, made several important omissions. Specifically, the Avellinos

"[n]ever told" the Elderly Investors (1) that Mr. Avellino "alone operated" Kenn Jordan Associates, (2) that Mr. Avellino was a "long time friend and business associate" of Bernie Madoff, (3) that Madoff was "involved in" Kenn Jordan Associates, (4) that Kenn Jordan Associates' performance "relied upon [Madoff's] advice," or (5) that Kenn Jordan Associates had invested all their money with Bernard L. Madoff Investment Securities LLC ("Madoff Securities"). Doc. 1 at 4.

Subsequently, Ms. Avellino called Mr. Stout in December 2008 to inform him of Madoff's now-infamous Ponzi scheme. Doc. 1 at 4. At this time, the Avellinos disclosed only that the Elderly Investors' reverse mortgage retirement funds had been invested with Madoff Securities and were lost. *See* Doc. 1 at 4.

In an attempt to recover their money, the Elderly Investors filed claims pursuant to the Securities Investor Protection Act ("SIPA"), 15 U.S.C. § 78aaa *et seq.* *See* Doc. 1 at 4. But the Elderly Investors' SIPA claims were denied on December 3, 2010, apparently because they had not held direct accounts with Madoff Securities. *See* Doc. 1 at 4.

Thereafter, the Elderly Investors first learned about Mr. Avellino's "involvement" in the Madoff "scandal" and "connection" to

Madoff himself by reading an April 2009 *Vanity Fair* article and by researching it on the Internet sometime in late July or early August 2012. Doc. 1 at 4. The *pro se* Complaint does not allege when the Elderly Investors read the *Vanity Fair* article. *See* Doc. 1 at 4.

At any rate, the Elderly Investors expressly alleged four state law counts for breach of fiduciary duty, negligent misrepresentation, negligence, and unfair and deceptive trade practice. Doc. 1 at 6-9.

First, the Elderly Investors claimed Mr. Avellino breached his fiduciary duty because it was "unethical" to invest Mr. Stout's reverse mortgage money in Kenn Jordan Associates. Doc. 1 at 6.

Second, the Elderly Investors claimed Mr. Avellino committed negligent misrepresentation (1) "when he failed to advise" them that he "was allowing" Madoff to "control" their money, and (2) "failed to verify" that Madoff, his "long time friend and business associate," was "running a ponzi Scheme" before investing their money "based on . . . Madoff's advice." Doc. 1 at 6-7.

Third, the Elderly Investors claimed Mr. Avellino committed negligence when he "failed to advise [them] that there was a risk associated with depositing [their] money into his Kenn Jordan

Associates fund," "failed to verify" that Madoff "was running a ponzi scheme," and "failed to verify the accuracy of" Madoff's advice." Doc. 1 at 7.

Fourth, the Elderly Investors claimed Mr. Avellino engaged in an unfair and deceptive trade practice when he "intentional[ly] and deceptive[ly]" led them to believe their money was invested in an "insured, secure investment account," "fail[ed] to advise" them that he was relying on Madoff's advice, and "fail[ed] to verify the accuracy of" Madoff's advice. Doc. 1 at 8-9.

B. The Motion To Dismiss The *Pro Se* Complaint And Motion For Leave To File A *Pro Se* Amended Complaint

The Avellinos moved to dismiss the *pro se* Complaint on two bases Doc. 9. First, the Avellinos argued the *pro se* Complaint failed to allege subject-matter jurisdiction because it did not properly plead a federal question or diversity of citizenship. Doc. 9 at 1, 3. Second, the Avellinos asserted the *pro se* Complaint failed to state claims of breach of fiduciary duty or unfair and deceptive trade practice. Doc. 9 at 6-7. The Avellinos did not, however, argue that the *pro se* Complaint failed to

state claims of negligent misrepresentation (Count II) or negligence (Count III). *See* Doc. 9.

In response, the Elderly Investors moved for leave to amend the *pro se* Complaint to expressly state a federal securities claim based essentially on the prior allegations. Doc. 19.

C. The Dismissal Without Prejudice

The District Court dismissed the *pro se* Complaint without prejudice and granted the Elderly Investors 14 days to amend. Doc. 21 at 4. The dismissal was based on two grounds. First, the District Court ruled the *pro se* Complaint did not adequately allege a basis for federal jurisdiction. Doc. 21 at 3. Second, the District Court ruled the *pro se* Complaint did not "specify[]" (1) "which Defendants were responsible for each act," and (2) "which acts support each cause of action." Doc. 21 at 4. This dismissal without prejudice did not address whether the *pro se* Complaint adequately stated claims. *See* Doc. 21.

D. The *Pro Se* Amended Complaint

On March 18, 2013, the Elderly Investors timely filed a *pro se* Amended Complaint, which expressly claimed violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rule 10b-5.

Doc. 26 at 1. The Amended Complaint raised substantially similar allegations as the Complaint. *Compare* Doc. 26, *with* Doc. 1. For example, the Elderly Investors alleged Mr. Avellino represented there would be "no problem" meeting their requirement that the Kenn Jordan Associates investment would produce $1,000 per month in income. Doc. 26 at 2. Moreover, the Elderly Investors alleged they "relied on" Mr. Avellino's representation that their investment was placed in a "legitimate investment vehicle," was "safe," was "earning income as required," and that "all was well" with Kenn Jordan Associates. Doc. 26 at 3. The Elderly Investors requested $250,000 in compensatory damages, interest, and $500,000 in punitive damages. Doc. 26 at 3-4.

After filing the *pro se* Amended Complaint, the Elderly Investors sought to correct the *pro se* Amended Complaint by alleging Kenn Jordan Associates was a "fictitious, fraudulent, feeder fund." Doc. 29 at 1.

E. The Motion To Dismiss The *Pro Se* Amended Complaint

Once again, the Avellinos moved to dismiss. Doc. 30. This time, the Avellinos contended the *pro se* Amended Complaint was time barred, failed to allege subject-matter jurisdiction, and failed to state a claim. Doc. 30 at 1.

The Elderly Investors filed a response. Doc. 31. Among other things, the Elderly Investors argued that the date of actual discovery was not December 2008 but sometime during the summer of 2012. Doc. 31 at 2; Doc. 36 at 2-3. Additionally, the Elderly Investors also pointed the District Court's attention to a $1 million jury verdict entered against Mr. Avellino in Nantucket, Massachusetts, in which a couple had prevailed in their claims that Mr. Avellino directed their investment to another Kenn Jordan account.[1] Doc. 31 at 2. Finally, the Elderly Investors also clarified that the *pro se* Amended Complaint also included "all . . . grievances listed in the original complaint." Doc. 31 at 3.

F. The Dismissal With Prejudice

The District Court dismissed the *pro se* Amended Complaint with prejudice as time barred and for failure to state a claim. Doc. 45 at 6-11. This was the first and only time the District Court addressed whether the Elderly Investors had stated a claim. *See* Docs. 21, 45.

First, relying on Eleventh Circuit decisions rendered before 2007, the District Court concluded "inquiry notice" was established in Decem-

[1] That jury verdict has now been vacated on appeal. *See Daley* v. *Avellino*, 83 Mass. App. Ct. 1125 (2013) (vacating $1 million judgment against Mr. Avellino due to failure to give requested jury instruction regarding statute of limitations).

ber 2008 when Ms. Avellino informed Mr. Stout that his retirement funds had been invested with Madoff Securities and were lost. Doc. 45 at 8. As such, the District Court concluded this "inquiry notice" immediately triggered the two-year statute of limitations, which then ran in December 2010. Doc. 45 at 8. The District Court did not mention that the Supreme Court had expressly rejected "inquiry notice" as the proper standard for triggering the two-year statute of limitations in *Merck & Co.* v. *Reynolds*, 559 U.S. 633, 130 S. Ct. 1784 (2010).

Second, the District Court concluded the *pro se* Amended Complaint did not meet the heightened pleading standard for federal securities fraud claims. Doc. 45 at 9-10. Characterizing the Elderly Investors' securities fraud claim as based on "general allegations," the District Court focused solely on the allegations that Mr. Stout "sought advice" from Mr. Avellino, who merely "suggested" the investment in Kenn Jordan Associates. Doc. 45 at 10. The District Court did not, however, consider whether, liberally construed, the omissions in Mr. Avellino's October 1, 2008 letter and the misrepresentation that "all was well" at Kenn Jordan Associates sufficed to state a claim. Doc. 26 at 2. Recall that the original *pro se* Complaint, liberally construed, had alleged that in this

letter the Avellinos "[n]ever told" the Elderly Investors (1) that Mr. Avellino "alone operated" Kenn Jordan Associates, (2) that Mr. Avellino was a "long time friend and business associate" of Bernie Madoff, (3) that Madoff was "involved in" Kenn Jordan Associates, (4) that Kenn Jordan Associates' performance "relied upon [Madoff's] advice," or (5) that Kenn Jordan Associates had invested all their money with Madoff Securities. Doc. 1 at 4. The District Court also concluded the *pro se* Amended Complaint did not plead scienter (Doc. 45 at 10-11), even though the original *pro se* Complaint had alleged the Avellinos had "intentional[ly] and deceptive[ly]" led the Elderly Investors to believe their money was invested in an "insured, secure investment account." Doc. 1 at 8-9. Moreover, the District Court did not give the *pro se* Elderly Investors any opportunity to remedy these supposed pleading defects. Doc. 45 at 11.

Finally, the District Court did not liberally construe the *pro se* Amended Complaint as stating any state common law or statutory claims. In this regard, the District Court did not mention whether it would have exercised supplemental jurisdiction over those claims pursuant to 28 U.S.C. § 1367.

G. The Motion For Reconsideration, The Order Denying Reconsideration, And The Notices Of Appeal

The Elderly Investors moved for reconsideration. Doc. 48. Among other things, this motion directed the District Court's attention to *Merck & Co.* v. *Reynolds*, 559 U.S. 633, 130 S. Ct. 1784 (2010). Doc. 48 at 5. The District Court denied reconsideration. Doc. 52.

The Elderly Investors then filed a *pro se* notice of appeal that designated the Order denying reconsideration (Doc. 52) but not the original dismissal Order (Doc. 45). After the Elderly Investors retained appellate counsel, they filed a counseled amended notice of appeal that designated both Orders. Doc. 57. Subsequently, the District Court entered an Order granting the Elderly Investors' motion (Doc. 58) and thereby purported to enter final judgment on a separate document as required by Federal Rule of Civil Procedure 58. Doc. 61. To date, the District Court still has not entered final judgment on a separate document.[2]

STANDARD OF REVIEW

1. The "interpretation and application of a statute of limitations is a question of law that this Court may review de novo." *Harrison* v. *Digital Health Plan*, 183 F.3d 1235, 1238 (11th Cir. 1999).

[2] This Court nevertheless has appellate jurisdiction because Rule 58 is waivable. *Bank* v. *Pitt*, 928 F.2d 1108, 1110-11 (11th Cir. 1991).

2. "We review de novo an order granting a motion to dismiss for failure to meet the heightened pleading standards embodied in the PSLRA." *Mizzaro* v. *Home Depot, Inc.*, 544 F.3d 1230, 1236 (11th Cir. 2008).

3. "Moreover, because denial of leave to amend based on futility is a legal conclusion, we review the denial de novo as well." *Id.*

SUMMARY OF THE ARGUMENT

The District Court committed three errors, all of which require this Court to reverse.

1. The District Court misconceived how the two-year statute of limitations for federal securities fraud claims operates for two reasons. First, the District Court mistakenly ruled "inquiry notice" was established in December 2008 when Ms. Avellino called Mr. Stout and informed him that Kenn Jordan Associates had invested all his retirement funds in Madoff Securities and that they were lost. That is not how "inquiry notice" works. Rather, this did not establish "inquiry notice" because it gave no indication that the Avellinos committed fraud. Rather, it merely indicated Madoff and Madoff Securities had committed fraud. Second, "inquiry notice" is the wrong standard altogether. In-

stead, under *Merck & Co.* v. *Reynolds*, 559 U.S. 633, 130 S. Ct. 1784 (2010), the two-year statute of limitations is triggered only by actual or constructive "discovery." Actual "discovery" occurred sometime in summer 2012, and neither the *pro se* Complaint nor the *pro se* Amended Complaint pleads any facts that indicate when constructive "discovery" should have occurred. Indeed, under this Court's precedent, a jury trial would be required to determine this constructive discovery issue.

2. In dismissing the *pro se* Amended Complaint for failure to state a claim, the District Court overlooked that securities fraud claims can be based not only on misrepresentations, but also on omissions. Liberally construed, the Elderly Investors alleged Mr. Avellino's October 1, 2008 letter contained numerous misrepresentations and omissions and that Mr. Avellino acted with scienter.

3. The District Court's dismissal with prejudice overlooked that the Elderly Investors could easily remedy any pleading defects in the *pro se* Amended Complaint. This dismissal was the first time the District Court addressed the substantive sufficiency of the allegations, and the Elderly Investors were therefore denied any opportunity, to which to they are entitled as *pro se* litigants, to amend their pleading.

ARGUMENT AND CITATIONS OF AUTHORITY

I. THE DISTRICT COURT ERRED WHEN IT DISMISSED THE *PRO SE* AMENDED COMPLAINT AS TIME BARRED

The District Court's statute-of-limitations ruling was error.

A. Securities Fraud Plaintiffs Must File Suit Within Two Years After "Discovery" And Within Five Years After "Such Violation"

Securities fraud lawsuits "may be brought not later than the earlier of—2 years after the discovery of the facts constituting the violation; or 5 years after such violation." 28 U.S.C. § 1658(b). There are therefore two key dates that must be determined. First, when did the "discovery of the facts constituting the violation" occur? *Id.* Second, when did "such violation" occur? *Id.*

B. The Elderly Investors Filed Suit Within Five Years "After Such Violation," So The Only Remaining Issue Was Whether They Filed Suit Within Two Years After "Discovery"

There is no real dispute that the Elderly Investors filed suit within five years "after such violation." *Id.* Rather, the only pertinent question is whether they filed suit within two years after "discovery." *Id.*

The pleadings indicate October 1, 2008 is the most important date. That is the date when Mr. Avellino wrote a letter to Mr. Stout that misrepresented that "all was well" with Kenn Jordan Associates (Doc.

26 at 3), and also contained numerous omissions about his relationship with Kenn Jordan Associates and Madoff himself (Doc. 1 at 4).

The Elderly Investors filed suit on November 16, 2012. Doc. 1. Accordingly, there is no dispute that the Elderly Investors filed suit within "5 years after such violation." 28 U.S.C. § 1658(b). The true question, therefore, is whether the Elderly Investors filed suit within "2 years after the discovery of the facts constituting the violation." *Id.*

C. The District Court's "Inquiry Notice" Ruling Was Incorrect

The District Court ruled "inquiry notice" was the proper standard for triggering the two-year statute of limitations when it relied on this Court's decisions in *Tello* v. *Dean Witter Reynolds, Inc.*, 494 F.3d 956 (11th Cir. 2007) ("*Tello II*"), *Tello* v. *Dean Witter Reynolds, Inc.*, 410 F.3d 1275 (11th Cir. 2005) ("*Tello I*"), *Franze* v. *Equitable Assurance*, 296 F.3d 1250 (11th Cir. 2002), and *Theoharous* v. *Fong*, 256 F.3d 1219 (11th Cir. 2001). Doc. 45 at 7-8. Applying that standard, the District Court ruled "inquiry notice was established in December 2008" when Ms. Avellino informed Mr. Stout that his retirement funds had been invested with Madoff Securities and were lost. Doc. 8. This ruling was incorrect for two reasons.

1. The District Court Misapplied The Inquiry Notice Standard

First, inquiry notice was not established in December 2008, because it would not have led a reasonable person to believe there was a possibility the Avellinos or Kenn Jordan Associates had committed fraud. *See Franze*, 296 F.3d at 1254 (inquiry notice occurs when plaintiff learns "facts that would lead a reasonable person to begin investigating the possibility that his legal rights had been infringed'"); *accord Tello*, 410 F.3d at 1283; *Theoharous*, 256 F.3d at 1228. Many honest investors and investment funds were duped by Madoff and innocently invested money with Madoff Securities. *Cf. Tello II*, 494 F.3d at 969 ("we have rejected a sharp decline in stock value as indicating securities fraud, which would constitute inquiry notice"). Rather, a reasonable person, particularly one who had been longtime friends with Mr. Avellino, would have been led to believe at that time only that Madoff and Madoff Securities had committed fraud—not that Mr. Avellino committed fraud.

The District Court's conclusion to the contrary is not supported by this Court's law. *Tello I* explained that generally, "[w]hether a plaintiff had sufficient facts to place him on inquiry notice of a claim for securi-

ties fraud . . . is a question of fact, and as such is often inappropriate for resolution on a motion to dismiss under Rule 12(b)(6)." 410 F.3d at 1283 (citation omitted). And even under an inquiry notice standard, courts must "[a]llow[] time for appropriate investigation for financially injured plaintiffs to obtain the evidence of securities fraud needed to file suit." *Id.* at 1285. Moreover, *Tello I* also recognized that "unsubstantiated knowledge is an insufficient basis for filing actions for violations of the securities laws, and, waiting until such facts are developed and available, promotes judicial efficiency and justice." *Id.* at 1287.

At the dismissal stage, the District Court improperly resolved a question of fact, did not allow the Elderly Investors any time to conduct an appropriate investigation, and would have required the Elderly Investors to file suit based on nothing more than unsubstantiated knowledge before facts were developed and available. As such, the District Court's inquiry notice ruling was incorrect.

2. The Supreme Court Expressly Rejected Inquiry Notice As The Standard Generally

Second, inquiry notice is not the correct standard to begin with. This Court decided *Tello II*, *Tello I*, *Franze*, and *Theoharous* several years before the Supreme Court issued its landmark statute-of-

limitations ruling in *Merck & Co.* v. *Reynolds*, 559 U.S. 633, 130 S. Ct. 1784 (2010). *Merck* expressly rejected the "inquiry notice" standard. *Id.* at 652, 130 S. Ct. at 1798 ("we reject 'inquiry notice' as the standard generally").

Carefully parsing the text of 28 U.S.C. § 1658(b) and the historical meaning of the word "discovery," *Merck* concluded the statute of limitations "encompasses not only those facts the plaintiff actually knew, but also those facts a reasonably diligent plaintiff would have known." *Id.* at 644-48, 130 S. Ct. at 1793-95. Given this textual interpretation of "discovery," *Merck* further explained there was no basis for the concept of "inquiry notice." *Id.* at 650-53, 130 S. Ct. at 1797-98. Indeed, *Merck* could not reconcile the concept of "inquiry notice" with the statute of limitation's textual use of the word "discovery." *Id.* Accordingly, the Supreme Court expressly held "the 'discovery' of facts that put a plaintiff on 'inquiry notice' does not automatically begin the running of the limitations period." *Id.* at 653, 130 S. Ct. at 1798.

Instead, *Merck* adopted the following rule: "a cause of action accrues (1) when the plaintiff did in fact discover, or (2) when a reasonably diligent plaintiff would have discovered, 'the facts constituting the

violation'—whichever comes first." *Id.* at 637, 130 S. Ct. at 1789-90. Moreover, these facts to be discovered "include the fact of scienter." *Id.*, 130 S. Ct. at 1790. In adopting this rule, *Merck* clarified that concepts like "storm warnings" or "inquiry notice" "may be useful to the extent that they identify a time when the facts would have prompted a reasonably diligent plaintiff to begin investigating." *Id.* at 653, 130 S. Ct. at 1798. "But the limitations period does not begin to run until the plaintiff thereafter discovers or a reasonably diligent plaintiff would have discovered 'the facts constituting the violation,' including scienter—irrespective of whether the actual plaintiff undertook a reasonably diligent investigation." *Id.*

With this understanding of *Merck*, it is easy to identify the flaw in the District Court's ruling: it applied the wrong standard altogether when it failed to analyze when a reasonably diligent plaintiff would have discovered the facts constituting the violation, including scienter. Nor do any such facts illuminating when and what a reasonably diligent would have discovered arise from the pleadings. Rather, that is a fact-intensive question that at best would require further proceedings conducted by the District Court. Indeed, this Court has long held that

"questions of notice and due diligence are particularly suited for a jury's consideration." *Kennedy* v. *Tallant*, 710 F.2d 711, 716 (11th Cir. 1983).

II. THE DISTRICT COURT ERRED WHEN IT DISMISSED THE *PRO SE* AMENDED COMPLAINT FOR FAILURE TO STATE A CLAIM

The District Court also erred in dismissing the *pro se* Amended Complaint for failure to state a claim.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), does not provide investors with an express private right of action. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 196, 96 S. Ct. 1375, 1382 (1976). Nevertheless, the SEC's promulgation of Rule 10b-5, 17 C.F.R. § 240.10b-5, provides investors with an implied private right of action. *Ernst & Ernst* 425 U.S. at 196, 96 S. Ct. at 1382. "The scope of Rule 10b-5 is coextensive with the coverage of § 10(b)." *SEC* v. *Zandford*, 535 U.S. 813, 816 n.1, 122 S. Ct. 1899, 1901 n.1 (2002).

"The elements of a primary section 10b-5 claim are: '(1) a misstatement or omission (2) of a material fact (3) made with scienter (4) upon which the plaintiff relied (5) that proximately caused the plaintiff's loss.'" *In re Bilzerian*, 153 F.3d 1278, 1282 (11th Cir. 1998) (quoting *McDonald* v. *Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989)). Allegations that create a "*strong inference*" of scienter are suffi-

cient. *Mizzaro* v. *Home Depot, Inc.*, 544 F.3d 1230, 1247 (11th Cir. 2008) (emphasis in original). Although securities fraud claims must be pled with particularity, *see* Fed. R. Civ. P. 9(b); 15 U.S.C. § 78u-4(b)(1), "[*p*]*ro se* pleadings are held to a less stringent standard than pleadings drafted by attorneys and will, therefore, be liberally construed," *Tannenbaum* v. *United States*, 148 F.3d 1262, 1263 (11th Cir. 1998). Liberally construed, the pleadings pled every element of a 10b-5 claim with particularity.

On October 1, 2008, Mr. Avellino wrote Mr. Stout a letter that stated "all was well" at Kenn Jordan Associates. Doc. 1 at 4; Doc. 26 at 3. In reality, Madoff's Ponzi scheme was already unraveling at that time. Accordingly, this representation was a misstatement made by a particular defendant on a particular date in a particular document of a material fact on which the Elderly Investors relied that proximately caused their loss by depriving them the opportunity to withdraw their reverse mortgage retirement funds before Madoff's Ponzi scheme ultimately collapsed in December 2008. *See* Doc. 26 at 2-3.

Moreover, this same October 1, 2008 letter contained numerous omissions as well. Specifically, the Elderly Investors had previously

alleged Mr. Avellino omitted telling them in this letter (1) that Mr. Avellino "alone operated" Kenn Jordan Associates, (2) that Mr. Avellino was a "long time friend and business associate" of Madoff, (3) that Madoff was "involved in" Kenn Jordan Associates, (4) that Kenn Jordan Associates' performance "relied upon [Madoff's] advice," and (5) that Kenn Jordan Associates had invested all their money with Madoff Securities. Doc. 1 at 4. Like the misstatement, these omissions were made by a particular defendant on a particular date in a particular document of material facts on which the Elderly Investors relied that proximately caused their loss by denying them the opportunity to withdraw their retirement funds before Madoff's Ponzi scheme collapsed in December 2008.

With respect to scienter, the Elderly Investors had also previously alleged that Mr. Avellino's conduct was "intentional, fraudulent, and dceptive." Doc. 1 at 9. When coupled with Mr. Avellino's omissions of the material facts that he was a "longtime friend and business associate" of Madoff, that Madoff was "involved in" Kenn Jordan Associates, and that Kenn Jordan Associates' performance "relied upon [Madoff's] advice," (Doc. 1 at 4), these allegations, liberally construed,

suffice to create *Mizzaro*'s required "*strong inference*" of scienter with respect to Madoff's Ponzi scheme.

Aside from these Madoff-related scienter allegations, the Elderly Investors also alleged that Mr. Avellino had omitted the facts that he "alone operated" Kenn Jordan Associates and had invested all their money with only one entity (Madoff Securities). The Elderly Investors thought Kenn Jordan Associates was not run exclusively by Mr. Avellino but rather was a bona fide firm with a full panoply of staff and employees. Additionally, the Elderly Investors thought Kenn Jordan Associates held a diversified portfolio instead of engaging in the extraordinarily risky investment strategy of placing all the money in only one entity. Liberally construed, these omissions also suffice to create a "*strong inference*" of scienter with respect to Kenn Jordan Associates' inadequate organizational structure and risky business model.

Having liberally construed the pleadings, the problem with the District Court's ruling is easy to see. It focused on the Elderly Investors' general allegations regarding misrepresentations, overlooked Mr. Avellino's particular omissions, and failed altogether to recognize the significance of the October 1, 2008 letter. *See* Doc. 45 at 8-11.

Additionally, the District Court did not consider whether, liberally construed, the Elderly Investors also stated state common law and statutory claims. *See* Doc. 45. Nor did the District Court explain whether it would have exercised supplemental jurisdiction over such claims following dismissal of the federal securities fraud claim. *See* Doc. 45.

When district courts already have original jurisdiction, they "shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy." 28 U.S.C. § 1367(a). The only pertinent exception is that district courts "may decline to exercise supplemental jurisdiction" in certain circumstances. *Id.* § 1367(c). The problem here is that the District Court never answered this question one way or the other. Remand is necessary for this reason alone.

III. The District Court Erred When It Failed To *Sua Sponte* Grant The *Pro Se* Elderly Investors Leave To Amend

Even if the District Court had properly dismissed the *pro se* Amended Complaint for failure to state a claim, it erred when it denied the Elderly Investors leave to amend.

"Where it appears a more carefully drafted complaint might state a claim upon which relief can be granted," district courts "should give a plaintiff an opportunity to amend his complaint instead of dismissing it." *Bank* v. *Pitt*, 928 F.2d 1108, 1112 (11th Cir. 1991). Although *Bank* no longer applies to counseled parties, its rule still applies to *pro se* litigants. *Wagner* v. *Daewoo Heavy Indus. Am. Corp.*, 314 F.3d 541, 542 & n.1 (11th Cir. 2002). Accordingly, district courts should *sua sponte* grant *pro se* litigants leave to amend unless "the complaint as amended would still be properly dismissed or be immediately subject to summary judgment for the defendant." *Cockrell* v. *Sparks*, 510 F.3d 1307, 1310 (11th Cir. 2007); *see also Clark* v. *Maldonado*, 288 Fed. App'x 645, 647 (11th Cir. 2008) (vacating dismissal for failure to *sua sponte* grant *pro se* plaintiff leave to amend); *Spear* v. *Nix*, 215 Fed. App'x 896, 902 (11th Cir. 2007) (reversing dismissal for failure to *sua sponte* grant *pro se* plaintiff leave to amend).[3]

An amended complaint would not be futile. Indeed, it would be quite easy to draft a viable securities fraud claim based only on the mis-

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[3] Unpublished Eleventh Circuit opinions are "not binding precedent," *Bravo* v. *United States*, 532 F.3d 1154, 1164 n.5 (11th Cir. 2008), but "may be cited as persuasive authority," 11th Cir. R. 36-2.

statements and omissions in Mr. Avellino's October 1, 2008 letter. *See supra* Argument II.

With respect to scienter, it is also important to understand the closeness of the relationship between Mr. Avellino and Madoff that commenced in 1962. Indeed, Mr. Avellino appears to be one of the central characters in the Madoff scandal. Given his lengthy and close relationship with Madoff, Mr. Avellino is now defending many lawsuits related to the Madoff Ponzi scheme, including a $900 million lawsuit in *Picard* v. *Avellino*, No. 10-05421 (Bankr. S.D.N.Y. filed Dec. 10, 2010), filed by Irving H. Picard, the SIPA Trustee for Madoff Securities' liquidation. Mr. Picard claimed Mr. Avellino was "among the earliest enablers" of Madoff's Ponzi scheme and knew "[a]s early as 1992" that Madoff Securities "had created a phony account with backdated statements detailing fabricated trades." Press Release, Irving H. Picard, Trustee For Liquidation of Bernard L. Madoff Investment Securities Files Claims Against Frank Avellino, Michael Bienes, Family Members and Related Entities Seeks Recoveries of More Than $900 Million (Dec. 10, 2010), *at* http://www.madofftrustee.com/statements-07.html. Similarly, Mr. Picard's complaint extensively sets forth Mr. Avellino's al-

leged fraud in detail. For instance, Mr. Avellino operated Madoff's "first feeder fund." *Picard* Compl. ¶ 2. Among those feeder funds, Kenn Jordan Associates was one of several entities that Mr. Avellino used, alongside his family and business partner, to funnel over $900 million to Madoff Securities. *Id.* ¶ 10. And Mr. Avellino "began investing with Madoff in or around 1962, and thereafter spent the majority of his professional career investing with and, funneling other people's money into Madoff's Ponzi scheme." *Id.* ¶ 15. Put simply, there is a federal securities lawsuit to be had here for the Elderly Investors. In denying leave to amend, the District Court did not consider any of this.

It would likewise be quite easy to draft common law claims for negligence and negligent misrepresentation using essentially the original *pro se* Complaint's allegations. *See* Doc. 1. In this regard, it is notable that even the Avellinos themselves had not previously sought dismissal of the negligence or negligent-misrepresentation claims for failure to state a claim. *See* Doc. 9. An amended complaint might even be able to invoke federal jurisdiction for these state law claims based not only on supplemental jurisdiction, 28 U.S.C. § 1367, but also on diversity of citizenship, 28 U.S.C. § 1332. That is because it remains unclear

whether the Avellinos are citizens of New York or Massachusetts rather than citizens of Florida. *See* Doc. 1 at 1 (alleging Avellinos have residential addresses in Florida, New York, and Massachusetts).[4]

CONCLUSION

For the foregoing reasons, this Court should vacate the Order dismissing the action with prejudice (Doc. 45) and the Order denying reconsideration (Doc. 52) and remand for further proceedings.

November 1, 2013

Respectfully submitted,

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[4] The *pro se* Complaint's residency allegation cannot be liberally construed to invoke federal jurisdiction based on diversity of citizenship. *See Taylor* v. *Appleton*, 30 F.3d 1365, 1367 (11th Cir. 1994) ("Citizenship, not residence, is the key fact that must be alleged in the complaint to establish diversity for a natural person.").

CERTIFICATE OF COMPLIANCE

1. This brief complies with Federal Rule of Appellate Procedure 32(a)(7)(B)'s type-volume requirement. As determined by Microsoft Word 2010's word-count function, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii) and 11th Circuit Rule 32-4, this brief contains 5,720 words.

2. This brief further complies with Federal Rule of Appellate Procedure 32(a)(5)'s typeface requirements and with Federal Rule of Appellate Procedure 32(a)(6)'s type-style requirements. Its text has been prepared in a proportionally spaced serif typeface in roman style using Microsoft Word 2010's 14-point Century font.

November 1, 2013 /s/ Thomas Burns
Thomas A. Burns

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I filed the original and six copies of the foregoing brief with the Clerk of Court via regular mail on this 1st day of November, 2013, to:

John Ley, Clerk of Court
U.S. COURT OF APPEALS FOR THE
ELEVENTH CIRCUIT
56 Forsyth Street N.W.
Atlanta, GA 30303

I FURTHER CERTIFY that I served a true and correct copy of the foregoing brief via regular mail on this 1st day of November, 2013, to:

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November 1, 2013

/s/ Thomas Burns
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