

9/14/01

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA

UNITED STATES SECURITIES
AND EXCHANGE COMMISSION,

Plaintiff,

v.

KENNETH R. PAYNE, JOHANN M. SMITH,
DANIEL G. DANKER, CONSTANCE
BROOKS-KIEFER, HEARTLAND
FINANCIAL SERVICES, INC., JMS
INVESTMENT GROUP, LLC,

Defendants.

CIVIL ACTION

FILE NO. IP00-1265 C-T/G

Judge John D. Tinder

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION'S
RESPONSE TO DEFENDANT KENNETH PAYNE'S
MOTION TO SET ASIDE DEFAULT**

Simply stated, Defendant Kenneth Payne ("Payne") failed to answer the Commission's complaint against him for 7 months after settlement negotiations failed, and the default entered against him for his failure to answer or otherwise defend this action should stand. In Payne's Motion to Set Aside Default Judgment¹ ("Motion"), Payne offers no good reason why he failed to answer the Commission's complaint. Payne has been represented by counsel in this action since the Commission filed its complaint on August 10, 2000. He knew about the Commission's complaint against him since the time it was filed. Further, he apparently attempted to avoid criminal and

¹ Although Payne entitled his motion "Motion to Set Aside Default Judgment," the Commission has neither sought nor has the Court entered a default judgment against Payne. To date, the Commission has only obtained the entry of a default, as distinguished from a default judgment, against Payne.

12/10

civil liability for the allegations set forth in the complaint by fleeing the country in September of 2000. His intent to disregard the Commission's case is apparent based on the uncontroverted facts. Nevertheless, Payne asserts a variety of reasons why he believes the Entry of Default should be set aside, including claims that (1) he attempted to file an answer to the Commission's complaint, even though no answer is on file with the Clerk of Court for the United States District Court for the Southern District of Indiana ("Clerk") and (2) he has "legitimate answers and defenses" to the allegations in the Commission's complaint, even though he fails to state what those answers and defenses are. As described in more detail below, Payne fails to show "good cause" for setting aside the default, as required by Rule 55(c) of the Federal Rules of Civil Procedure. Therefore, Payne's Motion should be denied.

Legal Discussion

A court may set aside an entry of default for "good cause shown." Fed. R. Civ. P. 55(c). To succeed on a motion to set aside a default, the moving party must show (1) good cause for the default; (2) quick action to correct the default; and (3) a meritorious defense to the complaint. Pretzel & Stouffer v. Imperial Adjusters, Inc., 28 F.3d 42, 45 (7th Cir. 1994). A party must meet all three factors in order to succeed in vacating an entry of default. Id. at 46-47. Here, Payne fails to satisfy any of these factors and his Motion should fail.

1. No Good Cause for Payne's Default

Payne's answer to the Commission's complaint, which alleges Payne and others engaged in a \$29.1 million Ponzi scheme, was technically due on October 9, 2000. However, the Commission engaged in settlement discussions with Payne's attorney

Fred Scott ("Scott") shortly after the Court entered an Order of Preliminary Injunction against Payne (by his consent) on August 21, 2000. Those discussions ended in January 2001, when it became evident that Payne did not want to settle with the Commission, at which point we advised Scott that the litigation would proceed against Payne in lieu of a settlement. Nevertheless, after settlement discussions ended, Scott never answered the Commission's complaint on behalf of Payne. Payne admits that he knew Scott failed to answer the Commission's complaint. See Payne Affidavit, attached to Motion ("Aff."), at ¶2. Payne offers no good explanation, let alone any explanation, why Scott failed to answer the complaint.

Incredibly, while his attorney Scott was in settlement negotiations with the staff of the Commission, Payne claims that he attempted to file an answer to the Commission's complaint, *pro se*, in December 2000. At no time during these settlement discussions did Scott mention that Payne was filing or intended to file an answer to the Commission's complaint, either on a *pro se* basis or through Scott. Even if Payne attempted to file an answer, he failed to serve the Commission with his answer, as required by Fed. R. Civ. P. 5(a). Payne at one time was licensed to practice law and should have known that the Federal Rules of Civil Procedure required that the Commission, the plaintiff in this action, be served with his answer. If, as Payne claims, he could not make copies of the answer, he should have made some effort to inform the Commission that he attempted to file an answer to the Commission's complaint. For example, he could have mailed a letter to the Commission as he often did with his friends. See Aff. ¶11. However, for "no good cause," Payne never served the Commission with an answer, never informed the

Commission that he attempted to file an answer until he served his Motion, and never actually filed an answer in this action. Moreover, Payne does not claim that he contacted the Clerk's office to ascertain whether the answer he supposedly mailed had arrived and had been filed. It seems that ensuring that his answer was actually filed would have been prudent, especially considering that he learned from his friends that "not all of his letters were received" by them. Id. Payne's failure to inquire of the Clerk's office regarding the receipt and filing of his answer after he supposedly mailed it further substantiates that there is no "good cause" for Payne's default.

Additionally, Payne apparently attempted to avoid the Commission's litigation altogether as well as the possibility of criminal prosecution by fleeing the country in September 2000, approximately one month after the Commission filed its complaint. See Lego Irrigational International, Inc. v. First National Bank of Northbrook, 108 F.R.D. 9, 11 (N.D. IL 1985) (courts may also consider the "peculiar facts and circumstances surrounding the case" in determining whether to set aside a default entry). But for the fact that Payne was subsequently caught by federal authorities in Mexico, arrested and confined, Payne would likely still be "on the run." Payne's prior attempt to escape criminal and civil sanctions strongly evidences an intent to evade the Commission's action. Interestingly, Payne seems to suggest that his arrest and confinement contributed to his default because of the "lockdown" conditions he was under. Aff. at ¶¶3-5. However, notwithstanding Payne's arrest, Payne continued to be represented in this action by Scott. Payne's arrest and detention did not compromise Payne's ability, through his attorney, to answer or otherwise plead in this action.

Payne's actions belie any claims of good cause for the default and his Motion should be denied.

2. No Quick Action to Correct Default

Payne's Motion, which was filed on August 31, 2001, was not done so in a quick manner. The Clerk entered the default against Payne on June 5, 2001. Now, almost three months later, Payne is seeking to have the default set aside. Payne claims that he was unaware of the default until his new counsel, Linda Wagoner, reviewed the Clerk's file on or about August 23, 2001 and informed him of the default. However, on or about May 31, 2001, the Commission served Payne's counsel of record, Scott, with a Request for Entry of Default against defendants Payne and Heartland Financial Services. The Commission received no notice of any objection until it received Payne's Motion almost three months later. A response time of three months is not "quick." Because Payne failed to take "quick action" to correct the default, his Motion should be denied.

3. No Meritorious Defenses Set Forth

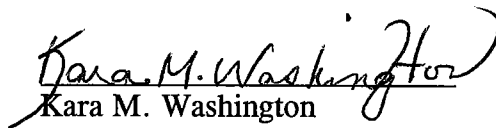
Finally, Payne fails to set forth a meritorious defense to the allegations raised in the Commission's complaint. The only reference that Payne makes to any defense is his claim that "he feels he has legitimate answers and defenses to the matters set forth in the complaint." Aff. at ¶15. However, this vague, conclusory statement, without more, is inadequate to show a meritorious defense. See Pretzel & Stouffer, 28 F.3d at 46 (court held that more than "general denials" and "bare legal conclusions" is required to satisfy meritorious defense factor). Payne does not provide even a hint of a defense to the Commission's allegations that he participated in and profited from a

massive Ponzi scheme, let alone a defense to any of the specific allegations raised in the Commission's complaint. Furthermore, although Payne claims that he wants to answer the Commission's complaint, he has yet to do so. Thus, Payne's Motion should be denied.

Conclusion

As described in more detail above, Payne's Motion should be denied because he fails to state a good cause for the default, he failed to take quick action to correct the default and he failed to set forth any meritorious defenses to the allegations raised in the Commission's complaint.

Respectfully submitted,

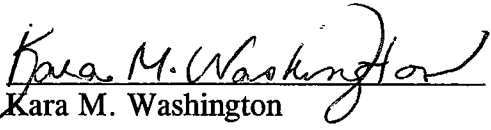

Kara M. Washington

Illinois Bar No. 06226335
One of the attorneys for plaintiff
Securities and Exchange Commission
500 West Madison, Suite 1400
Chicago, Illinois 60661

Dated: September 14, 2001

CERTIFICATE OF SERVICE

I, Kara M. Washington, hereby certify that on this 14th day of September 2001, I caused a true and correct copy of the Securities and Exchange Commission's Response to Defendant Kenneth Payne's Motion to Set Aside Default to be served on the following parties via Federal Express: **SEE ATTACHED SERVICE LIST**


Kara M. Washington
Securities and Exchange Commission
500 West Madison Street, Suite 1400
Chicago, Illinois 60661
Dated: September 14, 2001

SERVICE LIST

Daniel G. Danker
c/o Bill Marsh, Esq.
Indiana Federal Community Defenders
111 Monument Circle, Suite 752
Indianapolis, Indiana 46204

Stephen W. Dillon, Esq.
3601 North Pennsylvania Street
Indianapolis, Indiana 46205-3435
Attorney for Defendant Constance Brooks-Kiefer

Dexter Johnson, Esq.
Mallon & Johnson, P.C.
19 S. LaSalle Street, Suite 1202
Chicago, Illinois 60603
Attorney for Defendants JMS Investment Group, LLC and
Johann M. Smith

James A. Knauer
Kroger, Gardis & Regas
111 Monument Circle, Suite 900
Indianapolis, Indiana 46204-5175
Receiver for Defendants JMS Investment Group, LLC and Heartland
Financial Services, Inc.

Fred Scott, Esq.
55 Monument Circle, Suite 814
Indianapolis, Indiana 46204
Attorney for Defendants Heartland Financial Services, Inc. and
Kenneth R. Payne

Linda M. Wagoner, Esq.
156 E. Market, Suite 900
Indianapolis, Indiana 46204
Attorney for Kenneth R. Payne