

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

FILED
DISTRICT COURT
INDIANAPOLIS DIVISION
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LAURA A. BRIGGS
CLERK

UNITED STATES SECURITIES)
AND EXCHANGE COMMISSION,)
)
Plaintiff,)
)
KENNETH R. PAYNE,)
JOHANN M. SMITH,)
DANIEL G. DANKER, CONSTANCE)
BROOKS-KIEFER,)
HEARTLAND FINANCIAL SERVICES,)
INC., AND JMS INVESTMENT)
GROUP, LLC.)
)
Defendants.)

Civil Action No. IP00-1265 C -T/K

RECEIVER'S FOURTH REPORT OF ACTS AND TRANSACTIONS

James A. Knauer, the Receiver for Heartland Financial Services, Inc., and JMS Investment Group, LLC, Defendants herein, in support of *Receiver's Fourth Report of Acts and Transactions* states:

1. The undersigned was appointed Receiver for Heartland Financial Services, Inc., JMS Investment Group, LLC, and their related companies ("Heartland and JMS") on August 21, 2000.
2. The Order that appointed the Receiver directed that he should file with the Court an inventory and appraisal of all property and assets in his possession or in the possession of others (the "Inventory Report"), within sixty (60) days of his appointment as Receiver.
3. The Order appointing the Receiver directed that after the filing of the Inventory Report the Receiver should file reports of his acts and transactions (the "Activity Reports") in his official capacity as Receiver.
4. This is the Receiver's Fourth Activity Report.

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BACKGROUND

5. Upon his appointment, the Receiver began to take possession of the assets of Heartland and JMS. To assist him in this endeavor he engaged, with the Court's approval, the accounting firm of Birk, Gross, Bell and Coulter and the law firm of Kroger Gardis & Regas, LLP.
6. The Receiver was also granted the power to take possession of the assets of several affiliated companies, namely Lincoln Fidelity Escrow Fund, 21st Century Banking Group, Ltd., and Caribbean Federal, Ltd.
7. The Court issued an Order on August 10, 2000, directing financial institutions to freeze all bank accounts of the individual defendants in this action, namely Kenneth R. Payne, Johann M. Smith, Daniel G. Danker and Constance Brooks-Kiefer (the "Individual Defendants").
8. On August 10, 2000, the Court issued an Order, enjoining and restraining, among other things, the Individual Defendants from:

"transferring selling, assigning, pledging dissipating, concealing or otherwise disposing of in any manner, any funds, assets, accounts, or other property belonging to Defendants or in their possession, custody or control, wherever located."
9. The Receiver is not presently serving as a Receiver over any of the Individual Defendants, except in limited instances in which the Receiver has requested Court approval to protect property of the Individual Defendants from loss or destruction or received a court order or the consent of one of the Individual Defendants to take possession of and/or liquidate the Defendant's property.¹ Also, The Receiver has previously made application to the Court to take possession of or liquidate various assets of the Heartland Companies

¹ At various times in the course of this Receivership the Receiver has obtained the consent of Defendant's Danker, Payne or Smith to take possession of property which they owned or had an interest in. For example, Defendant Danker agreed to quitclaim his home to the Receiver and it was sold pursuant to an Order of this Court. Defendant Smith agreed to relinquish any claim against his frozen bank accounts and defendant Payne, by counsel, agreed for the Receiver to liquidate several of his vehicles.

or the Individual Defendants. In fact, the Receiver believes that he has now taken possession of, or liquidated, virtually all of the non-exempt assets of the Individual Defendants that have value over and above any valid liens.

10. The Receiver, his counsel and accountants have taken depositions of a number of former associates of Kenneth R. Payne ("Payne"); subpoenaed records of numerous banks and other brokerage firms, financial institutions, and businesses; and interviewed former Heartland employees and their affiliates.
11. The Receiver has personally responded to the calls and other communications of numerous investors in and creditors of the Heartland Companies and various related entities.

NOTICE OF THE RECEIVERSHIP AND IDENTIFICATION OF THE RECEIVERSHIP ENTITIES

12. Due to the large number of Receivership creditors the Receiver has maintained a website at heartlandfinancialinfo.com. The Heartland Companies website contains copies of all pleadings filed in these and all related proceedings; a listing of miscellaneous information which includes depositions taken by the Receiver in the search for assets; information about the Heartland Companies assets and liabilities; all correspondence with the creditors of the Receivership and other information is added to the site as the Receivership progresses.
13. In the course of examining the records of the original Defendants, the Receiver compiled a list of 28 names representing entities that were used by the principals of the Heartland Companies to either receive investor funds or as a means of diverting funds out of the Heartland Companies. In December 2000 the Receiver requested that the Court administratively consolidate this cause and expand the Receivership to include all of the 28 entities that he had identified as being alter ego entities utilized to conduct

the investment scheme. The Court approved the Receiver's motion and ordered that all of the entities identified by the Receiver would constitute part of the Receivership (hereafter collectively referred to as the "Heartland Companies").

ALLOWANCE OF CLAIMS AND DISTRIBUTIONS TO CREDITORS

14. The Court previously fixed a deadline for the filing of claims. Thereafter all claims of approximately 500 creditors were reviewed, appropriate objections filed and all claims were resolved² and approved by the Court with the sole exception of a claim by the United States Internal Revenue Service which remains pending.³
15. The Receiver made distributions in 2002 and 2003 totaling \$2,604,226.44⁴ to the holders of allowed Receivership claims.

ASSET COLLECTION AND LIQUIDATION SINCE THE RECEIVER'S THIRD REPORT

Real Estate

² Most of the disputed claims were resolved without the necessity of Court intervention due to the efforts of Receiver's counsel and his accountants

³ The claim originally filed by the IRS was \$42,961.63; subsequently the IRS amended its claim by increasing it to \$226,107.15. The Receiver's accountants have analyzed the claim and determined that it asserts income tax, interest and penalties for periods during which Heartland had no taxable income and seeks payroll taxes, penalties and interest for periods during which Heartland was not an operating business. The Accountants had hoped to compromise the claim without the necessity of preparing all of the unfiled income and payroll tax returns for the periods that Heartland had failed to file them. The IRS insisted that all prior returns be filed and the accountants have only recently completed this difficult task given the paucity of records available to them. The conclusion of the Accountants is that the IRS claim will likely be reduced to approximately one-half its present amount.

⁴ See Receivership Cash Flow Report attached as Exhibit "A" hereto (see Item "Investor Repay").

16. *Heartland Real Estate.* As noted in earlier reports, the Heartland Companies had no interests in real estate other than leaseholds.
17. *Payne Belize Real Estate.* Litigation remains pending in the country of Belize to establish ownership and the right to pay off a mortgage type indebtedness for a condominium that was owned by Payne. Payne was purchasing the condominium on a form similar to a land contract, however, most of the records detailing the purchase are missing. The Receiver engaged a Belizeian law firm to represent him in what is essentially a real estate foreclosure suit on the condominium⁵. Further inquiry has indicated that the value of the condominium is between \$120,000.00 and \$150,000.00. The contract seller claims ownership or, alternatively that Payne owes approximately \$100,000.00 although Payne actually failed to make a balloon payment of only \$40,000.00 that was due in June of 2000. The Receiver has offered to pay the remaining balance in order to obtain title to the condominium, plus interest, but settlement offers to date have been rejected.

Bank Accounts and Deposits

18. *Miscellaneous US Bank and Investment Accounts.* The Receiver last reported that he had completed collection of all known Heartland Companies bank accounts (numbering 148) and received a total of \$53,607.31. Subsequent to the filing of the report, the Receiver discovered several additional accounts and collected the amounts on deposit.
19. *Heartland Company's Offshore Bank Accounts.* The Receiver identified several possible offshore accounts in the names of Payne, Daniel G. Danker ("Danker") or entities they owned or controlled, however he has been unable to collect any funds in those accounts and does not believe that they can be collected without the hiring of foreign counsel in the country where the account is located. The amounts involved, based upon the best available

⁵ The condominium seller claims that a forfeiture has occurred and it is unclear under Belizeian law whether this is enforceable.

information, are not believed to be significant⁶ and the Receiver believes the cost of hiring foreign counsel might exceed any amounts that could be recovered.

20. *Heartland Principal's Bank Accounts.* The Receiver has obtained the balances on hand in all known domestic bank accounts of Defendants Danker, Payne and Johann M. Smith.
21. The total amounts collected to date from all bank and investment accounts of the Heartland Companies and their principals is \$193,142.85.⁷
22. *Offshore Deposits.* The Heartland Companies controlled *21st Century Banking Group, Ltd.*, in the country of Grenada. This enterprise was a bank that closed shortly after it opened.⁸ A deposit to secure the bank's performance with the government of Grenada in the amount of \$100,000.00 was originally posted. Thus far, the country of Grenada has not recognized the authority of the Receiver to obtain a refund of the deposit.⁹ The Receiver obtained court approval to hire Grenadian counsel on a contingent fee basis to attempt collection of the bank deposit. Attached hereto as Exhibit "B" is a letter recently received from the Receiver's Grenadian counsel indicating that after receiving a formal demand, Grenada has refused to recognize the

⁶ The largest known account balance was approximately \$6,000 and owned by a non-receivership entity incorporated in the Bahamas. The account was in a bank in Nassau, Bahamas which, despite repeated demands, refuses to provide information to the Receiver. Most of the accounts identified appear to contain only a few hundred dollars. For example, the Receiver located an account of Danker in Costa Rica containing, in US dollar values, \$200.00.

⁷ Receivership Cash Flow Report, *supra*, (see Items "Acquired Funds" & "FROM Lincoln Fidelity Escrow").

⁸ The bank never actually opened. It had no accounts of any depositors. It was shut down just prior to its planned opening.

⁹ The Grenada International Financial Services Authority (a/k/a "GIFSA") is the governing body for overseeing bank licensure matters in Grenada. This organization was formed after Heartland Companies' 21st Century Bank made its \$100,000.00 deposit with GIFSA's predecessor agency. The Receiver has hired Grenadian counsel on a 10% contingent fee basis to attempt collection of the bank deposit.

Receiver's authority and that a suit may be necessary to establish the Receiver's authority to act in Grenada.

Freeze Order Violations

23. *Freeze Order Violations.* In his last report, the Receiver explained his contention that a bank upon which the asset freeze Order issued in this cause was served has liability for failing to promptly initiate the account hold ordered by the Court. After a demand, upon the bank by the Receiver, the bank refunded \$146,000.00 of the money withdrawn. Negotiations with the bank to resolve the remainder of this claim without litigation have not been completed.

Investor Claims for Repayment of Fictitious Profits

24. As explained in his earlier reports, the Receiver and his accountants identified investors who, within the period of the applicable statute of limitations, received payments from the Heartland Companies in excess of their investments which the Receiver contends are recoverable under well established law. After making demand on all investors who were potentially liable for the receipt of excess profits, the Receiver filed lawsuits against investors who refused to repay amounts that they had received in excess of their investment. Much of the work of the Receiver and his counsel since the date of the last report has been devoted to pursuing settlements of such claims and the ensuing litigation.
25. *Settlement of Investor Claims.* As of the filing of his Second Report of Acts and Transactions, the Receiver reported that he had collected \$283,339.95 in investors repayments. As of the filing of his Third Report of Acts and Transactions, the Receiver reported that he had collected a total of \$792,391.52 in investor repayments. The Receiver has now managed to settle all of the recovery litigation and, as of this date, all of the claims in litigation are disposed of and the settlement funds collected. The total of all

collections by the Receiver is the sum of \$2,738,955.53.¹⁰

Loans Commissions and Referral Fees

26. *Loans.* The Receiver has pending a lawsuit for repayment of a loan made to an individual in the sum of \$50,000.00. A Motion for Summary Judgment is pending.

Liquidation of Personal Property

27. Most of the personal property of the Heartland Companies or the individual Defendants has been liquidated and reduced to cash. Since the Receiver's last Activity Report, the following personal property has been liquidated pursuant to orders issued by this Court.

Property Description	Amount
Harley Davidson Motorcycle (Danker)	\$5,900.00
Pontoon Boat (Payne)	\$4,250.00
Harley Davidson Motorcycle (claim settlement)	\$7,105.00
Danker Coin Collection	\$2,993.00

28. There remains unliquidated a Rolex Watch, a ring and several firearms that were formerly the property of Payne which the Receiver has caused to be appraised. Offers to purchase this property in excess of the appraisals have been received. The Receiver intends to accept the offers, subject to Court approval. There are also two jet skis in extremely poor condition.¹¹ The Receiver has been unable to obtain an offer to purchase this property other than for its scrap value and the value of the trailer which totals approximately \$700 to \$800. The Receiver intends to file motions with the Court to liquidate all of the foregoing property within the next 30 days.

¹⁰ Receivership Cash Flow Report, *supra*, (see Item "Investor Repay")

¹¹ One will not run and the other has significant body damage.

Broker Dealer Claims

29. The Receiver filed suit to recover on claims against several brokerage firms who held the securities licenses of Payne and Danker during the time that the investment scheme was ongoing. The Court granted the broker dealer defendants' motions to dismiss the Receiver's claims. Given the enormity of the claims, the Receiver's good faith believe that existing precedent supported bringing the claims and after consultation with the United States Securities and Exchange Commission, the Receiver appealed the Court's order to the 7th Circuit Court of Appeals. This Court's decision was recently affirmed by the 7th Circuit.

Claim Against Internal Revenue Service

30. Defendant Payne paid the approximate sum of \$500,000.00 to the Internal Revenue Service ("IRS") to settle personal tax liabilities arising from the receipt of investor funds directly deposited into his account. This payment was made approximately three months prior to the filing of these proceedings. Although the facts of the transfer can be defined within traditional fraudulent conveyance terms, after significantly researching the subject, the Receiver has concluded that recovery of these transfers from the IRS is not supported by existing law and has determined not to pursue this claim.

Costs of Administration of the Receivership

31. The Receiver, his law firm and the accountants for the Receivership will be filing requests for payment of fees and expenses at or near the time of the filing of this report. For the period covering November 2001 through November 30, 2003. The accountants claims will approximate \$9,500.00 the Receiver's counsel's claim will approximate \$258,000.00 and the Receiver's claim will approximate \$41,000.00.

Current Accounting

32. A current report showing the income and expenses of the Receivership is

attached hereto as Exhibit "A."

Closing of the Receivership

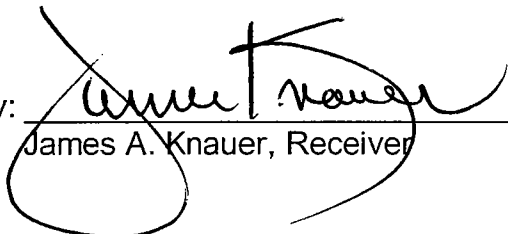
33. The Receiver believes that all remaining matters can be wound up, a final report filed and a final distribution made to all creditors prior to the end of 2004.

Notice to Creditors and the public

34. This report will be posted on the Receiver's website within three business days of its filing.

THEREFORE the Receiver requests that the Court approve his *Receiver's Fourth Report of Acts and Transactions* and for all other proper relief.

By: _____


James A. Knauer, Receiver

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing has been served upon the following parties by placing a copy of the same in the United States Mail, first class postage pre-paid, on this 22 day of December, 2003:

Paul A. Montoya
Kara M. Washington
Jeannette L. Lewis
United States Securities\ and
Exchange Commission
175 West Jackson Boulevard
Suite 900
Chicago, Illinois 60604

Dexter B. Johnson
Mallon & Johnson, P.C.
19 S. LaSalle Street
Suite 1202
Chicago, Illinois 60603

Dennis Zahn
Symmes, Voyles, Zahn, Paul & Hogan
700 Jefferson Plaza
One Virginia Avenue
Indianapolis, Indiana 46204

Linda M. Wagoner
Attorney at Law
156 East Market Street, Suite 900
Indianapolis, Indiana 46204

Joseph L. Meadows
U.S. Department of Justice
P.O. Box 55
Ben Franklin Station
Washington DC 20044

Irwin B. Levin
Scott D. Gilchrist
Eric S. Pavlack
Cohen & Malad, L.L.P.
136 North Delaware Street
Suite 300
P.O. Box 627
Indianapolis, Indiana 46206-0627

Kroger, Gardis & Regas, L.L.P.
111 Monument Circle, Suite 900
Indianapolis, Indiana 46204-5125
317-692-9000 - phone
317-264-6832 - fax

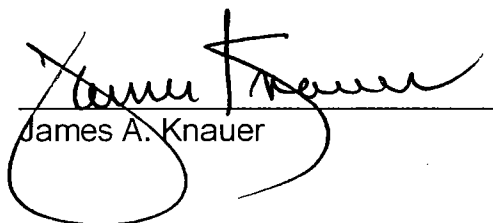

James A. Knauer

EXHIBIT "A"

Heartland Receivership Cash Flow Report

1/1/00 Through 12/16/03

Category Description	1/1/'00- 12/16/'03
INFLOWS	
Acquired Funds:	
Danker	23,032.11
Payne	44,539.64
Acquired Funds-Other	75,571.10
	<hr/>
TOTAL Acquired Funds	143,142.85
adjust	217.75
Asset Sales	462,465.44
Interest Inc	70,931.52
Investor Repay	2,738,955.53
Other Inc	359,792.20
Refunds	6,651.79
FROM Lincoln Fidelity Escrow	50,000.00
	<hr/>
TOTAL INFLOWS	3,832,157.08
OUTFLOWS	
Advertising	7,801.73
Bank Charges	2,968.19
Claim Distrib's	2,604,226.44
Litigation Exp:	
deposition exp	3,762.22
electronic res	1,862.76
filing costs	3,770.00
misc	138.01
process service	315.00
Litigation Exp-Other	7,380.84
	<hr/>
TOTAL Litigation Exp	17,228.83
Maintenance	700.00
Office Expense:	
copying exp	11,456.50
mailing exp	3,028.25
supplies	363.98
telecomm exp	3,393.19
Office Expense-Other	1,233.70
	<hr/>
TOTAL Office Expense	19,475.62
Prof Fees:	
Accountants	226,103.43
Attorneys	167,168.50
Foreign Atty	15,555.10
Other	395.00
Receiver	78,861.00
	<hr/>
TOTAL Prof Fees	488,083.03
Rent & Storage	41,503.84
Subcont Labor	9,579.58
Travel	2,287.47
Utilities:	
Gas & Electric	182.63
Water	102.13
	<hr/>
TOTAL Utilities	284.76
Website	2,040.00
Uncategorized Outflows	0.00
	<hr/>
TOTAL OUTFLOWS	3,196,179.49

Heartland Receivership Cash Flow Report
1/1/00 Through 12/16/03

Category Description	1/1/00- 12/16/03
OVERALL TOTAL	<u>635,977.59</u>

EXHIBIT "B"

J.A. Seales & Co.

Jerry A. Seales
Shadel Nyack Compton

Attorneys at law
P.O. Box 550, Victoria Street
Grenville, Grenada W.I.
Telephone: (473) 440-9410 Fax: (473) 442-5525
Email: seales@caribsurf.com

Ref: JAS/ch

November 18, 2003

Brett R. Fleitz, Esq
Kroger, Gardis & Regas
Attorneys-at-Law
111 Monument Circle, Suit 900
Indianapolis
Indiana 46204-5125
USA

By Fax & Post

Dear Sir,

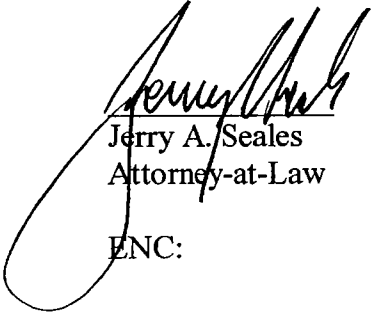
Re: **21st Century Banking Groups Limited**
Recovery - Update

Please find enclosed herewith a final response we received from GIFSA today. Our hope was that a standard claim as drafted would facilitate recovery based on the power of a sole director. This is not possible given their position.

Unfortunately, we must resort to the lengthy and more costly liquidation process therefore our petition will be filed and advertised for hearing, unless you can persuade Mr Payne to get all other Directors to resign or pass a voluntary winding-up resolution.

I look forward to discussion this at our upcoming conference.

Yours faithfully,



Jerry A. Seales
Attorney-at-Law

ENC:



Grenada International Financial Services Authority

..... establishing new frontiers in international financing

Mr. Jerry A Seales
Attorney-at-Law
P O Box 550
Victoria Street
Grenville
ST.ANDREW'S

Dear Mr. Seales,

**Re: Refund of Special Deposits – 21st Century Banking
Group Limited (“the Bank”)**

I refer to your letter of November 10, 2003 on the subject at caption, and wish to inform you that GISFA's file indicates that Mr. Kenneth R. Payne is one of seven (7) directors of the Bank and that Nisha Telesford is the only shareholder with one (1) share of an undetermined value.

In the circumstance, I wish to advise that the Board of Directors of GISFA has determined that there is no legal basis for the refund of the Bank's special deposit to be paid to Mr. James Knauer either as Receiver for Heartland Bank or as Power of Attorney for Mr. Kenneth R. Payne.

Therefore, GISFA recommends that you provide the legal basis for the payment of the funds.

Please be guided accordingly.

Sincerely

**ULRIC LEUNG-TAT
SENIOR BANK SUPERVISOR**