

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

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SOUTHERN DISTRICT
OF INDIANA
LAURA A. BRIGGS
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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 THIRD 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 Third 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 (the "Heartland Companies") 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 Third Report of his acts and transactions.

BACKGROUND

5. Upon his appointment, the Receiver began to take possession of the assets of the Heartland Companies. 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, L.L.P.
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., 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 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 recently 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.

10. Given the evidence amassed by the Receiver since his appointment, the Receiver deems it likely that all of the assets of the Individual Defendants will become a part of this Receivership either as the proceeds of a succession of fraudulent conveyances or as the result of execution upon a judgment entered in these proceedings against the Individual Defendants or as a consequence of a judgment entered in a separate action against the Individual Defendants in these proceedings or in related proceedings which have been filed by the Receiver.
11. Prior to the date of the Court's various freeze Orders, the Defendant Danker had concealed his whereabouts, ostensibly to avoid service of process or to avoid prosecution, Danker was charged with a criminal indictment by the United States for money laundering on December 6, 2000, subsequently surrendered and entered a guilty plea to certain charges, was sentenced and is presently serving his sentence.
12. Subsequent to the issuance of the various freeze Orders, the Defendant Payne fled the United States and was only recently returned to this jurisdiction and is presently in jail, also charged with money laundering. A trial in the case of Payne is scheduled for January 28, 2002.
13. The Receiver, his counsel and accountants have taken depositions of a number of former Payne associates; subpoenaed records of numerous banks and other brokerage, financial institutions, and businesses, interviewed former Heartland employees and their affiliates. The Receiver has personally responded to the calls and other communications of numerous investors in and creditors of Heartland and various Heartland related entities.

**NOTICE OF THE RECEIVERSHIP
AND FILING OF CLAIMS**

14. Due to the large number of creditors and the time required to compile

information about the creditors, their claims and the collection and liquidation of assets, the Receiver initially established a website at heartlandfinancialinfo.com. The Heartland website contains copies of all pleadings filed in these proceedings, a form for the filing of investor claims, a listing of miscellaneous information which includes depositions taken by the Receiver in the search for assets; information about the Heartland assets and liabilities; other information is added to the site as the Receivership progresses.

15. Since July of this year, the Receiver's website has recorded approximately 2000 'hits', thus it continues to be an important source of information for creditors of the receivership estate.
16. In the course of examining the records of the Heartland Companies, 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.
17. The Court then fixed a deadline for the filing of claims in the Receivership of March 30, 2001, and the Receiver gave notice pursuant to the Orders of the Court.
18. Since the filing of his last report, the Receiver and his accountants have worked to resolve disputes related to the filed creditor claims. Most, if not all, of such disputes have been resolved without the necessity of Court intervention.
19. At or near the time of the filing of this report, the Receiver anticipates filing

a request for allowance of the filed claims and a separate motion to make an interim partial distribution to the Receivership creditors.

ASSET COLLECTION

Real Estate

20. *Heartland Real Estate.* The Heartland Companies owned no interests in real estate other than their office leasehold which has been abandoned by the Receiver and a certain lease of offices on the Island of Grenada which was used for the headquarters of an offshore bank. The bank was owned by 21st Century Banking Group, Ltd. The sole value of the lease is its relationship to the bank which is further discussed hereafter.
21. *Payne Indiana Real Estate.* As more particularly described in the prior reports, real estate of Heartland principal Kenneth Payne was abandoned by the Receiver as having no value.
22. *Payne Belize Real Estate.* According to documents in the Heartland files a condominium in the country of Belize was owned by Payne. Payne was purchasing the condominium on a form of land contract, however, most of the records detailing the purchase are missing. The Receiver engaged a Belizeian law firm to assist him in obtaining information about the status of the condominium. Despite many efforts, to obtain the information, the law firm initially engaged by the Receiver reported many inconsistent versions of the facts.² After approximately nine months of fruitless inquiry, the Receiver obtained a copy of mail addressed to defendant Payne from the country of Belize which was, essentially, a real estate foreclosure suit directed to Payne on the condominium. The Receiver then engaged

² This was on the occasions when the Belizeian law firm even bothered to respond to the Receiver's inquiries. In many instances, the contacts by the Receiver were ignored. At one point the Belizeian law firm advised the Receiver that the condominium was now owned by a private individual who had taken possession and declared the purchase agreement void. As more fully set forth above, this was not even remotely close to the truth.

replacement counsel who now represents the Receiver in the foreclosure litigation. Further inquiry has indicated that the value of the condominium is between \$120,000.00 and \$150,000.00. The contract seller claims that Payne failed to make a balloon payment of \$40,000.00 that was due to pay off the purchase contract in June of 2000. This appears to be correct and the Receiver has offered to pay the remaining balance in order to obtain title to the condominium. Unfortunately, the Seller also claims that the sale agreement provides that the Receiver must pay interest at five per cent per month (sixty per cent per year) on not only the contract balance, but a plethora of miscellaneous fees and charges together with attorney fees of an additional fifteen percent. Thus the seller has taken a payoff balance of approximately \$50,000 and almost doubled it to \$100,000.00. The Receiver is disputing the Seller's interpretation of the contract.

23. *Danker Real Estate.* Heartland principal Daniel Danker was the owner of a home located in Marion County, Indiana. The Receiver initially investigated the value of the home and compared it with the remaining mortgage balance debt in order to determine the existence of any equity. The Receiver earlier reported that there was no equity. After the filing of his *Second Activity Report*, the Receiver was served with a foreclosure complaint that contained a prayer seeking payment of less than the mortgage balance originally believed to be correct. The Receiver then intervened in the foreclosure action, obtained a quitclaim deed to the property from Daniel Danker and moved the Court for the authority to sell the home. The sale closed in October and the net proceeds received were approximately \$9,000.00.³

Bank Accounts and Deposits

24. *Miscellaneous Bank Accounts.* The Receiver has now completed collection

³ The sale proceeds do not appear as a deposit in the attached Receiver's income and Expense Report due to the fact that they were not actually deposited until after the October 31, 2001, cut off date of the report.

of all of the 148 bank accounts described in his earlier reports. The Receiver has also collected the distributions from several investments of nominal value held by Messrs. Payne and Danker. The results to date are as follows:

Danker Accounts	\$15,526.65
Payne Accounts	\$38,170.66
TOTAL	\$53,697.31

25. *Heartland Companies Bank Accounts.* The Receiver previously reported that he had collected the proceeds of all known bank accounts of the Heartland Companies which are located in the United States. On a recent trip to Grenada (as more fully discussed below) the Receiver discovered an account of the Heartland Companies located at the Bank of Miami in Miami Florida believed to contain about \$5,000.00 and has recently made demand for its turnover. As also noted in his earlier report, there are a few accounts located in foreign countries which the Receiver has identified and continues to attempt to collect. He estimates that the total value of these accounts is not greater than \$33,000.00.
26. *Heartland Principals Bank Accounts.* The Receiver has obtained the balances on hand in all known domestic bank accounts of Defendants Danker, Payne and Smith.
27. *Offshore Deposits.* Heartland controlled *21st Century Banking Group, Ltd.*, in the country of Grenada. This enterprise was a bank that closed shortly after it opened.⁴ 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

⁴ Although unclear, there is reason to believe that the bank never actually opened. It had no accounts of any depositors.

Receiver to obtain a refund of the deposit.⁵ The Receiver is exploring alternatives to recover this deposit with Grenadian counsel.

Grenada Bank

28. *Grenada Bank . 21st Century Banking Group, Ltd.*, was licensed as an offshore bank by the government of Grenada. Following the filing of his *Second Activity Report*, the Receiver was given notice that GIFSA (see footnote 5 below) was revoking the bank's charter for its failure to remain open for business. By this time the Receiver had reluctantly concluded that the perceived value of the bank was probably not realizable due to a number of scandals that served to decrease the value of an offshore banking license in Grenada. Given the fact that the principals of Heartland had invested between \$750,000.00 and \$1,000,000.00 dollars in the bank and the license, the Receiver felt that he should explore every possibility to liquidate the bank and its license. At the end of September, 2001, the Receiver went to Grenada to make arrangements for the liquidation of the bank's personal property and to meet with GIFSA to attempt to recover the bank's \$100,000 deposit. When the Receiver went about the first efforts to liquidate the personal property of the bank, he then learned that the landlord of the premises leased by the bank was claiming the equivalent of a landlord's lien against the personal property of the bank for the remaining term of the lease which runs through December, 2001. Whether the liquidation value of the bank's personal property is equal to the office rent through December of this year is questionable, however the Receiver has been advised by Grenada counsel that in order to recover the \$100,000.00 deposit, there must be no claims against the bank by any creditor, thus the Receiver has kept the rent

⁵ 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's 21st Century Bank made its \$100,000.00 deposit with GIFSA's predecessor agency. GIFSA seems to be playing cat and mouse with the deposit and has not officially admitted that it has the deposit or that it is liable for its return. The predecessor agency no longer exists.

current.⁶ The Receiver is in the process of obtaining bids for liquidation of the office equipment of the bank through a local businessman. The bank also owns a 1999 Ford Explorer (left hand drive, approximately 2,500 miles, some exterior damage) that has been stored due to the Receiver's inability to obtain a vehicle title.⁷ As a consequence of his Grenada trip, the Receiver believes he has convinced the appropriate authority to issue a replacement title if a purchaser can be located. Unfortunately, Ford Explorers are not a car of choice on this island. In fact, the Receiver saw only one other such vehicle during his trip. After consulting with several local persons, the Receiver determined that automobiles are not sold in Grenada through newspaper advertising as in the United States.⁸ Supposedly, word is spread through local contacts of taxi drivers and others. The Receiver has engaged a person to solicit offers for the vehicle. Its value is hoped to be in the range of \$10,000.00 to \$12,000.00.

Freeze Order Violations

29. *Freeze Order Violations.* In his last report, the Receiver explained his belief 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. A demand was made upon the bank by the Receiver for a refund of the monies withdrawn by Defendant Payne. The Receiver previously reported that the bank has 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.

⁶ Since returning from his trip, the Receiver has made an agreement with the landlord of the bank to vacate ½ of the space and consolidate the bank's equipment into the remaining space.

⁷ The Receiver has discovered that matters of title involving vehicles in Grenada are difficult when one has no records.

⁸ Indeed, the Receiver reviewed the local newspaper and observed that there were no adds for any used vehicles published during the two days that he was there.

Investor Claims for Repayment of Fictitious Profits

30. As explained in his earlier reports, the Receiver's accountants have identified investors who, within the period of the applicable statute of limitations, received payments from the Heartland Companies totaling \$5,000,000.00 in excess of their investments which the Receiver contends are recoverable under well established law.
31. *Settlement of Investor Claims.* The Receiver, reached agreements with numerous investors for the repayment of excess profits to the Heartland Receivership. As an inducement to settlement the Receiver was authorized by the Court to allow a discount of 15% of the claim. As of the date of his *Second Activity Report*, the Receiver disclosed that he had collected \$283,339.95 in investor repayments.⁹ As of the date of this report, the Receiver has collected investor repayments of \$792,391.53.
32. *Litigation to recover Investor Claims.* The Receiver has filed fifteen lawsuits to recover on claims for excess investor payments, more are anticipated.

Loans Commissions and Referral Fees

33. *Loans.* The Receiver has identified two loans to individuals which total approximately \$100,000.00 and is pursuing claims for repayment of the loans. The Receiver earlier reported that he expected to file litigation to recover these amounts prior to the week of April 2001, however there has been some settlement negotiation and filing of these actions has been delayed.
34. *Commissions and Referral Fees.* The Receiver's accountants have compiled a list of 32 persons who received payments totaling \$732,184.00 designated as either commissions or referral fees for 'steering' investors to the Heartland Companies. The Receiver believes that these payments were illegal

⁹ In that report the Receiver estimated that collections of investor settlements would exceed \$500,000.00.

inasmuch as they were not made to licensed securities representatives. The Receiver has completed research on the right of recovery of such transfers. Prior to the filing of litigation to recover these amounts, the Receiver is attempting to determine the ability of some of the claimants to pay. Several have filed large claims as creditors of the Receivership. A setoff of any payout may be the most appropriate way to deal with some persons in this class.

Liquidation of Personal Property

- 35. *Office Equipment.* As earlier discussed, the Heartland Companies have additional equipment in Grenada that is in the process of being liquidated.
- 36. *Motor Vehicles and Watercraft.* All vehicles which the Receiver has been able to obtain possession of have been liquidated except as follows:

Description	Estimated Value	Issue
Waverunner	??	No offers; poor conditon
Waverunner	??	No offers; poor condition
Pontoon Boat	\$6,000.00 to \$8,000.00	Title problems; Off brand; some missing parts; no keys
Harley Davidson Motorcycle	\$5,000.00 to \$6,500.00	Title problems; poor condition; offer to purchase received, subject to clear title
Ford Explorer (Grenada)	\$10,000.00 to \$12,000.00	See discussion in paragraph 29 above

Broker Dealer Claims

- 37. The Receiver has 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 value of these claims is

unknown at this time.

IRS Claims

38. The Receiver has discovered that Payne paid the approximate sum of \$500,000.00 to the Internal Revenue Service 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. The Receiver believes that this transfer was, in effect, a fraudulent conveyance of assets of the Heartland companies. The claim is being reviewed by counsel.

Costs of Administration of the Receivership

39. The Receiver, his law firm and the accounts 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 March 2001 through October 31, 2001. The accountants claims will approximate \$20,236.25; the Receiver's claim will approximate \$24,450.00 and the Receiver's counsel's claim will approximate \$79,013.50.

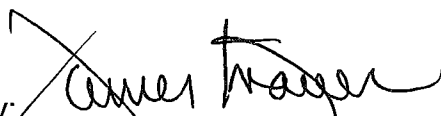
Current Accounting

40. A current reports showing the income and expenses of the Receivership is hereto as Exhibits "A."

Notice to Creditors and the public

41. This report will be posted on the Receiver's website withing seven days of its filing.

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

By: 
James A. Knauer, Receiver

