

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

UNITED STATES SECURITIES)
AND EXCHANGE COMMISSION,)
)
Plaintiff,)
) Civil Action No. IP00-1265 C -T/K
KENNETH R. PAYNE,)
JOHANN M. SMITH,)
DANIEL G. DANKER, CONSTANCE)
BROOKS-KIEFER,)
HEARTLAND FINANCIAL SERVICES,)
INC., AND JMS INVESTMENT)
GROUP, LLC.)
)
Defendants.)

RECEIVER’S FIFTH REPORT OF ACTS AND TRANSACTIONS

James A. Knauer, the Receiver for Heartland Financial Services, Inc., and JMS Investment Group, LLC, Defendants herein¹, in support of *Receiver’s Fifth Report of Acts and Transactions* states:

1. The undersigned was appointed Receiver for Heartland Financial Services, Inc. (“Heartland”) and JMS Investment Group, LLC (“JMS”) on August 21, 2000.
2. The Order appointing the Receiver directed that after the filing an initial inventory and appraisal of all property and assets in his possession or in the possession of others (the “Inventory Report”) the Receiver should file reports

¹ On December 26, 2000, the Court consolidated the assets and liabilities of the following companies: *Aero Technolgias Ltd.*, *Atlas Income Fund, LLC*, *BMC Investment Group, LLC*, *Carribbean Federal Trust, Ltd.*, *Carribbean Federal Services, Ltd.*, *Carribbean Financial Services*, *Carribbean Investments International, Ltd.*, *Celtic Centre II, Ltd.*, *Charmar, Ltd.*, *Dolphin International Development, Ltd.*, *Dolphin Peninsula Partners*, *First Fidelity Trust, Ltd.*, *First International Limited*, *Heartland Advisory Services, Inc.*, *Heartland Financial Services, Inc.*, *Heartland International Trust Services, Ltd.*, *Heartland Money Management of Florida, Inc.*, *International Leisure Centers, Inc.*, *JMS Investment Group, LLC*, *KJL Ltd. of Belize*, *Lincoln Fidelity Escrow Services*, *MDS Investment Ltd.*, *PMK, Ltd.*, *RMP, Ltd.*, *Terens, Ltd.*, *1st Century Bank Group, Ltd.*, *21st Century International Bank & Trust, Ltd. of Grenada*, *21st Century International Advisors, Inc.*, *21st Century International Advisors of Bermuda, Ltd.*, *21st Century International Advisors of Ireland, Ltd.*, *21st Century Personnel, LLC*, *Universal Financial Services, Ltd* and on July 5, 2001 the Court expanded the Receiver’s authority to include the assets of Kenneth R. Payne.

of his acts and transactions (the “Activity Reports”) in his official capacity as Receiver.

3. This is the Receiver’s fifth Activity Report.

BACKGROUND

4. 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 BGBC Partners, PC and the law firm of Kroger Gardis & Regas, L.L.P.
5. 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”).
6. 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.
7. 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.
8. 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 (hereafter collectively referred to as the “Heartland Companies”).

9. Due to the large number of creditors the Receiver maintains a website at www.heartlandfinancialinfo.com. The Heartland Companies website continues to be updated on a regular basis with copies of all pleadings filed in these and all related proceedings; a listing of miscellaneous 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.
10. The Receiver and his counsel continue to communicate directly with creditors providing them updates on the status of the case and recording any changes in their contact information.

ASSET COLLECTION AND LIQUIDATION SINCE THE RECEIVER’S FOURTH REPORT

Real Estate

11. *Payne Belize Real Estate*. As explained in an earlier report, litigation was pending in the country of Belize to establish ownership and the right to pay off a mortgage type of 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 Belizian law firm to represent him in what is essentially a real estate foreclosure suit by the contract seller seeking to recover fee title to the condominium². The value of the unit was believed to be between \$120,000.00 and \$150,000.00. The original developer (the contract seller) claimed ownership under Belizian law as a forfeiture due to missed payments or, alternatively, that Payne owed approximately

² The condominium seller claims that forfeiture has occurred and it is unclear under Belizian law whether this is enforceable.

\$100,000.00, when, in fact, Payne actually failed to make a balloon payment of only \$40,000.00 that was due in June of 2000. The Receiver had offered to pay the remaining balance of \$40,000 in order to obtain title to the condominium, plus interest, but settlement offers were rejected. The Receiver's position with regard to the facts surrounding the contract is set forth in a letter sent to his Belizian counsel early in the litigation, a copy of which is attached hereto as Exhibit "A". After unsatisfactory communications problems, the Receiver terminated his original counsel and engaged a second Belizian law firm who appeared to be more optimistic about a successful defense. The Receiver also engaged a local realtor in an effort to confirm the value of the condominium. The realtor advised the Receiver that many of the units had fallen into disrepair and some of the units had decreased in value. The Receiver then requested the realtor to make an inspection of the particular unit, but despite repeated efforts to obtain the information, the realtor, one Lincoln Eiley, was never able to gain access to the unit. When it became clear that settlement was not possible, the Receiver requested his local counsel to arrange for a trial which the Receiver planned to attend. Local counsel then advised that trials were rare in Belize and that the courts held sessions only in certain months. Also, despite what the Receiver believed was an outrageous claim by the developer, local counsel became considerably less enthusiastic in his assessment of a probable outcome. Since the developer was now claiming more than \$100,000 was due and the value of the condominium and condition of the development was questionable, the Receiver asked to be furnished with comparable sales information for units in the development and information concerning the time to affect the sale of a unit. This information was only provided to the Receiver orally (apparently the custom in Belize) and was not encouraging. The local realtor advised the sale of units in this particular development were stagnant and it could be 6 months to a year to sell the condominium if the trial was successful. About that time, the Receiver was contacted by his local counsel

to advise that a trial date had been scheduled and was to occur within 48 hours. Local counsel professed not to have known of the impending date, but stated that he doubted he could convince the court of that fact and accordingly, had entered into a settlement agreement for the Receiver (without the Receiver's knowledge or consent) to pay the sum of \$112,000 to obtain title to the condominium, but that such sum would have to be paid immediately. The Receiver had also learned that the ultimate sale of the unit would involve not only the payment of realtor fees and other sale expenses, but the payment of significant transfer taxes imposed under Belize law. In light of the lack of satisfactory information on the value and marketability of the unit, the Receiver refused to agree to the settlement terms negotiated by his counsel, after which the counsel stopped responding, except to advise the Receiver that a judgment would be entered in favor of the developer. Thus any value in this asset has not been realized.

Bank Accounts and Investments

12. *Miscellaneous US Bank Accounts and Investments.* Heartland owns illiquid investment units in several partnerships that the Receiver is attempting to sell. The total amount collected to date from all bank and investment accounts of the Heartland Companies and their principals is \$893,283.54³.

Offshore Deposits

13. Heartland controlled *21st Century Banking Group, Ltd.*, in the country of Grenada. This enterprise was a bank that closed shortly after it opened.⁴ In order to obtain approval to begin business, a statutory deposit to secure the bank's performance was paid to the Grenadian International Finance Authority ("GIFSA") in the amount of \$100,000.00. Thus far, the country of

³ Receivership Cash Flow Report, attached, (see Items "Acquired Funds", "FROM Heartland Bank One", "FROM Lincoln Fidelity Escrow" & a portion of "Other Inc.").

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

Grenada has not recognized the authority of the Receiver to obtain a refund of the deposit.⁵ The Receiver obtained approval from this Court to hire Grenadian counsel on a contingent fee basis to attempt collection of the bank deposit. After receiving a formal demand from the Receiver's Grenadian counsel, GIFSA refused to recognize the Receiver's authority to recover the deposit. Grenadian counsel filed suit in the Supreme Court of Grenada and the West Indies Associated States in November, 2003, in the cause styled In the Matter of 21st Century Banking Groups Limited, claim number GDA HVC 2003/0507 (the "Grenadian Proceedings"). Notice of the Grenadian Proceedings was published in the Grenada Government Gazette and The Grenadian Voice in April and May, 2004. The Grenadian Proceedings came to hearing on May 20, 2004, before Justice Francis Belle. The Grenadian court dismissed the case, finding that the Receiver lacked standing to pursue the matter. The court also refused to recognize what the Receiver believes to be a readily-identifiable link between Heartland and 21st Century. In 2005, the Receiver renewed his efforts to repatriate the funds on deposit with GIFSA. These efforts were hampered by hurricane damage to Grenadian local counsel's offices, and to the Grenadian Supreme Court chambers, which were destroyed. While the Receiver continues to seek advice on ways to collect the banking deposit, it is doubtful it will be successfully collected.⁶

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.

⁶ In an unrelated but similar proceeding, United States Securities and Exchange Commission v. Wellington Bank & Trust, et al., United States District Court, Southern District of Indiana, no. IP 01 0259 C H/G, the Receiver successfully caused the return of a GIFSA deposit, but with substantial and unexpected Grenadian receiver fees, and alleged statutory deductions from the deposit to the benefit of the Grenadian government.

Freeze Order Violations

14. *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.

Investor Claims for Repayment of Fictitious Profits

15. *Settlement of Investor Claims.* As previously reported, the Receiver has settled all of the recovery litigation and 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 \$2,738,955.53⁷. The Receiver also obtained a timeshare in Gatlinburg, Tennessee as a result of a settlement reached in a recovery litigation. The timeshare is currently listed for sale with a timeshare sales company, as well as several for sale by owner websites. The sale should yield approximately \$8,000.00.

Loans Commissions and Referral Fees

16. *Loans.* As of the last Activity Report the Receiver had filed a motion for summary judgment against Leslie Reed, who had received \$45,000 from the Heartland companies for services that were never performed, for which the Receiver obtained a judgment against Mr. Reed for the full amount. Mr. Reed filed bankruptcy on August 5th of 2005. The bankruptcy was deemed a “no-asset” case by the bankruptcy trustee.

Liquidation of Personal Property

17. Most of the personal property of the Heartland Companies or the individual Defendants has been liquidated and reduced to cash. Since the Receiver's

⁷ Receivership Cash Flow Report, attached, (see Item "Investor Repay").

last Activity Report, the following personal property has been liquidated.

<i>Property Description</i>	<i>Amount</i>
Jet Skis and Trailer	\$700.00
Rolex Watch	\$4,775.00
Firearms	\$550.00
TOTAL	\$6,025.00

18. There remains unliquidated some jewelry that was formerly the property of Payne which the Receiver had caused to be appraised. While the property was being liquidated, Mr. Payne sent the receiver a letter inquiring about its status and complaining that it was worth much more than the appraisals obtained by the Receiver. Accordingly, after receiving Payne's letter, the Receiver stopped the liquidation and the remaining property was appraised again. The second appraisal did not materially change the value opinions obtained from the first appraisal. The Receiver plans (as he once previously offered) to give Mr. Payne the opportunity to have his relatives make an offer to bid on the property (which is what Mr. Payne has suggested could occur in his letter), after which he will most likely offer it for sale on E-Bay.
19. The total amount collected to date from the sale of assets of the Heartland Companies and their principals is \$476,332.67⁸.

ADMINISTRATION

Costs of Administration of the Receivership

20. 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 December 2003 through May 31,

⁸ Receivership Cash Flow Report, attached, (see Item "Asset Sales").

2006. The accountants fees will approximate \$9,500.00 the Receiver's counsel's fees will approximate \$37,300.00 and the Receiver's fees will approximate \$9,000.00.

Current Accounting

21. A current report showing the income and expenses of the Receivership is hereto as Exhibit "B"

Closing of the Receivership

22. The Receiver believes that all remaining matters can be wound up, a final report filed and a final distribution made to all creditors by the end of this year.

Notice to Creditors and the Public

23. 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 Fifth Report of Acts and Transactions* and for all other proper relief.

/s/ James A. Knauer
James A. Knauer, Receiver
Attorney #5436-49

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing has been served upon the following parties by the Court's Electronic Case Filing System or by depositing a copy of same in the United States Mail, first class postage pre-paid, on this 12 day of July, 2006:

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