

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF INDIANA

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UNITED STATES SECURITIES))
AND EXCHANGE COMMISSION,))
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Plaintiff,))
)	Case No. 00-C-1265-JMS/TAB
))
)	Hon. Jane Magnus-Stinson
v.))
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))
KENNETH R. PAYNE, JOHANN M. SMITH,))
DANIEL G. DANKER, CONSTANCE))
BROOKS-KIEFER, HEARTLAND))
FINANCIAL SERVICES, INC., JMS))
INVESTMENT GROUP, LLC,))
))
Defendants.))
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**PLAINTIFF S REPLY MEMORANDUM IN SUPPORT OF ITS REQUEST FOR ENTRY OF A
PERMANENT INJUNCTION AGAINST DEFENDANT KENNETH R. PAYNE**

A. Introduction

Defendant acknowledged in his response brief (CM/ECF dkt. 37) and during the status hearing held on February 3, 2011, that the Court has the authority to enter the permanent injunction requested by the SEC. This is correct. *See, e.g., SEC v. Keller Corp.*, 323 F.2d 397, 402-03 (7th Cir. 1963) (expressly rejecting argument that injunction framed to enjoin future violations of specific securities laws violated Rule 65 of the Federal Rules of Civil Procedure). Moreover, Defendant does not contest the fact that most of the factors to be considered by the Court in determining whether to grant the statutory injunction weigh strongly in favor of the SEC’s position. *See SEC v. Church Extension of the Church of God, Inc.*, 429 F.Supp.2d 1045, 1048 (S.D. Ind. 2005) (the factors must be balanced and the SEC need not prove all factors

weigh in favor of the injunction). Rather, Defendant argues that no injunction should be entered because he claims he will be 71 years old when he is released from prison and therefore unlikely to be “running securities scams.” (Resp. at 2.) In the alternative, Defendant claims that the scope of the injunction should be limited in two ways: (a) it should apply only to him, to protect him from the wholly unsubstantiated worry that the SEC will abuse the injunction by using it to “scare” his future business partners; and/or (b) it should be modified to make clear “that the Defendant is not proscribed ... from participation in securities transactions which are exempt from registration.”

Each one of Defendant’s arguments, which are made without citation to any legal authority or evidence, is meritless and should be rejected. Statutory injunctions are important enforcement tools Congress specifically imparted to the SEC to protect the investing public from suffering further harm at the hands of those who already have committed serious breaches of the securities laws. A permanent injunction is more than warranted in this case.

B. The Balancing Factors Tip Decidedly In Favor Of The Injunction, And Defendant’s Age Upon Release From Prison And Belated Expressions of Remorse Do Not Overcome The Strong Inference That The Injunction Is Warranted.

In his response, Defendant does not dispute the egregiousness of his crimes or the gravity of the harm he inflicted on his investors. His complex investment scams defrauded literally hundreds of investors out of tens of millions of dollars. This conduct alone creates a strong inference that an injunction is appropriate here.¹ (See cases cited at CM/ECF dkt. 32 at 3.) Nor does he contest the extent of his own substantial participation in and knowledge of the frauds. As the president of Heartland and a former attorney, Defendant devised and committed these

¹ The massive fraud perpetrated in this case was not Defendant’s first misstep. Defendant was disbarred by the Indiana Supreme Court in 1986. See July 10, 1986, *Disciplinary Action*, Supreme Court of Indiana, attached as Exhibit 1.

frauds knowing full well their illegality and the horrific consequences they would have on his clients. In other words, this case did not involve isolated or technical violations of the securities laws. There were no close calls here. This fact – *i.e.*, Defendant’s degree of *scienter* – “bears heavily on the determination” to issue the injunction. *SEC v. Patterson*, No. 03-CV-302-CVE-PJC, 2006 WL 770626, * 3 (N.D. Okla. Mar. 23, 2006); *SEC v. Marker*, 427 F. Supp. 2d 583, 591 (M.D.N.C. 2006) (although not determinative, “the degree of [defendant’s] scienter bears heavily on the decision to issue an injunction”) (internal quotes and citation omitted). Defendant also does not dispute that his violations were recurring (essentially continuous) over an extended period of time, that he profited substantially from his conduct², and that he maintains a continued interest in the securities industry. Indeed, Defendant has indicated more than once in these proceedings that he believes he should be allowed to “participat[e] in securities transaction which are exempt from registration” (*see, e.g.*, Resp. at 2). He also has expressed concern that the injunction could interfere with his future business activities. The seriousness of the misconduct in this case, coupled with Defendant’s continued effort to preserve his ability to deal in unregistered securities, weigh strongly in favor of granting the injunction to protect future investors. *See SEC v. Bonastia*, 614 F.2d 908, 912-13 (3d Cir. 1980) (noting that cases involving numerous violations over an extended period weigh “heavily in favor of the imposition of an injunction”).

The primary reason advanced by Defendant against the issuance of a permanent injunction is that he claims he will be 71 when he is released from prison. Although Defendant (significantly) has not given assurances that he will not engage in future securities law violations, he quips: “How many penniless 70 year old multiple heart attack sufferers do you know are out

² *See SEC v. Quinlan*, 373 Fed. Appx. 581, 586 (6th Cir. 2010) (noting that defendant benefitted from his misconduct and may return to it once released from prison).

there running securities scams?’. (Resp. at 1-2.) There are at least two reasons Defendant’s argument should be rejected. First, according to the Federal Bureau of Prisons, Defendant is presently 61 years old and his projected release date is January 23, 2016, when he will be 66. (See Federal Bureau of Prisons Record for Kenneth Richard Payne, attached as Exhibit 2.)³ Second, even if Defendant were correct, and he was not released until he was 71, that factor does not overcome the strength of the other factors weighing heavily in favor of this Court granting the requested permanent injunction to protect future investors. Defendant cites no authority supporting his position. Moreover, courts have entered permanent injunctions against imprisoned defendants who will be in their sixties and seventies when released. See e.g., *SEC v. Blackwell*, 477 F. Supp. 2d 891, 912 (S.D. Ohio 2007) (granting injunction, notwithstanding fact defendant will be 70 when released from prison); *SEC v. Black*, No. 04 C 7377, 2008 WL 4394891, *21 (N.D. Ill. Sept. 24, 2008) (finding that defendant’s imprisonment until he was 70 was not sufficient reason to deny permanent injunction barring defendant from future securities law violations); *Marker*, 427 F. Supp. 2d at 591 (where defendant’s fraud involved 43 investors and over \$4.6 million, fact that defendant will be in his sixties when he is released from prison was not sufficient reason to deny injunction). Defendant’s age will not inhibit his ability to perpetrate similar investment scams.⁴

At the status hearing on February 3, 2011, Defendant indicated that he wanted to express his regret and apologize for his misconduct. Although expressions of remorse are one factor the courts may consider it determining whether to grant a permanent injunction, a defendant’s self-serving statements of regret should be given little weight when they surface after the defendant

³ Defendant was born in 1949. (See CM/ECF 20-6 at 1.)

⁴ Bernard Madoff was 70 when he pled guilty to running the country’s largest Ponzi scheme. (See http://en.wikipedia.org/wiki/Bernard_Madoff.)

has been caught. *SEC v. Koracorp. Indus., Inc.*, 575 F.2d 692, 698 (9th Cir. 1978) (“Promises of reformation and acts of contrition are relevant in deciding whether an injunction shall issue, but neither is conclusive or even necessarily persuasive, especially if no evidence of remorse surfaces until the violator is caught.”); *SEC v. First City Fin. Corp.*, 688 F.Supp. 705, 725-26 (D.D.C. 1988) (same). Here, Defendant’s belated expression of remorse, while welcome, comes many years after he was caught and convicted, and only after the SEC filed its motion seeking a permanent injunction. This factor should be given no or little weight in these circumstances.⁵

Defendant’s unsubstantiated assertion that the entry of a permanent injunction creates a situation rife for abuse by the Government – supposedly because an “SEC employee 15 years from now can slap a copy of a dusty covered injunction on anyone that [Defendant does] business with, scare the hell out of them, and ruin any chance [Defendant] has to make even a modest living” – is meritless. Not surprisingly, Defendant cites no authority and not a single example to validate his fanciful hypothetical. The SEC staff does not have the time or resources to track endlessly the affairs of this or any other defendant. In fact, because the SEC cannot be everywhere at all times, the injunction serves as an important deterrent for defendants who might be tempted to pick up where they left off. The injunction, including the remedies available for its violation, is a significant and efficient enforcement tool provided to the SEC by Congress to protect the investing public from being harmed once again by people who already have committed egregious violations of the law. *See Bonastia*, 614 F.2d at 912-13 (recognizing the “importance of injunctions in enforcing the securities laws” and to deter the violator from

⁵ Further detracting from the weight, if any, to be accorded this factor is the fact that after Defendant’s frauds were discovered by the SEC, Defendant did not turn himself in. He used a false passport and other government documents, and then fled the country to evade capture. He was arrested in Mexico. (*See* Chris Carey, *Diamonds, cash aided getaway*, Indianapolis Star, October 1, 2000, http://www2.indystar.com/library/factfiles/crime/financial/heartland/stories/2000_1001.html, which is attached hereto as Exhibit 3.)

committing future infractions). Because a violation of the injunction is punishable through contempt, *SEC v. Dimensional Entertainment Corp.*, 518 F.Supp. 773, 776 (S.D.N.Y. 1981), it helps “streamline future enforcement efforts” in the event a defendant commits additional violations of the specified securities laws. *Church Extension*, 429 F.Supp.2d at 1049; *Blackwell*, 477 F. Supp. 2d at 910 (“Injunctions ease the Commission’s access to the court because they permit the Commission to forgo certain administrative requirements that might delay the commencement of future actions.”). Under the circumstances of this case, the investing public deserves the protections afforded by the entry of a permanent injunction.

C. The Scope And Terms Of The Proposed Injunction Are Appropriate And Have Been Approved By This And Many Other Courts.

Finally, Defendant challenges the scope and terms of the injunction in two respects. First, he claims it should apply only to him, so as to negate the possibility that the SEC will use it to scare away his future business partners. Defendant’s unsubstantiated hypothetical is addressed above. Moreover, the express wording of the proposed injunction limits its application to “Defendant’s agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of this Judgment.” This language tracks almost verbatim the language approved by Rule 65(d)(2), which provides:

(2) *Persons Bound.* The order binds only the following who receive actual notice of it by personal service or otherwise:

- (A) the parties;
- (B) the parties’ officers, agents, servants, employees, and attorneys; and
- (C) other persons who are in active concert or participation with anyone described in Rule 65(d)(2)(A) or (B).

Fed. R. Civ. P. 65(d)(2). This language has been included in SEC statutory injunctions for many years and has been approved by countless courts, including this one. *See, e.g., SEC v. Montana*, No. 1:03-cv-1513-SEB-VSS, 2007 WL 1536842, *2 (S.D. Ind. May 23, 2007) (attached as part of Group Ex. 2 to SEC's Supplemental Brief in Support of Permanent Injunction) (CM/ECF dkt. 33-2 at 1-3.)

Similarly, Defendant's complaint that the injunction must make "crystal clear that the Defendant is not proscribed by the order from participating in securities transactions which are exempt from registration" (Resp. at 4) is misplaced. Section 5 of the Securities Act of 1933 governs the registration of securities. Section II of the proposed injunction, which enjoins future violations of Section 5, expressly states that it applies "in the absence of any applicable exemption." The language of the injunction pertaining to Section 5, therefore, appropriately specifies that certain exemptions may apply. Again, this language has been approved time and time again by courts throughout the country, including this one. (CM/ECF dkt. 33-2 at 2.)⁶

To the extent Defendant continues to suggest that the federal securities laws do not apply to transactions in unregistered securities that are exempt from registration, Defendant is simply wrong. Although the sale of an unregistered security may not violate Section 5 (if it is exempt from the registration requirements of that statute), it still could run afoul of other securities laws. For example, the sale of an unregistered security, although exempt from registration, may violate the anti-fraud sections of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act of 1934) if the seller makes material misrepresentations of fact to induce a would-be investor to buy the security. Parties may not fraudulently induce the purchase or sale of a security simply because that security is not required to be registered.

⁶ Rather than inundate the Court with copies of injunctions entered by courts in other cases, counsel will certainly provide examples of such injunctions should the Court desire to review them.

Defendant's persistence in pressing the argument that he cannot be enjoined from selling unregistered securities that are exempt from registration raises troubling concerns. Defendant's position strongly suggests that he is contemplating a return to the securities industry. Given Defendant's apparent misunderstanding of the scope of federal securities laws, there is even a greater likelihood that Defendant will violate those laws in the future. This further underscores the need for the issuance of an injunction to protect the public. *See SEC v. Quinlan*, No. 02-60082, 2008 WL 4852904, *12 (E.D. Mich. Nov. 7, 2008) (noting that defendant's challenge to injunction as being time-barred was made so defendant could retain access to the investment industry upon release from prison).

D. Conclusion

Congress statutorily authorized the SEC to seek permanent injunctions barring defendants from violations of the securities laws. The injunction is a critical tool used by the SEC to aid its core mission – the protection of investors from fraudulent and unscrupulous behavior. In determining whether to grant a permanent injunction, the Court must balance several factors. Here, the balance of those factors tips decidedly in favor of the SEC. This is a case where Defendant egregiously, repeatedly and continuously violated the securities laws over an extended period of time, causing the investing public to lose tens of millions of dollars. Defendant has shown a continued interest in the securities industry, as well as a misunderstanding of the scope and application of the securities laws. The entry of the permanent injunction in this case is not only warranted but necessary to protect the public.

Respectfully submitted,

**UNITED STATES SECURITIES
AND EXCHANGE COMMISSION**

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing document 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 February 10, 2010:

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