

## FACTUAL BASIS FOR PLEA

This investigation determined that Kenneth R. Payne, with the assistance of others, operated a multi-million dollar stock fraud "Ponzi" investment scheme from the offices of Heartland Financial Services, Inc., 8060 Knue Road, Indianapolis, IN, from at least late 1996 to August 2000. Payne was founder, president, and owner of HFS, Inc. which began operations in 1991 or 1992. Daniel Danker was the vice-president and secretary of HFS and a close associate of Payne's. Initially, Payne's goal was to run a full-service brokerage service with lawyers, investment brokers, and accountants on staff that offered various financial and investment services, including annuities, mutual funds, estate planning, and some stocks and bonds. Payne recruited clients through newspaper advertisements, dinner seminars, and mailers. Sometime around 1995 or 1996, Payne realized that with his new client ratio, he could not compete with legitimate investment brokerage firms. At that point, Payne made a conscious decision to offer investment opportunities that paid higher rates of return than could be secured at legitimate brokerage firms, and thus attract more customers. Payne then created the first "Ponzi" scheme, which was an investment opportunity entitled Atlas Income Fund. Later, during approximately 1997, Payne created a more lucrative "Ponzi" investment scheme entitled JMS Investment Group LLC. Both of these investment schemes will be detailed shortly.

With the creation of these "Ponzi" schemes, HFS, Inc. grew significantly. During 1996, deposits to the account from investors' funds totaled approximately 2.3 million dollars. During 1999, deposits to this account exceeded 13 million. Prior to the shut down of HFS, Inc. in August 2000, deposits to this account had also exceeded 13 million dollars for the year

2000. The client base for HFS, Inc. increased from a handful of repeat investors during the early years, to over 600 investors during the year 2000. As the business grew, Payne hired various individuals to assist in operating the business, including Johann Smith and Constance Brooks-Kiefer. Smith was hired to assist in estate planning and to be the investment fund manager for JMS Investment Group LLC. Brooks-Kiefer was hired to oversee the bookkeeping at HFS, Inc. and to supervise computer automation. However, Payne maintained complete authority at HFS, Inc. He made the ultimate decisions concerning the operation of the business. He supervised the recruitment of new investors and recruited most of them himself. Payne supervised the creation of records that were mailed to investors detailing their alleged investments. He represented to the investors that he was personally responsible for purchasing stocks that were then allegedly made available to HFS, Inc. clients for purchase. He planned seminars for HFS, Inc. clients that were conducted in various locations. He approved all checks written on behalf of HFS, Inc. including those that represented returns on investment, interest, or dividends.

As to the actual operation of the "Ponzi" schemes, Payne and other HFS, Inc. representatives systematically accepted large sums of money (usually checks) purportedly for investment opportunities and investment packages promoted by Heartland. Although a small amount of the funds accepted were actually invested in some stocks, banks, and other entities, the majority of the funds were deposited into bank accounts held and controlled by HFS, Inc, primarily an account maintained at Union Planters Bank entitled Lincoln Fidelity Escrow. Even the very small percentage of money actually invested was not invested at the time or at the low (usually the IPO) price Payne represented to the investors through confirmation and

portfolio statements. The monies deposited were subsequently disbursed for the personal use of Kenneth Payne, and other HFS, Inc. officers and employees, or to further the "Ponzi" scheme by paying HFS, Inc. operating and travel expenses, commission, and payments to investors purporting to be returns on investments. The amount of money lost by investors in this scheme has been determined to be at least 10 million dollars. The investigation has determined that four HFS, Inc. officers and employees were criminally culpable in this scheme, and those individuals are Kenneth R. Payne, Daniel G. Danker, Johann M. Smith, and Constance Brooks-Kiefer. In addition, Payne recruited Mark Berger to pose as a stock broker, a fictitious person named J. Silverman. Payne told investors that Silverman was a broker from Goldman Sachs, a prominent stock brokerage firm in New York, through whom he obtained stocks at an initial public offering price.

The following is a description of the different investment opportunities offered by HFS, Inc:

#### **ATLAS INCOME FUND**

Kenneth R. Payne through Heartland agents, employees, and officers (some unknowingly) represented to investors that their money would be invested in unit investment trusts (UITs). Each UIT was given an identification number that was assigned for each initial investment by the investor. It was represented to investors that UITs purchased in the Atlas Income Fund were similar to money market funds that paid a guaranteed rate of return for a fixed period of time. For example, some investors were guaranteed a rate of return of 15.8% for a period of 2 years, others were guaranteed a rate of return of 14.3% for 4 years, and still others were guaranteed 13.9% for 5 years. The investigation determined that there were no

assets or equities acquired as represented relative to the Atlas Income Fund.

**JMS, BMC, AND MDS LLC'S INVESTMENT GROUP**

Kenneth R. Payne and other HFS, Inc. employees and officers sold investors "units" in these investments groups for \$10,000.00 per unit. These units purportedly represented a specific number of shares in a specific publicly traded corporation, and they were represented to be comprised almost exclusively of bank and technology stocks. Bank stocks were represented by Payne to have been purchased at or near the time the bank's stock was sold publicly. Payne told investors that HFS, Inc. was able to obtain the bank stocks at the price the stock was initially sold because Heartland had opened accounts at the banks before they went public. Payne required that investors hold these stocks for a minimum period of time, usually 18 months. The investigation determined that although accounts were opened at numerous banks throughout the country prior to their initial public sale of stock, the large number of shares purportedly sold to investors were not purchased by Heartland. Also, in most cases, the bank stock shares were not purchased at the initial price that they were sold to the public, but rather at the market price at date later than the date HFS told investors they were purchased. In similar fashion, technology stocks were represented by Payne to have been purchased at the initial public offering (IPO) price. Payne told investors that he had a relationship with the New York brokerage firm Goldman Sachs that supplied HFS, Inc. with a large number of shares at the IPO price, provided that the investors held the stocks for a year and a day before selling them. The investigation determined that Payne had no such relationship with Goldman Sachs, and therefore no opportunity to purchase the technology stocks at their IPO price. In fact, HFS, Inc. purchased some shares of the technology stocks

they promoted to investors at a local discount brokerage firm (Olde Discount Corporation), at the current market price, after their initial public offering. Again, with certain stocks, the total number of shares purportedly sold to investors were not purchased. In other instances none of the shares purportedly sold to investors were purchased. Investments in these funds were deposited into the Lincoln Fidelity Escrow account and used by Payne to further the Ponzi scheme.

### **MAIL FRAUD COUNTS 1 -5**

Regular mailings by HFS, Inc. included prospectuses and stock analysis for various bank and technology stocks offered to HFS, Inc. clients, quarterly portfolio statements, and confirmation statements relating to specific alleged investments made by HFS, Inc. clients.

Included in these mailings were

1) A JMS Investment Group LLC confirmation statement dated March 20, 1996, that was mailed from 8060 Knue Road, Indianapolis, IN 46240 to an investor showing the purchase of \$10,000 in bank stock that was not purchased as represented in the confirmation statement (Count 1):

2) An Atlas Income Fund confirmation statement dated April 15, 1996, that was mailed from 8060 Knue Rd., Indianapolis, IN 46240 to an investor showing a \$5,000 investment in the Atlas Income Fund that was not purchased as represented in the confirmation statement (Count 2)

3) An Atlas Income Fund confirmation statement dated May 23, 1997, that was mailed from 8060 Knue Rd., Indianapolis, IN 46240 to an investor showing a \$15,000 investment in the Atlas Income Fund that was not purchased as represented in the confirmation statement

(Count 3);

4) An Atlas Income Fund Confirmation statement dated September 8, 1997, that was mailed form 8060 Knue Rd., Indianapolis, IN 46240 to an investor showing a \$531,000 investment in the Altas Income Fund that was not purchased as represented in the confirmation statement (Count 4);

5) A JMS Investment Group LLC confirmation statement dated July 24, 1998, that was mailed form 8060 Knue Rd., Indianapolis, IN 46240 to an investor showing the purchase of \$12,000 in bank stock that was not purchased as represented in the confirmation statement (Count 5).

**MONEY LAUNDERING (Count 1 of Information)**

In the last months of the Ponzi scheme, Payne claimed to certain investors that he obtained CORIO, Inc. shares personally as a result of being a top IPO stock salesman for Goldman Sachs. Payne told investors he was willing to sell them some of the CORIO stock at the special price but that the investors needed to pay him personally rather than make their check payable to HFS companies. Making these representations, Payne obtained approximately \$625,000 in checks from investors payable to him personally which he deposited into his personal checking account Union Planters Bank in Indianapolis. Almost all of these investor funds were obtained as a result of Payne offering them shares of a technology stock entitled CORIO, Inc. The investigation determined that neither Payne nor HFS, Inc. ever owned any shares of CORIO and that Payne never had a relationship with Goldman Sachs or its agents.

On July 19, 2000, Kenneth R. Payne made a \$245,000.00 withdrawal from his

personal bank account at Union Planters Bank. With the \$245,000.00 withdrawal, Payne purchased the following cashier's checks, in addition to withdrawing \$25,000.00 in currency:

A \$20,000.00 cashier's check payable to Connie Kiefer.

A \$25,000.00 cashier's check payable to himself.

A \$25,000.00 cashier's check payable to himself.

A \$10,000.00 cashier's check payable to Bettie Sue Payne.

Another \$20,000.00 cashier's check payable to Bettie Sue Payne.

A \$20,000.00 cashier's check payable to Herbert Eaton.

Another \$100,000.00 cashier's check payable to Herbert Eaton.

Bettie Sue Payne was Kenneth Payne's wife at the time of the withdrawal.

Herbert Eaton owns Eaton's Gold Mandrel of Indianapolis. The cashier's checks were used to purchase numerous loose diamonds. Payne cashed at least one of the cashier's checks payable to Payne himself.

#### **EVIDENCE RELATING TO USE OF MASS MARKETING TO FURTHER THE SCHEME**

Throughout the period of the Ponzi scheme, Payne used several mass-marketing means to solicit investors. Through Heartland, he sent out mass mailings inviting persons to attend dinner meetings at which Heartland presented its various investment schemes. He also advertised on television and in the newspaper soliciting investors for Heartland. HFS had an advertisement sign at Market Square Arena. Many of the victims who lost money through investments at Heartland began their relationship with Heartland as a result of the mass marketing methods used by Payne.

**EVIDENCE RELATING TO  
SOPHISTICATED MEANS OF EXECUTION OF THE SCHEME**

Throughout the course of the scheme Payne maintained a two story office in upscale commercial office space in the Castleton area. He hired several employees, most of whom were unaware of the illegal scheme, to work at Heartland. He had a computerized and well organized filing system at Heartland and kept detailed records concerning the investors and their purported investments. Using this system, Heartland routinely mailed out quarterly portfolio statements which reflected the alleged market value of the alleged stock investments at the time of the statement. Payne treated some of the client investors to vacations in locations such as Cozumel and the Bahamas paying the airfare and hotel for the investors. He also treated many investors to free tickets to expensive concerts, shows, and Pacer games.

**EVIDENCE RELATING TO ABUSE OF POSITION OF TRUST**

Payne was the President and owner of a financial investment firm and had a fiduciary duty to his clients. His clients turned over millions of dollars to him to invest for their future; many of the investors were persuaded to take funds from their retirement IRAs and turn them over to Payne to invest for their future.

**EVIDENCE RELATING TO  
OBSTRUCTION OF JUSTICE**

In about July 2000 Payne became aware that he and other Heartland agents and employees were under criminal investigation for the business dealings occurring at Heartland. Payne retained a criminal attorney and agreed to meet with an Assistant United States Attorney and IRS and FBI agents to be interviewed concerning the case. At the first meeting which was on August 23, 2000, Payne outlined the various Ponzi schemes and was advised that he would

be charged and that he was facing prison time as a result of his activities. At that meeting, Payne represented that he would not flee the jurisdiction and that he would continue to cooperate in the investigation. He turned over his valid United States passport to the United States Attorney's office and agreed to meet again at the United States Attorney's Office on September 6, 2000.

On September 6, 2000, Payne's attorney contacted the United States Attorney's office to advise that Payne would not be at the meeting and that the attorney did not know where Payne had gone. That day the government obtained an arrest warrant for Payne. The United States Marshal's Service assigned Deputy United States Marshal Steve Prosser to commence a fugitive investigation. Deputy Prosser learned that while Payne ostensibly had been cooperating with the United States in the criminal investigation, Payne had obtained a false United States Passport in the name of David R. Baldwin, an individual who has recently died and who had been a friend of Payne's. Prosser learned that Payne had fled the United States and was hiding in The Netherlands but that he had plans to travel to Cancun, Mexico.

On September 28, 2000, Deputy Prosser located Payne at the Cancun, Mexico airport after Prosser followed one of Payne's Indianapolis girlfriends from Indianapolis to the Cancun Airport. Payne was deported by Mexican officials at the Cancun airport to the custody of Deputy Prosser based on the fact he was traveling under a false passport which he had on his person at the time. At the time of the deportation, Payne said he was having chest pains. Because of Payne's medical complaints, the commercial airlines refused to let Payne board the commercial flight with Deputy Prosser. Therefore the United States Marshal's service contracted with a private air ambulance out of Miami, Florida to have Payne brought back to

Indianapolis for a cost to the United States of approximately \$30,000.