

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA

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U.S. DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
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LAURA A. BRIGGS
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UNITED STATES SECURITIES)
AND EXCHANGE COMMISSION,)
)
Plaintiff,)
)
KENNETH R. PAYNE,)
JOHANN M. SMITH,)
DANIEL G. BANKER, CONSTANCE)
BROOKS-KIEFER,)
HEARTLAND FINANCIAL SERVICES,)
INC., AND JMS INVESTMENT)
GROUP, LLC.)
)
Defendants.)

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

MEMORANDUM OF LAW IN SUPPORT OF RECEIVER'S MOTION TO APPROVE SETTLEMENT OF CLAIMS AGAINST CERTAIN INVESTORS IN THE HEARTLAND COMPANIES WHO RECEIVED PAYMENTS IN EXCESS OF THEIR INVESTMENTS

GENERAL SUMMARY OF THE RELIEF REQUESTED IN THE MOTION

James A. Knauer, the Receiver for Heartland Financial Services, Inc. ("Heartland") and JMS Investment Group, Inc. ("JMS") has filed with the court his *Receiver's Motion to Approve Settlement of Claims Against Certain Investors in the Heartland Companies Who Received Payments in Excess of Their Investments (the "Settlement Motion")*. The motion seeks the approval of this court for a compromise of claims of the Receivership against certain investors in the Heartland Companies who received what are described as "Excess Payments". Excess Payments are defined in the Settlement Motion as payments to investors in a Ponzi Scheme that exceed the amount of their aggregate principal investment.

The Settlement Motion further explains that On November 16, 2000, the Receiver sent a letter to approximately 135 investors who received Excess Payments from the Heartland Companies. The Receiver's letter sought to induce investors who had received Excess Payments to enter into a settlement agreement with the Receiver by the terms of which the investor would agree to pay to the Receivership eighty-five per cent (85%) of the

77

Excess Payments that they had received. The Receiver's letter provides that any such settlement accepted by the investor is subject to the approval of this Court.

Many investors have expressed an intent to accept the Receiver's settlement proposal. The Receiver represents to the Court that he believes that the settlement proposal represents a fair and reasonable offer when weighed against the costs of litigation with each individual investor to recover upon the claims for receipt of the Excess Payments. The Receiver explains in the Settlement Motion that he did not extend the settlement proposal to those investors who received the largest Excess Payments because he believes that the applicable law is well settled and the costs of litigation with those investors, although significant, will not approach the 15% discount that has been proposed to be extended to the investors who received smaller sums. The modest discount of 15% is clearly an attempt to avoid both the costs of litigation and the costs of collection.

APPLICABLE LAW

Payments to investors in a Ponzi Scheme that exceed their actual principal investment are recoverable by federal receiver. In the signal case of *Scholes V. Lehmann*, 56 F.3d 750 (7th Cir. 1995), Phillips was an innocent investor from whom the federal receiver sought to recover Excess Payments. The court held:

"The money used for the trades came from investors gulled by fraudulent representations. Phillips was one of those investors, and it may seem "only fair" that he should be entitled to the profits on trades made with his money. That would be true as between him and Douglas or Douglas's corporations. It is not true as between him and either the creditors of or the other investors in the corporations. He should not be permitted to benefit from a fraud at their expense merely because he was not himself to blame for the fraud. All he is being asked to do is to return the net profits of his investment - the difference between what he put in at the beginning and what he had at the end."
Scholes V. Lehmann , 56 F.3d 750 at 755.

The Receiver believes that the law which is most clearly applicable to this Court's consideration of the Receiver's settlement proposal is that which has been applied by courts of bankruptcy where, as here, the interests of parties who are creditors are not individually represented before the court. The applicable standard was enunciated *in In*

re Martin, ___ F.3d ___ (8th Cir. 1997).

"The standard for compromise and approval of a settlement is whether the settlement is 'fair and equitable' and 'in the best interests of the estate.'" In *re Apex Oil Company, et al.*, 92 B.R. 847, 867 (Bankr. E.D. Mo. 1988), quoting, *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424, 88 S.Ct. 1157, 1163, (1968). "The purpose of a compromise is to 'allow the trustee and creditor[s] to avoid the expenses and burdens associated with litigating sharply contested and dubious claims.'" *Apex Oil Company*, 92 B.R. at 866, quoting, *United States v. Alaska Nat'l Bank, (In re Walsh Constr., Inc.)* 669 F.2d 1325,1328 (9th Cir. 1982). In so doing, it is not necessary for a bankruptcy court to conclusively determine claims subject to a compromise, nor must the court have all of the information necessary to resolve the factual dispute, for by so doing, there would be no need of settlement. *New Concept Housing, Inc.*, 951 F.2d at 939. Neither must the court find that the settlement constitutes the best result obtainable. Rather, the court need only canvass the issues to determine that the settlement does not fall "'below the lowest point in the range of reasonableness.'" *Apex Oil Company*, 92 B.R. 67, quoting, *Cosoff v. Rodman (In re W.T. Grant Co.)*, 699 F.2d 599, 608 (2d Cir.), cert denied, 464 U.S. 822, 104 S.Ct. 89, 78 L.Ed.2d 97 (1983). See also, *New Concept Housing, Inc.*, 951 F.2d at 938.

Here, the Receiver has negotiated a settlement of a claim for 85% of its maximum recoverable value. While the dollar amount of recovery varies considerably, the 15% discount proposed by the Receiver to be given the settling parties is reasonable and fair. Although premised upon the concept of averting litigation costs, in some cases (the smaller settlements) the actual cost of litigation and collection of such a claim would be considerably higher than the proposed discount.¹

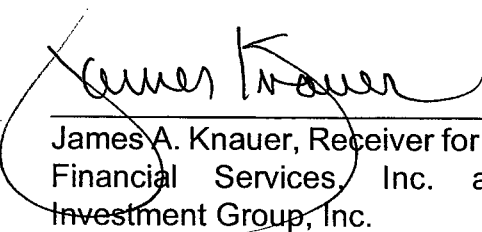
"The court does not substitute its judgment for that of the

¹ The Receiver does not preclude the possibility that he may later seek to settle other similar claims for a greater or lesser discount. While all of the Excess Payment claims proceed on the same legal premise, nevertheless, there may be mitigating factors warranting additional consideration. For example, some investors may simply not have the funds to pay the settlement and their individual financial condition may be a very relevant point.

trustee, but reviews the issues to see if the settlement falls below the lowest point of reasonableness. In re Bates, No. BKY4-95-4063, 1997 WL 392434 at *5 (Bankr. D. Minn. July 9, 1997). After considering all of the factors involved, the court should approve a proposed settlement only if it is "fair and equitable and in the best interests of the estate." Id. See also, Protective Comm. For Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424, 88 S.Ct. 1157 (1968). [9] In assessing the reasonableness of a settlement, the factors to be considered can be summarized as follows: (A) the probability of success in the litigation; (B) the difficulties, if any, to be encountered in the matter of collection; (C) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (D) the paramount interest of the creditors and a proper deference to their reasonable views in the premises. [10] Id., quoting, Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1929). Accord, In re Bowman, 181 B.R. 836, 843 (Bankr. D. Md. 1995). *In re Martin*, ___ F.3d ___ (8th Cir. 1997) at

In view of the amount of each of the proposed settlements in relation to the total claim, the Receiver does not believe that an evidentiary hearing on each of the settlements is necessary or prudent. Indeed, some of the settling investors are doing so to avoid the necessity of hiring counsel or appearing in court. Each of the settling investors have accepted the Receiver's calculation of their liability and each has agreed to pay the discounted settlement amount. The liability is primarily a question of law from that point on, thus a formal hearing would not provide the court with additional evidence not already set out in the calculations contained in the attachments to the Settlement Motion.

THEREFORE the Receiver requests that the court approve the Settlement Motion and for all other proper relief.


James A. Knauer, Receiver for Heartland
Financial Services, Inc. and JMS
Investment Group, Inc.

CERTIFICATE OF SERVICE

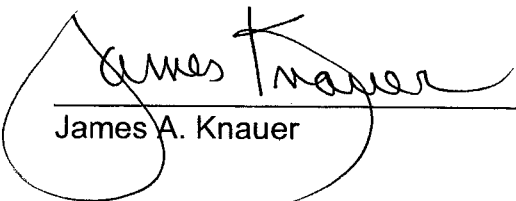
The undersigned hereby certifies that the foregoing has been served on the following counsel of record by placing a copy in the United States Mail, first class, postage pre-paid, this 30 day of December, 2000:

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