

10/5/01

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

JAMES A. KNAUER as the Court Appointed)
Receiver for HEARTLAND)
FINANCIAL SERVICES, INC., and JMS)
INVESTMENT GROUP, LLC,)

Plaintiff,)

v.)

CAUSE NO. IP01-1168-C T/K

JONATHON ROBERTS FINANCIAL)
GROUP, INC.,)
ALLIANCE CAPITAL MANAGEMENT)
CORP.,)
ANDOVER SECURITIES INC.,)
FSC SECURITIES CORPORATION, and)
FFP SECURITIES, INC.,)

Defendants.)

**MEMORANDUM IN SUPPORT OF FFP SECURITIES, INC.'S MOTION TO DISMISS
PLAINTIFF'S COMPLAINT**

Defendant FFP Securities, Inc. ("FFP"), by counsel, submits this memorandum in support of its motion to dismiss plaintiff's Complaint pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure.

INTRODUCTION

Plaintiff, the receiver for two corporations that engaged in an elaborate Ponzi scheme, has asserted claims on behalf of investors who lost money as a result of the alleged fraud. The receiver alleges that defendants, all brokerage firms, are liable for those losses because the officers of the corporations engaged in the wrongdoing were registered as representatives of defendants at the time they engaged in their fraud.

The receiver has no standing to assert such claims. The receiver can only assert claims of the corporations in receivership in order to recover their assets. Because the receiver is asserting only claims on behalf of investors and is not alleging that FFP holds any assets of the corporations or otherwise was involved in or benefited from the Ponzi scheme, the Complaint must be dismissed in its entirety.

Factual Background

On August 21, 2000, this Court appointed James A. Knauer to act as receiver for two corporations, Heartland Financial Services, Inc. (“Heartland”) and JMS Investment Group, LLC (“JMS”). The appointment of a receiver was made at the behest of the Securities & Exchange Commission following the filing of its Complaint against Heartland, JMS and certain individuals alleging that they had engaged in a Ponzi scheme to defraud investors. United States Securities & Exchange Commission v. Kenneth R. Payne, et al., No. IP00-1265 (the “SEC Complaint”). This Court appointed Mr. Knauer as receiver “for the benefit of investors to marshal, conserve, protect, hold funds, operate, and, with the approval of the Court, dispose of any wasting assets, wherever those assets may be found, of Heartland.” Agreed Order Appointing Receiver for Heartland Financial Services, Inc., dated August 21, 2000 (the “Agreed Order”)(attached as Exhibit A), ¶1.¹

Kenneth Payne and Daniel Danker were officers and employees of Heartland and JMS during the relevant time period. The SEC Complaint, which is incorporated by reference into plaintiff’s Complaint (Complaint ¶ 26), alleges that Payne, Danker and others formed Heartland and JMS Investment Group for the purpose of soliciting investments and running a Ponzi scheme. SEC Complaint ¶ 1. Heartland operated as a broker-dealer, selling various

¹ The Agreed Order appointing plaintiff as receiver for JMS Investment Group, LLC contains identical language.

securities and also issuing “units” in Heartland. SEC Complaint ¶¶ 46, 49. JMS issued “units” at \$10,000 apiece representing investments in financial institution initial public offerings. SEC Complaint ¶¶ 20, 34, 71. JMS also sold shares in offshore banks located in Belize. SEC Complaint ¶¶ 40-45, 71. All funds were deposited and commingled in a Lincoln Fidelity Escrow Account, and instead of being used to purchase investments were diverted to the personal use of Payne, Danker and others. SEC Complaint ¶¶ 21, 35, 51, 57, 62, 65, 71. Fake confirmations and account statements were issued to the investors by Heartland and JMS to cover up their fraud. SEC Complaint ¶¶ 37, 70, 52.

Payne and Danker were both licensed securities brokers. During the time period that they operated Heartland and JMS, they were also affiliated with several brokerage firms, including FFP. Payne and Danker were registered representatives of FFP from February 26, 1997 to October 1, 1998. Payne and Danker maintained similar relationships with defendant Andover Securities, Inc. from December 1991 to January 1996, FSC Securities Corporation from January 1996 to February 1997, and Jonathon Roberts Financial Group from March 1999 to March 2000. See Complaint ¶¶ 20-21.

Significantly, there is no allegation that FFP (nor any other of the brokerage firm defendants) participated in any way in the activities of Heartland or JMS, that any of the defendants received any of the monies invested in Heartland or JMS or that they benefited in any way from the alleged Ponzi scheme of Payne and Danker. There is no allegation that any of the defrauded investors were customers of FFP. Nor is there any allegation that any of the transactions were made through or approved by FFP. Indeed, the Complaint affirmatively alleges that “Payne and Danker were offering investments that were not approved or authorized by the brokerage firms with whom Payne and Danker were licensed.” Complaint ¶ 44.

The gravamen of the Complaint is that FFP is liable to investors in Heartland/JMS because Payne and Danker were the agents of, or under the control of, FFP. Complaint ¶ 35. The receiver contends that investors in Heartland or JMS “were lulled into a false sense of security by Payne and Danker’s association with one or more of the Broker Dealers.” Complaint ¶ 34. The receiver further alleges that FFP and the other brokerage firms had a duty to monitor and supervise Payne and Danker but failed to do so. Complaint ¶ 36.

In Count I, the receiver alleges that Payne and Danker committed securities fraud in violation of federal and Indiana securities laws and that FFP is liable for any damages suffered by investors because FFP was a "controlling person" of Payne and Danker. In Count II, plaintiff alleges that Payne and Danker sold unregistered securities in violation of federal and Indiana securities laws and that FFP is again liable as a “controlling person.” In Count III, the receiver alleges that Payne and Danker breached their fiduciary duty to investors and that FFP is liable because of their apparent authority to act on behalf of FFP. In Count IV, plaintiff alleges that Payne and Danker are liable to investors under Ind. Code § 34-24-3-1 for their criminal actions and that FFP is also liable because Payne and Danker were its agents. In Count V, the receiver alleges that FFP breached its duty to investors to supervise Payne and Danker.

The receiver seeks damages solely on behalf of Heartland and JMS investors, not on behalf of Heartland or JMS. Plaintiff prays for damages against defendants in “the amount of the actual loss *of each person to whom Payne and Danker sold securities.*” Complaint, p. 13 (emphasis added). The receiver does not seek, nor does he allege any basis for recovery of, damages to Heartland and JMS.

ARGUMENT

The party invoking federal jurisdiction bears the burden of establishing the elements of standing. Lujan v. Defenders of Wildlife, 504 U.S. 555, 561 (1992); Rixson v. Village of Arlington Heights, 186 F.3d 826, 829 (7th Cir. 1999). When considering a motion to dismiss for lack of standing, the court accepts all well-pleaded factual allegations as true and draws all reasonable inferences in favor of the plaintiff. Retired Chicago Police Ass'n v. City of Chicago, 76 F.3d 856, 862 (7th Cir. 1996).

Article III of the Constitution requires a party seeking to invoke a federal court's jurisdiction to demonstrate the "irreducible constitutional minimum of standing":

(1) an injury in fact, which is an invasion of a legally protected interest that is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical; (2) a causal relationship between the injury and the challenged conduct, such that the injury can be fairly traced to the challenged action of the defendant and not from the independent action of some third party not before the court; (3) a likelihood that the injury will be redressed by a favorable decision.

Rixson, 186 F.3d at 829 (citing Lujan, 504 U.S. at 560-561; Warth v. Seldin, 422 U.S. 490, 498 (1975)).

THE RECEIVER LACKS STANDING BECAUSE HE HAS NO RIGHT TO ASSERT CLAIMS NOT PERSONAL TO HEARTLAND OR JMS

Mr. Knauer was appointed by the Court as receiver for two Indiana corporations. Complaint ¶¶ 2-5. Therefore, the receiver's rights and duties are governed by Indiana law. See Schacht v. Brown, 711 F.2d 1343 (7th Cir. 1983) (applying Illinois law where receiver was appointed for Illinois corporations).

In Indiana, receivers are given power by statute "to bring and defend actions, to take and keep possession of the property, to receive rents, and collect debts in the receiver's own name, and generally to do such acts respecting the property as the court or judge may authorize."

Burns Ind. Code Ann. § 34-48-1-7 (2000); see also Burns Ind. Code Ann. § 23-1-47-3(c) (2000). A receiver has only such powers as are conferred by statute and by the order of the court under which he is appointed. State ex rel. Pancol v. Cleveland, 241 Ind. 206 (1961); Fleming v. Lind-Waldock, 922 F.2d 20, 24 (1st Cir. 1990). Among the ends to be attained by a general receivership are the seizure of property in the hands of a defendant, the recovery of such property illegally transferred for which a suit or action may be maintained, and, in the case of a corporation, the recovery of all such sums of money as may be due, owing, or coming to the corporation upon any accounting whatever. Coddington v. Canaday, 157 Ind. 243, 252 (1901).

Under Indiana law, an appointed receiver may only enforce those rights connected with the receivership and its underlying entity. Northwestern Mutual Life Ins. Co. v. Kidder, 162 Ind. 382 (1904). A receiver takes only the rights of the corporation such as could be asserted in its own name. Schact, 711 F.2d at 1347 (citing Republic Life Ins v. Swigert, 135 Ill. 150, 167 (1890)). "The plaintiff in his capacity of receiver has no greater rights or powers than the corporation itself would have." McCandless v. Furland, 296 U.S. 140, 148 (1935). "The receiver can only make a claim which the corporation could have made." Caplin v. Marine Midland Grace Trust Co. 406 U.S. 416, 429 (1972). "Representation of the corporation and protection of its assets [is] the only purview of the receiver." Fleming, 922 F.2d at 25 (interpreting McCandless and Caplin).

In the present case, the receiver is not asserting claims on behalf of Heartland or JMS against FFP. He is asserting the claims of investors who lost money in the Ponzi scheme. Although he states in conclusory terms that FFP owed a "duty" to Heartland and JMS (e.g., Complaint ¶¶ 49, 61), there are no facts pleaded which would support any such "duty." The receiver does not plead any sort of relationship between FFP and Heartland or JMS or, indeed,

that FFP had any dealings of any kind with the two entities he represents. Under the circumstances, there is a presumption that neither Heartland nor JMS has any direct claim. See Caplin, 406 U.S. at 429 (trustee's attempt to assert claims on behalf of investors failed to include allegations that the trustee's entity could make a claim against the opposing corporation; the Court held the "conspicuous silence on this point is a tacit admission that no such claim could be made").

The only concrete and actual harm alleged by the receiver, i.e., losses on investments, is the investors'. See Complaint ¶¶ 24, 34, 43, 44. In fact, Heartland and JMS were the very mechanisms used to cause these losses.² Therefore, Heartland and/or JMS, on their own or through an appointed receiver, cannot raise these claims.

This case falls squarely under the rule enunciated by Indiana courts: a receiver has no standing to bring a claim that is personal to an investor. Scholes v. Stone, 821 F. Supp. 533, 535 (N.D. Ill. 1993)(receiver has no standing to bring suit representing those who had invested in the entities nor could the receiver recover losses that investors had suffered); see Cagan v. Muccianti, 1992 U.S. Dist. LEXIS 5707 *9 (N.D. Ill. 1992)(the investors who purchase interests bear the "real brunt of the wrongdoing"); Scholes v. Schroeder, 744 Supp. 1419, 1422 (N.D. Ill. 1990)("fraud on the investors that damages those investors is for those investors to pursue--not the receiver"); see also Caplin, 406 U.S. at 429-34 (receiver or like surrogate cannot pursue claims that belong, not to the receivership estate as such, but rather to those who may have an ultimate derivative interest in the estate); Koch, 831 F.2d 1339 (7th Cir. 1987); Schacht, 711 F.2d 1343 (7th Cir. 1983); State ex rel. Pancol, 241 Ind. 206 (1961); Reel v. Brammer, 56 Ind. App. 180 (1913); Marion Trust Company v. Blish, 170 Ind. 686 (1908); Northwestern

² See SEC Complaint, ¶¶ 4, 5, 84-94; Complaint, ¶¶ 24, 26.

Mutual Life Ins. Co., 162 Ind. 382 (1904). It is the investors, alone and individually, whom possess standing to raise such issues--plaintiff does not.³

Furthermore, the Court's order appointing Mr. Knauer does not authorize him to bring such claims on behalf of the investors. Although the Agreed Order states that "[t]he Receiver may bring such legal actions based on law and equity in any state or federal court as he deems necessary or appropriate in discharging his duties as Receiver," (¶ 3(G)), that right must be construed in harmony with the statute and well-settled Indiana law. In La Follett v. Akin, 36 Ind. 1 (1871), defendant transferred all assets, in trust, to Akin in order to pay off all debts owed to Akin. Akin was to then apply the remainder to any other outstanding debts of Richie's. Prior to transfer, a firm recovered judgments against defendant. A receiver was then appointed. Subsequently, Akin kept the remainder of Richie's assets and was unwilling to give the to the firm. The receiver instituted suit for recovery of the assets. In determining the receiver improperly brought the action, the court held that the statutory language providing the receiver the power to "bring and defend actions" did not allow such a suit. Id. at 6. This language "d[id] not authorize the court to empower the receiver to bring an action in any and all cases" but only in cases where the receivership entity could have brought the action. Id. at 10.⁴

Indiana has recognized only two situations wherein a receiver may have standing to assert a right of action not vested in the receivership entity: (1) the receiver may sue to set aside a fraudulent conveyance; and (2) where the Indiana statute authorizes, the receiver of an

³ The merits of the investors' potential claims are not before this Court and not addressed in this motion.

⁴ If a court order were to grant a receiver the ability to bring an action for which the receiver has no legitimate standing, the that order itself could not stand. See Scholes v. Schroeder, 744 F. Supp. 1419, 1421 (N.D. Ill. 1990) (judge's order authorizing the receiver to bring suit on behalf of investors is at odds with the fundamental command of Article III).

insolvent corporation may sue the stockholders. See State ex rel. Shepard v. Sullivan, 120 Ind. 197, 198 (1889). Neither exception applies here. Nowhere in the receiver's Complaint is there an allegation of a fraudulent conveyance made to FFP. Nor is there any attempt by the receiver to recover from stockholders.

The receiver cannot maintain this action simply on the basis that it could potentially increase the size of the receivership estate and thereby benefit the corporation's creditors. Turner v. Henshaw, 86 Ind. App. 565 (1927) so holds. A receiver appointed for the Hudson Motor Indemnity Exchange brought suit to recover on a note filed with the Indiana Insurance Commissioner. The note was required for the protection of Indiana policyholders. In attempting to collect on the note, the receiver argued that he had standing because the receiver was attempting to increase the size of the receivership estate for the general benefit of the creditors. The court rejected that argument, concluding that the receiver only takes those rights of the corporation that could have been asserted by the corporation in its own name. Id. at 575.

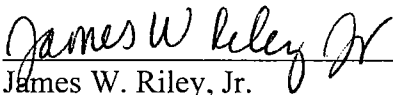
To the same effect is Schacht v. Brown, 711 F.2d 1343 (7th Cir. 1983). There, the plaintiff-liquidator sued defendant-directors of an insolvent company under RICO, alleging that defendants' fraudulent schemes caused plaintiff to continue business beyond the point of insolvency. In moving to dismiss the claim, defendants asserted that the plaintiff-liquidator lacked standing to raise claims of the insurance company's policyholders or creditors either derivatively or through a receiver. Id. at 1346-1347. The court agreed that a receiver only takes the rights of the corporation that may be asserted in its own name, "and upon that basis, only, can [a receiver] litigate for the benefit of other shareholders or creditors." Id. at 1347 (citing

Republic Life Ins. Co., 135 Ill. at 167; Sangamon Loan & Trust Co. v. People's Savings, 204 Ill. App. 7, 14 (1917)).⁵

CONCLUSION

For the foregoing reasons, FFP respectfully requests that this Court dismiss Plaintiff's Complaint in its entirety.

Respectfully submitted,


James W. Riley, Jr.
No. 6073-49
RILEY BENNETT & EGLOFF, LLP
One American Square
Box 82035
Indianapolis, IN 46282
(317) 636-8000

BRYAN CAVE LLP
One Metropolitan Square
211 N. Broadway, Suite 3600
St. Louis, MO 63102-2750
(314) 259-2000

Attorneys for Defendant
FFP Securities, Inc.

⁵ A narrow exception to the rule, noted by Schact, is where the receiver sues to on behalf of a plaintiff's creditors to recover a specific asset from a defendant who has, with the knowledge of the plaintiff's corporate officials, misrepresented its existence. 711 F.2d at 1347 (citing Sangamon, 204 Ill. App. at 14). Here, there is no allegation whatsoever that specific assets have been transferred to FFP by Payne, Danker, Heartland or JMS.

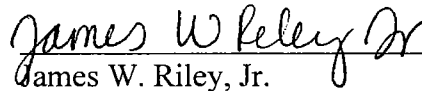
CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing Memorandum in Support of FFP Securities, Inc.'s Motion to Dismiss Plaintiff's Complaint has been served this 5th day of October, 2001, via First Class United States Mail, postage prepaid, upon:

William Bock III
Kroger Gardis & Regas
Bank One Center/Circle
111 Monument Circle, #900
Indianapolis, IN 46204

William L. O'Connor
Kightlinger & Gray
Market Square Center, Suite 600
151 Delaware Street
Indianapolis, IN 46204

Thomas E. Wheeler, II
Locke Reynolds LLP
201 North Illinois Street, Suite 1000
P.O. Box 44961
Indianapolis, IN 46244-0961


James W. Riley, Jr.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA

UNITED STATES SECURITIES
AND EXCHANGE COMMISSION,

Plaintiff,

v.

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

Judge J.D. Tinder

**AGREED ORDER APPOINTING RECEIVER
FOR HEARTLAND FINANCIAL SERVICES, INC.**

The Plaintiff, Securities and Exchange Commission (Commission) and Defendants, Kenneth R. Payne (Payne) and Heartland Financial Services, Inc. (Heartland), agree and stipulate as follows:

1. That the Court appoint a Receiver for the benefit of investors to marshal, conserve, protect, hold funds, operate and, with the approval of the Court, dispose of any wasting assets, wherever those assets may be found, of Heartland.
2. The Commission, Payne and Heartland submit for the Court's consideration as Receiver the following attorneys and consent to the appointment of any of them as Receiver over Heartland: Douglass G. Boshkoff, James A. Knauer, James M. Carr, Stephen W. Terry and Edmund M. Mahern. Copies of their qualifications are attached as

Exhibit A. Accordingly, the Court appoints James A. KNAUER as Receiver over Heartland in this matter.

3 The Receiver shall have the following powers and duties to fulfill his obligations:

- A. Oversee the operations of Heartland.
- B. Use reasonable efforts to determine the nature, location, and value of all assets and property owned by or in possession of Heartland.
- C. Use reasonable efforts to determine the identity of all investors, amounts invested by investors, and payouts to investors in Heartland or persons who invested through Heartland, and communicate, as necessary, with the investors.
- D. Engage and employ necessary professionals (Retained Personnel), with the approval of the Court, as the Receiver deems necessary to assist in his duties.
- E. Take such action as necessary and appropriate to prevent the dissipation or concealment of any funds and assets or for the preservation of any such funds and assets of Heartland.
- F. The Receiver shall have the authority to issue subpoenas to compel testimony of persons or production of records in a manner consistent with the Federal Rules of Civil Procedure and the Rules of the Court concerning any subject matter relating to the identification, preservation, collection or liquidation of assets of Heartland, and;
- G. The Receiver may bring such legal actions based on law or equity in any state or federal court as he deems necessary or appropriate in discharging

