

UNITED STATES OF AMERICA
Before The
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 1842 / October 4, 1999

ADMINISTRATIVE PROCEEDING
File No. 3-10073

In the Matter of James William Fuller, Respondent.

ORDER INSTITUTING PUBLIC PROCEEDINGS, MAKING FINDINGS, IMPOSING REMEDIAL SANCTIONS, AND ISSUING CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest to institute public administrative and cease-and-desist proceedings pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), to determine whether James William Fuller ("Fuller" or "Respondent") willfully aided and abetted and caused violations of Sections 206(1) and 206(2) of the Advisers Act committed by Morgan Fuller Capital Management, LLC ("Morgan Fuller"), an investment adviser registered with the state of California.

In anticipation of the institution of these proceedings, Fuller has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except that Respondent admits the jurisdiction of the Commission over him and over the subject matter of these proceedings, Respondent consents to the issuance of this Order Instituting Public Proceedings, Making Findings, Imposing Remedial Sanctions, and Issuing Cease-and-Desist Order ("Order").

Accordingly, IT IS ORDERED that administrative and cease-and-desist proceedings pursuant to Sections 203(f) and 203(k) of the Advisers Act be, and hereby are, instituted.

II.

On the basis of this Order and the Respondent's Offer, the Commission makes the following findings: 1

A. NATURE OF PROCEEDING

1. This proceeding concerns fraudulent misrepresentations and omissions made by a state-registered investment adviser and its associated persons to investors in a failed hedge fund. Beginning in late 1996, Morgan Fuller Capital Management, LLC ("Morgan Fuller"), an investment adviser registered with the state of California, acted as general partner and investment adviser to the Paradigm Capital Fund, L.P. ("Paradigm" or the "Fund"), a hedge fund in which eight individuals invested \$941,500. Morgan Fuller and certain associated persons concealed substantial trading losses in the Fund by misrepresenting the Fund's performance in quarterly reports sent to investors in April and July 1997.

B. RESPONDENT

2. James Fuller, 59, is a resident of San Francisco, California. During the relevant period, Fuller was associated with Morgan Fuller, a California investment adviser, as one the firm's principals. Fuller is currently a principal of North Coast Securities Corporation, a registered broker-dealer, and Stinson Capital Management, an investment adviser registered with the state of California.

C. RELATED ENTITY

3. Morgan Fuller Capital Management, LLC is a California limited liability company registered as an investment adviser in the state of California based in San Francisco. Morgan Fuller began operations in late 1996 and subsequently acted as general partner and investment adviser for Paradigm. Morgan Fuller has no current operations.

D. Paradigm Capital Fund's Formation and Early Losses

4. In late 1996, Morgan Fuller began soliciting investments in Paradigm Capital Fund, L.P., a California limited partnership. Paradigm was held out to investors as a diversified hedge fund with a negative bias towards the United States stock market. Between December 1996 and March 1997, eight limited partners from across the country (including James Fuller) invested a total of approximately \$941,500 in Paradigm. Morgan Fuller served as Paradigm's general partner and investment adviser.

5. Trading began in the Fund in January 1997. The fund manager's trading strategy (investing heavily in put options and actively short-selling the U.S. market) led to substantial losses for the Fund. Between February 10 and February 18 alone, Paradigm's asset value decreased from \$764,057 to \$305,325.

E. The Bankas Hermis Transaction

6. In late February 1997, one of Morgan Fuller's principals -- in an apparent effort to help Paradigm recoup its trading losses -- arranged for Paradigm to purchase shares of AB Bankas Hermis ("Hermis"), a Lithuanian bank listed on the Lithuanian National Stock Exchange, in a private transaction. Paradigm paid \$240,000 (nearly all of the Fund's assets) to purchase the Hermis stock at a discount of approximately 75%. The Fund planned to resell the stock at a substantial gain in order to restore its profitability. Fuller was involved in the decision to enter into the Hermis transaction.

F. The April 4 Letter

7. By April 1997, six weeks had passed without Morgan Fuller's receiving any confirmation that the Hermis stock had been transferred to Paradigm. Nonetheless, on or around April 4, 1997, Morgan Fuller sent a letter to Paradigm's limited partners stating the following:

We are pleased to inform you that the Paradigm Capital Fund LP generated returns of 6% (after fees and expenses; unaudited) in the first quarter of 1997. Considering the net short position which the Fund maintained in the quarter in line with our mandate providing our partners a hedge against the effect of a stock market decline, we are happy with these returns -- especially in light of the S&P 500's advance of 3% in the same period.

8. This letter was misleading. First, the 6% returns included the Hermis stock, which had not yet been delivered to Paradigm. In the absence of the Hermis stock, the assets remaining in the Fund actually totaled about \$61,000, or a 93% decline in value from the \$827,500 invested in Paradigm to date.

9. Second, even if it were proper to include the Hermis stock in calculating Paradigm's returns, the letter nonetheless misrepresented the Fund's performance. The letter conveyed the impression that the positive returns were due to the Fund's "net short position" maintained in accord with the Fund's hedge mandate. In truth, the fund manager's trading strategy was a complete failure, resulting in substantial losses to the Fund. The only reason Paradigm could claim even 6% returns was because the Fund had purchased the Hermis stock at a substantial discount.

10. Fuller reviewed a draft of the April 4 letter prior to its dissemination to Paradigm's investors. At that time, he was aware of Paradigm's trading losses and the Hermis stock transaction, and thus he knew or was reckless in not knowing that the letter was false and misleading.

G. The July 29 Letter

11. In June 1997, Bankas Hermis informed Morgan Fuller that the stock could not be delivered to Paradigm, as the seller of the shares did not in fact own the stock. To date, Morgan Fuller has been unable to recover the Hermis stock or the money it had paid to purchase the stock.

12. Nevertheless, on or around July 29, 1997, Morgan Fuller sent a second letter to Paradigm's limited partners. The letter began:

Our bearish mandate did not benefit us during the second quarter; at the close of the first half the Paradigm Capital Fund LP was down 4% for the year (unaudited). While it is frustrating not to have delivered absolute returns, we are a little proud to have performed as we did while maintaining a negative bias. That bias will stand us in good stead when this market finally corrects.

13. After a page of detailed technical analysis of the stock market, the letter noted:

On an administrative level, you should be aware that a company in a less-developed country failed to deliver shares in the company purchased by the Fund in a related-party transaction. . . . We are taking vigorous action to investigate the situation further and enforce our interests. . .

14. The July 29 letter contained material misrepresentations and omissions. First, Morgan Fuller calculated the 4% loss figure by including the market value of the Hermis stock. However, by July 29, Morgan Fuller and its principals knew not only that Paradigm did not have possession of the stock, but that there was a serious problem with the transaction. Had Morgan Fuller excluded this security from the Paradigm portfolio, the actual value of the Fund would be approximately \$105,000, or an 89% decline from the \$941,500 invested in the Fund.

15. Second, the admission that the firm had an "administrative" problem obtaining delivery of one investment was misleading. The Hermis stock (using the market value ascribed to it by Morgan Fuller) accounted for approximately 88% of the Fund's assets at the time the letter was sent.

16. Finally, as with the April 4 letter, the July 29 letter gave a false picture of Paradigm's financial performance. Even if Morgan Fuller could properly include the Hermis stock in calculating the Fund's returns, the letter misstated the performance of the Fund's hedging strategy. The Fund's "bearish mandate" did not lead to a mere 4% loss; in truth, it essentially wiped out the Fund.

17. Fuller was aware of the representations contained in the July 29 letter at the time of its dissemination to Paradigm's investors. Fuller was aware that the Fund had suffered significant losses and that the Hermis stock had not been delivered to Paradigm, and thus he knew or was reckless in not knowing that the letter was false and misleading.

H. The Dissolution of the Paradigm Fund

18. The non-delivery of the Hermis shares effectively wiped out the Paradigm fund. The \$240,000 used to purchase the Hermis stock represented the majority of the assets remaining in the Fund at the end of February 1997, and the continued failure of the Fund's trading strategy resulted in a near-total loss of all remaining assets by mid-1997.

IV.

Based on the foregoing, Fuller willfully aided and abetted and caused Morgan Fuller's violations of Advisers Act Sections 206(1) and 206(2).

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified by Fuller in his Offer.

Accordingly, IT IS ORDERED, that:

A. Fuller shall be, and hereby is, censured;

B. Pursuant to Section 203(k) of the Advisers Act, Fuller shall, effective immediately, cease and desist from committing or causing any violation and any future violation of Sections 206(1) and 206(2) of the Advisers Act;

C. Pursuant to Section 203(f) of the Advisers Act, Fuller shall be suspended from being associated with any investment adviser for a period of nine months, effective on the second Monday following the entry of this Order. Fuller shall provide to the Commission, within 30 days after the end of the nine-month suspension period described above, an affidavit that he has complied fully with the suspension period; and

D. Fuller shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$15,000 to the United States Treasury. Such payment shall be: (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities Exchange Commission; (3) hand delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (d) submitted under cover letter which identifies Fuller as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helene Morrison, San Francisco District Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 1100, San Francisco, CA 94104.

By the Commission.

Jonathan G. Katz
Secretary

Footnote

1 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.