

**ADMINISTRATIVE PROCEEDING**

**BEFORE THE**

**SECURITIES COMMISSIONER OF SOUTH CAROLINA**

**IN THE MATTER OF:**

**James Rodney McGee, II**

**Respondent.**

**NOTICE OF INTENT TO SEEK  
CENSURE AND CIVIL PENALTY**

**File No. 11061**

WHEREAS, the Securities Division of the Office of the Attorney General of the State of South Carolina (the "Division"), pursuant to authority granted in the South Carolina Uniform Securities Act of 2005 (the "Act"), S.C. Code Ann. §§ 35-1-101 to 35-1-703 (Supp. 2012), received information regarding alleged activities of James Rodney McGee, II ("McGee" or "Respondent") which, if true, could constitute violations of the Act; and

WHEREAS, the information led the Division to open and conduct an investigation of Respondent pursuant to S.C. Code Ann. § 35-1-602; and

WHEREAS, in connection with the investigation, the Division has determined that evidence exists to support the following findings and conclusions:

1. Respondent McGee is a citizen and resident of Greenville County, South Carolina, with a last known address of 105 Augusta Drive, Greenville, SC 29605.
2. McGee is currently, and at all times relevant, was registered with the Division as an investment adviser representative.
3. From on or about January 2007, through on or about June 2010, McGee was employed by a registered investment adviser firm called Congaree Capital Management, LP.
4. McGee was the founder or director of one or more portfolios, hedge funds, or similar investment vehicles, for which he served as portfolio manager.

5. In his roles as investment adviser representative and as portfolio manager, McGee invested funds on behalf of investors grouped together as shareholders or limited partners of a single fund as well as on behalf of individual investors with their own separate accounts.
6. On information and belief each fund managed by McGee had its own investment contract, as did each individual account managed by McGee.
7. One fund for which McGee served as portfolio manager was called Congaree Offshore Capital, Ltd. (the "Offshore Fund"), a company incorporated in the Cayman Islands.
8. McGee served as director of the Offshore Fund since its organization.
9. The Offshore Fund began taking investors in or around June 2009.
10. The Offshore Fund had a stated investment objective of "first and foremost capital preservation and the prudent assessment of risk."
11. The Offshore Fund afforded McGee total discretion to make investment decisions.
12. The Offshore Fund's private offering circular highlighted options as one of the investment strategies it may employ. The private offering circular discussed the structural characteristics and operational mechanics of put and call options strategies as well as the risks associated therewith. This discussion of options in the private offering circular concluded by stating that the use of uncovered options, which to that point had remained unmentioned, is highly specialized and entails greater than ordinary investment risks.
13. In addition to conducting securities activities via the Offshore Fund, McGee also engaged in investment adviser activities in South Carolina.
14. Pursuant to South Carolina law, investment advisers must maintain investment advisory agreements with their clients. S.C. Code Regs. § 13-408(10).
15. Upon request, an executed investment advisory agreement dated February 11, 2008, for Client A was provided to the Division.
16. By signing the Investment Advisory Agreement, Client A gave McGee discretion to make investment decisions on his behalf.

17. The Investment Advisory Agreement incorporated the client's investment objectives for the account, upon which McGee stated in the agreement that he would base his investment decisions.
18. McGee managed Client A's Individual Retirement Account ("IRA"), for which his listed investment objectives were "growth and preservation of capital."
19. During late July 2009, McGee convinced Client A to roll over his IRA account, totaling about \$5,400,000, into the Offshore Fund.
20. At the time of McGee's solicitation of Client A's IRA funds for investment into the Offshore Fund, Client A's IRA was invested in a diversified portfolio of stocks and money market funds that did not include any use of options.
21. On or around August 12, 2009, McGee deposited roughly \$6,000,000 of new funds into the Offshore Fund.
22. On or around August 13, 2009, McGee spent roughly \$5,700,000 buying put options called "Put Spy Option Sep 100."
23. All or a significant portion of Client A's money was used to fund the Offshore Fund's purchase of a single position of put options. These put options were uncovered or "naked," which increased the risk of the position even more. The put options expired worthless only a few weeks later.
24. On or around December 24, 2009, Client A received an email from McGee stating the following:
  - (i) his investment strategy failed;
  - (ii) the Fund went from a book of 23 million dollars of long equity positions and 8.5 million dollars of short equity positions at the end of May 2009, to less than \$70,000.00 total in December 2009;
  - (iii) McGee overreacted to the market and became focused on how to profit using options, and;
  - (iv) the options tactic "ruined" McGee and the Fund.
25. As an investment adviser representative, McGee is bound to maintain a fiduciary duty to his clients. Such a duty is implied in the Investment Company Act of 1940, and is further discussed by the United States Supreme Court as far back as 1963 in *S.E.C. v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

26. In order to satisfy his fiduciary duty to his clients, McGee is required to put his clients' interests above his own, to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser to render advice which was not disinterested, and employ utmost good faith and full and fair disclosure of all material facts as well as an affirmative obligation to employ reasonable care to avoid misleading. *Id.*
27. A less stringent, but still necessary standard to which investment professionals must adhere is known as the suitability standard. The South Carolina Code of Regulations states that an investment adviser representative must not recommend a transaction to a client without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the adviser after reasonable examination of the client's records. S.C. Code Regs. § 13-502 A (1).
28. An investment adviser representative's failure to adhere to his fiduciary duty and failure to make suitable recommendations in compliance with South Carolina regulations subjects such a person to discipline under S.C. Code Ann. § 35-1-412(d)(2).
29. The Offshore Fund's own private offering circular stated that uncovered, or naked, options are highly specialized and entail greater than ordinary investment risks. However, there was no further disclosure of the highly speculative nature of uncovered options, or the potentially devastating effects of such a risky strategy in a fund with the stated goal of "capital preservation and the prudent assessment of risk."
30. Furthermore, Respondent failed to disclose to his clients that his strategy had devolved into over-concentrating the Offshore Fund into a single uncovered put option. Such a strategy is substantially different from what Client A was used to in his IRA and what the offering circular indicated Client A could expect from the Offshore Fund.

31. Such non-disclosure, incomplete disclosure, or deceptive practices violate S.C. Code Regs. § 13-502(B), and are grounds for denial, suspension or revocation of registration, imposition of administrative fines, or such other action authorized by statute.
32. Based on the foregoing analysis, Respondent's placement of client funds, especially IRA monies, into a single uncovered put option without first disclosing such a strategy, violated the suitability standard as well as his fiduciary duty to his clients.

WHEREAS, based on the foregoing, the Division has determined that Respondent has engaged, is engaging, or is about to engage in an act, practice, or course of business constituting a violation of the Act or a rule adopted or order issued under the Act as follows:

- a. Placing a transaction or transactions in client accounts that are unsuitable for the investment objectives and/or financial situation and needs of the client or clients, especially as it relates to investing IRA monies in a fund that over-concentrated its investment in a single naked put option;
- b. Failing to uphold his fiduciary duty to his clients by engaging in activities including, but not necessarily limited to, the following:
  - a. Failing to fully disclose the extent of the risk associated with diverging from his prior investment strategy to essentially risk the entire value of the Offshore Fund on a single naked put option;
  - b. Failing to place the interests of his clients ahead of his own;
  - c. Failing to employ utmost good faith and full and fair disclosure of all material facts, and/or;
  - d. Failing to employ reasonable care to avoid misleading clients.

**CENSURE AND CIVIL PENALTY**

WHEREAS, pursuant to S.C. Code Ann. § 35-1-412(c) of the Act, if the Securities Commissioner finds that the order is in the public interest and subsection (d)(1) through (6), (8), (9), (10), or (12) and (13) authorizes the action, an order under this chapter may censure, impose a bar, and/or impose a civil penalty in an amount not to exceed \$10,000 for each violation, on a registrant.

NOW THEREFORE, the Division requests that the Commissioner issue an order that Respondent:

- a. Is hereby censured for failing to comply with the Act and the rules and regulations adopted thereunder; and
- b. Pay a civil penalty of \$10,000 if this Order becomes effective by operation of law, or, if Respondent seeks a hearing and a hearing officer or any other legal authority resolves the matter, pay a civil penalty in an amount not to exceed \$10,000 for each violation of the Act by Respondent and the actual cost of the investigation or proceeding.

**REQUIREMENT OF ANSWER AND  
NOTICE OF OPPORTUNITY FOR HEARING**


Respondent is hereby notified that he has the right to a hearing on the matters contained herein. To schedule such a hearing, Respondent must file with the Securities Division, Post Office Box 11549, Rembert C. Dennis Building, Columbia, South Carolina, 29211-1549, attention: Thresechia Navarro, within thirty (30) days after the date of service of this Order to Cease and Desist a written Answer specifically requesting a hearing.

In the written Answer, Respondent, in addition to requesting a hearing, shall admit or deny each factual allegation in this Order, shall set forth specific facts on which Respondent relies, and shall set forth concisely the matters of law and affirmative defenses upon which Respondent relies. Respondent shall state if he is without knowledge or information sufficient to form a belief as to the truth of an allegation.

Failure by Respondent to file a written request for a hearing in this matter within the thirty-day (30) period stated above shall be deemed a waiver by that Respondent of the right to such a hearing. Failure of Respondent to file an Answer, including a request for a hearing, shall result in this Order, including the stated civil penalty and assessed fees, becoming final as to Respondent by operation of law.

CONTINUING TO ENGAGE IN ACTS DETAILED BY THIS ORDER AND/OR SIMILAR ACTS MAY RESULT IN THE DIVISION'S FILING ADDITIONAL ADMINISTRATIVE ACTIONS AND/OR SEEKING FURTHER ADMINISTRATIVE FINES. WILLFUL VIOLATION OF THIS ORDER COULD RESULT IN CRIMINAL PENALTIES UNDER S.C. CODE ANN. § 35-1-508 OF THE ACT.

**IT IS SO ORDERED**, This the 10<sup>th</sup> day of June, 2013.

By:  \_\_\_\_\_

Andrew J. MacLeod  
Assistant Attorney General  
Securities Division  
Rembert C. Dennis Building  
1000 Assembly Street  
Columbia, S. C. 29201

(803) 734-9916

STATE OF SOUTH CAROLINA  
OFFICE OF THE ATTORNEY GENERAL  
SECURITIES DIVISION

CERTIFICATE OF SERVICE AND  
AFFIDAVIT OF COMPLIANCE  
File Number 11061

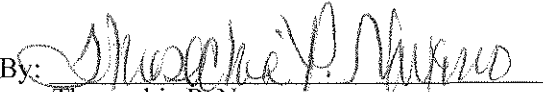
I hereby certify that I served upon the individual/entity listed below a copy of the document indicated below and dated June 10, 2013, by serving a copy of said document upon the Securities Commissioner of the State of South Carolina and by placing a copy of said document in the United States mail, certified mail, return receipt requested, first class postage prepaid and addressed to:

James Rodney McGee, II  
105 Augusta Drive  
Greenville, SC 29605

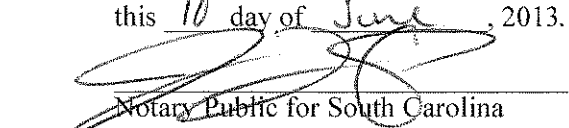
Document(s): Notice of Intent to Seek Censure and Civil Penalty

Mailed June 10, 2013 from Columbia, South Carolina.

I further hereby certify, swear and affirm that, service of the above-listed entity is in compliance with Section 35-1-611, Code of Laws of South Carolina.

By:   
Thresechia P. Navarro  
South Carolina Attorney General's Office  
Securities Division  
Post Office Box 11549  
Columbia, SC 29211-1549  
(803) 734-4731

Subscribed and sworn to before me on  
this 10 day of June, 2013.

  
Notary Public for South Carolina

My commission expires: 7-2-18