UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940

ADMINISTRATIVE PROCEEDING
File No. 3-13276

In the Matter of

MEDCAP MANAGEMENT &
RESEARCH LLC and
CHARLES FREDERICK
TONEY, JR.

Respondents.

ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e), 203(f)
AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND CEASE-AND-DESIST
ORDERS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against MedCap Management & Research LLC ("MMR") and Charles Frederick Toney, Jr. ("Toney") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") 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 to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders ("Order"), as set forth below.

III.

On the basis of this Order and Respondents’ Offers, the Commission finds that:
Summary

Respondent Toney, through his investment advisory firm MedCap Management & Research LLC (“MMR”), is the manager of MedCap Partners L.P. (“MedCap”), a hedge fund which suffered dramatic losses throughout 2006. At the end of the fund’s third quarter, in an effort to report favorable news to the fund’s investors, Toney – through a separate fund he managed – placed large orders for a thinly-traded OTC Bulletin Board stock (“OTC Company”) in which MedCap was heavily invested. Toney’s extensive purchases succeeded in driving the price of the stock up 338% on the last four days of the quarter. Because the stock (a small health care company) represented over a third of MedCap’s holdings, the brief boost in its price inflated the reported value of the MedCap fund from approximately $9 million to $38 million.

By engaging in “portfolio pumping” – pushing up the price of a thinly-traded holding to boost fund asset values at the end of a reporting period – Toney was able to mask over 40% of MedCap’s loss for the quarter. Indeed, immediately after the quarter ended, Toney reported to MedCap’s investors that the fund’s investments had begun to “bounce” and the fund’s performance was improving. Toney breached his fiduciary duties to both MedCap (which paid higher management fees due to the inflated quarter-end asset value) and his other fund (which paid high prices to acquire OTC Company stock and drive up the share price).

Accordingly, MMR willfully violated the antifraud provisions of the Advisers Act, and Toney willfully aided and abetted and caused those violations.

Respondents

1. Respondent MMR, a Delaware limited liability company, is an investment adviser located in San Francisco, California. The firm is registered as an investment adviser with the California Department of Corporations. MMR is the investment adviser of two hedge funds, MedCap and MedCap Partners Offshore, Ltd. (“Offshore”). As investment adviser, MMR possesses sole and complete authority to manage the funds’ activities.

2. Respondent Toney, age 42, lives in San Francisco, California, and is Managing Member of MMR. Toney handles all trading and investment decisions at MMR. Since December 2003, Toney has also served on OTC Company’s Board of Directors.

Other Relevant Entities

3. MedCap Partners L.P., a Delaware Limited Partnership, is one of two hedge funds managed by MMR. Beginning in early 2006, MedCap experienced sharp declines in assets. On December 31, 2005, MedCap had approximate assets of $125 million; redemptions and significant market decline caused that number to drop to $15 million by the end of 2006. MedCap’s assets declined to $5 million by the end of 2007.

4. MedCap Partners Offshore, Ltd., a Cayman Islands Exempted Limited Partnership, is the smaller of two hedge funds managed by MMR.
Background

5. Since November 2001, Toney has served as the Managing Member and sole owner of MMR, handling all trading and investment decisions at MMR. MMR charged MedCap a quarterly management fee of 0.25% of each non-affiliated partner’s capital account, as well as a 20% annual performance incentive fee on any gains. MMR calculated its management fee using the fund’s balance as of the first day of each quarter.

6. In addition to his fund responsibilities, Toney served on the Board of Directors of OTC Company, a company whose stock Toney had accumulated for years for MedCap through private offerings. As of September 25, 2006, MedCap owned approximately 10.3 million shares of OTC Company in the form of common stock, options, preferred stock, and convertible warrants. Based on OTC Company’s September 25 closing price of $0.85 per share, MedCap’s OTC Company holdings had an estimated value of $8.8 million, or over 30% of MedCap’s total asset value.

January to Mid-September 2006: MedCap Loses 75% of Its Value and Redemptions Increase

7. In 2006, MedCap experienced significant investment losses. The fund’s value dropped 3.7% in the first quarter (ended March 31), under-performing all ten of the fund’s benchmarks, which included both healthcare-specific and broader market indices. For the second quarter (ended June 30), MedCap lost an additional 36.4%, trailing its benchmarks by an average of over 30 points. MedCap’s second quarter results were due in part to a freefall in OTC Company’s share price, which posted a 75% decline during that period. By September 25, MedCap had fallen an estimated 62% from its second quarter value. In real terms, this was a quarterly loss of nearly $50 million, from MedCap’s June 30 value of approximately $76 million to an estimated September 25 value of $29 million.

8. The number of investors leaving MedCap also rose during this time. On June 30, seven partners redeemed their full capital interests in the fund, accounting for over 6% of MedCap’s total assets. By August 31, after MedCap’s second quarter results, 10 more partners submitted demands for full redemption.1 Given MedCap’s approximate value of $29 million on September 25, these 10 partners made up nearly 15% of the fund. With only $250,000 in approximate cash on hand, MedCap distributed securities instead of cash to MedCap’s departing investors, a first for the fund.

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1 MedCap generally allowed partners to redeem part or all of their MedCap stakes only at the end of a quarter and only after giving 30 days notice. Thus, August 31 was the deadline for a third quarter redemption.
September 26-29, 2006: Toney Uses The Offshore Fund To Inflate OTC Company’s Price and Increase MedCap’s Value

9. Faced with another down quarter and mounting redemptions, Toney used the final four trading days of September to elevate the price and trading volume of OTC Company securities and thereby increase the value of MedCap’s portfolio.

10. Since MedCap itself had limited money to use for trading, Toney turned to his other fund, Offshore, to buy shares of OTC Company. Through Offshore, Toney purchased 161,500 shares of OTC Company from September 26-29. Toney’s purchases pushed OTC Company’s share price from $0.85 per share to $3.72 per share by the final trading day of the fund’s quarter, quadrupling the value of the 10.3 million OTC Company shares held by MedCap and doubling the value of MedCap’s total portfolio.

11. From September 26 to 29, Toney’s purchases comprised nearly 60% of the total volume of OTC Company shares traded, making Offshore the largest retail purchaser of OTC Company stock. No shares of OTC Company traded on September 22 and September 25, the two trading days before Toney’s purchases, demonstrating that there was little other retail interest in the stock. OTC Company’s volume reverted back once Toney finished buying – fewer than 20,000 total shares traded during the first three days after Toney exited the market.

12. Toney placed orders for OTC Company at ever-increasing values at or above the “Inside Ask” price at the time of Toney’s order. By offering to buy shares of OTC Company in this way, Toney ensured that his orders would be executed. He thus showed the market sharply-increased demand and successively-increasing prices, as follows:

- On September 26, Toney purchased 18,000 shares of OTC Company, making up over 62% of the total trading volume for the day. By the end of day, OTC Company’s price had increased from $0.85 to $1.30.

- On September 27, Toney purchased another 21,000 shares of OTC Company, representing nearly 40% of the total trading volume for the day. OTC Company’s price increased for the second straight day, moving up from $1.30 to $1.55 per share.

- On September 28, Toney purchased another 55,000 shares of OTC Company, over 70% of the total trading volume. In response to Toney’s purchases, OTC Company’s price rose from $1.55 to $2.20 per share on September 28.

- On September 29, the last trading day of the quarter, Toney purchased 67,500 shares of OTC Company. This represented over 60% of the trading volume for the day.

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2 In the equity markets, the “Inside Ask” represents the lowest price at which a market participant will sell a stock at any given time. The “Inside Bid” price is the highest price that a market participant will pay to buy the stock.
volume for the day. OTC Company’s price rose from $2.20 to $3.72 by the end of trading.

13. By the end of Toney’s four-day purchases, the share price of OTC Company had risen from $0.85 to $3.72 per share, a 338% increase. Toney’s buying pressure took the value of MedCap’s OTC Company holdings from $8.8 million to $38.3 million, and the $29 million increase in MedCap’s OTC Company holdings allowed the fund to report a third quarter portfolio value of $58 million.

14. After Toney completed his purchases (including 4,500 shares on October 3), OTC Company slowly but steadily returned to its previous price levels. On December 31, 2006, OTC Company’s stock closed at $0.60 per share.

**October 2006: Toney Reports to His Investors**

15. On October 2, Toney e-mailed MedCap’s investors to inform them of the fund’s quarterly returns. While acknowledging a down quarter overall, Toney emphasized what he saw as cause for optimism:

> MedCap Partners L.P. Q3:06 performance results reflect some of the same, albeit not as damaging as we experienced in the prior quarter. For the quarter ending September, MedCap’s preliminary estimated results are -17.7% with the month of August contributing the majority of the down quarter. One silver lining appeared later in September as many of our investments began to bounce (perhaps reflecting how truly undervalued they had become) and began to actually react better to good news (whereas before they have recently not been reacting at all or reacting negatively). We remain optimistic that our current investments will show improvements as companies continue to execute.

16. Toney’s representation that MedCap’s third quarter performance improved on its second quarter loss of 36.4% was almost entirely based on his quarter-end inflation of OTC Company’s stock price. But for this price rise, precipitated by Toney’s purchases of OTC Company through the Offshore fund, MedCap would have reported a 62% loss, not a 17.7% loss. In addition, Toney did not explain that most of the “bounce” in MedCap’s investment value was the result of Toney’s inflation of OTC Company’s share price.

17. Since every $0.10 increase in OTC Company inflated the total MedCap portfolio by approximately $1 million, MMR and Toney received an additional $2,500 in management fees from MedCap for each $0.10 rise in OTC Company stock. In total, MMR and Toney collected $61,180.86 in additional MMR management fees due to OTC Company’s quarter-end price spike.

18. Furthermore, Toney used the Offshore fund’s cash to make large purchases of OTC Company stock, not because it was necessarily in the interests of Offshore, but rather so he could improve the reported value of the MedCap fund. Moreover, by buying the shares in a manner that caused OTC Company’s stock price to quadruple over the course of Toney’s purchases, Offshore paid higher-than-necessary prices for the OTC Company stock.
19. As a result of the conduct described above, MMR willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Toney willfully aided and abetted and caused MMR’s violations of Sections 206(1) and 206(2) of the Advisers Act.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in the Respondents’ Offers.

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents MMR and Toney cease and desist from committing or causing any violations and any future violations of Sections 206(1) and 206(2) of the Advisers Act;

B. Respondent Toney be, and hereby is, barred from association with any investment adviser, with the right to reapply for association after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission;

C. Respondent MMR is censured.

D. Any reapplication for association by Respondent Toney will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent Toney, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. IT IS FURTHER ORDERED that Respondent MMR shall, within 30 days of the entry of this Order, pay disgorgement of $61,180.86 and prejudgment interest of $9,452.83 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. 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 and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies MMR as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Marc J. Fagel, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

F. It is further ordered that Respondent Toney shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Toney as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Marc J. Fagel, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

By the Commission.

Florence E. Harmon
Acting Secretary