

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF WEST VIRGINIA

SECURITIES AND EXCHANGE  
COMMISSION,

Plaintiff,

v.

KNOX H. FUQUA and  
KHF ADVISORS LLC,

Defendants.

Civil Action No. 2:06-0666

COMPLAINT

Plaintiff Securities and Exchange Commission (SEC or Commission) alleges:

SUMMARY

1. This case involves a fraudulent scheme by investment adviser Knox H. Fuqua (Fuqua) to misappropriate money from his investment advisory clients, from at least January 2003 until late 2005. Fuqua engaged in much of his fraudulent activity through his alter ego, Commission-registered investment adviser KHF Advisors, LLC (KHF Advisors).

2. Fuqua and KHF Advisors were fiduciaries of their investment advisory clients. As such, they owed their clients a duty of honesty, undivided loyalty, fair-dealing and full disclosure. Fuqua and KHF Advisors breached their fiduciary duties by: (1) misappropriating client funds, (2) materially misrepresenting the nature and risk of the

investments made on behalf of the clients, and (3) investing client funds in a manner contrary to client instructions.

3. Several of Fuqua's clients were risk-averse investors. They gave him discretionary authority over their money, with the caveat that he not put their money in high-risk investments. These clients included two 401(k) employee retirement plans and a widowed mother-of-two under court order to conservatively invest the estate of her late husband on behalf of her children. Instead of investing his clients' funds according to their instructions, Fuqua, through the fraudulent scheme described below, used the funds to pay his personal and business expenses and repay money he had misappropriated from other investors.

4. Fuqua used two investment vehicles to facilitate his fraudulent scheme: the Fixed Income Fund and AAM Investments LLC. These investment vehicles—which operated as investment contracts—were little more than tools for Fuqua to access his clients' funds. Fuqua funneled his clients' money through these investment vehicles and into bank accounts that he alone controlled, recording these transfers as purported "loans." Fuqua then used the client funds transferred into these bank accounts to repay other clients wanting to redeem their investments, to pay business expenses and to siphon over \$200,000 dollars to pay a multitude of personal expenses.

5. Fuqua was able to continue his scheme unchecked by deceiving his clients into believing that their investments retained their value. He did so by, among other deceptive actions, inflating the share prices and account balances on his clients' account statements.

6. The Commission requests that this Court permanently enjoin Fuqua and

KHF Advisors from violating federal securities laws and rules pursuant to Section 20(b) of the Securities Act of 1933 (Securities Act), Section 21(d)(1) of the Securities Exchange Act of 1934 (Exchange Act), and Section 209(d) of the Investment Advisers Act of 1940 (Advisers Act) [15 U.S.C. §77t, 78u, 80b-9]; order disgorgement of all ill-gotten gains, with prejudgment interest thereon; and impose civil penalties pursuant to Securities Act Section 20(d), Exchange Act Section 21(d)(3), and Advisers Act Section 209(e) [15 U.S.C. §§77t(d), 78u(d)(3), and 80b-9(e)].

#### **JURISDICTION AND VENUE**

7. The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d) and 22(a) of the Securities Act [15 U.S.C. §§77t(b), 77t(d) and 77v(a)]; Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§78u(d), 78u(e), and 78aa]; and Section 214 of the Advisers Act [15 U.S.C. §80b-14] to permanently enjoin the defendants from engaging in the acts, practices, and courses of business alleged herein, and to order other relief.

8. The defendants, directly or indirectly, have made use of the means and instrumentalities of interstate commerce, or of the mails, or of the facilities of a national securities exchange in connection with the acts, practices, and courses of business alleged herein, certain of which occurred within the Southern District of West Virginia. Venue is proper in this District pursuant to Section 22(a) of the Securities Act, Section 27 of the Exchange Act, and Section 214 of the Advisers Act [15 U.S.C. §§77v(a), 78aa and 80b-14].

**DEFENDANTS**

9. Knox H. Fuqua, age 46, resides in Charleston, West Virginia. Fuqua acted as an investment adviser at all relevant times. Between 2001 and 2003, Fuqua was employed by Charleston, West Virginia-based Kanawha Investment & Trust Company (Kanawha). He provided investment advice to Kanawha's clients. Between 2003 and 2005, Fuqua was the sole person in control of Commission-registered investment adviser KHF Advisors, his alter ego. Fuqua was also in sole control of the Fixed Income Fund and AAM Investments LLC. For managing the assets of AAM Investments LLC, Fuqua paid himself a salary that was set by him.

10. KHF Advisors, a West Virginia limited liability company with its principal place of business in Charleston, West Virginia, is a Commission-registered investment adviser that Fuqua created in 2003. Fuqua was in sole control of KHF Advisors, his alter ego. KHF Advisors received a fee from its clients based upon a percentage of the value of the assets managed by KHF Advisors. References in this Complaint to Fuqua's fraudulent activity in connection with his investment advisory business after June 2003 include KHF Advisors.

**RELATED ENTITIES**

11. The Fixed Income Fund is an investment vehicle that Fuqua created and controlled. Fuqua established the Fixed Income Fund in or about September 2003, purportedly to invest in "fixed rate investments." Fuqua used the Fixed Income Fund to fraudulently funnel client money to AAM Investments LLC, another investment vehicle that Fuqua created and controlled. Fuqua issued shares of Fixed Income Fund stock to several of his investment advisory clients, and then caused client account statements to

reflect inflated share values and account balances. He did this to hide the fact that he had misappropriated client money.

12. Appalachian Asset Management Investments, Limited, dba Appalachian Asset Management Investments, LLC (AAM Investments) is also an investment vehicle that Fuqua created and controlled. Fuqua established AAM Investments as a holding company whose primary assets during the relevant period were Fuqua's investment advisory businesses and, at different times, two resort rental properties on Kiawah Island, South Carolina. Fuqua used AAM Investments to purportedly "borrow" client funds from the Fixed Income Fund and then deposited those funds into AAM Investments bank accounts that he alone controlled, from which Fuqua siphoned client funds to pay business and personal expenses. Fuqua issued shares of AAM Investments stock to several of his investment advisory clients, and then caused client account statements to reflect inflated share values and account balances. He did this to hide the fact that he had misappropriated client money.

### FACTS

#### **Fuqua's Clients Were Risk-Averse**

13. A number of Fuqua's investment advisory clients instructed him not to make high-risk investments with the money they entrusted to him. By investing his clients' funds in investment vehicles from which he misappropriated their money, Fuqua breached his fiduciary duties and disregarded the clients' instructions not to make high-risk investments.

14. Two of these clients, West Virginia medical practices Retina Consultants and Community Health Systems, were 401(k) employee retirement plans subject to

Employee Retirement Income Security Act (ERISA) requirements that the plans' funds be invested with prudence and exclusively for the benefit of the participants and their beneficiaries, as Fuqua knew or was reckless in not knowing. Another client, Barbara Leonard (Leonard), was a widowed mother-of-two, whose husband had died in a coal mining accident. Leonard was under court order to invest her deceased husband's estate conservatively on behalf of her children. Fuqua knew, or was reckless in not knowing, the substance of the court order requiring that the Leonard estate be invested conservatively.

**Fuqua Misappropriated Client Monica Hatfield's \$300,000**

15. In or about February 2003, Fuqua misappropriated approximately \$175,000 in Kanawha client funds. Fuqua secretly transferred Kanawha client funds to bank accounts that he alone controlled—AAM Investments bank accounts—and then improperly used Kanawha clients' funds to pay his personal and business expenses.

16. To replace the funds he had misappropriated from Kanawha clients, Fuqua turned to a ready source of cash: longstanding investment advisory client Monica Hatfield (Hatfield). Fuqua fraudulently induced Hatfield to give him \$300,000. He did so by misrepresenting to her that he needed the money for just three days, to satisfy an SEC requirement for starting a mutual fund—a false statement. Fuqua further misrepresented that he would then invest her \$300,000 in a money market account.

17. Instead of placing Hatfield's \$300,000 in a money market account, as promised, Fuqua wired approximately \$175,000 of it back to Kanawha, and deposited much of Hatfield's remaining \$125,000 into AAM Investments bank accounts that he alone controlled. Fuqua never disclosed to Hatfield this misuse of her funds.

18. To lull Hatfield into believing she still had her money, Fuqua issued her 30,000 shares of the Fixed Income Fund. Fuqua deposited no assets into the Fixed Income Fund to support Hatfield's 30,000 shares. Hatfield did not know that there were no assets supporting her 30,000 shares or that the value of those shares was far less than \$300,000 because—at Fuqua's instruction—Hatfield's brokerage account statements reflected that she owned 30,000 shares of the Fixed Income Fund having a market value of \$298,500—a false statement of its value.

**Fuqua Misappropriated Client Retina Consultants' \$600,000**

19. Fuqua also misappropriated several hundred thousand dollars from the 401(k) employee retirement plan for Dr. Mark Hatfield's (Monica Hatfield's husband) medical clinic—Retina Consultants. From approximately September 2003 through April 2005, Fuqua used his discretionary investment authority over Retina Consultants' money to deposit a total of \$600,000 into the Fixed Income Fund. In exchange for the deposits, Fuqua issued 60,000 Fixed Income Fund shares in the name of Retina Consultants.

20. Immediately after Fuqua began depositing Retina Consultants' money into the Fixed Income Fund, he began moving Retina Consultants' money to AAM Investments bank accounts that he alone controlled. Fuqua improperly used much of this money to pay business and personal expenses.

21. Fuqua concealed his misappropriation of Retina Consultants' money in the same way he had concealed his misappropriation of Monica Hatfield's money: He caused Retina Consultants' account statements to reflect that Retina Consultants owned 60,000 Fixed Income Fund shares having a market value of \$600,000—a false statement of its value. In reality, as Fuqua knew, or was reckless in not knowing, because Fuqua

had misappropriated Retina Consultants' money, its Fixed Income Fund shares were worth only a fraction of \$600,000.

22. In June 2005, Monica Hatfield and Retina Consultants demanded that Fuqua redeem their interests in the Fixed Income Fund. According to these investors' false account statements, their shares in the Fixed Income Fund were worth, in total, approximately \$900,000. In reality, the Fixed Income Fund had assets of only \$311,000—a mere one-third of what Fuqua had told the clients, through their account statements, their shares were worth. The brokerage firms preparing the client account statements did not know that the share values Fuqua gave them were false.

**Fuqua Misappropriated Client Community Health Systems' \$600,000 To Repay Retina Consultants**

23. Short on funds in the Fixed Income Fund account, with Hatfield and Retina Consultants demanding their Fixed Income Fund invested money back, Fuqua again took money from one unsuspecting client to repay another unsuspecting client whose money he had misappropriated. This time, Fuqua took \$600,000 from investment advisory client Community Health Systems' 401(k) employee retirement plan to repay Retina Consultants' 401(k) employee retirement plan.

24. Fuqua misappropriated Community Health Systems' 401(k) funds through multiple steps. On June 23, 2005, Fuqua deposited Community Health Systems' 401(k) employee retirement plan's \$600,000 into a new bank account that he alone controlled at First Bank of Charleston. Instead of directly wiring Community Health Systems' money to Retina Consultants' account, Fuqua laundered the money to conceal the fraud: One day after opening the account, Fuqua used Community Health Systems' 401(k) plan's \$600,000 to purchase certificates of deposit (CDs) in the name of the Fixed Income Fund,

and then used the CDs as collateral to secure a \$600,000 loan. Fuqua then wired the \$600,000 in loan proceeds to Retina Consultants to redeem its shares.

25. After the fact, Fuqua deceived representatives of Community Health Systems regarding their investment: He informed them that he had invested \$600,000 of their 401(k) employee retirement plan's assets in CDs, however, he did not inform them that he had used the CDs as collateral to secure a \$600,000 loan or that he had used the loan proceeds to repay another client.

#### **Fuqua Wrongfully Used Client Funds and Real Property**

26. By June 2005, Fuqua, without disclosing it to his investment advisory clients, had transferred more than \$600,000 from the Fixed Income Fund to AAM Investments bank accounts. In turn, Fuqua had written more than \$100,000 in checks to himself, drawn on AAM Investments accounts. Fuqua also used the AAM Investments bank accounts to pay American Express and other third parties for his personal expenses, such as supermarket, pharmacy, and jewelry store bills.

27. Additionally, Fuqua used AAM Investments funds to purchase a resort rental property on Kiawah Island, South Carolina, for AAM Investments. Without authorization from AAM Investments' owners (Fuqua's investment advisory clients), Fuqua instructed the rental agent to rent the property for only five months of the year. For the remaining seven months, Fuqua and his family treated the property as their own, using rental income—that should have accrued to the benefit of AAM Investments' shareholders—to pay the Fuqua family's personal resort expenses. A placard inside the house read, "Welcome The Fuquas."

28. Fuqua issued “promissory notes,” to which he was the sole signatory, to make it appear that AAM Investments had merely borrowed funds from the Fixed Income Fund. He recorded the money transferred from the Fixed Income Fund as “loans” to AAM Investments. Fuqua did not have legal authority to cause AAM Investments to borrow money without 75 percent shareholder approval—which approval Fuqua never sought and never obtained. Fuqua likewise recorded his personal use of client funds as “loans” to himself from AAM Investments. Fuqua never repaid the principal or interest on the loans from the Fixed Income Fund to AAM Investments, or on the loans from AAM Investments to Fuqua. By November of 2005, Fuqua’s own records reflected that he had “borrowed”—and not repaid—approximately \$227,000 from AAM Investments for personal expenses.

**Fuqua Misrepresented the Value of AAM Investments to His Clients**

29. When Fuqua initially invested his clients’ funds in AAM Investments he misrepresented the value of AAM Investments shares. In June 2003, Fuqua made an investment for Leonard and other clients in shares of AAM Investments totaling approximately \$1.9 million. Fuqua made this investment by converting a previous investment he had made on behalf of these clients in “Senior Notes” paying a guaranteed 8% return. Fuqua, among others, was a guarantor on the Senior Notes and obligated to pay his clients the 8% return. As Fuqua knew, or was reckless in not knowing, AAM Investments did not have assets even close to \$1.9 million in value at the time he converted his clients’ investments.

30. In or about May 2005, Leonard directed Fuqua to redeem her and her children’s shares in AAM Investments. Fuqua refused to redeem the shares, informing

her that AAM Investments was cash-strapped, that the value of the company had declined considerably, and that he could only guess at its share value. During a conference call in September 2005, Fuqua admitted to Leonard and other clients that at the time he converted their Senior Notes to shares of AAM Investments (June 2003), AAM Investments had assets worth approximately \$700,000. Fuqua's clients removed him as manager of AAM Investments soon after this admission. Fuqua's conversion of his clients' invested funds to shares of AAM Investments was contrary to his clients' instructions not to engage in high-risk investments.

**FIRST CLAIM**

**Fuqua and KHF Advisors Violated Securities Act Section 17(a)**

31. The Commission re-alleges and incorporates paragraphs 1 through 30 as if fully set forth herein.

32. Fuqua, from at least February 2003, and KHF Advisors, from approximately June 2003 through August 2005, by use of the means or instrumentalities of interstate commerce or the mails, in connection with the offer or sale of securities, directly or indirectly: (a) employed devices, schemes, or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and /or (c) engaged in acts, practices or courses of business which operated or would operate as a fraud or deceit upon the purchasers of the securities offered and sold by Fuqua and KHF Advisors.

33. By reason of their actions alleged herein, Fuqua and KHF Advisors each violated Securities Act Section 17(a) [15 U.S.C. §77q(a)].

**SECOND CLAIM**

**Fuqua and KHF Advisors Violated Exchange Act Section 10(b)  
and Exchange Act Rule 10b-5**

34. The Commission re-alleges and incorporates paragraphs 1 through 30 as if fully set forth herein.

35. Fuqua, from at least February 2003, and KHF Advisors, from approximately June 2003 through August 2005, by use of the means or instrumentalities of interstate commerce or the mails, in connection with the purchase or sale of securities, directly or indirectly: (a) employed devices, schemes, or artifices to defraud; (b) made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading and /or (c) engaged in acts, practices or courses of business which operated or would operate as a fraud or deceit.

36. By reason of their actions alleged herein, Fuqua and KHF Advisors each violated Exchange Act Section 10(b) and Rule 10b-5 thereunder [15 U.S.C. §78j(b); 17 C.F.R. §240.10b-5].

**THIRD CLAIM**

**Fuqua and KHF Advisors Violated, and Fuqua Aided and Abetted Violations  
of, Advisers Act Sections 206(1) and (2)**

37. The Commission re-alleges and incorporates paragraphs 1 through 30 as if fully set forth herein.

38. Fuqua, from at least February 2003, and KHF Advisors, from approximately June 2003 through August 2005, by use of the means or instrumentalities of interstate commerce or the mails, and while each engaged in the business of advising

others for compensation as to the advisability of investing in, purchasing or selling securities, directly or indirectly: (a) employed devices, schemes and artifices to defraud clients or prospective clients; and/or (b) engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon clients or prospective clients.

39. Fuqua, from approximately June 2003 through August 2005, knowingly provided substantial assistance to KHF Advisors in the perpetration of schemes to defraud and in the course of business that operated as a fraud upon clients or prospective clients.

40. By reason of their actions alleged herein, Fuqua and KHF Advisors each violated, and Fuqua aided and abetted KHF Advisors' violations of, Advisers Act Sections 206(1) and (2) [15 U.S.C. §§80b-6(1) and (2)].

**RELIEF REQUESTED**

WHEREFORE, the Commission respectfully requests that this Court:

**I.**

Enter a final judgment in favor of the Commission finding that Fuqua and KHF Advisors each violated the securities laws and rules promulgated thereunder as alleged herein.

**II.**

Permanently enjoin Fuqua and KHF Advisors from violating Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Advisers Act Sections 206(1) and (2) [15 U.S.C. §§77q(a), 78j(b), 80b-6(1) and (2); 17 C.F.R. § 240.10b-5], pursuant to Securities Act Section 20(b), Exchange Act Section 21(d)(1), and

Advisers Act Section 209(d), respectively [15 U.S.C. §77t, 15 U.S.C. §78u, and 15 U.S.C. §80b-9].

**III.**

Order Fuqua to disgorge all ill-gotten gains, including but not limited to salary paid to Fuqua, loans to Fuqua and fees paid to KHF Advisors, all in connection with the actions alleged herein, and to pay prejudgment interest thereon.

**IV.**

Order Fuqua to pay civil money penalties pursuant to Securities Act Section 20(d) [15 U.S.C. §77t(d)], Exchange Act Section 21(d)(3) [15 U.S.C. §78u(d)(3)], and Advisers Act Section 209(e) [15 U.S.C. §80b-9].

**V.**

Grant such other relief as this Court may deem just and proper.

Dated: August 28, 2006

Respectfully submitted,

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