

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 8774 / January 18, 2007

SECURITIES EXCHANGE ACT OF 1934

Release No. 55123 / January 18, 2007

INVESTMENT ADVISERS ACT of 1940

Release No. 2581 / January 18, 2007

INVESTMENT COMPANY ACT OF 1940

Release No. 27667 / January 18, 2007

ADMINISTRATIVE PROCEEDING

File No. 3-12541

In the Matter of

**KELMOORE
INVESTMENT COMPANY,
INC.,**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-
DESIST ORDER PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
SECTION 203(e) OF THE INVESTMENT
ADVISERS ACT OF 1940, AND
SECTIONS 9(b) AND 9(f) OF THE
INVESTMENT COMPANY ACT OF 1940**

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 Section 8A of the Securities Act of 1933 (“Securities Act”), Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”), Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Kelmoore Investment Company, Inc. (“Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “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 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, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, Section 203(e) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. From 1999 to 2005, Kelmoore Investment Company, Inc. ("Kelmoore"), a dually registered investment adviser and broker-dealer, understated the total fees it charged for managing five mutual funds ("the Funds"). Kelmoore's publicly disclosed advisory fee of 1% of assets under management did not include the substantial brokerage commissions which Kelmoore additionally charged for certain services that normally, in the context of providing advice to mutual funds, would be deemed advisory services. Kelmoore's disclosures were misleading and had the effect of obscuring from mutual fund shareholders the full cost of these investment advisory services. The misleading disclosures also prevented investors from making a fair comparison of the advisory fees charged by Kelmoore and the fees charged by other mutual funds.

Respondent

2. Kelmoore Investment Company, Inc. was incorporated in California in 1978, and became registered with the Commission as an investment adviser in 1996. Kelmoore has also been registered with the Commission as a broker-dealer since 1988. During the relevant time period, Kelmoore served as both the investment adviser and broker-dealer for the Kelmoore Strategic Trust and the Kelmoore Strategy Variable Trust.

Facts

Kelmoore's Dual Role as Investment Adviser and Broker-Dealer

3. Kelmoore is a single, dually-registered entity that served as both the adviser and the broker-dealer for the Funds during the relevant period. Kelmoore has no subsidiaries.

4. Kelmoore's strategy for the Funds involved writing options on stocks owned by the Funds in order to generate cash flow. To implement its strategy, Kelmoore purchased common stocks in large or mid-cap companies that had adequate price fluctuation in order for the Funds to write options that would generate high premiums. According to Kelmoore, this

complex strategy was quite labor intensive. For instance, Kelmoore needed to determine the timing and terms of the options (such as duration, price and strike price), when to buy puts to hedge downside risk, when to close out options contracts, and when to establish new contracts. When the Funds generated positive cash flow, they would make monthly distributions to the shareholders.

Kelmoore's Disclosure of its Advisory Fees Was Misleading

5. Kelmoore oversaw the preparation of and was responsible for the Funds' initial registration statements, including the prospectuses, and continued to be responsible for the misrepresentations contained in the Funds' subsequent registration statements. Although the Funds' prospectuses reported that Kelmoore charged an advisory fee equal to 1% of assets under management, in actuality investors in the Funds paid an advisory fee from 1.5% to over 3%. Kelmoore obscured the magnitude of these fees by suggesting in the prospectuses that the 1% fee covered all of the significant advisory work done by the firm. In fact, Kelmoore charged the Funds brokerage commissions designed in part to compensate the firm for this work. Kelmoore's commission charges were substantial -- \$5.63 per option contract. The Funds' prospectuses did not adequately describe the advisory work Kelmoore performed in return for brokerage commissions as opposed to the work Kelmoore performed in return for the 1% advisory fee. Kelmoore's disclosures were therefore misleading in light of the manner in which Kelmoore divided up the work it performed for the Funds. As a result, it would have been difficult for investors to understand the amount they were paying for advisory services or make an informed investment decision when comparing the Kelmoore Funds to other mutual funds.

6. Additionally, the Funds' prospectuses, which repeatedly referred to Kelmoore as "the Advisor," were misleading in suggesting that the options strategy was being managed by Kelmoore in its capacity as an investment adviser and that Kelmoore was compensated for these services through the 1% advisory fee. Contrary to what a reasonable investor might infer from reading the prospectuses, Kelmoore in its capacity as an adviser performed limited work to implement the Funds' options strategy.

7. Had Kelmoore's advisory fee included all the money it charged for options strategy services, its advisory fee would have been over 3% for some periods, rather than the 1% reported to investors and potential investors.

8. Kelmoore consulted with counsel in preparing its disclosures and the Funds' Boards understood and approved of the fees and commissions that the Funds were paying. Even so, Kelmoore's disclosures were materially misleading, which had the effect of benefiting Kelmoore and harming Fund investors. Kelmoore is responsible for the disclosures that it made to investors. Kelmoore also disclosed that its complex options strategy could result in higher commissions than would normally be charged by other broker-dealers and Kelmoore annually reported the Funds' commission expenses as required in the Funds' Statement of Additional Information. Nevertheless, Fund investors would have had difficulty determining from the Funds' disclosures what they were paying Kelmoore in return for its advisory services and it was Kelmoore's obligation to ensure that those disclosures were not misleading.

9. Kelmoore has recently made changes to the Funds' prospectus and SAI that are intended to more accurately describe Kelmoore's dual roles as both an investment adviser and a broker-dealer. In addition, Kelmoore no longer charges commissions for options strategy services. Instead, all of its advisory services are provided in return for the disclosed advisory fee.

Violations

10. As a result of the conduct described above, Kelmoore willfully violated:

a. Section 17(a)(3) of the Securities Act in that it engaged in a "transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser." Specifically, Kelmoore was responsible for the misrepresentations contained in the Funds' prospectuses and SAIs. In those documents, Kelmoore misrepresented the total amount of Fund expenses for advisory services by stating its advisory fees were 1% of average daily net assets when in actuality total fees for Kelmoore's services were from 1.5% to over 3.0%. Kelmoore's business practice had the effect of misrepresenting its total fees by not including fees for certain services related to writing options; and

b. Section 34(b) of the Investment Company Act in that it made untrue statements of material fact in a registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act, or omitted to state therein any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they made, from being materially misleading.

Kelmoore's Remedial Efforts

11. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertakings

12. Respondent Kelmoore undertakes:

a. To hire for fiscal year 2006, at its expense, an Independent Consultant not unacceptable to the staff to: (1) review at year-end the advisory fees and options commissions charged to comparable funds and to make a report with recommendations thereafter on Kelmoore's policies, procedures, and practices for pricing its advisory fees and options commissions; and (2) review Kelmoore's compliance with relevant rules and regulations governing commissions and fees including, among other things, the best execution obligations;

b. Within 60 days of completing the 2006 year-end review, to require the Independent Consultant to submit a report of his/her findings and recommendations to Kelmoore, the independent trustees of the Kelmoore Strategic Trust and to Marc J. Fagel, Associate District Administrator, of the Commission's San Francisco District Office;

c. To require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years after completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Kelmoore, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such other than the Funds' Independent Trustees. The agreement also will provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Commission's San Francisco District Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Kelmoore, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such other than the Funds' Independent Trustees for the period of the engagement and for a period of two years after the engagement;

d. Within thirty (30) days of entry of the Order, to mail a copy of this Order, together with a cover letter in a form not unacceptable to the staff, to each of the existing shareholders of the Kelmoore Strategic Trust. Within forty-five (45) days of entry of this Order, Kelmoore shall certify in writing that this undertaking has been completed to Marc J. Fagel, Associate District Administrator of the Commission's San Francisco District Office;

e. From the effective date of this Order until the expiration of 365 days, to maintain a link to this Order on the home page of any and all of Kelmoore's website(s) (to the extent Kelmoore maintains more than one website) in a form not unacceptable to the staff of the Commission. Within thirteen (13) months from the date of this Order, Kelmoore shall certify in writing that this undertaking has been completed to Marc J. Fagel, Associate District Administrator of the Commission's San Francisco District Office.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in the Respondent's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, Section 203(e) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

- A. Respondent Kelmoore is hereby censured.
- B. Respondent Kelmoore shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act, and Section 34(b) of the Investment Company Act.
- C. Respondent Kelmoore shall comply with the undertakings enumerated in paragraph 12 above.
- D. Respondent Kelmoore shall pay a civil penalty in the amount of \$100,000 to the United States Treasury within 30 days of entry of this Order. Payment of the civil penalty 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 Kelmoore as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helane L. Morrison, District Administrator, Securities and Exchange Commission, San Francisco District Office, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

By the Commission.

Nancy M. Morris
Secretary