

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64467 / May 11, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3199 / May 11, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-12574

In the Matter of

**MELHADO, FLYNN &
ASSOCIATES, INC.,
GEORGE M. MOTZ AND
JEANNE MCCARTHY**

Respondents.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934 AND SECTIONS 203(e) AND 203(k) OF
THE INVESTMENT ADVISERS ACT OF
1940 AS TO MELHADO, FLYNN &
ASSOCIATES, INC.**

I.

On February 26, 2007, the Securities and Exchange Commission (“Commission”) instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against respondents, including Melhado, Flynn & Associates, Inc. (“MFA” or “Respondent”).

II.

Respondent 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 to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-And-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 as to Melhado, Flynn & Associates, Inc. (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. These proceedings arise out of fraudulent trade allocation – or “cherry-picking” – at MFA. From at least January 2001 through April 2005 (the “relevant period”) the President and Chief Executive Officer of MFA (“MFA’s CEO”), engaged in cherry-picking at MFA. MFA was a registered broker-dealer and investment adviser at the time. During the initial period of the scheme – January 2001 until approximately September 2003 – MFA’s CEO unfairly allocated trades that had appreciated in value during the course of the day to MFA’s proprietary trading account and allocated purchases that had depreciated in value during the day to the accounts of his advisory clients. Beginning in the summer of 2003, MFA’s CEO engaged in cherry-picking to favor one of the firm’s advisory clients, a hedge fund affiliated with MFA, over his other advisory clients. MFA’s CEO accomplished this cherry-picking by purchasing securities toward the beginning of the trading day but waiting until later in the day – after he saw whether the securities appreciated in value – to allocate the securities. MFA’s CEO was able to generate approximately \$1.4 million in profits through this scheme. In the fall of 2003, MFA’s CEO with the assistance of another MFA employee, altered order tickets in an attempt to cover-up these fraudulent trade allocations. In addition, MFA and MFA’s CEO earned commissions and fees from advisory clients who were disadvantaged, and therefore harmed, by the cherry-picking scheme. Neither MFA nor MFA’s CEO disclosed to clients that the firm was engaged in cherry-picking and that the firm would favor itself in the allocation of appreciated securities. Nor did they disclose that the firm engaged in cherry-picking to favor an advisory client hedge fund over other advisory clients. MFA also violated and MFA’s CEO and another MFA employee aided, abetted and caused violations of the books and records provisions of both the Advisers Act and the Exchange Act.

Respondent

2. Melhado, Flynn & Associates, Inc., a New York corporation, is a registered broker-dealer (since December 29, 1976) and investment adviser (since February 18, 1977). Until it stopped doing business, its main office was located in New York, New York. As of the end of the relevant period, MFA had approximately \$318.2 million in assets under management and 749 advisory client accounts; the firm had discretionary control over 734 of those accounts whose assets totaled \$249.2 million. MFA’s clients included, among others, individuals, trusts and pension plans. In October 2009, MFA pled guilty to one count of securities fraud relating to the cherry-picking alleged in these proceedings. MFA was later sentenced to five years probation.

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.

Other Relevant Entity

3. Third Millennium Fund, L.P. (“Third Millennium”), a Delaware limited partnership, was formed in March 2002. The fund’s shares are exempted from registration with the Commission under Regulation D of the Securities Act. Third Millennium GP, LLC, serves as a general partner of Third Millennium. MFA and MFA’s CEO, among others, were members of the general partner. During the relevant period, MFA’s CEO was responsible for investing a portion of the Third Millennium assets. During the relevant period, investors in the fund included high net worth individuals, some of whom were also advisory clients of MFA. Another advisory client opened an account with MFA pursuant to an agreement that the trading in its account would emulate the trading of Third Millennium (the “companion account”).

Background

4. From 2001 through approximately September 2003, MFA’s CEO engaged in a cherry-picking scheme that generated virtually risk-free profits for the firm’s trading account at the expense of the firm’s advisory clients. MFA’s CEO, the only MFA employee who executed trades in the firm’s proprietary account, engaged in day-trading in that account. MFA’s CEO was able to generate approximately \$1.4 million in profits through this scheme. Then, beginning in the summer of 2003 and until at least May 2005, MFA’s CEO engaged in cherry-picking to boost the returns of the Third Millennium, an advisory client hedge fund affiliated with MFA. During this period, MFA’s CEO had trading responsibility for a portion of Third Millennium’s assets.

5. To effectuate the cherry-picking scheme, MFA’s CEO typically submitted equity buy orders to the MFA trading desk in the morning without indicating the accounts to which those purchases should be allocated. MFA’s CEO did not provide the trading desk with allocation instructions concerning those purchases until much later in the day – often shortly before the close of the market. Thus, MFA’s CEO purchased securities in the morning and then decided later in the day whether to sell the position and book the profit in MFA’s proprietary account or to allocate the securities, often those which had depreciated in value during the day, to advisory client accounts.

6. Neither MFA’s CEO nor MFA disclosed to clients that the firm was engaged in cherry-picking and that the firm would favor itself in the allocation of appreciated securities. Nor did MFA or MFA’s CEO disclose to clients that the firm engaged in cherry-picking to favor Third Millennium over other advisory clients. In fact, the firm’s ADV disclosures during the relevant period indicated that clients would not be disadvantaged by the firm’s proprietary trading.

7. Trading records for MFA’s proprietary account for January 2001 through September 2003 show that nearly every trade that MFA’s CEO allocated to MFA’s proprietary account during this period had appreciated in value from the time it was purchased earlier in the day. Through this cherry-picking scheme, MFA’s CEO executed day-trades in MFA’s proprietary account that were more than 98% profitable and yielded a net gain of close to \$1.4 million.

8. Performance data for the proprietary account was used by MFA employees to solicit investments in Third Millennium.

9. MFA's CEO was advised by others in the firm that he should allocate his trades at the time he submitted the order but through at least April 2005, MFA's CEO did not change his allocation practices.

10. In June 2003, MFA's CEO began to engage in cherry-picking to boost the returns of Third Millennium. During the period from December 18, 2003 through May 9, 2005, Third Millennium had a number of trades that were opened and closed out on the same or the next trading day. The profitability of such trades conducted in the Third Millennium account during this period was 100%. MFA's CEO also favored the companion account in the allocation of securities during this period. The profitability of the trades that were opened and closed out on the same or the next trading day in the companion account was over 98%. Consequently, MFA's CEO continued to harm certain MFA advisory clients by consistently allocating profitable trades to Third Millennium and the companion account during this period.

11. As a result of the unfair allocations during the relevant period, MFA earned approximately \$1.4 million in profit. In addition, MFA and MFA's CEO received significant management fees and commissions from their advisory clients who were disadvantaged, and therefore harmed, by the cherry-picking scheme.

12. During an SEC examination of MFA in the fall of 2003, MFA's CEO, with the assistance of another MFA employee, altered certain order tickets relating to the cherry-picked trades in order to try to conceal his fraudulent practices from regulators. Specifically, MFA's CEO, with the assistance of another MFA employee, gathered relevant order tickets from their designated locations and altered some of the tickets by adding markings or changing existing markings to make it appear that allocations had been made at the time of the initial purchases rather than later in the day.

13. MFA failed to make and keep true, accurate and current order memoranda for the purchase and sale of any security on behalf of a client. When submitting his initial trades, MFA's CEO failed to indicate the account for which the trades were entered, sometimes leaving the customer name field blank on order tickets. In addition, MFA's CEO and another MFA employee were involved in the alteration of order tickets which rendered the memoranda inaccurate.

14. MFA's CEO signed and caused to be filed with the Commission on behalf of MFA materially misleading Forms ADV. Specifically, in response to Item 9 of Part II of MFA's Forms ADV filed during the relevant period, the firm acknowledged that it "buys and sells for itself securities that it also recommends to clients." An investment adviser that answers "yes" to that question is then required to disclose on Schedule F "what restrictions or internal procedures, or disclosures are used for conflicts of interest in" transactions in which it buys or sells for itself the same securities that it recommends to clients. Rather than disclosing its internal procedures, MFA

disclosed only that “[t]he Investment Advisor might be purchasing or selling the same security for his/her own account as that of the client’s in which case the Investment Advisor account never receives a lower price in cases of a purchase or a higher price in cases of a sale.” Accordingly, as MFA and MFA’s CEO willfully made material misstatements in the Forms ADV for the relevant period, these Forms ADV were misleading.

15. From October 5, 2004 through at least April 2005, MFA was an investment adviser registered with the Commission that failed to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons. This failure permitted MFA’s CEO to continue his allocation practices and cherry-pick trades to favor Third Millennium.

16. On October 15, 2009, MFA pled guilty to one count of securities fraud in violation of Title 18 United States Code, Sections 1348(1), (2) and 3551, et seq. before the United States District Court for the Eastern District of New York, in *United States v. Motz*, 08-CR-598 (ADS) (the “Criminal Case”). On April 28, 2010, a judgment in the Criminal Case was entered against MFA, sentencing it to five years probation. MFA did not appeal the judgment.

Violations

17. As a result of the conduct described above, MFA willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. In addition, through this cherry-picking scheme and by failing to disclose the scheme, MFA willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser with respect to advisory clients or prospective clients.

18. As a result of the conduct described above, MFA willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 17(a)(1) of the Exchange Act and Rule 17a-3(a)(6)(i) thereunder which require registered investment advisers and broker-dealers to make and keep true, accurate and current order memoranda for the purchase and sale of any security on behalf of a client by failing to make accurate order tickets that contained all the information required by those rules. In addition, MFA willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 17(a)(1) of the Exchange Act and Rule 17a-4(b)(1) thereunder, by subsequently altering order tickets. MFA also willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(2) thereunder, and Section 17(a)(1) of the Exchange Act and Rules 17a-3(a)(2) and 17a-4(a) thereunder, by failing to create and maintain a general ledger for substantial portions of the relevant period. And MFA willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(6) thereunder, and Section 17(a)(1) of the Exchange Act and Rule 17a-4(b)(5) thereunder, by failing to maintain a record of a trial balance during much of the relevant period. MFA also willfully violated Section 207 of the Advisers Act, by filing misleading Forms ADV that willfully made material misstatements – *i.e.*, falsely asserting that when MFA buys or sells for itself the same securities that it recommends to clients, it “never receives a lower price in cases of a purchase or a higher price in cases of a sale.” Finally, MFA willfully violated

Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, by failing to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons.

Disgorgement and Civil Penalties

19. Respondent has asserted its inability to pay either disgorgement or a civil penalty and submitted both to the court in the Criminal Case and to the Commission evidence of its inability to pay. Among other things, MFA has effectively been out of business since early 2008, has not paid New York State taxes since 2007, and has virtually no assets (although it does have liabilities).

IV.

In view of the foregoing, the Commission deems it appropriate, and in the public interest to impose the sanctions agreed to in Respondent Melhado, Flynn & Associates, Inc.'s Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent MFA shall cease and desist from committing or causing any violations and any future violations of Sections 10(b) and 17(a)(1) of the Exchange Act and Rules 10b-5, 17a-3(a)(6)(i), 17a-3(a)(2), 17a-4(a), 17a-4(b)(1), and 17a-4(b)(5) thereunder, and Sections 204, 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2(a)(2), 204-2(a)(3), 204-2(a)(6), and 206(4)-7 thereunder;

B. The registrations of Respondent MFA as a broker, dealer and investment adviser with the Commission be, and hereby are, revoked;

C. Based upon evidence of its inability to pay submitted both to the court in the Criminal Case and to the Commission, the Commission is not imposing disgorgement against Respondent.

D. Based upon evidence of its inability to pay submitted both to the court in the Criminal Case and to the Commission, and given the Commission's revocation of Respondent's registrations as a broker, dealer and investment adviser, as well as the sentence of five years of probation imposed on Respondent in the Criminal Case, the Commission is not imposing a penalty against Respondent.

E. The Division of Enforcement may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest and/or the maximum civil penalty allowable under the law. No other issue shall be considered in connection

with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment

of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Making Findings and Imposing Remedial Sanctions and a Cease-And-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 as to Melhado, Flynn & Associates, Inc. ("Order"), on the Respondent and its legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray
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