

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**  
**February 26, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12574**

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: **ORDER INSTITUTING PUBLIC**  
**In the Matter of** : **ADMINISTRATIVE AND CEASE-AND-**  
: **DESIST PROCEEDINGS PURSUANT TO**  
: **SECTIONS 15(b) AND 21C OF THE**  
**Melhado, Flynn & Associates, Inc.,** : **SECURITIES EXCHANGE ACT OF**  
**George M. Motz and** : **1934, AND SECTIONS 203(e), 203(f)**  
**Jeanne McCarthy,** : **AND 203(k) OF THE INVESTMENT**  
: **ADVISERS ACT OF 1940, AND**  
**Respondents.** : **NOTICE OF HEARING**  
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**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 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Melhado, Flynn & Associates, Inc. (“MFA”), and Sections 15(b) and 21C of the Exchange Act, and Sections 203(f) and 203(k) of the Advisers Act against George M. Motz and Jeanne McCarthy (collectively with MFA, “Respondents”).

**II.**

After an investigation, the Division of Enforcement alleges that:

**OVERVIEW**

A. From at least January 2001 through April 2005 (the “relevant period”) George M. Motz, the President, CEO and Chairman of the Executive Committee of MFA, engaged in fraudulent trade allocation – “cherry-picking” – at MFA. MFA is a registered broker-dealer and investment adviser. During the initial period of the scheme – January 2001 until approximately September 2003 – Motz 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, Motz engaged in cherry-picking to

favor one of the firm's advisory clients, a hedge fund affiliated with MFA, over his other advisory clients. Motz 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. In the fall of 2003, Motz with the assistance of Jeanne McCarthy, altered order tickets in an attempt to cover-up these fraudulent trade allocations. As a result of this fraud, MFA realized ill-gotten gains of approximately \$1.4 million. In addition, MFA and Motz earned commissions and fees from advisory clients who were disadvantaged, and therefore harmed, by the cherry-picking scheme. Neither MFA nor Motz 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 Motz and Jeanne McCarthy aided, abetted and caused violations of the books and records provisions of both the Advisers Act and the Exchange Act.

### **RESPONDENTS**

B. **MFA**, a New York corporation, is a registered broker-dealer (since December 29, 1976) and investment adviser (since February 18, 1977) with its main office located in New York City. As of April 30, 2005, 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 currently has approximately 34 registered representatives. MFA's clients include, among others, individuals, trusts and pension plans.

C. **George M. Motz**, age 66, is President and CEO, Director, and Chairman of the Executive Committee at MFA. Until October 2006, Motz was also Chief Compliance Officer of the firm. He has been employed at the firm since June 4, 1979. During the relevant period, Motz managed approximately 183 discretionary accounts and six non-discretionary accounts, which had assets at MFA of approximately \$58.9 million and \$19.6 million respectively. Motz is also the mayor of the incorporated village of Quogue, New York, a position he has held since 2002. In addition, he is a 9.3% equity owner of MFA. When called for testimony by the Division of Enforcement, Motz invoked his Fifth Amendment privilege and refused to answer questions. Motz earned over \$300,000 annually from MFA during the relevant period. Motz holds Series 1, 24 and 40 licenses with the NASD.

D. **Jeanne McCarthy**, age 55, is Comptroller, Financial and Operations Principal ("FINOP"), and since approximately August of 2003, Director of Compliance Coordination ("DCC") at MFA. McCarthy had been Motz's administrative assistant for 20 years prior to becoming DCC. McCarthy is a partial equity owner of MFA. When called for testimony by the Division of Enforcement, McCarthy invoked her Fifth Amendment privilege and refused to answer questions. She currently resides in New York City.

## **OTHER RELEVANT ENTITY**

E. **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 of 1933. Third Millennium GP, LLC, serves as a general partner of Third Millennium. MFA and Motz, among others, are members of the general partner. During the relevant period, Motz 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”).

## **RESPONDENTS’ CONDUCT**

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

F. To effectuate the cherry-picking scheme, Motz typically submitted equity buy orders to the MFA trading desk in the morning without indicating the accounts to which those purchases should be allocated. Motz 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, Motz 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.

G. Neither MFA nor Motz 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 Motz 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.

H. Trading records for MFA’s proprietary account for January 2001 through September 2003 show that nearly every trade that Motz 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, Motz 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.

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

J. Motz 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, Motz did not change his allocation practices.

K. In June 2003, Motz 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%. Motz 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, Motz continued to harm certain MFA advisory clients by consistently allocating profitable trades to Third Millennium and the companion account during this period.

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

M. During an SEC examination of MFA in the fall of 2003, Motz, with the assistance of Jeanne McCarthy, altered certain order tickets relating to the cherry-picked trades in order to try to conceal his fraudulent practices from regulators. Specifically, Motz, with the assistance of McCarthy, 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.

N. During the time of the order ticket alteration, McCarthy was aware of Motz's late-day allocation practices. In addition, at the time of the order ticket alteration, McCarthy held a compliance role at MFA. Thus, by assisting in the alteration of these order tickets, McCarthy substantially assisted the ongoing fraudulent scheme.

O. 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, Motz failed to indicate the account for which the trades were entered, sometimes leaving the customer name field blank on order tickets. In addition, Motz and McCarthy were involved in the alteration of order tickets which rendered the memoranda inaccurate.

P. Motz 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 Motz willfully made material misstatements in the Forms ADV for the relevant period, these Forms ADV were misleading.

Q. 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 Motz to continue his allocation practices and cherry-pick trades to favor Third Millennium.

### **VIOLATIONS**

R. By knowingly or recklessly allocating profitable trades to MFA at the expense of advisory clients, and later, to Third Millennium at the expense of other advisory clients as described above, Motz and MFA willfully violated and McCarthy willfully aided and abetted and caused violations of 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 and Motz and McCarthy willfully aided and abetted and caused violations of 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.

S. As described above, MFA willfully violated, and Motz and McCarthy willfully aided and abetted and caused MFA's violations of 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, and Motz and McCarthy willfully aided and abetted and caused MFA's violations of 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.

T. In addition, MFA willfully either failed to create a general ledger for substantial portions of the relevant period in violation of Section 204 of the Advisers Act

and Rule 204-2(a)(2) thereunder and Section 17(a)(1) and Rules 17a-3(a)(2) of the Exchange Act, or it created a general ledger which it failed to maintain for substantial portions of the relevant period in violation of Section 204 of the Advisers Act and Rule 204(2)(a)(2) thereunder and Section 17(a)(1) and Rules 17a-4(a) of the Exchange Act. MFA also willfully failed to maintain a record of a trial balance during much of this period in violation of Rule 204-2(a)(6) of the Advisers Act and Rule 17a-4(b)(5) of the Exchange Act. As President and CEO, Chief Compliance Officer, Director, and Chairman of the Executive Committee of MFA, Motz willfully aided and abetted and caused these violations.

U. During the relevant period, MFA filed 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.” Therefore, MFA willfully violated Section 207 of the Advisers Act. By signing and causing to be filed on behalf of MFA these misleading Forms ADV, Motz also willfully violated Section 207 of the Advisers Act.

V. From October 5, 2004, MFA was an investment adviser registered with the Commission but 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. By failing to adopt and implement written policies and procedures, MFA violated and Motz aided and abetted and caused violations of Section 206(4) and Rule 206(4)-7 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford each Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Motz pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, including, but not limited to, disgorgement, prejudgment interest, and civil penalties pursuant to Section 21B of the Exchange Act and Sections 203(i) and 203(j) of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against McCarthy pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, including, but not limited to, civil penalties pursuant to Section 21B of the Exchange Act and Sections 203(i) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against MFA pursuant to Section 15(b)(4) of the Exchange Act and Section 203(e) of the Advisers Act including, but not limited to, disgorgement, prejudgment interest, and civil penalties pursuant to Section 21B of the Exchange Act and Sections 203(i) and 203(j) of the Advisers Act;

E. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, MFA and Motz should be ordered to cease and desist from committing or causing violations of and any future violations of the Sections or Rules specified in Section II, above, and whether MFA and Motz should be ordered to pay disgorgement and prejudgment interest pursuant to Section 21C(e) of the Exchange Act and Section 203(k)(5) of the Advisers Act; and

F. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, McCarthy should be ordered to cease and desist from committing or causing violations of and any future violations of the Sections or Rules specified in Section II, above.

#### IV.

**IT IS HEREBY ORDERED** that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

**IT IS FURTHER ORDERED** that each Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 221(f) and 201.310.

This Order shall be served forthwith upon each Respondent personally or by certified mail.

**IT IS FURTHER ORDERED** that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris  
Secretary