

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 64468 / May 11, 2011**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3200 / May 11, 2011**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 29667 / 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, SECTIONS 203(f) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
AND SECTION 9(b) OF THE INVESTMENT  
COMPANY ACT OF 1940 AS TO JEANNE  
MCCARTHY**

**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 Jeanne McCarthy (“McCarthy” 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 her 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, Sections 203(f) and

203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 as to Jeanne McCarthy (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings arise out of fraudulent trade allocation – or “cherry-picking” – at Melhado, Flynn & Associates, Inc. (“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 McCarthy, altered order tickets in an attempt to cover-up these fraudulent trade allocations. In addition, MFA and its CEO earned commissions and fees from advisory clients who were disadvantaged, and therefore harmed, by the cherry-picking scheme. Neither MFA nor its 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 McCarthy aided, abetted and caused violations of the books and records provisions of both the Advisers Act and the Exchange Act.

#### Respondent

2. Jeanne McCarthy, age 59, was Financial and Operations Principal during the relevant period. From approximately August 2003 through at least the end of the relevant period, she was also the Director of Compliance Coordination (“DCC”) at MFA. McCarthy had been the CEO’s administrative assistant for 20 years prior to becoming DCC. When called for testimony by the Division of Enforcement, McCarthy invoked her Fifth Amendment privilege and refused to answer questions. During the relevant period she resided in New York City; she currently resides in Plymouth, Michigan.

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<sup>1</sup> 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 Entities**

3. 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.

4. 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").

### **The Cherry-Picking Scheme at MFA and McCarthy's Misconduct**

5. 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.

6. 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.

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. 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%.

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

10. During an SEC examination of MFA in the fall of 2003, MFA's CEO, with the assistance of McCarthy, 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 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.

11. During the time of the order ticket alteration, McCarthy was aware of MFA's CEO'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.

12. 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 McCarthy were involved in the alteration of order tickets which rendered the memoranda inaccurate.

### **Violations**

13. As a result of the conduct described above, McCarthy willfully aided and abetted and caused MFA and MFA's CEO's 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, McCarthy willfully aided and abetted and caused MFA's 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.

14. As a result of the conduct described above, 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, 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 assisting in the CEO's alteration of order tickets.

#### **Civil Penalties**

15. Respondent has submitted a sworn Statement of Financial Condition dated September 8, 2010 and other evidence and has asserted her inability to pay a civil penalty.

#### **IV.**

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent McCarthy 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) and 17a-4(b)(1) thereunder, Sections 204, 206(1) and 206(2) of the Advisers Act and Rule 204-2(a)(3) thereunder;

B. Respondent McCarthy be, and hereby is barred from association with any broker, dealer, or investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter;

C. Any reapplication for association by the Respondent 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 the Respondent, 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.

D. Based upon Respondent's sworn representations in her Statement of Financial Condition dated September 8, 2010 and other documents submitted to the Commission, 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 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, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 as to Jeanne McCarthy ("Order"), on the Respondent and her 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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