ADMINISTRATIVE PROCEEDING
FILE NO. 3-5950

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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| In the Matter of | : |
| PETER J. KISCH<br>GEORGE R. ZENANKO | : |
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| | : |

# INITIAL DECISION



April 17, 1981
Washington, D.C.

Ralph Hunter Tracy
Administrative Law Judge

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APPEARANCES: Ronald P. Kane and Ellen E. Douglas of the Chicago Regional Office for the Division of Enforcement.

Michael R. Cunningham and Lindley S. Branson of Gray, Plant, Mooty, Mooty & Bennett for George R. Zenanko.

Peter J. Kisch, pro se

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This public proceeding was instituted by Commission Order (Order) of August 4, 1980, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act) and Section 14(b) of the Securities Investors Protection Act of 1970 (SIPA) to determine whether the above-named respondents, among others,[1/] committed various charged violations of the Securities Act of 1933 (Securities Act), the Exchange Act, SIPA, and regulations thereunder as alleged by the Division of Enforcement (Division) and the remedial action, if any, that might be appropriate in the public interest.

The Order alleges, in substance, that Peter J. Kisch (Kisch) and George R. Zenanko (Zenanko) wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and wilfully aided and abetted violations of Sections 15(b)(1), 15(c)(1), 15(c)(3) and 17(a) of the Exchange Act and Rules 10b-3, 10b-5, 15bc-1, 15c1-2, 15c3-1, 15c3-3, 17a-3 and 17a-11 thereunder; and Kisch failed reasonably to supervise those persons under his supervision with a view to preventing the alleged violations.

The evidentiary hearing was held at Minneapolis, Minnesota from November 3 through November 7, 1980, with respondent Zenanko being represented by counsel and Kisch appearing pro se. Proposed findings of fact, conclusions of law and supporting briefs

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1/ The Order also named as respondents Gerald M. Levine, Equity Securities Trading Company, Inc., and Nathan Newman, all of whom submitted offers of settlement which were accepted by the Commission. Exchange Act Release No. 17043/August 4, 1980. While this initial decision refers to certain of the former respondents, the findings herein are binding only on Kisch and Zenanko.

were filed by Zenanko and the Division. Kisch filed a combined "closing statement and brief."

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.[2/]

## FINDINGS OF FACT AND LAW

### Respondents

Peter J. Kisch (Kisch) was born on June 26, 1939, in St. Paul, Minnesota, educated in the local public schools, and graduated from high school in 1957. He served 2 years in the Marine Corps and has attended various colleges and business schools, including the University of Minnesota and Minnesota School of Business. He has taken many courses in business and finance, accounting and auditing. He has been employed in the securities business since 1968, principally in the back offices of various brokerage firms. He was executive vice-president and treasurer of Pagel, Inc. (Pagel) (formerly known as Effress, Goldman & Pagel, Inc.), a Minneapolis broker-dealer, from 1975 until April 1978 when he left to form P.J. Kisch & Co., Inc. where he was president, treasurer and a director.

George R. Zenanko (Zenanko) was born August 4, 1944 in Macyville, California. He attended high school and college in Minnesota and received a B.S. degree from St. Cloud State

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2/ Steadman v. Securities and Exchange Commission, No. 79-1226, U.S.L.W. Vol. 39, No. 33 (February 25, 1981).

College, St. Cloud, Minnesota in June 1972. He has been employed in the securities business since 1972 when he joined Paine, Webber, Jackson & Curtis (PWJC) as a clerk. He became a registered representative in June 1973. In December 1974 he left PWJC to join Pagel as a registered representative. He and Kisch became acquainted at Pagel, and Zenanko left Pagel in April or May of 1978 to help in the organization of P.J. Kisch & Co. where he became part owner, vice-president, secretary and a director.

Background

Kisch formed P.J. Kisch & Co. Inc. in April 1978 and filed an application for registration with the SEC on Form BD on April 19, 1978. Form BD showed that Zenanko had loaned $30,000 to Kisch to establish the firm and that it was the intention that Zenanko become an equal shareholder when he became qualified with the NASD. At the time Zenanko was a registered representative and Kisch was a registered NASD operations principal, a registered NASD financial principal and a registered options principal. P.J. Kisch & Co.'s registration was granted by the SEC on June 15, 1978.

Kisch & Co. entered into a written clearing agreement, dated April 19, 1978, with Equity Securities Trading Company, Inc. (Equity) by which Equity was to clear customer securities transactions for Kisch & Co. on a fully disclosed basis. Kisch & Co. apparently began clearing transactions through Equity in August 1978; at this time Kisch and Nathan Newman (Newman), president and

principal owner of Equity, also reached a verbal understanding of a trading arrangement whereby Equity would become a market maker in certain stocks. This arrangement lasted until March 1979. At the request of Kisch & Co., Equity listed itself as market maker in at least 8 over-the-counter stocks. One of these was the stock of Mini Computer Systems, Inc. (Mini Computer) which will be more fully discussed hereinafter.

In June 1978 Zenanko invested another $30,000 in Kisch & Co. and in October 1978 Kisch and Zenanko formed the Minnesota corporation of Beth Leasing, Inc. (Beth Leasing). The latter was formed as a holding company for Kisch & Co. and held the shares of the broker-dealer. As directors of this corporation Kisch and Zenanko each owned 50% of the stock.

In February 1979 Robert O. Nikoley (Nikoley) a CPA and partner in an accounting firm, was induced to invest in P.J. Kisch & Co. Between February 2, 1979 and March 30, 1979 he invested $120,000 in Beth Leasing, which he understood owned P.J. Kisch & Co.[3/] Nikoley had known Zenanko since 1974 when Zenanko had been his broker at PWJC. Nikoley subsequently invested a total of $154,000. Zenanko's total investment was $104,500 plus some commissions of $35,000 to $50,000 which he left in the firm as additional capital. The amount contributed by Kisch is not shown in the record.[4/]

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3/ On July 23, 1979, Beth Leasing was merged into P. J. Kisch & Co. resulting in Kisch owning 20% and Zenanko and Nikoley each owning 40% of P. J. Kisch & Co.

4/ The minutes of action of the board of directors of P.J. Kisch & Co., dated April 6, 1978, when Kisch was the sole member of the board, shows a capital contribution of $30,000 by Kisch. However, the evidence indicates that this was a loan from Zenanko.

On November 9, 1979, the Federal District Court for the District of Minnesota permanently enjoined Kisch & Co. from violating Sections 15(c)(3), 17(a) and 17(b) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-3 and 17a-4 thereunder. The court also appointed the Securities Investor Protection Corporation (SIPC) as trustee for the liquidation of Kisch & Co.

Anti-Fraud Provisions

The Order alleges that during the period from August 1978 to in or about March 1979, Kisch and Zenanko wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 [5/] thereunder in connection with the offer, sale, and purchase of stock of Mini Computer Systems, Inc. (Mini Computer).

As stated previously, Kisch & Co. had a clearing agreement with Equity. Sometime in August 1978 several of the registered representatives of Kisch & Co., including Zenanko, became interested in Mini Computer and began recommending it to their customers. Kisch & Co. requested Equity to make a market in Mini Computer. Transactions in Mini Computer were effected by Kisch & Co. through a trading inventory account established by Equity at the request

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5/ Section 10(b) as here pertinent makes it unlawful for any person to use or employ in connection with the purchase or sale of a security any manipulative device or contrivance in contravention of rules and regulations of the Commission prescribed thereunder. Rule 10b-5 defines manipulative or deceptive devices by making it unlawful for any person in such connection: "(1) to employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person..." Section 17(a) contains analogous anti-fraud provisions.

of Kisch which was designated as the "Trader #9" account on Equity's records. Equity purchased Mini Computer stock for the Trader #9 account at the direction of Kisch & Co. registered representatives.

As a result of this arrangement Kisch & Co. dominated the market in the stock of Mini Computer. During the period from September 18, 1978 through February 28, 1979, Equity, while listed as a market maker at the request of Kisch & Co., reported buy transactions for 179,714 shares or 45.86% of the buy volume and sale transactions for 186,694 or 46.44% of the sell volume of Mini Computer among 14 market makers. Zenanko's customers purchased 74,589 shares of Mini Computer or approximately 44% of the total number of shares purchased by Kisch & Co. customers. By comparison, during this same period the second highest volume reported by a market maker was 56,223 shares (or 15.35%) bought and 51,146 shares (12.72%) sold.

During the period that Kisch & Co. acted as market maker, the "float" or available trading supply of shares of Mini Computer was approximately 434,757 shares. Of that number of shares, as of February 28, 1979, Kisch & Co. held 32.1% in its firm and customer accounts. As of the same date Kisch & Co. held 71.85% of all shares held among market makers and their customers. The market maker which reported the second largest position held only 16.2% of the shares held among market makers or only 7.2% of the float as of that date.

During the period from August 24, 1978 through February 28, 1979, while the above described activities were taking place, neither

Kisch & Co., Kisch, or Zenanko disclosed to their customers that the actual market maker in Mini Computer stock was Kisch & Co. Neither did they disclose that excessive markups were being charged customers in the sale of Mini Computer shares. The Division prepared and introduced into evidence a chronological schedule (Ex. D-44) of all of the transactions effected in Mini Computer stock in the Trader #9 account for the period August 24, 1978 through February 28, 1979. This schedule was prepared in order to compute the markups applied to customer transactions in the Trader #9 account. This period of time was selected because this was the entire period during which Kisch & Co. salesmen sold Mini Computer stock to their customers out of the Trader #9 account which was carried at Equity. The schedule purports to show the markup from contemporaneous cost which is the price at which the Trader #9 account purchased the stock at or about the time it sold shares of Mini Computer to its customers. The accepted method of computing markups based on contemporaneous cost is at or about the time that is within one or two days of the actual transaction.[6/] However, in this particular exhibit, in virtually all of the transactions, the contemporaneous cost is based on transactions that occurred on the same day as the customer's transactions.

Based on these calculations, markups (i.e., the spread

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6/ First Pittsburgh Securities Corp., Exchange Act Release No. 16897, 20 SEC Docket 401 (June 16, 1980); Charles Michael West, Exchange Act Release No. 15454, 15 SEC Docket 592, 594 (January 2, 1979); J.A. Winston & Co., Inc., 42 S.E.C. 62, 69 (1964).

between the markup basis price and the price charged customers) was determined for a total of 231 transactions in Mini Computer for the period from August 28, 1978 through February 28, 1979, as shown in the following table (Ex. D 44):

| Markups | Number of Transactions | Dollar Amount of Markups | Percent of all Transactions | Cumulative Percentages |
|---|---|---|---|---|
| Over 15% | 27 | $ 18,225.00 | 11.69 | 11.69 |
| 10-15% | 80 | 34,661.87 | 34.63 | 46.32 |
| 8-10% | 37 | 19,187.50 | 16.02 | 62.34 |
| 5-8% | 66 | 20,325.00 | 28.59 | 90.91 |
| 0-5% | 21 | 4,113.50 | 9.09 | 100.00 |
| Total | 231 | $ 96,512.87 | 100.00 | 100.00 |

As can be seen from the above table, out of the 231 transactions, 210, or over 90 percent, of the markups exceeded 5 percent. Twenty-seven had markups of over 15 percent while 80 had markups of between 10-15 percent.

The table below (Ex. D 45) shows the results of a similar analysis done for the transactions which Zenanko effected for his customers who bought 74,589 shares and sold none.

| Markups | Number of Transactions | Dollar Amount of Markups | Percent of all Transactions | Cumulative Percentages |
|---|---|---|---|---|
| Over 15% | 11 | $ 8,125.00 | 12.09 | 12.09 |
| 10-15% | 30 | 15,836.87 | 32.97 | 45.06 |
| 8-10% | 21 | 10,112.50 | 23.08 | 68.14 |
| 5-8% | 24 | 8,737.50 | 26.37 | 94.51 |
| 0-5% | 5 | 1,200.00 | 5.49 | 100.00 |
| Total | 91 | $ 44,111.87 | 100.00 | 100.00 |

The above table of Zenanko's transactions for his customers in Mini Computer stock shows that out of the 91 transactions, 86 or over 94 percent exceeded 5 percent. Eleven had markups of over

15 percent while 30 had markups of between 10-15 percent.

The Commission has long held that as part of his conduct a broker-dealer is required to sell securities at prices which are reasonably related to the current market price.[7/] Excessive and unreasonable markups are contrary to the duty of a broker-dealer to deal fairly with his customers and, therefore, are in violation of the anti-fraud provisions of the federal securities laws.[8/]

The Commission has found in broker-dealer revocation proceedings that markups over the prevailing market of lesser percentages than were used here were fraudulent: 5% in Linder Bilotte & Co., Inc., 42 S.E.C. 807, 809 (1965); 5.2% in J.A. Winston & Co., Inc., 42 S.E.C. 49 (1964); 5.4% in Powell & McGovern, Inc., 41 S.E.C. 933 (1964). The fraud lies in the failure of a broker-dealer to adhere to the implied representation that his customers will be dealt with fairly and honestly (Duker v. Duker, supra).

In his brief Kisch states that Gerald M. Levine (a former respondent in this proceeding, see note page 1, supra) had a secret account established at Equity and that if Equity had a relationship with Levine in the buying and selling of Mini Computer stock, or any other stock, that relationship was set up between Mr. Levine, Mr. Newman, and Equity Securities, Inc., not Mr. Peter J. Kisch and/or the firm of P.J. Kisch & Co.

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7/ Duker v. Duker, 6 S.E.C. 386, 389 (1939).

8/ Barnett v. United States, 319 F.2d 340 (8th Cir. 1963).

Kisch states, further, that the markets were not placed into NASDAQ by Kisch & Co. or its employees, and that Equity arranged the trading procedures for Kisch & Co.

The record does not support Kisch's position. Newman testified that the arrangement whereby his company, Equity, opened the Trader #9 account for Kisch & Co. to carry inventory for market making was entered into at the request of Kisch. There was no written agreement of this arrangement, as there was with the clearing arrangement. Newman was aware that Kisch & Co. had an interest in Mini Computer so Equity would make a high bid to attract the stock. He was not aware of any particular order that a customer may have had at a specific time. Newman said his only concern was that the markup would not exceed the guideline set forth by the NASD, which is generally referred to as the five percent rule. On several occasions the trader at Equity told Newman that the quotes of Mini Computer being received from Kisch & Co. were too high and he would then call Kisch to reduce them. While Equity was making the market in Mini Computer, it had no real interest in the stock and made only one or two trades.

Levine testified that he was a registered representative at Kisch & Co. from June 1978 to January 1979 and that he, Zenanko and Kisch all wanted to be market makers in the stock of Mini Computer. He stated that Kisch discussed market making with Newman, president of Equity, whereupon Equity became the market maker. Each registered representative at Kisch & Co. was

charged 100% of any losses incurred in Mini Computer transactions and received 50% of any profits. Most of the Mini Computer transactions by Kisch & Co. were on a principal basis. That is, Kisch & Co. owned the stock in its Trader #9 account at Equity and would sell it at a markup and not on a commission basis. The salesman at Kisch & Co. set the price, including markup, on each transaction. The markup would be added to the current offering price so that if the shares in inventory in the Trader #9 account had been purchased at a lower price, then the markup would be added on top of that profit.

Zenanko asserts that he was not primarily responsible for the interest in Mini Computer. However, the record shows that he generated a substantial percentage of the Mini Computer business at Kisch & Co. (Page 6 , supra).

Zenanko also denies that the markups were excessive on the ground that the actual gross trading profit for all sales and purchases of Mini Computer stock was less than 9% of the gross amount of such transactions. This assumption obfuscates the issue. Whether or not a broker-dealer generates a gross trading profit in all of its transactions in a particular stock is irrelevant to the issue of markups since the stock held by the broker-dealer may fluctuate in price and since many transactions are inter-dealer transactions rather than customer transactions. The markups computed by the Division, as shown on the foregoing schedules, page 8 supra, were computed in customer transactions only,and then from records where the contemporaneous

cost could be determined.

It is found that Kisch and Zenanko wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[9/] It is found, also, that Kisch and Zenanko, by their above described conduct wilfully aided and abetted violations of Section 15(c)(1) of the Exchange Act and Rules 10b-3, 15c1-2 thereunder, relating to the fraudulent practices of broker-dealers in connection with the purchase or sale of over-the-counter securities.

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9/ Because of the knowing participation of Kisch and Zenanko in the events culminating in the violations, it is found that they had the scienter requisite to findings of such violations of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and Section 17(a)(1) of the Securities Act. However, findings are also made under Sections 17(a)(2) and (3) of the Securities Act, under which scienter is not required. Aaron v. Securities and Exchange Commission, 100 S. Ct. 1945 (1980).

Net Capital Violations

The Order charges that during the periods from March to June and in October 1979, Kisch & Co. wilfully violated and Kisch and Zenanko wilfully aided and abetted violations of the net capital provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder. 10/

Kisch & Co. terminated its clearing agreement with Equity as of March 1, 1979. This termination increased Kisch & Co.'s net capital requirements and eliminated its exemption from the customer reserve account requirement of Rule 15c3-3. As a result of carrying its own customer margin accounts for the first time, in March 1979, Kisch & Co. was in immediate violation of the net capital and customer reserve requirements. Moreover, Kisch & Co. had been having difficulty complying with net capital requirements for some time. A report by its accountant, Touche Ross & Co. for the period from the beginning of its operation on April 19, 1978 to March 31, 1979 states in its covering letter:

> The Company has required substantial contributions to capital during the period to maintain the required net capital under Rule 15c3-1 of the Securities and Exchange Commission. Continued operations by the Company will be dependent on the continued availability of necessary capital.

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10/ Section 15(c)(3) of the Exchange Act, insofar as here pertinent, prohibits securities transactions by a broker or dealer in contravention of the Commission's rules prescribed thereunder providing safeguards with respect to the financial responsibility of brokers and dealers. Rule 15c3-1 provides, subject to certain exemptions not applicable here, that no broker or dealer shall permit his aggregate indebtedness to all persons to exceed 1,500% of his net capital computed as specified in the rule or or have a net capital of less than $25,000. However, in his first year of operation a broker-dealer must not let his aggregate indebtedness exceed 800% of his net capital.

The substantial contributions to capital referred to by Touche Ross were $60,000 by Zenanko between April 5, 1978 and June 5, 1978, and $120,000 by Nikoley between February 2, 1979 and March 30, 1979. However, these contributions were not sufficient to keep Kisch & Co. in compliance, as can be seen from Note D to the financial statements prepared by Touche Ross:

> Net capital and the related net capital ratio fluctuate on a daily basis; however, as of March 31, 1979, the net capital ratio was 14.64 to 1 net capital was $44,516, which was less than the required minimum capital (eight to one ratio) by $36,974.

Beginning with March 31, 1979, Kisch & Co. had net capital deficiencies for the months ending March, April, May, and October 1979 and at various interim dates as shown in the following schedule (Exs. D90 and D91):

| Date | Required Net Capital | Actual Net Capital | Deficiency |
|---|---|---|---|
| 3/31/79 | $ 81,490 | $ 44,516 | $36,974 |
| 4/30/79 | 61,406 | 31,894 | 28,512 |
| 5/30/79 | 25,469 | 8,140 | 17,329 |
| 6/12/79 | 31,784 | 10,405 | 21,379* |
| 6/13/79 | 27,188 | 5,993 | 21,195* |
| 10/5/79 | 23,320 | 60,272 | 83,592 |
| 10/12/79 | 23,968 | 69,727 | 93,695 |
| 10/17/79 | 25,964 | 110,808 | 136,772 |
| 10/18/79 | 26,795 | 103,030 | 129,825 |
| 10/31/79 | 11,112 | 123,643 | 134,755 |

On June 15, 1979, Nikoley contributed another $3,000, so that as of June 30, 1979, the firm was in capital compliance by $6,106 and

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* These deficiencies were corrected on June 14, 1979 by contributions of $7,000 and $25,000 by Nikoley and Zenanko, respectively.

apparently remained in compliance until October 1979. However, during the period from June 30 to October 5, 1979, the firm and its principals, Kisch, Zenanko, and Nikoley were attempting to raise additional capital from various sources. One of the sources considered was a private offering and a prospectus was prepared, dated September 24, 1979, proposing to offer 25,000 shares of Kisch & Co. common stock, $.05 par value, at $10.00 a share. However, the offering never materialized.

As shown in the foregoing schedule (page 14, supra), Kisch & Co. had a substantial net capital deficiency as of October 5, 1979, which continued until the end of the month when it was forced to close. In addition, the firm was unable to meet the requirements of Rule 15c3-3 (the customer protection rule) so that its customer reserve account was also deficient. This will be discussed hereinafter in a separate section.

In an effort to conceal the net capital deficiencies occurring in October, Kisch and Zenanko engaged in a "check kiting" scheme designed to mislead the NASD and SEC examiners. On Friday, ~~April~~ October 19, 1979, the Chicago office of the SEC was informed by the NASD that Kisch had notified the NASD of a funding problem with respect to reserve requirements. Accordingly, an SEC examiner went to Minneapolis on Monday, October 22, 1979, and met with Kisch, Zenanko and the NASD examiner at P. J. Kisch & Co.'s offices.

At the meeting on October 22, 1979, it was disclosed that Kisch & Co. had a net capital deficiency of $129,825, and

a customer reserve deficiency of $120,509, as of October 18, 1979. However, the two examiners were told that these deficiencies had been corrected by an infusion of capital in the amount of $125,000 and were shown two deposit slips, totalling $125,000 deposited in the Kisch & Co. bank account. These deposits represented two checks of $75,000 and $50,000 from Zenanko to P. J. Kisch & Co. In addition to the deposit slips, the examiners were shown an intra-bank wire transfer of $120,509, from the $125,000, into a special reserve account for the benefit of customers. These transactions were represented as having taken place on Friday, October 19, 1979. The NASD examiner verified the deposits with the bank on Tuesday, October 23. The SEC examiner, satisfied with the evidence he had been shown of an infusion of capital to correct the net capital and reserve account deficiencies, returned to Chicago on Wednesday, October 24, 1979.

What the examiners did not know was that the whole transaction was a sham devised for their benefit. What actually occurred on October 19 was an exchange of checks between Zenanko and Kisch & Co. Zenanko had written his checks on a joint account maintained by him with his wife, which on October 18 had a balance of $567.74. Kisch had written two checks on the P.J. Kisch & Co. account payable to Zenanko totalling $125,000. These checks were not recorded on Kisch & Co.'s books and records.

On October 22, 1979, Kisch, stating that he "had to do it again," asked Zenanko for another $125,000, apparently to cover the overdraft in Kisch & Co.'s general checking account caused by

the checks written to Zenanko on October 19. This time Zenanko wrote a check to Kisch & Co. for $125,000 and later on the same day, October 22, Kisch wrote a check for $125,000 on P. J. Kisch & Co.'s account payable to Zenanko. This check was taken out of sequence from Kisch & Co.'s checkbook by over 200 numbers, apparently in an attempt to prevent its discovery by the examiners. The books of Kisch & Co. never reflected the October 22 deposit and did not reflect the October 22 check to Zenanko until October 31. These exchanges of checks had no effect on Kisch & Co.'s net capital position or customer reserve accounts.

The final step in this scheme of deception and fraud was the sending of mailgrams to the Chicago Regional Office of the SEC stating that any net capital problems had been corrected. A mailgram sent on October 23, 1979 stated:

> Due to an error within our calculation of the reserve calculation on 9-28-79, as of 10-2-79 we failed to make the correct deposit. This was brought to our attention by the NASD on 10-19-79, and we made the required deposit. The NASD and the SEC were on the premisis (sic) and check (sic) our figures on 10-22 and 10-23, 79 and we were in compliance. Details will follow.

The follow-up mailgram sent to the SEC's Chicago office on October 25, 1979, stated:

> As of 10-18-79 per the NASD calculation, we were in a deficient net capital of about $93,000. In relation to the telegram sent on 10-23-79, we injected $125,000 and a liquidation of inventory which brings the net capital to an adjusted net capital $56,068, as of the close of 10-19-79 as computer (sic) per both NASD and SEC examiners on premises. Details to follow.

On October 31, 1979, Kisch informed the NASD that Kisch & Co. would cease to do business. The NASD and SEC examiners returned to the premises and on November 5, 1979, the SEC filed

a lawsuit against Kisch & Co. in the District Court for the District of Minnesota. The Court entered an order of permanent injunction and appointed a trustee on November 9, 1979. (See page 5 supra)

Kisch does not dispute the net capital violations. He asserts that anytime the firm had a violation it requested help from the NASD and, also, notified the proper agencies, except for the last two weeks in October, 1979. He holds Zenanko and Nikoley responsible for the net capital deficiencies. He states that when he realized that they were not going to inject more monies into the firm he called the NASD and informed it that Kisch & Co. was going to cease doing business.

Zenanko acknowledges that he issued two checks to Kisch & Co. on October 19, 1979, and one check to Kisch & Co. on October 22, 1979, when indeed he did not have sufficient funds to cover them. He claims that at the time that he issued each of the checks he was unaware of the true financial condition of Kisch & Co. and that he did not intend that the issuance of these checks would or should be used for concealing what he later discovered to be the firm's serious financial condition. He admits that he did not take any affirmative action to advise anyone of the issuance of the checks even after he was advised by the NASD examiner that Kisch & Co.'s net worth was approximately $60,000 after giving effect to the checks which he had issued on October 19, 1979.

Respondents' explanations are simply not credible. They both knew of the financial problems besetting Kisch & Co. and had engaged in unsuccessful efforts to raise money, including the

preparation in September of a prospectus for a private offering. Zenanko, in addition to capital contributions, had left some of his commissions in the firm. It should be noted, also, that when Zenanko issued his personal check for $25,000 on June 15, 1979, to correct the capital deficiency existing at that time (page 14, supra), he had only $240.92 in his bank account. However, he was able to cover that check on the following day by borrowing from relatives.

Kisch and Zenanko are charged with wilfully aiding and abetting violations of the net capital provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder. In the context of the federal securities laws one may be found to have aided and abetted a violation when (1) some other party has committed a securities law violation, (2) the aider and abettor was aware that his role was part of an overall activity that was improper, and (3) the aider and abettor knowingly and substantially assisted the violation.[11/] All of these elements are clearly present in this case.

It is found that Kisch and Zenanko wilfully aided and abetted Kisch & Co.'s violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.[12/]

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11/ Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94 (C.A. 5, 1975). See also In the Matter of William R. Carter and Charles J. Johnson, Jr., Exchange Act Release No. 74597/February 28, 1981.

12/ Except for the anti-fraud provisions of the securities laws it is well established that a finding of wilfullness does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing. Billings Associates, Inc., 43 S.E.C. 641, 649 (1967); Tager v. S.E.C., 344 F.2d 5, 8 (1965); Hughes v. S.E.C., 174 F.2d 969, 977 (1949).

Customer Reserve Violations

The Order charges that during the period from in or about September 1979 to in or about October 1979, Kisch and Zenanko wilfully aided and abetted Kisch & Co.'s violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder by failing to maintain in a special reserve account sufficient funds for the protection of customers.[13/]

Following the termination of its clearing agreement with Equity in March 1979, Kisch & Co. had difficulty meeting the requirements of Rule 15c3-3, the customer protection rule, particularly throughout the period from September 28, 1979 to October 31, 1979, as shown in the following schedule (Exs. D136 and D138):

| Date | Amount Required In Reserve Account | Actual Amount In Reserve Account | Reserve Account Deficiency |
|---|---|---|---|
| 09-28-79 | $ 287,196.35 | $ 278,400.00 | $ 8,796.35 |
| 10-01-79 | 286,942.67 | 235,400.00 | 51,542.67 |
| 10-04-79 | 304,438.31 | 149,400.00 | 155,038.31 |
| 10-05-79 | 279,005.16 | 149,400.00 | 129,605.16 |
| 10-08-79 | 279,522.49 | 149,400.00 | 130,122.49 |
| 10-09-79 | 217,765.26 | 89,400.00 | 128,365.26 |
| 10-12-79 | 225,891.82 | 175,394.00 | 50,491.82 |
| 10-15-79 | 144,728.69 | 99,394.00 | 45,334.69 |
| 10-18-79 | 188,016.18 | 99,394.00 | 88,622.18 |
| 10-19-79 | 294,078.12 | 219,903.00 | 74,175.02 |
| 10-24-79 | 184,186.73 | 89,903.00 | 94,283.73 |
| 10-26-79 | 153,200.28 | 84,903.00 | 88,297.28 |
| 10-29-79 | 114,110.55 | 9,903.00 | 104,207.55 |
| 10-31-79 | 139,227.06 | 9,903.00 | 128,324.06 |

13/ Rule 15c3-3 provides that every broker or dealer shall maintain with a bank at all times when deposits are required a "Special Reserve Bank Account for the Exclusive Benefit of Customers" (the "Reserve Bank Account") and it shall be separate from any other bank account of the broker or dealer. The Rule includes a formula for the determination of a cash reserve with respect to all customer funds which are not deployed in customer related transactions.

The figures shown in the last column of the above schedule are the amounts which were required to be deposited (in either cash and/or qualified securities) to the customer reserve account in order to bring Kisch & Co. into compliance. However, not only were the deposits not made, but on two occasions, October 9 and 12, 1979, Kisch & Co. made withdrawals from the customer reserve account of $60,000 and $76,000, respectively. According to the firm's own computations these withdrawals resulted in deficiencies of $4,615 and $12,422 on those dates. The effect of these withdrawals from the reserve account was to reduce the overdrafts existing in the firm's general checking account. With the exception of only 4 days, Kisch & Co. operated in an overdrawn position in its general checking account for the entire month of October, 1979.

During October 1979 there were net withdrawals from the customer reserve account totalling $268,491, which were used in the operations of the firm. Of this amount $135,741.71 was used to satisfy customer and other broker-dealer obligations and $132,749.29 was used to meet actual operating expenses, such as salaries, commissions and office expenses.

During his visit to Kisch & Co. on October 22, 1979, the SEC examiner prepared a reserve computation for the firm as of October 18, 1979 which showed a deficiency of $120,509. However, during this meeting he was shown deposit slips reflecting $125,000 purportedly injected into the firm. He was also shown a wire transfer for $120,509 from the general checking account to the

customer reserve account which apparently resolved the deficiency. However, as previously described, this was part of an elaborate scheme to deceive the examiners. When this bogus contribution was excluded from the reserve account, it again had a reserve deficiency which continued until the firm ceased doing business on October 31, 1979.

The record fully supports a finding that Kisch and Zenanko wilfully aided and abetted violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-3.

Bookkeeping and Reporting Violations

The record establishes that during October and November 1979, Kisch & Co., aided and abetted by Kisch and Zenanko, violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by failing to maintain and to keep accurate certain required books and records.

As previously found and discussed at some length, respondents engaged in a deliberate scheme to deceive examiners from the SEC and the NASD as to the true financial condition of Kisch & Co. These activities took place from about October 19, 1979 until about November 5, 1979. In order to conceal the true net capital position and reserve account balance from the examiners certain entries were falsely made, or omitted, in the firm's books and records. These included, but were not limited to, ledgers (or other records) reflecting all assets and liabilities and a record of the proof of money balances of all ledger accounts in the form of trial balances.

In addition, respondents aided and abetted violations of Rule 17a-11 in that Kisch & Co. failed to file proper telegraphic notices in April and May 1979 and deliberately filed false and misleading notices on October 23 and 25, 1979 (page 17, supra). As the record shows (page 14, supra), Kisch & Co. had net capital deficiencies as of April 30 and May 30, 1979. No notice of the April deficiency was sent to the Commission and the notice of the May deficiency was not sent until June 15, 1979.

In view of the foregoing, it is found that Kisch and Zenanko wilfully aided and abetted Kisch & Co. in its violations of Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-11 thereunder. 14/

14/ Resch-Cassin & Co., Inc., 362 F. Supp. 964 (S.D.N.Y. 1973); In re Jay Rutledge (1976-1977) Fed. Sec. L. Rep. (CCH) ¶80,692 (August 19, 1976).

Supervision

The Order also charged that Kisch failed reasonably to supervise persons subject to his supervision with a view toward preventing the violations alleged in the Order.

Failure to supervise connotes an inattention to supervisory responsibilities and a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them. However, having found that Kisch & Co. wilfully violated several substantive provisions of the securities laws and the regulations thereunder and that Kisch wilfully aided and abetted such violations, it is inappropriate and inconsistent to find him responsible for a failure of supervision with respect to the same misconduct. See In the Matter of Anthony J. Amato, 45 S.E.C. 282 (1973); Adolph D. Silverman, 45 S.E.C. 328 (1973); Fox Securities Company, Inc., 45 S.E.C. 377 (1973).

Other Matters

Section II, paragraph M, of the Order alleges that Kisch and Zenanko aided and abetted violations of Section 15(b)(1) of the Exchange Act and Rule 15b3-1(b) by failing to disclose in Kisch & Co.'s Form B/D, or amendments thereto, the merger between Beth Leasing and Kisch & Co., the number of shares in Kisch & Co. owned by Kisch, Zenanko,and Nikoley, and the fact that Kisch & Co. was a market maker in the stock of Mini Computer.

In view of the findings previously made herein that Kisch and Zenanko wilfully aided and abetted the record keeping and reporting requirements of Section 17(a) of the Exchange Act and

Rules 17a-3 and 17a-11 thereunder, it appears that these allegations are in effect repetitious and cumulative and that further findings are unnecessary.

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the respondents who have been found to have committed certain violations as alleged in the Order. The Division urges that Kisch and Zenanko be barred from association with any broker or dealer.

The appropriate remedial action as to a particular respondent depends on the facts and circumstance applicable to him and cannot be measured precisely on the basis of action taken against other respondents,[15/] particularly where, as here, the action respecting others is based on offers of settlement which the Commission deemed appropriate to accept.[16/]

Zenanko asserts that he did not have any control over the books and records or the back office, that Kisch was the manager of the firm. He proposes that the Commission find that he violated Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-1 (net capital); 15c3-3 (customer protection); and 17a-11 (telegraphic notice of violation). He says that his issuance of the three checks to Kisch & Co. provided substantial assistance to Kisch & Co. in its subsequent misstatement of its true financial condition and its failure

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15/ See Dlugash v. S.E.C., 37 F.2d 107, 110 (C.A. 2, 1967).

16/ See Cortland Investing Corporation, et al. 44 S.E.C. 45, 54 (1969); Haight & Company, Inc., 44 S.E.C. 481, 512-513 (1971).

to comply with the net capital and customer reserve requirements of such rules. Zenanko states that while he did not issue the checks with the intent to so assist Kisch & Co., he must admit that he issued the checks voluntarily and that the checks provided substantial assistance to Kisch & Co. in connection with its violations of such sections and rules. Zenanko feels that an appropriate sanction would be a 3-week suspension in any capacity and a bar from association in any supervisory capacity with any broker or dealer.

Kisch argues that only the net capital and customer reserve activities should be considered as applying to him and that these activities covered a small two week or less period of time. He says that he is now aware that many of his actions came at a time when he was under extreme mental pressure that had been accumulating over a long period of time. He asks for consideration in his favor.

Zenanko's contention that he was only a salesman and not really a principal is not supported by the record. He was a 40% owner of the firm and was instrumental in securing the participation of Nikoley; the private offering circular characterized him as a "key employee"; he contributed large amounts of capital and left earnings in the firm; he signed checks on at least three occasions when he was aware that he did not have funds to cover them; he signed the cancellation of the clearing agreement with Equity as corporate secretary; he testified that he was aware of the firm's capital problems; he prepared memoranda instructing salesmen on their duties; and he participated in the deception practiced on the examiners.

The record shows that Zenanko had his securities agent's license suspended for 3 weeks by the State of Minnesota Securities Division on October 6, 1980. As stated previously (page 25, supra) Zenanko has now offered to admit to certain violations in order to obtain a lenient sanction.

Kisch does not actively deny the charges but seeks to confine the net capital problems to a small two-week period of time and to excuse his activity in deceiving the examiners because of pressures at the time. The facts disclose that the net capital problem was one of considerable duration and had been covered up on occasions other than just in October by sending untimely reports or omitting to send reports.

While he was at Pagel & Co., Kisch was censured and/or fined on 3 occasions by the NASD. For the period from January 1, 1975 to June 30, 1976, Kisch and Jack W. Pagel, were jointly fined $1,000 for failing to properly supervise; for the period from July 1976 to August 1977 Kisch and Pagel & Co. were censured and jointly fined $3,000 for failing to properly supervise; and on August 14, 1978, while executive vice-president and treasurer of Pagel & Co., Kisch was censured for violations of SEC rules which occurred in May 1977.

The evidence herein fully supports the conclusion that respondents not only knowingly violated the securities laws but engaged in a deliberate scheme to deceive the examiners, the NASD, the SEC, and the investing public. In addition to the violations found herein, the Division urges a finding of another violation of Section 10(b) of the Exchange Act and Rule 10b-5, as charged in the Order,

for the same activities which have already been found violative of Section 15(c)(3) of the Exchange Act and Rules 15c3-1 (net capital) and 15c3-3 (customer reserve). The basis for this finding would be that Kisch & Co. continued to engage in business while insolvent.[17/] However, the record until October 31, 1979, when Kisch & Co. ceased doing business, does not establish that it was insolvent at that time.[18/] SIPC was appointed as trustee for the liquidation of the firm on November 9, 1979, and on the same day, the matter was removed to the United States Bankruptcy Court. In any event such a finding would be repetitive and cumulative and does not appear necessary under the circumstances.

The investigation by SIPC disclosed only $9,903 in the customer reserve accounts and claims from customers of about $80,000 for securities which could not be located. As of October 16, 1980, SIPC had paid out approximately $171,000 in satisfaction of 695 claims against Kisch & Co. As the Division points out, the appointment of a trustee clearly triggers the provision of Section 14(b) of the SIPA which provides for the suspension of certain individuals designated therein who are associated with a broker-dealer for whom a trustee is appointed.

In view of all of the circumstances, it is concluded that the extent and character of the violations requires that respondents be excluded from the securities business. As the Court said in Arthur Lipper Corp. v. S.E.C., 547 F.2d 171, 184 (2d Cir. 1976), cert. denied (434 U.S. 1009):

> "The purpose of such severe sanctions must be to demonstrate not only to petitioners but to others that the Commission will deal harshly with egregious cases.

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17/ Securities and Exchange Commission v. Resch-Cassin & Co., Inc., 362 F. Supp. 964, 979 (S.D.N.Y. 1973); Weston & Co., Inc., 44 S.E.C. 692 (1971).

18/ C.B. Beal & Co., Ltd., Exchange Act Release 12532/June 10, 1976 (9 S.E.C. Docket 836).

In Steadman v. Securities and Exchange Commission, 603 F.2d 1126 (5th Cir. 1979), the Court said that when the Commission imposes severe sanctions it "should articulate why a lesser sanction would not sufficiently discourage others from engaging in the unlawful conduct it seeks to avoid."

A broker-dealer engaging in the type of conduct practiced herein by respondents imposes a social cost on the community which must be considered. Here, the NASD, two federal, and one state agency were required to devote a great deal of their resources to protect the public from the fraud and deception practiced by respondents. Broker-dealers must be put on notice that such conduct will not be tolerated. Accordingly, it is believed that any sanction less than a bar would be ineffectual.

ORDER

IT IS ORDERED that Peter J. Kisch and George R. Zenanko, and each of them, are barred from association with a broker-dealer.[19/]

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to that Rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within fifteen

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19/ It should be noted that a bar order does not preclude the persons barred from making such application to the Commission in the future as may be warranted by the then-existing facts. Fink v. SEC, 417 F.2d 1058, 1060 (2d Cir. 1969); Vanasco v. SEC, 395 F.2d 349, 353 (2nd Cir. 1968).

days after service of the initial decision upon him, unless the Commission, pursuant to Rule 17(d), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. 20/

Ralph Hunter Tracy
Administrative Law Judge

April 17, 1981
Washington, D.C.

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20/ All proposed findings, conclusions, and contentions have been considered. They are accepted to the extent that they are consistent with this decision.