UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10657 / July 2, 2019

SECURITIES EXCHANGE ACT OF 1934
Release No. 86284 / July 2, 2019

INVESTMENT ADVISERS ACT OF 1940
Release No. 5278 / July 2, 2019

INVESTMENT COMPANY ACT OF 1940
Release No. 33541 / July 2, 2019

Admin. Proc. File No. 3-17253

In the Matter of

JAMES A. WINKELMANN, SR. and
BLUE OCEAN PORTFOLIOS, LLC

ORDER DENYING MOTION FOR SUMMARY AFFIRMANCE, GRANTING PETITIONS FOR REVIEW, AND SCHEDULING BRIEFS

On October 15, 2018, an administrative law judge issued an initial decision finding that James A. Winkelmann, Sr. and Blue Ocean Portfolios LLC, his investment advisory firm, willfully violated, and Winkelmann caused Blue Ocean's violations of, Section 17(a)(2) and (3) of the Securities Act of 1933 and Section 206(2) of the Investment Advisers Act of 1940.[1] The law judge determined that respondents negligently made material misrepresentations and omissions regarding conflicts of interest and breached their fiduciary duty to their advisory clients to whom they offered and sold royalty units in Blue Ocean. The law judge also found that Blue Ocean willfully violated, and Winkelmann caused Blue Ocean's violations of, Advisers Act Section 206(4) and Advisers Act Rules 206(4)-2 and 206(4)-7, and that respondents willfully violated Advisers Act Section 207. The law judge suspended Winkelmann from the securities industry for six months, ordered him to pay disgorgement of $415,000 plus prejudgment interest and a civil money penalty of $25,500, and entered a cease-and-desist order against respondents. The law judge dismissed allegations that respondents violated, and Winkelmann caused and

[1] *James A. Winkelmann, Sr. and Blue Ocean Portfolios, LLC*, Initial Decision No. 1261, 2018 WL 5004712 (Oct. 15, 2018).

aided and abetted violations of, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, Securities Act Section 17(a)(1), and Advisers Act Section 206(1). The Division of Enforcement filed a petition for review, and respondents filed a cross-petition for review and motion for summary affirmance. For the reasons discussed below, we deny respondents' motion for summary affirmance, grant the petitions for review, and set a briefing schedule.

I. Background

On May 19, 2016, we issued an Order Instituting Proceedings ("OIP") alleging that respondents made fraudulent misrepresentations and omissions and breached their fiduciary duty in the course of four separate offerings of royalty units in Blue Ocean to their advisory clients and other investors.[2] The OIP included allegations that respondents materially misrepresented Blue Ocean's "advertising ratio," a metric designed to quantify Blue Ocean's success in converting advertising spending into new revenue for Blue Ocean; failed to disclose conflicts of interest that existed between respondents and their advisory clients who purchased royalty units and made materially misleading statements about the "alignment" of Winkelmann's and investors' interests; and failed to disclose that Winkelmann's business associate, Brian Binkholder, whose radio show Blue Ocean had touted in royalty unit offering materials as the focus of its advertising campaign, had been barred by the Missouri Division of Securities. In their answer, respondents denied the allegations in the OIP and raised numerous affirmative defenses, including the defense of reliance on the advice of counsel.

On March 20, 2017, following a six-day hearing, the law judge issued an initial decision finding that respondents violated the antifraud provisions of the securities laws with scienter by offering royalty units to their advisory clients without sufficient disclosure of conflicts of interest; the law judge dismissed the Division's other allegations of fraud against respondents.[3] In finding liability, the law judge rejected respondents' advice-of-counsel defense. The law judge found that respondents "failed to carry their burden of proof that they relied on [counsel's] advice before selling royalty units to advisory clients," and therefore "scienter [was] not negated with respect to the conflict-of-interest related antifraud violations."[4] The law judge also found that respondents violated Advisers Act Sections 206(4) and 207 and Advisers Act Rules 206(4)-2 and 206(4)-7. For all of these violations, the law judge barred Winkelmann from the securities industry, ordered him to disgorge $415,000 plus prejudgment interest and pay a civil money penalty of $187,500, and entered a cease-and-desist order against respondents.

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[2] *James A. Winkelmann, Sr. and Blue Ocean Portfolios, LLC*, Securities Exchange Act Release No. 77862, 2016 WL 2910089 (May 19, 2016).

[3] *James A. Winkelmann, Sr. and Blue Ocean Portfolios, LLC*, Initial Decision No. 1116, 2017 WL 1047106 (Mar. 20, 2017).

[4] *Id.* at *63.

Respondents petitioned for review of the initial decision, and the Division filed a cross-petition for review of that decision. We granted both petitions on May 8, 2017, and scheduled the filing of briefs.[5] During the briefing process, we granted leave for respondents to submit additional evidence supporting their advice-of-counsel defense.[6]

On November 30, 2017, we remanded this proceeding to the law judge with instructions to reconsider the record and allow the parties to submit new evidence.[7] Respondents submitted as new evidence an email between Winkelmann and counsel. Before the law judge completed his reconsideration of the record and new evidence, the Supreme Court decided *Lucia v. SEC*.[8] *Lucia* held that the Commission's administrative law judges were appointed in a manner that violated the Appointments Clause of Article II of the Constitution, and it remanded the proceeding at issue for the Commission to provide the respondent with a new hearing before a hearing officer who was properly appointed and had not participated in the matter previously.[9] Subsequently, having ratified the appointment of its administrative law judges, the Commission once again remanded this proceeding (and other similarly situated proceedings) to provide respondents with a "new hearing before an ALJ who did not previously participate in the matter," unless the parties expressly agreed to alternative procedures.[10]

Consistent with that order, the parties agreed that the same law judge would continue to preside over the matter and decide it based on the record already established, including the new evidence supporting respondents' advice-of-counsel defense.[11] Respondents waived any claim or entitlement to a new hearing before another law judge or the Commission, and waived any constitutional challenges based on the law judge's appointment or removal protections. The

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5 *James A. Winkelmann, Sr. and Blue Ocean Portfolios, LLC*, Exchange Act Release No. 80627, 2017 WL 1832426, at *1 (May 8, 2017).

6 *James A. Winkelmann, Sr. and Blue Ocean Portfolios, LLC*, Exchange Act Release No. 80945, 2017 WL 2591799, at *2 (June 15, 2017).

7 *See Pending Admin. Proceedings*, Exchange Act Release No. 82178, 2017 WL 5969234, at *2 (Nov. 30, 2017).

8 138 S. Ct. 2044 (2018).

9 *Id.* at 2055 ("To cure the constitutional error, another ALJ (or the Commission itself) must hold the new hearing to which Lucia is entitled.").

10 *See Pending Admin. Proceedings*, Exchange Act Release No. 83907, 2018 WL 4003609, at *1 (Aug. 22, 2018).

11 *See Order Affirming Assignments*, Admin. Proc. Rulings Rel. No. 6062 (Sept. 21, 2018), available at https://www.sec.gov/alj/aljorders/2018/ap-6062.pdf.

parties also agreed that further evidence and argument were not required and the matter should be resubmitted for decision without further proceedings.

After reviewing the new evidence and parties' briefs, the law judge issued a revised initial decision again finding that respondents defrauded their advisory clients by failing to disclose conflicts of interest but reversing his prior finding that they acted with scienter.[12] According to the law judge, "Winkelmann had a good faith belief that offering or selling royalty units to clients was permissible, and this belief was supported by the advice he received from his counsel."[13] The law judge stated that Winkelmann's belief "negate[d] the element of scienter[] and require[d] a finding of no liability" regarding the scienter-based antifraud charges.[14] Nevertheless, the law judge found that respondents' conduct was negligent and violated Securities Act Section 17(a)(2) and (3) and Advisers Act Section 206(2). In light of his negligence finding, the law judge reduced Winkelmann's permanent bar to a six-month suspension and the civil money penalty from $187,500 to $25,500. In all other respects, the law judge's findings and conclusions were essentially the same as his first initial decision.

On November 5, 2018, the Division filed a petition for review contending that the law judge erred in finding that respondents did not violate the scienter-based antifraud provisions. On November 14, 2018, the respondents filed the instant motion for summary affirmance and cross-petition for review challenging the law judge's negligence finding and the sanctions imposed in the event the motion for summary affirmance is denied.

II. Analysis

Under Commission Rule of Practice 411(e)(2), summary affirmance may be granted if "no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument."[15] The rule provides for denial of summary affirmance "upon a reasonable showing that a prejudicial error was committed in the conduct of the proceeding or that the decision embodies an exercise of discretion or decision of law or policy that is important and that the Commission should review."[16] We have previously observed that "[s]ummary affirmance is

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12 *See supra* note 1.

13 2018 WL 5004712, at *64.

14 *Id.*

15 17 C.F.R. § 201.411(e)(2).

16 *Id.*

rare, given that generally we have an interest in articulating our views on important matters of public interest and the parties have a right to full consideration of those matters."[17]

Respondents argue that summary affirmance is appropriate here because "[n]one of the items identified in the Petition for review reflect a 'clearly erroneous' finding by [the law judge] or an abuse of his discretion." They assert that the law judge, "who heard this case from its inception and witnessed the presentation of all testimony at trial, has twice considered the evidence presented by the Division and has twice rejected it as to the majority of appellate grounds identified in the Petition for Review." As a result, respondents assert, "[t]here is no need for the Commission to consider these arguments for a *third* time." Respondents also contend that summary affirmance should be granted "to put an end to this prosecution and the Division's fixation with proving scienter where none exists."

The Division argues in opposition that the Commission "strongly disfavors" motions for summary affirmance and that its petition for review makes the requisite showing under Rule 411(e) for denying respondents' motion. According to the Division, the "prejudicial errors" in the law judge's decision include the finding that Winkelmann did not act with scienter and the application of "the reliance on counsel defense in a way that would allow other investment advisers to disregard their duties to clients and would harm investors." The Division asserts that "affirming the ALJ's reliance holdings would set terrible precedent" because "[i]t would allow an experienced adviser to draft offering materials that lie about and conceal known conflicts" and "escape liability by merely passing those offering materials to an attorney without asking for specific guidance or providing the attorney with the necessary facts to provide informed advice."

Based on our review of the record and parties' submissions, we do not view summary affirmance as appropriate. This appeal raises issues as to which we have an interest in articulating our views and important matters of public interest. These issues include the fiduciary duty imposed on investment advisers under the Advisers Act and the elements of the advice-of-counsel defense. Under the circumstances, we conclude that our consideration of the record and parties' arguments would benefit from the normal appellate process rather than

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[17] *Theodore W. Urban*, Exchange Act Release No. 63456, 2010 WL 5092728, at *2 (Dec. 7, 2010) (internal quotations and citations omitted)*; see also Terry T. Steen*, Exchange Act Release No. 38675, 1997 WL 274955, at *1 (May 27, 1997) (denying summary affirmance and noting that such action is appropriate only where there are "compelling reasons").

summary affirmance.[18] We therefore deny respondents' motion.[19] Our denial should not be construed as suggesting any view as to the outcome of this case.

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In light of our determination to deny the motion for summary affirmance, we grant the parties' petitions for review and schedule the filing of briefs.

Accordingly, IT IS ORDERED that the motion for summary affirmance filed by James A. Winkelmann, Sr. and Blue Ocean Portfolios LLC is hereby denied; and it is further

ORDERED, pursuant to Rule of Practice 411,[20] that the petition for review filed by the Division of Enforcement and cross-petition for review filed by James A. Winkelmann, Sr. and Blue Ocean Portfolios LLC are hereby granted; and it is further

ORDERED, pursuant to Rule of Practice 450(a),[21] that the Division shall file its opening brief, not to exceed 14,000 words, by August 1, 2019. Respondents shall file a brief in support

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[18] Although respondents assert that we must defer to the law judge's conclusions, this assertion lacks merit. It is well-established that our "'review of the findings and conclusions of an initial decision is conducted de novo.'" *Sec. Indus. and Fin. Markets Ass'n*, Exchange Act Release No. 84432, 2018 WL 5023228, at *10 (Oct. 16, 2018) (quoting *Urban*, 2010 WL 5092728, at *2); *see also* Rule of Practice 411(a), 17 C.F.R. § 201.411(a) (stating that "[t]he Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record").

[19] *See, e.g.*, *Joseph C. Ruggieri*, Exchange Act Release No. 76614, 2015 WL 8519533, at *2 (Dec. 10, 2015) (denying motion for summary affirmance and granting petitions for review where appeal "raises issues as to which we have an interest in articulating our views and important matters of public interest, including insider trading law and the personal benefit requirement"); *David F. Bandimere*, Exchange Act Release No. 71333, 2014 WL 198175, at *3 (Jan. 16, 2014) (denying motion for summary affirmance where the appeal raises "multiple factual challenges" and "issues as to which we have an interest in articulating our views, including the interpretation of frequently litigated antifraud and registration provisions of the securities laws and potentially the selection of appropriate sanctions").

[20] 17 C.F.R. § 201.411.

[21] *Id.* § 201.450(a). As provided by Rule 450(a), no briefs in addition to those specified in this schedule may be filed without leave of the Commission. *Id.* Attention is called to Rules of Practice 150 through 153, 17 C.F.R. §§ 201.150-153, with respect to form and service, and Rule of Practice 450(b), 17 C.F.R. § 201.450(b), with respect to content limitations. Requests for extensions of time to file briefs and for additional words are disfavored.

of their cross-petition for review and in response to the Division's opening brief, not to exceed 16,000 words, by September 2, 2019. The Division shall file a brief in response to the respondents' brief in support of their cross-petition for review and in reply to the respondents' brief in response to the Division's opening brief, not to exceed 9,000 words, by October 2, 2019. Respondents may file a reply brief limited to the issues presented by their cross-petition for review, not to exceed 7,000 words, by October 16, 2019.

Pursuant to Rule of Practice 180(c),[22] failure to file a brief in support of the petition or cross-petition for review may result in dismissal of this review proceeding as to that party.

By the Commission.

Vanessa A. Countryman
Secretary

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[22] *Id.* § 201.180(c).