

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

**SECURITIES ACT OF 1933**  
**Release No. 10080 / May 19, 2016**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 77862 / May 19, 2016**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4389 / May 19, 2016**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 32118 / May 19, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17253**

**In the Matter of**

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

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS, PURSUANT  
TO SECTION 8A OF THE SECURITIES  
ACT OF 1933, SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTIONS 203(e), 203(f) AND 203(k) OF  
THE INVESTMENT ADVISERS ACT OF  
1940, AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF 1940**

**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 Section 8A of the Securities Act of 1933 (“Securities Act”), Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against James A. Winkelmann, Sr. (“Winkelmann”) and Blue Ocean Portfolios, LLC (“Blue Ocean”) (collectively, “Respondents”).

**II.**

After an investigation, the Division of Enforcement alleges that:

## Summary

1. These proceedings arise out of Respondents' fraudulent misrepresentations, omissions, and breaches of fiduciary duty in the course of their offerings of securities of Blue Ocean, a registered investment adviser. Blue Ocean and its principal, Winkelmann, offered and sold Blue Ocean securities – which Respondents' referred to as "Royalty Units" – primarily to Blue Ocean's advisory clients. In the course of those offerings, through which Respondents raised \$1.4 million from 24 investors, Respondents: (i) materially overstated Blue Ocean's success in converting advertising spending into new revenue for Blue Ocean; (ii) made materially misleading statements regarding the "alignment" of Winkelmann's and the Royalty Unit investors' interests and failed to disclose and explain the inherent conflicts of the Royalty Unit offerings; and (iii) made materially misleading statements regarding one of Winkelmann's business associates, whose radio show Blue Ocean had engaged and touted in offering materials as the focus of its advertising campaign, by omitting the fact that the business associate had been sanctioned by the Missouri Division of Securities. Respondents also failed to disclose that Blue Ocean could, and ultimately did, pay significant sums of money, in the form of "management fees," to three entities Winkelmann owned and controlled. Respondents additionally concealed from their clients that Winkelmann repeatedly chose to pay his investors the minimum returns possible while increasing his own compensation. Through their conduct in the Royalty Unit offerings, Respondents additionally breached the fiduciary duty that they owed to their advisory clients to whom Respondents offered and sold Royalty Units. Moreover, in connection with the Royalty Unit offerings, Respondents violated, or caused violations of, the custody, compliance, and reporting provisions of the Advisers Act.

## Respondents

2. **James A. Winkelmann, Sr.** is a resident of Saint Louis, Missouri and has worked in the securities industry since 1981. He is the Principal/CEO, Chief Compliance Officer ("CCO"), and Manager of Blue Ocean, and the Manager of the limited liability company that owns 100% of Blue Ocean. Winkelmann holds a series 65 securities license and is registered as an investment adviser representative in Illinois, Missouri, and Texas.

3. **Blue Ocean Portfolios, LLC** is located in Saint Louis, Missouri, and has been registered with the Commission as an investment adviser from April 7, 2011 to June 28, 2012 and from April 18, 2013 to the present.<sup>1</sup> According to Blue Ocean's most recently-filed Form ADV, dated February 16, 2016, it has discretionary authority over 295 accounts and \$106 million in regulatory assets under management.

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<sup>1</sup> Blue Ocean was registered as an investment adviser with the State of Missouri from October 2009 to May 2011 and June 2012 to April 2013, and was registered as an investment adviser with the State of Illinois from November 2009 to April 2011 and June 2012 to April 2013.

### **The Blue Ocean Royalty Unit Offerings**

4. In April 2011, Respondents began raising capital by offering Blue Ocean Royalty Units. Each Royalty Unit was offered in \$25,000 increments and granted purchasers a right to a percentage of Blue Ocean's cash receipts until Blue Ocean had repaid a specified amount ranging from 2.25 to 3.0 times the original investment amount. Winkelmann created, authored, and circulated four separate offering memoranda corresponding with four separate "financing rounds." While the specific terms of each of the four offering memoranda varied slightly, each memorandum contained similar representations about Blue Ocean's business, its intended use of investor funds, and the anticipated returns for investors. From April 2011 to February 2013, Respondents raised, through four offerings of Royalty Units, a total of \$1.4 million from 24 investors in Missouri, Illinois and Indiana, nineteen of whom were Blue Ocean advisory clients.

5. The offering memoranda represented that the primary use of investor proceeds would be to increase Blue Ocean's advertising budget and expand its advertising reach. Each offering memorandum described a financial metric which Respondents referred to as the "advertising conversion rate" or "advertising factor." Respondents calculated the advertising conversion rate by dividing (a) Blue Ocean's advertising expenses in a given period by (b) the new annually occurring revenue (typically in the form of new advisory client management fees) generated during the same period. In the offering memoranda, Respondents represented that the advertising conversion rate was the "key driver" that would impact the pace of returns on the Royalty Unit investments. Respondents further represented that a lower conversion rate indicated a more efficient use of advertising expenses, and that Blue Ocean's goal was to achieve the lowest rate possible. The conversion rate was important to investors because it directly impacted their rate of return: the lower the conversion rate, the faster they would be repaid.

### **Respondents' Material Misrepresentations, Omissions, and Breaches of Fiduciary Duty**

6. Each of the offering memoranda, which Winkelmann authored, controlled the content of, and circulated, contained material misrepresentations about Blue Ocean's advertising conversion rate.

7. The first offering memorandum, dated March 31, 2011, misrepresented the advertising conversion rate by more than 100%, as it incorrectly stated that "each \$10,000 in new recurring revenue will cost [Blue Ocean] \$2,200 in advertising – a 22/100 ratio." In reality, each \$10,000 in new recurring revenue cost Blue Ocean \$4,548 in advertising – a 45/100 ratio.

8. The second offering memorandum, which Respondents began circulating in March 2012, misrepresented the advertising conversion rate by more than 75%. That memorandum incorrectly stated that "each \$10,000 in new recurring revenue is currently costing [Blue Ocean] \$6,200 in advertising – a 62/100 ratio or an 'advertising conversion factor' of 0.62," and falsely claimed that Blue Ocean's "advertising factor for 2011 was 0.78." In reality, the current advertising conversion factor was 1.11, not 0.62, and for 2011, this factor was 1.28, not 0.78.

9. The third offering memorandum, dated September 1, 2012, misrepresented the advertising conversion rate by more than 50%. That memorandum falsely stated that “each \$10,000 in new recurring revenue is currently costing [Blue Ocean] \$6,700 in advertising – a 67/100 ratio or an ‘advertising conversion factor’ of 0.67.” In reality, the current conversion rate was 1.03, not 0.67. Moreover, the third offering memorandum contained the same misrepresentation about Blue Ocean’s 2011 advertising conversion rate that was contained in the second offering memorandum.

10. The fourth offering memorandum, dated February 2013, misrepresented the advertising conversion rate by approximately 15%, as it incorrectly stated that Blue Ocean’s 2012 conversion rate was 0.89. Blue Ocean’s actual conversion rate for 2012 was 1.02.

11. The misrepresentations set forth above led investors to believe that Blue Ocean’s advertising spend was more efficient than it really was, and that they would be repaid faster than they actually would be repaid.

12. In addition to making the above representations about Blue Ocean’s advertising efficiency, Respondents failed to disclose the material conflict of interest that existed between Respondents and their advisory clients who purchased Royalty Units. Specifically, Respondents had a fiduciary obligation to disclose and explain their financial interest in their advisory clients’ decision regarding whether to purchase Royalty Units. However, Respondents failed to make such disclosure, in the offering memoranda or otherwise.

13. Rather than disclosing the conflict of interest that existed between Winkelmann and his advisory clients, the offering memoranda made materially misleading statements about the “alignment” of Winkelmann’s and the Royalty Unit investors’ interests. The offering memoranda stated that: (i) Winkelmann would be compensated with a base salary plus a bonus based on the profitability of Blue Ocean; (ii) Royalty Unit investors would receive at least a “minimum” monthly cash payment (0.25% of cash receipts for rounds 1 and 2; 0.10% for round 3; and 0.05% for round 4); and (iii) Winkelmann had the sole discretion to set, on a monthly basis, both his own compensation and the rate at which investors would be repaid. However, the offering memoranda, among other things, also stated that: (i) the decision to pay Winkelmann based upon the profitability of the company was “directly in line with the investors’ payback and the owners’ potential distributions”; (ii) “expansion capital in the form of Royalty Units is a way to . . . align all interests for returns at relatively low risk”; and (iii) “the overall objective is to keep the interest of investors . . . and owners of Blue Ocean Portfolios aligned at all times.” These statements regarding the “alignment” of Winkelmann’s and the Royalty Unit investors’ interests were misleading because, in fact, their interests were competing, not aligned, with respect to how Winkelmann would allocate Blue Ocean’s funds to pay himself and the Royalty Unit investors. Indeed, Winkelmann used his discretion to increase his compensation during the period April 2011 through August 2014 while, during this same time period, he caused Blue Ocean to pay the Royalty Unit investors the minimum amount required under the terms of the offering memoranda.

14. The offering memoranda also made materially misleading statements regarding one of Winkelmann’s business associates. The second and third offering memoranda touted

Respondents' relationship with the business associate, and represented that the business associate's radio show, which was sponsored by Blue Ocean in return for Blue Ocean being advertised on the show, was the cornerstone of Blue Ocean's advertising strategy and a key factor in Blue Ocean's purportedly successful advertising campaigns. However, these offering memoranda did not disclose that, on December 29, 2011, the Missouri Division of Securities had entered an order barring the business associate from, among other things, acting "as an agent or investment adviser representative in the State of Missouri." The order resulted from the business associate's improper offering of securities of his companies to his own advisory clients. The statements regarding the business associate were thus misleading because, despite the prominence of the business associate and his radio show in the offering memoranda, Respondents failed to disclose the Missouri Securities Division order.

15. The offering memoranda additionally failed to disclose that Blue Ocean, in addition to paying Winkelmann a salary, was paying material amounts of Royalty Unit investor proceeds to companies owned and controlled by Winkelmann, and that Blue Ocean ultimately paid over \$100,000 from Royalty Unit proceeds as purported "management fees" to certain of Winkelmann's other companies.

16. In addition to the misrepresentations contained in the offering memoranda, Winkelmann made other false and misleading statements to his advisory clients. For instance, Winkelmann misrepresented the success of the Royalty Units offerings to prospective investors, including by sending an email to an advisory client in which Winkelmann materially overstated, by over 85%, the amounts earlier Royalty Unit investors had been repaid.

17. Respondents acted with scienter in making the above material misrepresentations and omissions to the Royalty Unit investors and in breaching their fiduciary duties to their advisory clients to whom Respondents offered and sold Royalty Units.

18. Additionally, at the very least, Respondents acted negligently, and violated the applicable standards of care, in making the above material misrepresentations and omissions to the Royalty Unit investors and in breaching their fiduciary duties to their advisory clients to whom Respondents offered and sold Royalty Units.

### **Respondents Violated the Advisers Act's Custody, Compliance, and Reporting Provisions**

19. Rule 206(4)-2 promulgated under Section 206(4) of the Advisers Act (the "custody rule") is designed to protect investor assets. The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets. An adviser has "custody" of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2). An adviser who has custody must, among other things: (i) maintain client funds in a separate account for each client under that client's name, or in accounts that contain only the clients' funds and securities under the investment adviser's name as agent or trustee for the clients; (ii) notify each client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained; (iii) have a reasonable basis, after

due inquiry, for believing that the custodian sends account statements directly to each client at least quarterly; and (iv) have an independent public accountant perform a surprise examination of the client funds and securities of which the adviser has custody at least once during each calendar year. *Id.* at § 275.206(4)-2(a)(1)- (4).

20. Pursuant to the terms of the offering memoranda, once Blue Ocean receives a cash receipt (such as client management fees), a percentage of that amount belongs to each Royalty Unit investor, and Blue Ocean is obligated to pay those accrued amounts on a monthly basis.

21. From May 2011 through May 2012, Respondents' practice was to accrue in Blue Ocean's operating bank account the percentage of cash receipts due to each Royalty Unit investor, and then pay the accrued amount on a monthly basis. In May of 2012, Blue Ocean altered this process slightly by then paying the accrued amounts on a quarterly basis. Respondents understood that all accrued amounts belonged to the respective Royalty Unit investors, that these accrued amounts owed to the Royalty Unit investors were held as cash in Blue Ocean's lone bank account for months at a time, and were commingled with Blue Ocean's operating cash.

22. Despite having custody of client assets – the accrued but unpaid percentage of cash receipts owed to the nineteen advisory clients who held Royalty Units – Respondents never: (a) maintained client funds in a separate account for each client under that client's name, or in accounts that contain only the clients' funds under Blue Ocean's name as agent or trustee for the clients; (b) notified those clients in writing that Blue Ocean was holding cash that belonged to them in Blue Ocean's operating account; (c) had a reasonable basis for believing that their advisory clients who held Royalty Units received at least quarterly statements from Blue Ocean's bank identifying the amount of their cash balance in Blue Ocean's operating account; or (d) had an independent public accountant perform a surprise examination of the client funds which Blue Ocean held in its operating account. In doing so, Blue Ocean failed to comply with the custody rule, and Winkelmann caused Blue Ocean's failure to comply.

23. Blue Ocean's internal policies and procedures established that Winkelmann, as Blue Ocean's CEO and CCO, was responsible for Blue Ocean's compliance program. During the relevant period, Winkelmann and Blue Ocean developed compliance manuals, the content of which Winkelmann controlled and approved, that contained written policies and procedures that were purportedly designed to prevent violations of the Advisers Act. However, Winkelmann and Blue Ocean failed to implement some of these policies and procedures.

24. For instance, each compliance manual stated that it was a policy of Blue Ocean not to have custody of client assets. Respondents failed to implement this policy by virtue of Blue Ocean holding Royalty Unit investors' accrued amounts as cash in its bank account for months at a time and commingling this Royalty Unit investor-owned cash with Blue Ocean's operating cash.

25. Moreover, during the relevant period, Blue Ocean's Form ADVs, which Winkelmann signed, controlled the content of, and caused to be filed with the Commission, consistently misrepresented that Blue Ocean did not have custody of client assets. Specifically, Blue Ocean filed ten different Form ADVs with the Commission between June 2011 and

November 2014 that each falsely represented that it did not have custody of client assets in response to Item 9.A(1)(a) of Part 1 of Form ADV.

### Violations

26. As a result of the conduct described above, Respondents willfully violated Section 17(a)(1) of the Securities Act, which prohibits any person in the offer or sale of securities from employing any device, scheme, or artifice to defraud. Also, by engaging in the conduct described above, Winkelmann caused and willfully aided and abetted Blue Ocean's violations of Section 17(a)(1) of the Securities Act.

27. As a result of the conduct described above, Respondents willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, which prohibit any person in the offer or sale of securities from: a) obtaining money or property by means of any misstatement or omission of material fact; and b) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser of such securities. Also, by engaging in the conduct described above, Winkelmann caused Blue Ocean's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

28. As a result of the conduct described above, Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of any security involving: a) the use of any device, scheme, or artifice to defraud; b) the making of material misrepresentations or omissions; and c) any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. Also, by engaging in the conduct described above, Winkelmann caused and willfully aided and abetted Blue Ocean's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

29. As a result of the conduct described above, Respondents willfully violated Section 206(1) of the Advisers Act, which prohibits an investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client. Also, by engaging in the conduct described above, Winkelmann caused and willfully aided and abetted Blue Ocean's violations of Section 206(1) of the Advisers Act.

30. As a result of the conduct described above, Respondents willfully violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client. Also, by engaging in the conduct described above, Winkelmann caused Blue Ocean's violations of Section 206(2) of the Advisers Act.

31. As a result of the conduct described above, Blue Ocean willfully violated, and Winkelmann caused Blue Ocean to violate, Section 206(4) of the Advisers Act, which prohibits a registered investment adviser from engaging in fraudulent, deceptive or manipulative conduct, and Rule 206(4)-2 thereunder, which requires an adviser to take certain enumerated steps to safeguard client assets over which it has custody.

32. As a result of the conduct described above, Blue Ocean willfully violated, and Winkelmann caused Blue Ocean to violate, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires, among other things, that registered investment advisers adopt and implement written policies and procedures reasonably designed to prevent violations, by the investment adviser and its supervised persons, of the Advisers Act and the rules promulgated thereunder.

33. As a result of the conduct described above, Respondents willfully violated Section 207 of the Advisers Act, which makes it unlawful for any person to willfully make any untrue statement of a material fact in any registration application or report filed with the Commission or to willfully omit to state in any such application or report any material fact which is required to be stated therein.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate 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 hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 8A of the Securities Act including, but not limited to, disgorgement and civil penalties;

C. What, if any, remedial action is appropriate in the public interest against Respondents, including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

D. What, if any, remedial action is appropriate in the public interest against Blue Ocean under Section 203(e) of the Advisers Act and Winkelmann under Section 203(f) of the Advisers Act including, but not limited to, disgorgement pursuant to Section 203(j) and 203(k)(5) of the Advisers Act and penalties pursuant to Section 203(i) of the Advisers Act;

E. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 9(d) and 9(e) of the Investment Company Act; and

F. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities

Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

#### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order 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 Respondents 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 Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, Respondents may be deemed in default and the proceedings may be determined against them 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), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields  
Secretary